



Scottish and Southern Energy plc  
**Annual Report 2011**





The stunning photograph used on the cover of this year's Annual Report was taken at SSE's Drumderg wind farm in Perthshire by award-winning photographer Toby Smith.

Last year SSE commissioned Toby to take a series of photographs of its renewable energy projects across Scotland. The photographs form a collection known as 'The Renewables Project', and are now in use on SSE's website, [www.sse.com](http://www.sse.com), and on display in its office buildings. The Renewables Project has also since featured in a range of publications including a special feature in National Geographic magazine.

## Contents

### Overview

- 01 Introduction
- 02 The energy sector in Great Britain
- 05 The energy sector in Ireland
- 06 SSE – a balanced range of energy businesses
- 08 Chairman and Chief Executive Questions and answers

### Strategy

- 10 Why invest in SSE?

### Group performance

- 16 Key performance indicators
- 17 Financial overview

### Segmental performance

- 23 Economically-regulated businesses
- 23 Energy networks
- 29 Market-based businesses
- 29 Generation and Supply
- 43 Other energy and utility services

### Corporate governance

- 47 Chairman's introduction to SSE corporate governance
- 48 Board of Directors
- 50 The SSE team
- 52 How the Board works
- 56 Risk management
- 60 Audit Committee
- 62 Risk and Trading Committee
- 63 Nomination Committee
- 64 Safety, Health and Environment Advisory Committee
- 65 Remuneration Report
- 65 Introduction
- 66 At a glance
- 67 Remuneration explained
- 72 Remuneration in detail
- 75 Other statutory information

## Financial statements

- 78 Independent auditors' report
- 79 Consolidated income statement
- 80 Statement of comprehensive income
- 81 Balance sheets
- 82 Statement of changes in equity
- 84 Cash flow statements
- 86 Notes on the financial statements
- 86 1. Significant accounting policies
- 95 2. Reclassification of comparative amounts
- 96 3. Segmental information
- 99 4. Other operating income and expense
- 100 5. Exceptional items and certain remeasurements
- 101 6. Directors and employees
- 102 7. Finance income and costs
- 103 8. Taxation
- 105 9. Dividends
- 105 10. Earnings per share
- 106 11. Intangible assets
- 110 12. Property, plant and equipment
- 111 13. Biological assets
- 112 14. Investments
- 115 15. Subsidiary undertakings
- 117 16. Acquisitions, disposals and held for sale assets
- 119 17. Inventories
- 120 18. Trade and other receivables
- 120 19. Cash and cash equivalents
- 120 20. Trade and other payables
- 121 21. Current tax liabilities
- 121 22. Construction contracts
- 121 23. Loans and other borrowings
- 124 24. Deferred taxation
- 125 25. Provisions
- 126 26. Share capital
- 126 27. Reserves
- 126 28. Hybrid capital
- 127 29. Retirement benefit obligations
- 130 30. Employee share-based payments
- 135 31. Financial instruments and risk
- 149 32. Related party transactions
- 150 33. Commitments and contingencies
- 151 34. Post balance sheet events

## Shareholder information

- 152 Shareholder information

The Directors' Report is set out on pages 6 to 76.

\*Unless otherwise stated, this Annual Report describes adjusted operating profit before exceptional items, remeasurements arising from IAS 39 and after the removal of taxation and interest on profits from jointly-controlled entities and associates. In addition, it describes adjusted profit before tax before exceptional items, remeasurements arising from IAS 39 and after the removal of taxation on profits from jointly-controlled entities and associates. It also describes adjusted earnings and earnings per share before exceptional items, remeasurements arising from IAS 39 and deferred tax.

## Introduction

### Overview

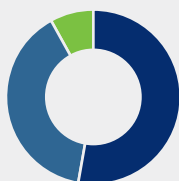
Strategy  
Group performance  
Segmental performance  
Corporate governance  
Financial statements  
Shareholder information

#### Dividend per share – pence

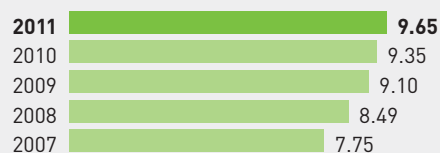


#### Operating profit by business 2010/11 – %

- Generation and Supply 53
- Energy networks 39
- Energy and utility solutions 8

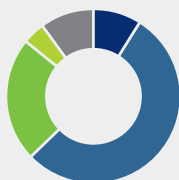


#### Energy customers – millions



#### Capital expenditure 2010/11 – %

- Thermal generation 9
- Renewable generation 54
- Power systems 23
- Gas storage 4
- Other 10



#### Our work

SSE is involved in the generation, transmission, distribution and supply of electricity, the production, storage, distribution and supply of gas and in the provision of other energy-related services.

#### Our values

In carrying out its work, SSE is guided by its core values, the 'SSE SET' of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork.

**“SSE’s core purpose is to provide the energy people need in a reliable and sustainable way. In fulfilling this purpose, SSE requires the support of shareholders, to whom this report is addressed.**

It summarises SSE’s performance in 2010/11 and its plans for 2011/12 and beyond. Plans for the future are of central importance. Providing energy is a long-term activity, and SSE is a company that plans for the long term.

SSE is a straightforward company with straightforward priorities. It provides vital services to customers, invests in essential energy assets and pays dividends to shareholders every year.

**In this report, SSE accounts for its performance against those priorities and it is on this that it should be judged.”**

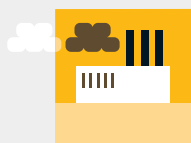
**Lord Smith of Kelvin**  
Chairman

# The energy sector in Great Britain

## Gas and electricity

### SSE in electricity

SSE is involved in the generation, transmission, distribution and supply of electricity.



1

#### ELECTRICITY GENERATION

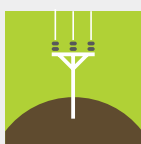
USING TURBINES TO CONVERT ENERGY FROM GAS, OIL, COAL, WATER AND WIND TO GENERATE ELECTRICITY



2

#### ELECTRICITY TRANSMISSION

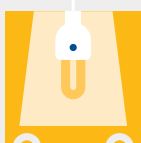
USING HIGHER VOLTAGE LINES AND CABLES TO TRANSMIT ELECTRICITY FROM GENERATING PLANT TO THE DISTRIBUTION NETWORK



3

#### ELECTRICITY DISTRIBUTION

USING LOWER VOLTAGE LINES AND CABLES TO DISTRIBUTE ELECTRICITY TO HOMES, WORKPLACES AND OTHER PREMISES



4

#### ELECTRICITY SUPPLY

RETAILING ELECTRICITY TO HOUSEHOLD, SMALL BUSINESS AND INDUSTRIAL AND COMMERCIAL CUSTOMERS

The majority of SSE's operations are in England, Scotland and Wales, where most parts of the energy sector have been privatised for at least two decades.

Reflecting its island status, Great Britain's energy (ie electricity and gas) sector is largely free-standing with the exception of some electricity interconnection with Ireland and mainland Europe and some gas pipelines from mainland Europe and to Ireland (see the map on page 4).

Around 34 million homes, offices and businesses are connected to the electricity network in Great Britain and around 22 million to the gas network. Total electricity consumption in Great Britain in 2010 (the latest for which information is available) was 325TWh and total gas consumption was 606TWh.

The stated goal of the UK government's energy policy is to achieve secure, affordable and low-carbon energy in the years and decades ahead.

The sector is split between activities which are economically-regulated (energy transmission and distribution networks) and activities which are market-based (energy production and retailing). Companies which operate in both parts of the sector must adhere to rules to maintain legal separation and confidentiality, under the Utilities Act 2000.

### Economic regulation of networks

As the Great Britain energy regulator, Ofgem, puts it, energy transportation (transmission and distribution) networks are 'natural monopolies – there is no realistic means of introducing competition'. There are four types of energy network:

- electricity transmission (three networks in GB) – high voltage electricity wires and cables;
- electricity distribution (14 networks in GB) – lower voltage wires and cables delivering electricity to customers' premises;
- gas transmission (one network in GB) – high pressure gas pipelines; and
- gas distribution (eight networks in GB) – lower pressure pipes delivering gas to customers' premises.

Distribution networks are owned and operated by the same company. Transmission networks

have a single, GB-wide system operator – National Grid operates the GB electricity and gas systems.

The companies operating these networks are the subject of economic regulation through a Price Control set by Ofgem which sets for periods of five (in the future, eight) years the index-linked revenue they can earn, through charges levied on network users, to cover their costs and earn a return on their regulated assets. Ofgem also places incentives on companies to be more efficient and innovative and to deliver an enhanced quality of service.

It also sets the framework for the capital investment they are able to make in maintaining and upgrading the networks. The networks each have a Regulatory Asset Value (RAV), which represents:

- the price paid for them when they were privatised; plus
- allowed capital expenditure; less
- annual depreciation.

The RAV is indexed to the Retail Price Index.

Companies cannot charge network users more than is allowed under the Price Control. If, in any year, regulated energy networks companies' revenue is greater (over recovery) or lower (under recovery) than is allowed under the relevant Price Control, the difference is carried forward and the subsequent prices the companies may charge are varied.

# 45% of gas

used in 2009/10 in the UK was imported. This is expected to increase to around 70% in 2020.

## Overview

Strategy  
Group performance  
Segmental performance  
Corporate governance  
Financial statements  
Shareholder information

Overall, Ofgem seeks to strike the right balance between attracting investment in electricity and gas networks, encouraging companies to operate them as efficiently as possible and ensuring that prices ultimately borne by customers are no higher than they need to be.

The current Price Controls are due to run until:

- 31 March 2013 (electricity transmission, gas transmission and distribution); and
- 31 March 2015 (electricity distribution).

For subsequent Price Controls, Ofgem is using its new RIIO (Revenue = Incentives + Innovation + Outputs) model, which is designed to secure greater stakeholder engagement in, and deliver an outputs-led approach to, energy network regulation.

### Electricity and gas markets

In line with its island status, around 99% of the electricity consumed by UK customers is generated in the UK. At 31 March 2011, there were 24 electricity generators with more than 100MW of capacity operating in Great Britain. In total there was around 85GW of installed capacity.

In the year 2009/10, around 45% of the gas used in the UK by customers and by electricity generators was imported, via pipelines from European gas fields, the England-Belgium pipeline or liquefied natural gas terminals. This is set to increase significantly in the years ahead, as production of gas from the North Sea declines.

The production of electricity and gas for customers in Great Britain is a market-based activity with wholesale markets in which:

- producers (generators), retailers (or suppliers), large users, National Grid Electricity Transmission Ltd and other energy traders buy and sell electricity like any other commodity. It can be purchased through bilateral contracts of various lengths and through trading in the market; and
- producers, shippers, retailers (or suppliers), electricity generators, large gas users, National Grid Gas plc and other energy traders buy and sell gas like any other commodity. As with electricity, gas (natural or liquefied natural) can be purchased through bilateral contracts of various lengths and through trading in the market.

It is part of Ofgem's responsibility to licence electricity generation and to make sure that electricity and gas markets are competitive.

The markets are designed to maintain a downward pressure on the cost of electricity and gas, for the benefit of customers, and to encourage greater diversity in the supply of fuels in order to enhance energy security. There are also related markets for coal, oil and carbon dioxide emissions allowances required for electricity generation.

### Gas storage

Unlike electricity, gas can be stored in large-scale facilities such as under ground caverns. Customers of these facilities can have gas injected or withdrawn, according to their needs, which means they can manage their gas portfolio more effectively and the country benefits from greater gas security.

### Electricity and gas retailing

In the retail electricity and gas markets, customers are free to choose their retailer (or supplier). It is the responsibility of the retailer to procure the electricity and gas customers need, arrange for it to be distributed to them through the relevant networks, provide the associated services such as metering and billing and promote the efficient use of energy.

At 31 March 2011, there were six electricity and gas suppliers in Great Britain with a market share each of more than 5%. Across Europe, only the markets in Slovenia and Denmark have a larger number of suppliers with a market share of more than 5%.

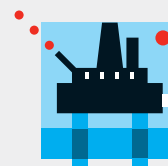
Ofgem is responsible for licensing the supply of electricity and gas and also scrutinises retail prices for electricity and gas and the overall effectiveness of the retail energy market. The outcome of its most recent review was announced in March 2011 and concluded that 'further action is needed to make energy retail markets in Great Britain work in the interests of consumers'. It outlined initial proposals for consultation.

### Other energy and utility services

Companies, including energy retailers, provide other energy-related services, such as the design, installation and maintenance of electrical and gas systems and facilities. Ofgem is not involved in regulating or scrutinising the provision of such services, although providers are subject to other laws and regulations, especially in respect of safety. ●

### SSE in gas

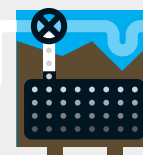
SSE is involved in the production, storage, distribution and supply of gas.



1

#### GAS PRODUCTION

USING PLATFORMS TO EXTRACT NATURAL GAS, FROM FIELDS SUCH AS THOSE IN THE NORTH SEA, FOR USE ONSHORE



2

#### GAS STORAGE

USING CAVERNS TO STORE UNDER GROUND LARGE VOLUMES OF NATURAL GAS FOR USE AT A FUTURE DATE



3

#### GAS DISTRIBUTION

USING PIPES TO DISTRIBUTE GAS FROM THE TRANSMISSION NETWORK TO HOMES, WORKPLACES AND OTHER PREMISES



4

#### GAS SUPPLY

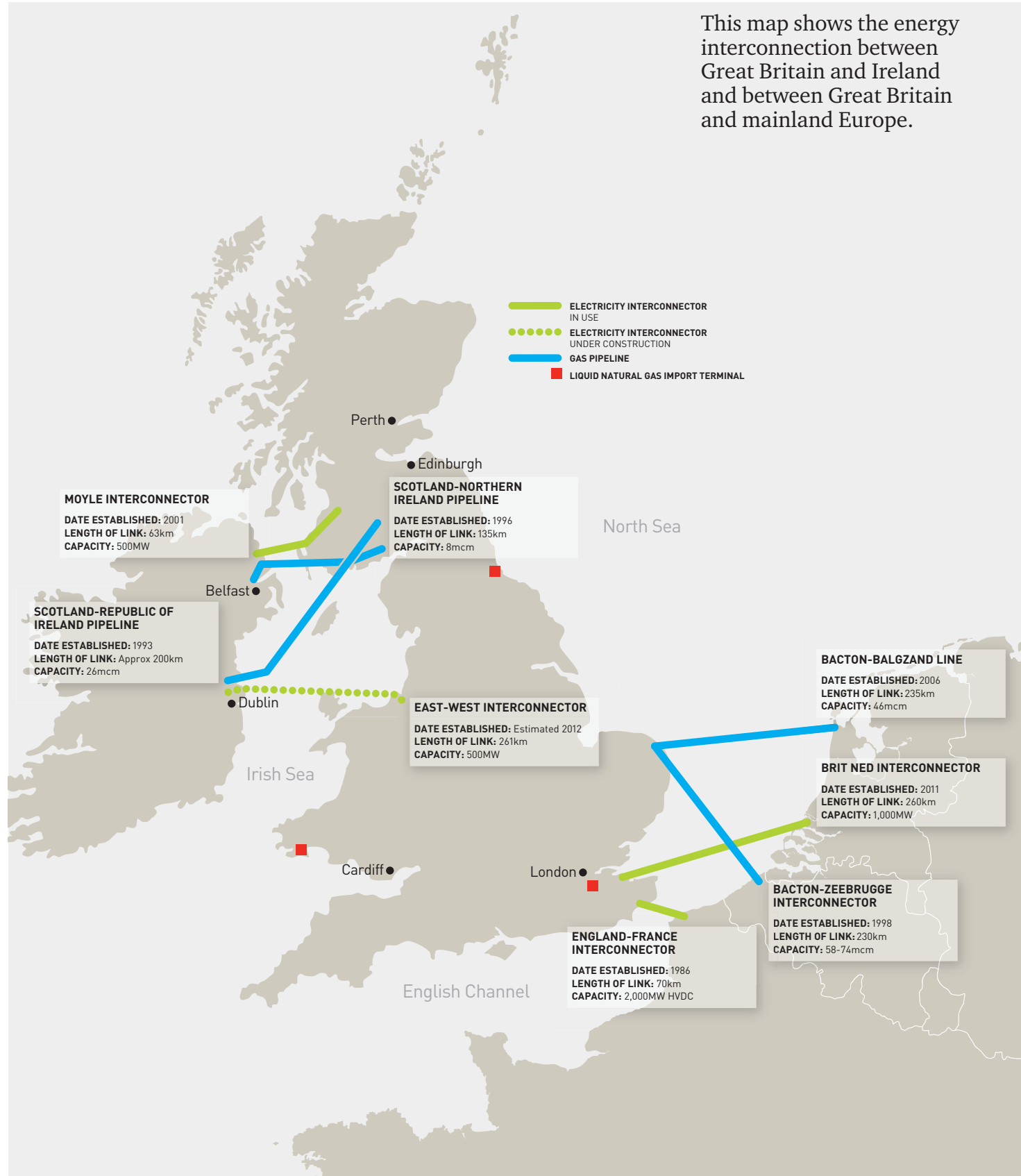
RETAILING GAS TO HOUSEHOLD, SMALL BUSINESS AND INDUSTRIAL AND COMMERCIAL CUSTOMERS

## The energy sector in Great Britain (continued)

### Gas and electricity

#### Physical energy links between mainland Europe, Great Britain and Ireland

This map shows the energy interconnection between Great Britain and Ireland and between Great Britain and mainland Europe.



## The energy sector in Ireland

### Gas and electricity

#### Overview

Strategy  
Group performance  
Segmental performance  
Corporate governance  
Financial statements  
Shareholder information

Since 2008, SSE has had significant operations in Ireland, including electricity generation and energy supply. Large parts of the sector remain state-owned.

The energy market in Ireland is split over two political and regulatory jurisdictions – the Republic of Ireland (ROI) and Northern Ireland (NI). At the same time it has a common electricity wholesale market.

As in GB, Ireland has limited interconnection consisting of:

- the 500MW Moyle interconnector;
- the Scotland-Northern Ireland gas pipeline; and
- the Scotland-Republic of Ireland gas pipeline.

An additional 500MW interconnector is under construction between Dublin and Wales, which is scheduled to come on stream in 2012.

Ireland is hugely dependent on fossil fuel, over 90% of which is imported. Ireland has very limited gas storage. However, a new gas production field is being developed off the West Coast.

Both governments have set a target of 40% renewable electricity to be delivered by 2020. Currently there is around 14% renewables installed, mainly hydro and wind. With largely untapped offshore resources Ireland has a significant opportunity to be an exporter of renewable energy.

#### Economic regulation of networks

The Commission for Energy Regulation (CER) and the Northern Ireland Utility Regulator (NIAUR) regulate the electricity and natural gas markets in Ireland and NI respectively.

The state owned (ROI) Electricity Supply Board (ESB) owns and operates the distribution network and the transmission network in ROI and NI. Similar to GB, these assets are regulated through Price Controls set by CER and NIAUR for five-year periods. The current price controls in ROI will run until 2015 for electricity and 2012 for gas.

The electricity Transmission System Operators (TSO) in ROI and NI are EirGrid plc and SONI Ltd, respectively. SONI is a wholly-owned subsidiary of EirGrid plc.

In ROI, state-owned Bord Gáis owns the gas transmission and distribution networks and maintains and develops the network Gaslink, a ring-fenced business within Bord Gáis, and operates the transmission system. Regulated by the CER the current price control runs until 2012.

In NI the gas market is in the early stage of development. Two companies Firmus Energy, a subsidiary of Bord Gáis, and Phoenix Natural Gas own and operate separate distribution networks, regulated by NIAUR.

There is likely to be considerable change in ROI with the new government indicating its intent to restructure the transmission network assets under a single, state owned, holding company.

#### Electricity and gas markets

Across ROI and NI there is a common wholesale electricity market; the Single Electricity Market (SEM). This market operates with dual currencies (euro and sterling) and dual support mechanisms for renewable energy (ROCS and REFIT). In 2009 the SEM controlled over 6,000MW of fully dispatchable generation and supplied over 30TWh, costing just under €2bn. The retail market continues to operate as two separate markets with 2.1 million customers in the Republic of Ireland and 0.8 million in Northern Ireland.

The island consumes approximately 73TWh of gas annually of which around two thirds is used in power generation. The majority of gas consumed is imported. The governments

and Regulatory Authorities are currently developing an all-island gas market. Gas prices in Ireland tend to be set by the UK wholesale price.

#### Electricity and gas retailing

At 31 March 2011 there were four main electricity and gas suppliers operating in ROI and NI.

Despite competitive business markets in ROI and NI for a number of years, domestic switching in electricity and gas has been a recent phenomenon. SSE's retail brand in Ireland, Airtricity, has been a significant contributor to the development of domestic competition across the Island. ROI now has the highest switching rate across Europe at 21% in 2010 (Q4) with over 450,000 customers joining Airtricity in 18 months.

This has allowed the regulator to deregulate the incumbent electricity supplier from April 2011, with gas likely to follow thereafter. In line with these changes the Regulatory Authorities will transition from tariff regulation to market monitoring.

**Over 85% of electricity generated in Ireland comes from fossil fuels, of which over 90% is imported.**

There is likely to be considerable change in the electricity and gas generation and retail sector as the new ROI government policy is likely to indicate the disposal of semi-state assets including those in the energy sector.

#### Other energy and utility services

Both governments are placing increasing emphasis on energy efficiency and fuel poverty. These will be key issues for the sector over the coming year. ●

#### Ireland and Northern Ireland fuel mix (combined) 2009 – %

- Solid fuels 21
- Oil 3
- Gas 62
- Renewables/other 14



## SSE – a balanced range of energy businesses

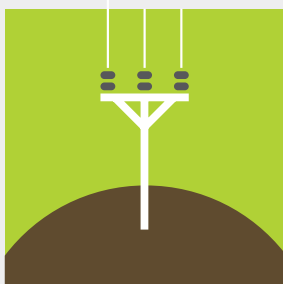
# SSE

### ECONOMICALLY- REGULATED

### MARKET-BASED

### ENERGY NETWORKS

### GENERATION AND SUPPLY



Electricity Distribution  
and Transmission

**£3.21bn**

Regulated  
asset value



Gas Distribution

**£2.15bn**

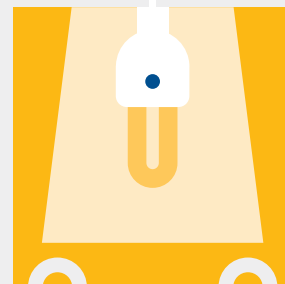
Regulated asset  
value (SSE share)



Generation

**11.29GW**

Generating capacity



Supply

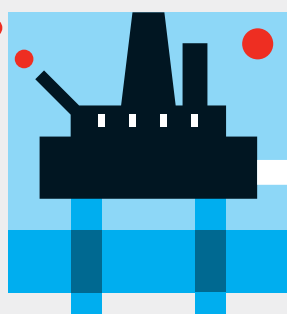
**10 million**

Customer accounts

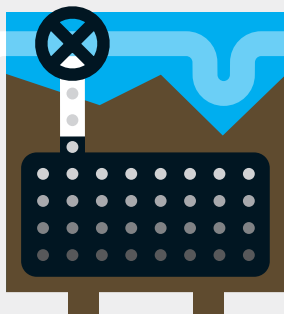
SSE's strategy is to deliver sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of economically-regulated and market-based energy-related businesses.

This balance, and the broad range of activities that flow from it, means SSE has a strong and diverse group of energy assets and businesses from which to secure the revenue to support future dividend growth.

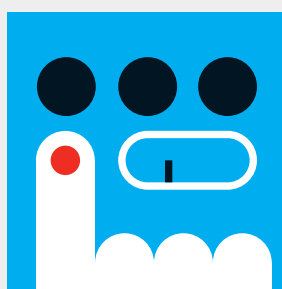
## OTHER ENERGY AND UTILITY SERVICES



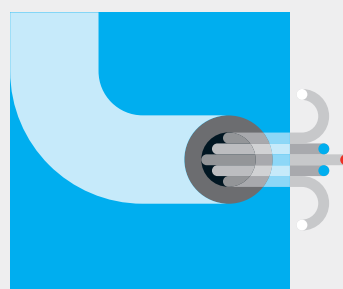
Gas Production



Gas Storage



Contracting, Utility  
Solutions and Metering



Telecoms

**12**

Fields in production

**440mcm**

Storage capacity

**£98m**

SSE contracting  
order book

**11,200km**

Network

## Chairman and Chief Executive

### Questions and answers

In SSE, the Chairman, Lord Smith of Kelvin, is responsible for the **operation** of the Board, ensuring it works effectively.

The Chief Executive, Ian Marchant, is responsible for the **management** of the business, implementing the **strategy** and **policies** agreed by the Board.

Here they answer questions about SSE's performance and plans for the future.

**Lord Smith of Kelvin** Chairman (left)  
**Ian Marchant** Chief Executive (right)

#### **It looks like 2010/11 was another challenging year for SSE. Was it?**

**Robert** → Yes, it was a challenging year – but let's keep things in perspective. SSE's adjusted profit before tax\* has continued to grow and passed the £1.3bn mark for the first time. It's now 50% higher than it was five years ago. A key financial question for the Board is whether the dividend target can be met while keeping dividend cover around the established range. Once again, it was.

**Ian** → We had to handle things including higher than forecast wholesale gas prices and lower than expected output of renewable energy, and they helped push down slightly operating profit in Generation and Supply. At the same time, our regulated energy networks businesses did well. That's why we have a balanced business model. It makes us more resilient, meaning we can deliver reasonable financial results and annual dividend growth even when the going is a bit tougher.

#### **Can SSE continue to grow the dividend and finance the investment in energy infrastructure that will be needed over the next decade?**

**Ian** → Yes. We have plans to invest between £1.5bn and £1.7bn a year in the period up to 2015. These plans are consistent with our financial principles and are designed to avoid any need to issue new equity. Forecasts

for investment by the energy sector over the next decade point to some very big numbers indeed – but investment opportunities shouldn't be confused with investment obligations. While there are plenty of opportunities, it's up to us which ones we pursue. Discipline will be our watchword.

**Robert** → You have to get this the right way round: it's not about sacrificing dividends to help finance investments – we expect returns from investments to help finance dividends. We always remember that dividends are not some kind of abstract concept. Shareholders rely on them for their own financial well-being, and we should never forget that.

#### **A year ago, you said you were 'confident' about SSE's ability to manage large capital projects. Has your confidence been borne out by events over the past year?**

**Robert** → I believe it has. It would be wrong to suggest it has been plain sailing all of the way, but good progress is being made – both in terms of projects currently under construction and in terms of building up the resources and skills needed to manage the projects that will come into construction in the next few years.

**Ian** → Our capital and investment spend has almost trebled in just five years and we have had to move quickly to make sure we have everything needed to support it.



We're now seeing results, with significant new assets being commissioned over the next couple of years. One of the key criteria for individual investment decisions, and for the shape of the investment programme overall, will always be whether we can manage individual projects effectively.

#### **Does that help explain the number of projects you seem to have shelved or scaled back over the past year and why you turned your back on some acquisition opportunities?**

**Ian** → Yes it does. As for acquisitions, if your business plan depends on them, you've got a problem because eventually you'll be forced to pay too much for something. Acquisitions should only ever be optional extras and that's what they are in SSE.

**Robert** → What the past year has again shown is the self-discipline in SSE. The Board doesn't believe in doing things for so-called 'strategic' reasons, so even if potential investments or acquisitions appear to have some business logic, we won't pursue them if the financial returns are not there. It's as simple as that.

#### **Do you worry that the energy sector is becoming more difficult to operate in, with more intervention from regulators and politicians, like Ofgem's energy**

## Overview

Strategy  
Group performance  
Segmental performance  
Corporate governance  
Financial statements  
Shareholder information



### retail market review and the UK government's Electricity Market Reform?

**Robert** → I understand completely why regulators and politicians take a close interest in energy. It's essential to the well-being of individual people and the successful functioning of society as a whole. If regulators and politicians make decisions for the right reasons, and after they've given a fair and reasonable opportunity for people to express their views, you have to respect them and the job they do.

**Ian** → I agree. Political and regulatory interventions are a fact of energy life. There was some pretty lurid language used when Ofgem published its retail market review proposals in March, but you have to look beyond that. What matters is that the review results in reforms which genuinely help customers and the competitive market in general. As for Electricity Market Reform, it's hugely complex, but I'm optimistic we'll end up with a package of reforms that will encourage investment in the types of generation we'll need in the future.

### How did you feel when SSE was called 'shameless' or 'cold-hearted' for putting up household energy prices?

**Ian** → Of course I didn't like it, but I accept that criticism goes with the territory.

It's actually in the interests of both customers and suppliers that prices should be more stable than they have been in the past few years. The reality is, however, that energy is now a global commodity for which there is rising global demand. It's affected by issues like political uncertainty in the Middle East or March's dreadful events in Japan. We do everything we can to moderate the impact of volatile global energy markets on our customers, and we'll continue to do that, but there is only so much upward pressure on energy prices that a supply business can withstand. The positive news is that all the energy efficiency investment that's been made over the past few years is starting to bring down people's energy consumption. This means they're paying less for their energy than they otherwise would.

**Robert** → It's easy to attach negative labels to big companies, but one of the things that impresses me about SSE is the day-to-day work of the customer service teams who are dedicated to helping vulnerable customers and other people whose circumstances mean they might be struggling to pay for their electricity and gas. The people in those teams are first class – professional, committed and caring.

### SSE's financial objective, strategy and business model are very familiar to people who have been following the Company over the years. Do you ever worry that SSE could become too set in its ways and unable to cope with the pace of change in the energy sector?

**Robert** → The SSE fundamentals have remained the same, particularly the commitment to real dividend growth, and I'm glad they have. That doesn't mean it's operating in some kind of time warp. The Company is actually very innovative and forward-looking and, on key issues like decarbonisation and reducing dependency on fossil fuels, really 'gets it'. It's the SSE way, however, just to get on with delivering things and not make a song and dance about them.

**Ian** → Sticking to the fundamentals is important. That said, performance has to be improved constantly if a business is to survive in the long term. That's why innovation has become a big thing in SSE. It's part of our Excellence value and it's innovation with a purpose – to deliver business improvements for the long term. We know that 'long term' means a very different energy sector from the one we operate in now, and we're building towards it all the time.

### How significant are the changes in Executive Directors' responsibilities and the formation of a new Management Board?

**Robert** → Colin Hood is retiring later this year after an outstanding career in the energy sector, culminating in nine years' excellent service as SSE's Chief Operating Officer. Main Board-level responsibilities will be divided between Ian, Gregor Alexander and Alistair Phillips-Davies. They are supported by the new Management Board and by other senior executives throughout the business. SSE has a very able and experienced management team and there is terrific strength in depth, that extends through the whole team of employees, who do an excellent job.

**Ian** → I agree with Robert about the strength of the team. The people in it are constantly being challenged and developed to make sure SSE will continue to be successful as the sector changes over the next few years.

### Is SSE sticking with its approach of not publishing a separate Corporate Responsibility Report?

**Ian** → Yes. A year ago we took the view that the content of the Annual Report should enable people to judge whether SSE is a responsible company, and we still believe that. A business should be designed so that everyone is expected to do their job in a responsible way. To put it another way, it's not about managing corporate responsibility, but about managing your corporation responsibly. That's our goal in SSE, and we maintain a set of core values – like Safety and Service – against which the management team, me included, is judged every year.

**Robert** → First on the list of those values is safety. It's the first item on the agenda for Board meetings, and the most important one.

### What are SSE's top priorities in 2011/12?

**Ian** → I can refer to the answer I gave to a similar question in the Annual Report last year, because it's the same: safe working; excellent customer service; well-run power stations and energy networks; good progress on major capital investment projects; and cost efficiency.

**Robert** → Continuity and consistency are really important. As a long-term business, SSE should have long-term priorities that transcend any one year, and that's exactly what we have. ●

## Why invest in SSE?

### Dividend

SSE has delivered above-inflation dividend increases every year since it was formed in 1998 – one of only six FTSE 100 companies to have done so.

### Diversity

SSE is the only company listed on the London Stock Exchange with a balanced mix of economically-regulated and market-based energy businesses.

### Discipline

SSE's commitment to above-inflation dividend growth is supported by the application of a series of financial principles, including a strong balance sheet.

### Delivery

SSE is focused on delivery of annual dividend growth, sector-leading service to customers and value-adding investments in new energy assets.

SSE's principal financial objective is to deliver annual above-inflation increases in the **dividend**. To do this, it operates and invests in a range of energy-related businesses, setting great store by **diversity**.

In doing this, it exercises **discipline** through adherence to a series of well-established financial principles and prioritises **delivery** in everything from cost control to constructing new assets.

### SSE has a balanced business, preparing for a decade of change in energy

Set out below are some of the developments that will affect the energy sector over the next decade and beyond and when they are set to take effect. SSE is actively preparing for the changes that these developments will bring.

The EU Energy Commissioner, Günther Oettinger, has said that Europe's energy sector is 'on the threshold of an unprecedented period of change'.

SSE has interests in electricity generation, transmission, distribution and supply and in gas production, storage, distribution and supply, and so this period of change will affect every part of its business.

With its balanced business model and commitment to core values such as efficiency, sustainability and excellence, SSE believes it is well-placed to make the most of the opportunities that change will bring.

| Key development | 2011<br>RENEWABLE HEAT INCENTIVE                                                             | 2012<br>GREEN DEAL                                                                                                                                  | 2013<br>PHASE 3 OF EU EMISSIONS TRADING SCHEME                                                                                                     | NEW ELECTRICITY TRANSMISSION PRICE CONTROL (RIIO-T1)                                                                 | NEW GAS DISTRIBUTION PRICE CONTROL (RIIO-G1)                                                                 |
|-----------------|----------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------|
| 2010            | ● ● ● ● ●                                                                                    | ● ● ● ● ●                                                                                                                                           | ● ● ● ● ●                                                                                                                                          | ● ● ● ● ●                                                                                                            | ● ● ● ● ●                                                                                                    |
| Main impact     | First part of a phased rollout designed to increase rapidly renewable sources of heat in GB. | Forecast implementation of new energy efficiency framework for GB, with the 'Green Deal' finance mechanism and new Energy Company Obligation (ECO). | In Phase 3 of EU ETS, all carbon dioxide emissions allowances for electricity generators will be auctioned. Carbon price support introduced in UK. | RIIO-T1 will set for an eight-year period the allowed revenues electricity transmission companies in GB can collect. | RIIO-G1 will set for an eight-year period the allowed revenues gas distribution companies in GB can collect. |

# 1. Strategy designed for dividend growth

SSE's core purpose is to provide the energy people need in a reliable and sustainable way. In fulfilling this purpose, SSE requires the support of the shareholders who have invested in its shares, and it believes their investment should be remunerated through the payment of dividends, for four key reasons:

- receiving and reinvesting dividends is the biggest source of an investor's return over the long term;
- dividends provide income for those investors who do not wish to reinvest them;
- dividend targets provide a transparent means with which to hold management to account; and
- a long-term commitment to dividend growth demands a disciplined, consistent and long-term approach to operations, investments and acquisitions.

As a result of this, SSE's strategy is to deliver sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of economically-regulated and market-based businesses in energy production, storage, distribution, supply and related services, mainly in the UK and Ireland.

The delivery of annual above-inflation increases in the dividend paid to shareholders is a clear, measurable and practical goal which sets the long-term financial context for SSE's operational and investment decisions.

## Financial discipline underpinning dividend growth

The requirement on SSE to maintain a disciplined, consistent and long-term approach to management is underpinned by a series of financial principles:

- maintenance of a strong balance sheet, evidenced by commitment to the criteria for a single A credit rating;
- rigorous analysis to ensure investments are well-founded and achieve returns greater than the cost of capital;
- deployment of a selective and disciplined approach to acquisitions, which should enhance earnings per share over the medium and long term; and
- use of the economics of purchasing the Company's own shares in the market as the benchmark against which financial decisions are taken.

The application of these principles supports the fulfilment of SSE's first financial responsibility to shareholders: the delivery of sustained real dividend growth.

## Delivering dividend growth – a twelfth successive increase

For 2010/11, the Board is recommending a final dividend of 52.6p per share, making a full-year dividend of 75p, an increase of 7.1% on the previous year. The full-year dividend is covered 1.5 times by SSE's adjusted profit after tax\* and is more than double the dividend per share paid eight years ago, in 2002/03. The recommended full-year dividend increase of 7.1% represents the twelfth successive above-inflation dividend increase since SSE paid its first full-year

dividend in 1999. SSE is one of just six FTSE 100 companies to have delivered better-than-inflation dividend growth every year during this period, and ranks fourth amongst that group in terms of compound annual growth rate over that time. Of the 50 companies which have been FTSE 100 constituents since 1998 SSE is ranked eighth for Total Shareholder Return.

## Targeting further dividend increases

According to Capita Registrars Dividend Monitor, published in February 2011, dividend payments by UK companies fell by 3.3% in 2010. This followed a 15% fall in 2009. As Capita said: 'Dividends are too often overlooked as a component of company return ... A company's value depends, most fundamentally of all, on the ability of the firm to make money and return it to shareholders. Ultimately, dividends are the principal way in which corporate profits are distributed.' Dividends are certainly not overlooked at SSE, as is evidenced by the fact its key financial objective is the delivery of sustained annual above-inflation increases in the dividend paid to shareholders. SSE's targets are to deliver:

- a full-year dividend increase of at least 2% more than Retail Price Index (RPI) inflation for 2011/12;
- a full-year dividend increase of at least 2% more than RPI inflation for 2012/13; and
- annual RPI-plus dividend increases thereafter.

In this context, inflation is defined as the average annual rate across each of the 12 months to March. SSE believes that these targets can be achieved while maintaining a dividend cover around its established range.

### 2014

#### NEW ELECTRICITY MARKET ARRANGEMENTS



Following UK government consultations on Electricity Market Reform, new arrangements are forecast to be implemented.

### 2015

#### NEW ELECTRICITY DISTRIBUTION PRICE CONTROL



The new price control will set for an eight-year period the allowed revenues electricity distribution companies in GB can collect.

#### LARGE COMBUSTION PLANT DIRECTIVE (LCPD) DEADLINE



Large combustion plants such as power stations must close if they have not opted in to and complied with the LCPD.

### 2020

#### DEADLINE FOR EU RENEWABLE ENERGY TARGETS



The UK and Ireland are required to meet 15% and 16% respectively of their energy requirements from renewable sources.

#### DEADLINE FOR EU EMISSIONS REDUCTION TARGETS



The UK and Ireland are required to achieve reductions of 34% and 40% respectively in emissions of greenhouse gases, compared with 1990 levels.

### 2023

#### INDUSTRIAL EMISSIONS DIRECTIVE DEADLINE



Large combustion plants such as power stations must close if they have not complied with limits on emissions of nitrogen oxides.

2020

## Why invest in SSE? (continued)

# 2. Diversity maintained for dividend growth

SSE is unique among companies listed on the London Stock Exchange in owning and operating a balanced group of economically-regulated energy businesses, such as electricity networks, and market-based energy businesses, such as electricity generation and energy supply. It is thus able to pursue operational, investment and acquisition opportunities throughout the electricity and gas sector to help achieve the levels of profitability required to support sustained real dividend growth.

This is because SSE is able to derive:

- stable and relatively predictable levels of profit from its economically-regulated

- energy networks; and
- more variable levels of profit, but also greater potential for growth, from its market-based businesses such as Generation and Supply.

As a result of this balance, SSE has greater resilience to risks associated with shorter-term trends or individual issues within its sector or the wider economy than do other companies which have less diversity within their business model.

Moreover, SSE's strategy of maintaining a balanced range of economically-regulated and market-based energy businesses provides a broad platform from which

to maintain sustained real dividend growth. This breadth is illustrated by the fact that:

- while energy is at their core, SSE has a diverse range of businesses;
- within those businesses, SSE has a diverse range of assets; and
- to add to those assets, SSE has a diverse range of investment options.

These businesses, assets and investment options are almost entirely in Great Britain and Ireland. This means SSE is able to focus closely on issues, giving greater experience, analysis and focus to the identification, consideration and management of issues and opportunities. It has, therefore, diversity with depth.

# 3. Delivering dividend growth in the future

The context for delivering future dividend growth is set by the EU Climate Change and Renewable Energy Package which aims to achieve by 2020:

- a reduction of at least 20% in the levels of greenhouse gas emissions across the EU, compared with 1990 levels; and
- an increase to at least 20% of all energy consumption to be generated from renewable sources.

In addition, the EU has a non-binding target to achieve a 20% reduction in energy consumption by 2020.

Against this background, the new UK government published its Annual Energy Statement in July 2010. Its goal is to support the transition to a 'secure, low-carbon, affordable' energy system in the UK and mobilise commitment to ambitious action on climate change internationally.

In its Programme for a National Government, the new government of the Republic of Ireland said in March 2011 that 'we will publish a Climate Change Bill which will provide certainty surrounding government policy and provide a clear pathway for emissions reductions, in line with negotiated EU 2020 targets'.

The European Commission adopted, in November 2010, a 'strategy for competitive, sustainable and secure energy'. It said that Europe's energy sector is on the threshold of 'an unprecedented period of change...

to diversify existing resources and replace equipment and to cater for challenging and changing energy requirements'.

## Sector developments to be faced over the next decade

Against this background, a large number of issues in the energy sector will have to be faced over the next decade. They include:

- a likely surge in the global demand for energy as emerging economies industrialise;
- a potential plateau in oil production as a result of which supply will be unable to keep pace with demand;
- a greater understanding of the output, potential cost and environmental impact of shale gas;
- the closure of a number of coal- and oil-fired power stations by 2016, under the EU's Industrial Emissions Directive;
- the end of the design life of many nuclear power stations, with a number of advanced gas-cooled reactor (AGR) stations scheduled to close;
- the impact of the increasing age and relative inefficiency of a number of gas-fired power stations;
- the increasing requirement for renewable sources of energy in response to legally-binding targets set for Member States under the EU Renewable Energy Directive;
- the requirement for flexible electricity generation capacity to respond to variations in output from renewable energy;

- implementation of potentially significant reforms to the Great Britain wholesale electricity and retail energy markets;
- continued downward pressure on energy consumption, with the possible EU adoption of legally-binding energy efficiency targets;
- the digitisation of energy supply following the roll-out of smart meters to all customers in Great Britain;
- the implementation of the RIIO (Revenue = Incentives + Innovation + Output) model for economic regulation of energy networks;
- an upgrading of transmission and distribution networks to accommodate new, and more decentralised, sources of electricity;
- increasing interconnection between electricity systems; and
- significant regulatory and political scrutiny of all aspects of the energy sectors in Great Britain and Ireland and at EU level.

SSE believes that the scale and significance of these issues are, in themselves, very good reasons for it to maintain a balanced and diverse range of energy businesses, so it can exploit opportunities and manage risks. More broadly, it believes that energy, as something which people need rather than want, will become increasingly valued, in the broad sense of the word. This means that SSE's strategy – the efficient delivery of operations and investments – should enable it to deliver above-inflation dividend increases in the decade ahead.

## The SSE approach

### DIVERSITY

#### Range of networks

Involved in five economically-regulated networks in electricity transmission and distribution and, through SGN, gas distribution.

#### Range of market businesses

Involved in Generation (with a diverse portfolio of generating plant) and Supply plus other energy and utility services.

#### Profit from networks

38.9% of operating profit derived from economically-regulated energy networks businesses in 2010/11.

#### Profit from market businesses

53.4% of operating profit derived from Generation and Supply and 7.7% from other energy and utility services in 2010/11.

#### Investment in networks

£328.5m invested in electricity distribution and transmission networks in 2010/11; plus 50% of SGN's capital/replacement expenditure was £199.7m.

#### Investment in market businesses

£784.4m invested in renewable energy, £126.5m invested in other generation plant and £52.6m invested in gas storage in 2010/11.

### DISCIPLINE

#### Focus on core markets

Businesses, assets and investment options almost entirely in markets in Great Britain and Ireland.

#### Asset optimisation

Disposals of non-core assets or assets in non-core markets undertaken in order to retain operational and financial focus.

#### Single A credit rating

Commitment to a strong balance sheet and the criteria for a single A credit rating.

#### Defined scale of investment

Investment of between £1.5bn and £1.7bn per annum planned in each of the years to March 2015.

#### Strong debt structure

Investment well-financed with average debt maturity of 10.6 years and £4.9bn of debt in medium- to long-term borrowings.

#### Capital programme governance

Implementation of new large capital project governance framework, supported by retention of external Project Management Partner.

### DELIVERY

#### Networks quality of service

Top-ranking electricity distribution network for five-year performance in customer interruptions and customer minutes lost.

#### Growing RAV

Effective investment in economically-regulated businesses taking Regulated Asset Value past £5bn for first time.

#### More onshore wind

An additional 90MW of new onshore wind capacity commissioned in 2010/11.

#### Large capital projects on course

Clyde, Griffin, Gordonbush, Walney, Greater Gabbard and Aldbrough all scheduled for completion by end of 2012.

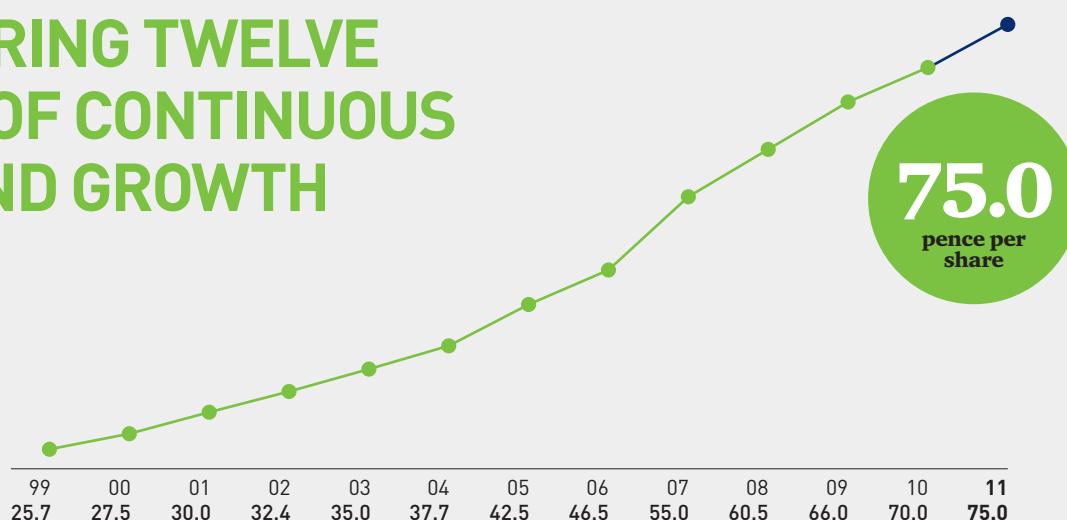
#### More customers

310,000 (net) additional customer accounts achieved across markets in Great Britain and Ireland.

#### Service leadership

Leadership in customer service in energy supply confirmed in a succession of independent surveys.

## DELIVERING TWELVE YEARS OF CONTINUOUS DIVIDEND GROWTH



## Why invest in SSE? (continued)

### Delivery priorities for SSE

SSE believes that these 'challenging and changing energy requirements' mean the following priorities should feature in its business activities:

- **Networks:** delivering upgraded electricity transmission networks and operational efficiency and innovation in electricity and gas distribution networks as they respond to the decarbonisation and decentralisation of energy;
- **Generation:** investing in the new capacity for renewable energy that will be needed in the transition to a lower-carbon economy while maintaining diversity in the type of assets owned and the type of fuels used, to generate electricity to support security of supply;
- **Supply:** evolving from the simple retailing of electricity and gas to the provision of a broader range of smarter products and services consistent with the long-term decarbonisation of energy production and consumption;
- **Gas Production:** securing medium- and long-term gas supplies to meet future energy needs;
- **Gas Storage:** reinforcing the security of energy supplies by providing storage capacity, as UK imports of gas rise; and

- **Energy and utility services:** providing key services for private and public sector organisations as they seek to install or upgrade existing energy and utility infrastructure.

As the energy company with the broadest range of operations in the UK and the fastest rate of growth in Ireland, SSE is well-placed to capitalise on the variety of operational and investment opportunities that are presenting themselves in the energy sector, without being over-exposed to risks associated with any of them.

### Delivery depends on safe and sustainable working

While SSE's first financial responsibility to shareholders is to deliver above-inflation increases in the dividend, it will only be able to achieve this if it exercises a wider corporate responsibility. It seeks to do this by maintaining a strong emphasis on its six core values, the 'SSE SET' of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork (see page 58).

Safety comes first in every sense. SSE believes that the effective management of safety issues is a barometer of effective management of all operational and

investment-related activities. In 2010/11 its Total Recordable Injury Rate per 100,000 hours fell from 0.14 to 0.12. SSE's ultimate goal is injury-free working and its Safety Management System is designed to achieve this by focusing on the five 'Ps' of:

- Policy;
- People;
- Processes;
- Plant; and
- Performance.

In addition, and in keeping with its commitment to sustainability, SSE's target for every year is zero environmental incidents which result in it being served with a formal statutory notice by a government-sponsored environment protection agency. There were no such incidents during 2010/11. More broadly, SSE's sustainability priorities are to:

- reduce emissions of greenhouse gases, especially carbon dioxide;
- facilitate customers' carbon dioxide reductions;
- use resources efficiently and with the minimum possible waste; and
- avoid pollution and improve environmental practice.

## 4. Outlook for 2011/12 and beyond

The economic outlook for the UK and Ireland in 2011/12 continues to be uncertain, and the global nature of energy markets means that SSE, like every other company in the sector, has to be prepared to manage the energy consequences of exceptional and unpredictable events such as the political upheaval in the Middle East and the March 2011 earthquake and tsunami in Japan.

Against this uncertain background, and with its strategic focus on efficiency in operations and investment, SSE's core operational priorities during 2011/12 are to:

- carry out all work in a safe and responsible manner, with a lower Total Recordable Injury Rate;
- maintain strong cost control throughout all business activities;
- distribute electricity and (through Scotia Gas Networks) gas with the minimum possible interruptions to supplies;
- demonstrate innovation in the management of electricity and gas networks;

- optimise the management of its portfolio of energy assets and contracts;
- ensure power stations maintain a high level of availability to generate electricity in response to customers' needs and market conditions;
- maintain and build on sector-leading performance in the quality of service with high standards delivered to energy supply customers;
- improve the standards of service delivered to energy supply customers and build on its sector-leading performance;
- develop and sustain long-term relationships and contracts with key customers of its other energy and utility services; and
- work with the UK government and Ofgem to secure a stable and competitive framework for electricity generation and energy supply.

SSE's investment priorities are to support sustainable earnings and dividend growth by:

- commissioning new assets in renewable energy, electricity networks and gas storage which contribute to the diversity of its portfolio;
- meeting other development and construction milestones in its investment programme;
- taking forward the wide range of additional options that it has identified for investment from the middle of this decade onwards, especially in electricity generation; and
- preparing for the transformation of energy supply, characterised by the forthcoming roll-out of smart meters in Great Britain.

The delivery of a strong operational performance and the achievement of its investment priorities should enable SSE to discharge its first financial responsibility to shareholders: to deliver its targets for annual dividend growth. ●

## How did we perform against the priorities set for 2010/11?

### SAFETY

#### What we said

Carry out all work in a safe and responsible manner, with a lower Total Recordable Injury Rate (TRIR).

#### How we did in 2010/11

TRIR reduced from 0.14 per 100,000 hours worked to 0.12. Dangerous/potentially dangerous road traffic accidents reduced from 0.34 per 100 Company vehicles to 0.31. (See page 64.)

### EFFICIENCY

#### What we said

Deliver maximum efficiency throughout all business activities.

#### How we did in 2010/11

Additional cost savings were achieved during 2010/11 and there were specific operational improvements in areas such as credit management.

### SERVICE

#### What we said

Maintain and build on sector-leading performance in all aspects of customer service, from energy supply to energy networks.

#### How we did in 2010/11

Leadership maintained in key independent studies of service performance in energy supply (see page 41) and most successful company in electricity networks in 'keeping the lights on' (see pages 23 and 24).

### CUSTOMERS

#### What we said

Increase the total number of energy supply and home services customer accounts across Great Britain and Ireland while supporting progress towards increased energy efficiency.

#### How we did in 2010/11

Total customer accounts increased by 310,000 to over 10 million. SSE-funded insulation installations (excluding DIY) took place in 193,000 homes throughout Great Britain. (See pages 39 to 42.)

### GENERATION

#### What we said

Ensure power stations maintain a high level of availability to generate electricity in response to customers' needs and market conditions.

#### How we did in 2010/11

Availability to generate electricity declined to 88% at SSE's gas-fired power stations and 84% at its coal-fired stations. Wind farm availability was unchanged at 97%. (See pages 29 to 38.)

### OTHER ENERGY BUSINESSES

#### What we said

Focus on cost control and customer relationship management to sustain energy services businesses through the period of economic uncertainty.

#### How we did in 2010/11

Total operating profit from Contracting, Utility Solutions and Metering rose by 10.3% year-on-year, with important steps for the long-term future taken in areas such as Utility Solutions. (See pages 43 to 46.)

### ASSETS

#### What we said

Deliver additional assets in electricity generation, electricity networks and gas storage.

#### How we did in 2010/11

90MW of new wind farm capacity commissioned, £400m (net) added to networks' Regulated Asset Value and 40mcm of gas storage all delivered. (See page 35 and 44.)

### PROJECTS

#### What we said

Meet other key milestones in the investment programme in generation, electricity networks and gas storage.

#### How we did in 2010/11

Almost all key projects remain on, or close to, the schedule set out in the Annual Report 2010, and a new Large Capital Project Governance Framework has been introduced. (See pages 20 and 57.)

### OPTIONS

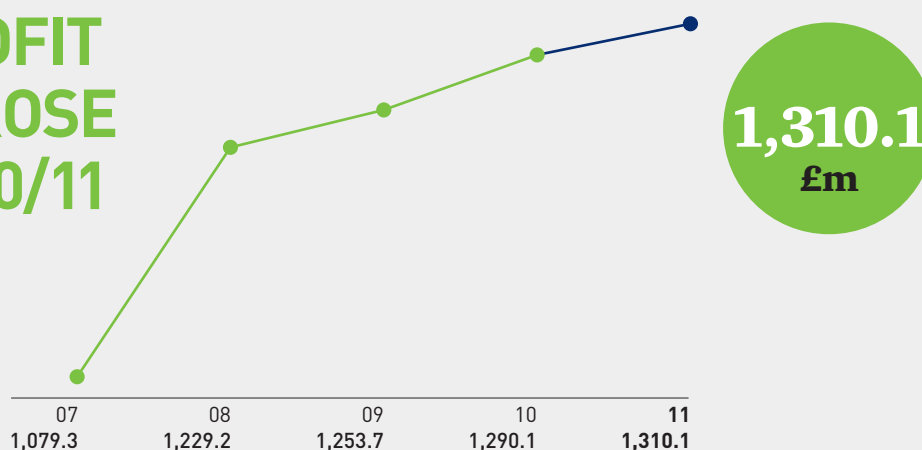
#### What we said

Take forward additional options for investment from the middle of this decade onwards.

#### How we did in 2010/11

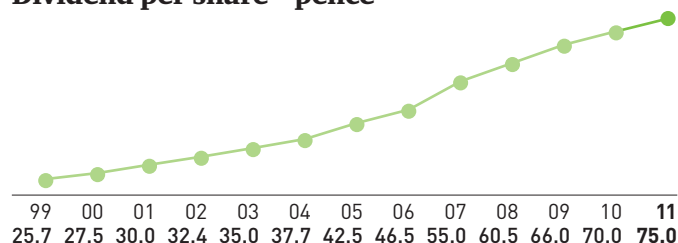
A broad range of options for future investment has been developed and retained across electricity generation and networks, energy supply and gas storage. (See pages 23 to 46.)

**ADJUSTED PROFIT  
BEFORE TAX\* ROSE  
BY 1.6% IN 2010/11**



## Key performance indicators

### Dividend per share – pence



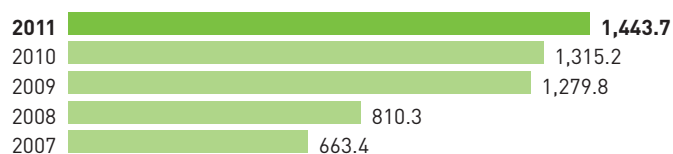
### Dividend cover – times



### Adjusted profit before tax\* – £m



### Capital expenditure and investment – £m



### Energy customer numbers – millions



### Safety, sustainability and teamwork

|                                                         | 2007   | 2008   | 2009   | 2010   | 2011   |
|---------------------------------------------------------|--------|--------|--------|--------|--------|
| Total Recordable Injury Rate – per 100,000 hours worked | N/A    | N/A    | 0.16   | 0.14   | 0.12   |
| Power station CO <sub>2</sub> emissions – grams per kWh | 555    | 496    | 491    | 494    | 504    |
| Reportable environmental incidents                      | 0      | 1      | 1      | 2      | 0      |
| Number of employees                                     | 13,427 | 16,892 | 18,795 | 20,177 | 20,249 |

### Dividend 2010/11 composition – %

- Interim 30 (22.4p)
- Final 70 (52.6p)



### Adjusted earnings per share\* – pence



### Operating profit\* by business – £m

|                              | 2009  | 2010  | 2011  |
|------------------------------|-------|-------|-------|
| Generation and Supply        | 832.0 | 896.0 | 882.8 |
| Energy networks              | 584.2 | 599.5 | 642.3 |
| Energy and utility solutions | 133.0 | 138.4 | 130.1 |

### Capital expenditure and investment 2010/11 – %

- Thermal generation 9
- Renewable generation 54
- Power systems 23
- Gas storage 4
- Other 10



### Networks regulated asset value – £bn



# Financial overview

|                          |
|--------------------------|
| Overview                 |
| Strategy                 |
| <b>Group performance</b> |
| Segmental performance    |
| Corporate governance     |
| Financial statements     |
| Shareholder information  |

## Financial overview

### Performance indicators

|                                                   | 2009    | 2010    | 2011    | Change |
|---------------------------------------------------|---------|---------|---------|--------|
| <b>Investment and capital expenditure</b>         |         |         |         |        |
| Thermal generation                                | 216.2   | 146.2   | 126.5   | -13.5% |
| Renewable generation                              | 525.6   | 666.6   | 784.4   | +17.7% |
| Gas storage                                       | 55.4    | 46.3    | 52.6    | +13.6% |
| Electricity networks                              | 314.6   | 334.5   | 328.5   | -1.8%  |
| Other                                             | 168.0   | 121.6   | 151.7   | +24.8% |
| <b>Total investment and capital expenditure</b>   | 1,279.8 | 1,315.2 | 1,443.7 | +9.8%  |
| <b>50% of SGN capital/replacement expenditure</b> | 191.4   | 206.4   | 199.7   | -3.2%  |
| <b>Financial management and balance sheet</b>     |         |         |         |        |
| Adjusted net debt and hybrid capital – £bn        | 4.822   | 5.292   | 5.891   | +11.3% |
| Average debt maturity – years                     | 11.8    | 11.0    | 10.6    | -3.6%  |
| Underlying interest cover (excluding SGN)         | 6.5     | 6.3     | 7.3     | +15.9% |
| Shares in issue at 31 March – millions            | 920.4   | 923.1   | 936.9   | +1.5%  |
| Shares in issue (weighted average) – millions     | 883.0   | 921.9   | 927.6   | +0.6%  |

### Focus on adjusted profit before tax\*

These results for the year to 31 March 2011 are reported under International Financial Reporting Standards, as adopted by the EU. SSE's focus has consistently been, and remains, on profit before tax before exceptional items, remeasurements arising from IAS 39, and after the removal of taxation on profits from jointly controlled entities and associates.

This 'adjusted profit before tax\*' was first adopted as a key performance indicator by SSE in 2005/06 and it:

- reflects the underlying profits of SSE's business;
- reflects the basis on which it is managed; and
- avoids the volatility that arises from IAS 39.

The table (right) reconciles SSE's reported profit before tax to its adjusted profit before tax\* and sets out the position after tax and in respect of adjusted earnings per share\*.

### Increasing adjusted profit before tax\* in 2010/11

Adjusted profit before tax\* rose by 1.6%, from £1,290.1m to £1,310.1m. The increase in adjusted profit before tax\* is mainly attributable to growth in **Energy Networks** as a result of:

- changes in the price of electricity units distributed following the introduction of the new Price Control for 2010-15;

- increased allowed revenue in respect of the electricity transmission network; and
- the continued focus on efficiency and cost control in the networks businesses.

At the same time, however, adjusted profit before tax\* was constrained by the following issues in **Generation and Supply**:

- the lower than expected output of renewable energy from SSE's hydro electric schemes and wind farms, including that qualifying for Renewable Obligation Certificates, due to relatively dry and still weather conditions;

- the higher than forecast wholesale gas prices;
- the underlying reduction of almost 2.5% in electricity consumption by household customers in the GB market; and
- the increase in some costs in Generation, such as operations, maintenance and business rates.

The financial performance of **Other Energy and Utility Services** (Gas Production; Gas Storage; Contracting, Utility Solutions and Metering; and Telecoms) was mixed. There was, for example, the decline in the price attained for Standard Bundled Units of gas storage capacity. At the same time, however, the expansion in recent years of SSE's metering activities, along with strong performance in particular areas such as lighting services, supported profitability.

### Movement on derivatives (IAS 39)

At 31 March 2011, there was a net derivative financial asset in SSE's balance sheet arising from IAS 39 of £438.8m, before tax, compared with a net liability of £985.1m, before tax, at 31 March 2010. These balances principally relate to some of the forward commodity purchase contracts for gas, coal, oil, carbon and wholesale electricity that SSE, like all major energy suppliers, has to enter into to ensure that the future requirements of its customers are met. IAS 39 requires SSE to record these contracts at their 'fair value'.

This involves comparing their contractual price against the prevailing forward market price at the financial year end. At 31 March 2011 the average contractual price was lower than the market price (in other words, 'in the money'). The market price rose particularly significantly towards the end of the financial year in response to developments in the

### Profit before tax

|                                                       | March 11<br>£m | March 10<br>£m | March 09<br>£m |
|-------------------------------------------------------|----------------|----------------|----------------|
| <b>Adjusted profit before tax*</b>                    | <b>1,310.1</b> | 1,290.1        | 1,253.7        |
| Movement on derivatives (IAS 39)                      | 1,423.3        | 399.8          | (1,262.1)      |
| Exceptional items                                     | (625.0)        | –              | 102.7          |
| Tax on JCEs and Associates                            | 3.3            | (51.3)         | (40.4)         |
| Interest on convertible debt                          | –              | –              | (0.6)          |
| <b>Reported profit before tax*</b>                    | <b>2,111.7</b> | 1,638.6        | 53.3           |
| Adjusted profit before tax*                           | 1,310.1        | 1,290.1        | 1,253.7        |
| Adjusted current tax charge                           | (268.2)        | (274.1)        | (300.4)        |
| <b>Adjusted profit after tax*</b>                     | <b>1,041.9</b> | 1,016.0        | 953.3          |
| <b>Reported profit after tax</b>                      | <b>1,504.5</b> | 1,235.5        | 112.3          |
| Number of shares for basic and adjusted EPS (million) | 927.6          | 921.9          | 883.0          |
| <b>Adjusted EPS*</b>                                  | <b>112.3p</b>  | 110.2p         | 108.0p         |
| <b>Basic EPS</b>                                      | <b>162.2p</b>  | 134.0p         | 12.7p          |

## Financial overview (continued)

Middle East and Japan. The actual value of the contracts will be determined as the relevant commodity is used to meet customers' energy needs. For around 60% of the total energy volume, this will be over the next 12 months. As a result, SSE believes movement in fair value of contracts is not relevant to the financial year in question, in this case 2010/11.

The movement on derivatives under IAS 39 of £1,423.3m shown in the table on the previous page and on the face of the Income Statement is primarily due to the contrast between the 'in the money' position at 31 March 2011 and the 'out of the money' position that existed on 31 March 2010, when the average contractual price was higher than the prevailing forward market price. SSE sets out these movements in fair value separately, as remeasurements, as the extent of the actual profit or loss arising over the life of the contracts giving rise to this liability will not be determined until they unwind.

### Exceptional items

The pre-tax exceptional item of £625.0m relates to impairment and other charges against the value of some electricity generation plant. Almost all of the total is non-cash and is mainly due to:

- the expiry of certain tolling arrangements at SSE's associate investments, Barking Power Ltd and Derwent Cogeneration Ltd, and to low 'spark' spreads associated with gas-fired generation;
- the impact of low spark spreads and a reduced economic life attributable to the Keadby and Medway power stations;
- the new Industrial Emissions Directive-related restrictions on running hours at SSE's Fiddler's Ferry and Ferrybridge power stations from 2015, and the

stations' probable closure in 2023, in accordance with the terms of the IED; and

- a range of issues relating to the operation and continuing rationalisation of SSE's portfolio of renewable and sustainable energy developments, such as the SSE Mineral Solutions (formerly RockTron (Widnes) Ltd) plant at Fiddler's Ferry, and development assets in Germany, which were disposed of during 2010/11.

### Delivering adjusted profit before tax\* in 2011/12

SSE's emphasis is on adjusted profit before tax\* on a full-year, as opposed to half-year, basis. Since it first reported full-year results in 1999 it has delivered 12 successive increases in adjusted profit before tax\*.

Adjusted profit before tax\* is an important measure of performance in any given year. In SSE's view, however, adjusted profit before tax\* is not an end in itself, and SSE does not have the goal of maximising profit in any single year or over any particular period. It takes a longer-term view and believes that profit is a means to an end: sustained real growth in the dividend, the delivery of which is its first financial responsibility to shareholders.

SSE's adjusted profit before tax\* in any single year will always be determined by issues such as:

- the availability of its gas- and coal-fired power stations to generate electricity;
- the performance of assets in gas production and gas storage;
- the output of renewable energy from its hydro electric stations and wind farms;
- the impact of the weather on energy production and consumption;
- the actual underlying level of customers' energy consumption;
- the interaction between wholesale

prices for energy and fuel and the prices for the electricity and gas charged to customers; and

- the timely commissioning of new assets.

In terms of 2011/12, SSE believes that its balanced range of market-based and economically-regulated energy businesses, and the diversity of opportunities within those businesses, should deliver a level of adjusted profit before tax\* capable of supporting the achievement of its principal financial objective, a full-year dividend increase of at least 2% more than RPI inflation, while maintaining dividend cover around the established range.

SSE will provide an update on its financial, operational and investment progress during 2011/12 when it presents its results for the six months to 30 September 2011. It does not, however, expect to provide an outlook for adjusted profit before tax\* in 2011/12 before the publication of its Interim Management Statement in early 2012, not least because its principal financial objective is dividend growth.

### Increasing adjusted earnings per share\* in 2010/11

To monitor financial performance over the medium term, SSE continues to focus on adjusted earnings per share\* because it has the straightforward benefit of defining the amount of profit after tax that has been earned for each Ordinary Share and so reflects a clear view of underlying financial performance. In 2010/11, SSE's adjusted earnings per share\* were 112.3p, based on 927.6 million shares, compared with 110.2p, based on 921.9 million shares, in the previous year.

### Dividend

#### Increasing the final dividend for 2010/11

SSE's first financial responsibility to its shareholders is to remunerate their investment through the delivery of sustained, above-inflation increases in the dividend. The Board is recommending a final dividend of 52.6p per share, compared with 49p in the previous year, an increase of 7.3%. This will make a full-year dividend of 75p, which is:

- an increase of 7.1% compared with 2009/10;
- a real-terms increase of 2.2%, based on the average annual rate of RPI inflation in the UK between April 2010 and March 2011, which exceeds the target of 2%;
- the twelfth successive above-inflation dividend increase since the first full-year dividend of 25.7p paid by SSE for 1998/99;

**SSE does not have the goal of maximising profit in any single year. It takes a longer-term view and believes that profit is a means to an end: sustained real growth in the dividend, the delivery of which is its first financial responsibility to shareholders.**

- double the dividend paid in 2002/03, since when there has been compound annual growth of 10%; and
- covered 1.5 times by SSE's adjusted profit after tax\*.

#### Targeting further dividend increases in 2011/12 and beyond

SSE is aiming to deliver an increase in the full-year dividend of at least 2% more than RPI inflation in 2011/12. The same target is in place for 2012/13, with sustained annual real growth thereafter also being targeted.

#### Scrip Dividend Scheme option for shareholders

At the Annual General Meeting in July 2010, SSE's shareholders approved the introduction of a Scrip Dividend Scheme, to give them the option to receive new fully paid Ordinary Shares in the Company in place of their cash dividend payments. Scrip dividend take-up was as follows:

- **September 2010:** 30,841 shareholders elected to receive the final dividend of 49p per share, in respect of 172,173,451 Ordinary Shares, in the form of Scrip dividend. This resulted in the issue of 7,524,682 new Ordinary Shares, fully paid, an increase of 0.82% on the issued share capital at the dividend record date of 30 July 2010; and
- **March 2011:** 30,482 shareholders elected to receive the interim dividend of 22.4p per share, in respect of 275,550,234 Ordinary Shares, in the form of Scrip dividend. This resulted in the issue of 5,264,873 new Ordinary Shares, fully paid, an increase of 0.57% on the ordinary issued share capital at the dividend record date of 28 January 2011.

This had the effect of reducing by £146.1m the amount of dividends paid in cash during 2010/11. The total number of shares in issue at 31 March 2011 was 936.9 million.

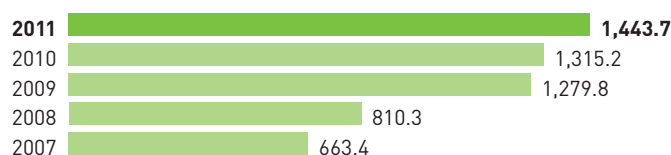
#### Investment and capital expenditure

##### Investing for sustained dividend growth

SSE's capital and investment expenditure totalled £1,443.7m, building on the expenditure of £1,315.2m in the previous year. During 2010/11:

- the investment of £126.5m in **thermal generation** included work at Peterhead power station to enhance its ability to operate on a 'two shift' basis;
- the investment of £784.4m in **renewable generation** included SSE's share of the investment at Greater Gabbard and Walney offshore wind farms;

#### Capital expenditure and investment – £m



#### Capital expenditure and investment 2010/11 – %

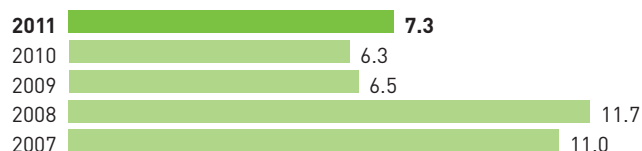
- Thermal generation 9
- Renewable generation 54
- Power systems 23
- Gas storage 4
- Other 10



#### Renewable energy capital expenditure – £m



#### Underlying interest cover – times



- the investment of £52.6m in **gas storage** included £29.4m invested in the new facility at Aldbrough, which takes the total invested by SSE in this development to £237.3m; and
- the investment of £328.5m in **electricity networks** included £28.6m on works related to the upgrade of the Beaulieu-Denny transmission line.

Including investment of £165.4m in 2011, SSE's cumulative investment in Greater Gabbard is now £538m, excluding transmission costs.

A total of £1.5bn has been invested by SSE in assets which were still largely under construction at 31 March 2011, including its share of the cumulative investment in Greater Gabbard (£538m, excluding transmission costs). The majority of these assets will make some contribution to SSE's earnings in 2011/12.

SSE is committed to constructing robust assets, from which revenue can be generated on a reliable basis and which support future dividend growth. This entails rigorous scrutiny and control of the costs of large capital projects but also a clear focus on the return which completed projects will generate.

In line with this, SSE keeps the economic evaluation of its investment programme under continuous review and remains confident that significant value is being created from its capital and investment expenditure programme, based on actual project delivery and on the most up-to-date project costs and schedules.

In addition to its own capital and investment expenditure programme, SSE effectively has a 50% interest in Scotia Gas Networks' capital and replacement expenditure, through its 50% equity share in that business. SGN is self-financing and all debt relating to it

## Financial overview (continued)

In November 2010, SSE announced that it expects that its investment and capital expenditure will be in the range of £1.5bn to £1.7bn in each of the five years to March 2015. Capital and investment expenditure is expected to be around £1.7bn during 2011/12.

is separate from SSE's balance sheet. Nevertheless, it is a very substantial business which gives SSE, through its 50% stake, a major interest in gas distribution.

In 2010/11, a 50% share of SGN's capital and replacement expenditure was £199.7m, compared with £206.4m in the previous year. SGN's total capital investment in 2010/11 was £142.7m, taking the amount so far for the 2008-13 gas Distribution Price Control period to £668.0m.

### Future investment priorities in 2011/12 and beyond

In November 2010, SSE announced that it expects that its investment and capital expenditure will be in the range of £1.5bn to £1.7bn in each of the five years to March 2015. Capital and investment expenditure is expected to be around £1.7bn during 2011/12.

There are four main categories in SSE's investment and capital expenditure plans to March 2015:

- economically-regulated electricity distribution expenditure plus essential maintenance of other assets;
- economically-regulated expenditure on electricity transmission upgrades;
- expenditure that is already committed to development of new assets such as wind farms; and
- expenditure that is not yet committed but which could be incurred to support the development of new assets.

Around one third of the potential total spend over the four years to 2015 is in the uncommitted category and the majority of the uncommitted spend would be incurred

towards the end of the period. It will only be incurred if it is consistent with SSE's financial principles.

A programme with these principles, this shape, and on this scale, is designed to allow SSE to maintain the development of a balanced and diverse range of assets to support sustained, above-inflation dividend growth while remaining consistent with the criteria for a single A credit rating without the need to issue new shares. Each individual investment decision will be made:

- in line with SSE's financial principles;
- in the context of SSE's commitment to maintaining a diverse range of assets within its economically-regulated and market-based businesses; and
- in the light of developments in public policy and regulation.

SSE's investment programme will deliver:

- a significantly-enhanced asset base in key businesses, including economically-regulated electricity networks;
- additional fuel for electricity in the form of renewable sources of energy; and
- additional cash flows and profits to support future dividend growth.

During the same period SGN, in which SSE has a 50% stake, will also be making a significant investment in economically-regulated gas distribution networks.

### Delivering investment efficiently

Central to SSE's strategy is efficient investment in a balanced range of economically-regulated and market-based energy businesses. This means that investments should be:

- consistent with SSE's financial principles and so should achieve returns which are greater than the cost of capital (with a risk premium applied to the expected rate of return from individual projects where appropriate), enhance earnings and contribute to dividend growth; and
- governed, developed, approved and executed in an effective manner, consistent with SSE's Large Capital Project Governance Framework which is, in itself, regularly updated.

In October 2010, to help ensure the effective implementation of this framework, and in keeping with its long-standing approach of retaining specialist contractors to assist with major developments, SSE appointed KBR, a leading engineering, procurement and construction company, as Project Management Partner to help maintain the processes, systems and skills needed to deliver large capital projects and to act as SSE's 'critical friend' in this area.

KBR teams have now been established alongside SSE teams and are supporting a range of individual projects as well as contributing to overall project management and reporting. As a result, KBR is supplementing and complementing the work done by SSE's four in-house specialist large capital projects teams which cover:

- onshore renewable energy developments;
- offshore renewable energy developments;
- thermal generation developments (including SSE's interests in nuclear power); and
- electricity transmission upgrades.

These teams were augmented in 2010/11 to increase further SSE's capacity to manage major projects, and ensuring there is enough senior management and other types of resource in place to support the delivery of the projects will remain a key priority for SSE.

## Financial management and balance sheet

### Maintaining a prudent treasury policy

SSE's operations and investments are generally financed by a combination of:

- retained profits;
- bank borrowings;
- bond issuance; and
- commercial paper.

As a matter of policy, a minimum of 50% of SSE's debt is subject to fixed, or inflation-linked rates of interest. Within this policy framework, SSE borrows as required on different interest bases, with derivatives

and forward rate agreements being used to achieve the desired out-turn interest rate profile. At 31 March 2011, after taking account of interest rate swaps, over 70% of SSE's borrowings were at fixed rates.

Borrowings are mainly made in Sterling and Euro to reflect the underlying currency denomination of assets and cash flows within SSE. All other foreign currency borrowings are swapped back into Sterling.

The United Kingdom remains SSE's main area of operation, although business activities in the Republic of Ireland are also substantial. Transactional foreign exchange risk arises in respect of:

- procurement contracts;
- fuel and carbon purchasing;
- commodity hedging and energy trading operations; and
- long-term service agreements for plant.

SSE's policy is to hedge all material transactional foreign exchange exposures through the use of forward currency purchases and/or derivative instruments. Indirect foreign exchange exposures created by SSE's gas purchasing are similarly hedged on an ongoing basis. Translational foreign exchange risk arises in respect of overseas investments, and hedging in respect of such exposures is determined as appropriate to the circumstances on a case-by-case basis.

#### Managing net debt and maintaining cash flow

SSE's adjusted net debt and hybrid capital was £5.891bn at 31 March 2011, compared with £5.292bn at 31 March 2010. This was lower than expected because of:

- lower than forecast capital expenditure;
- lower cash dividend payments because of the Scrip dividend scheme; and

- strong operating cash flow through improved working capital management particularly in reducing energy customers' aged debt and in SSE Contracting.

As the table below sets out, adjusted net debt excludes finance leases and includes outstanding liquid funds that relate to power purchase agreements and wholesale energy transactions. Hybrid capital is accounted for as equity within the Financial Statements but has been included within SSE's 'Adjusted net debt and hybrid capital' to aid comparability.

Shortly after the end of the financial year, in April 2011, SSE received proceeds of £178.4m relating to the sale of its equity interest in three onshore wind farms.

#### A strong debt structure through medium- and long-term borrowings

SSE's objective is to maintain a balance between continuity of funding and flexibility, with debt maturities staggered across a broad range of dates. Its average debt maturity as at 31 March 2011 was 10.6 years, compared with 11.0 years at 31 March 2010.

SSE's debt structure remains strong, with around £4.9bn of medium- to long-term borrowings in the form of issued bonds, European Investment Bank debt and long-term project finance and other loans. In addition, in September 2010, SSE issued hybrid capital of £1.16bn (see table below and 'Ensuring investment is well-financed' below). The balance of SSE's adjusted net debt is financed with short-term commercial paper and bank debt. SSE's adjusted net debt includes cash and cash equivalents totalling £476.9m.

Just over £100m of medium-to-long-term borrowings will mature in the year to 31 March 2012. The balance of SSE's adjusted

net debt is financed with short-term commercial paper and bank debt.

#### Ensuring investment is well-financed

SSE believes that maintaining a strong balance sheet, evidenced by a commitment to the criteria for a single A credit rating, is a key financial principle. Its corporate credit ratings are now:

- 'A-', with a 'stable' outlook (Standard & Poors; reaffirmed in June 2010); and
- 'A3' with a 'stable' outlook (Moody's; reaffirmed in July 2010).

SSE is committed to maintaining financial diversity and will move quickly to take the right financing options, including issuing new bonds and loans. During 2010/11 it:

- signed an amendment agreement with banks to extend its main revolving credit facilities (£1bn) by three years, to 2015, and reduce their price by around £5m per annum. The facilities are expected to remain for the foreseeable future, undrawn, and SSE's liquidity position is very strong; and
- launched an issue of hybrid capital, a financial instrument which brings together features of both debt and equity and is perpetual and subordinate to all senior creditors. The dual tranche issue comprised £750m and €500m and has an all-in funding cost to SSE of around 5.6% per annum. There is no fixed redemption date but SSE may, at its sole discretion, redeem all, but not part of, these bonds at their principal amount on 1 October 2015 or 1 October 2020 or any subsequent coupon payment date.

The hybrid capital issue in sterling was the first ever by a UK-listed company outside the financial services sector, and the launch was the first ever by a utility company which is not state-owned. It provides another source of attractively-priced funding for SSE to complement its already well-financed investment programme.

Indeed, the well-financed nature of SSE's investment programme has resulted in some external analysis suggesting that its commitment to the criteria for a single A credit rating could result in it missing out on opportunities to increase earnings. SSE believes, however, that it has sufficient financial flexibility to pursue the best opportunities to increase earnings. At the same time, it also believes that history – most recently the 'credit crunch' – demonstrates how companies with a commitment to the long term must be disciplined when managing their balance sheets and cautious in financing their activities.

| Adjusted net debt                           |                  |                  |
|---------------------------------------------|------------------|------------------|
|                                             | March 11<br>£m   | March 10<br>£m   |
| Loans and borrowings                        | (5,606.4)        | (6,047.0)        |
| Cash and cash equivalents                   | 476.9            | 261.7            |
| <b>Unadjusted net debt</b>                  | <b>(5,129.5)</b> | <b>(5,785.3)</b> |
| less:                                       |                  |                  |
| Finance leases                              | 372.2            | 384.4            |
| Add outstanding liquid funds                | 28.1             | 108.7            |
| <b>Adjusted net debt</b>                    | <b>(4,729.2)</b> | <b>(5,292.2)</b> |
| add: Hybrid capital                         | (1,161.4)        | –                |
| <b>Adjusted net debt and hybrid capital</b> | <b>(5,890.6)</b> | <b>(5,292.2)</b> |

## Financial overview (continued)

### Net finance costs

The table below reconciles reported net finance costs to adjusted net finance costs, which SSE believes is a more meaningful measure. In line with this, SSE's adjusted net finance costs during 2010/11 were £342.8m, compared with £335.9m in the previous year.

There was no charge for hybrid debt interest during the year. In future, any charge will be presented within dividends and reflected within adjusted earnings per share\*.

The average interest rate for SSE, excluding JCE/Associate interest, during the year was 5.43%, compared with 5.35% for the previous year. Based on adjusted interest costs, SSE's underlying interest cover was (previous year's comparison in brackets):

- 7.3 times, excluding interest related to SGN (6.3 times); and
- 5.7 times, including interest related to SGN (5.6 times).

Excluding shareholder loans, SGN's net debt at 31 March 2011 was £3.16bn, and within the adjusted interest costs of £290.5m, the element relating to SGN's net finance costs was £90.4m (compared with £63.0m in the previous year), after netting loan stock

interest payable to SSE. Its contribution to SSE's adjusted profit before tax\* was, therefore, £96.4m, compared with £120.7m in the previous year.

### Contributing to employees' pension schemes

In line with the IAS 19 treatment of pension scheme assets, liabilities and costs, pension scheme liabilities of £668.6m are recognised in the balance sheet at 31 March 2011, gross of deferred tax. This represents a decrease in net liabilities of £51.7m compared with the position at 31 March 2010, principally due to deficit repair contributions made to schemes.

During 2010/11, employer cash contributions amounted to:

- £48.5m for the Scottish Hydro Electric scheme, including deficit repair contributions of £29.5m; and
- £58.1m for the Southern Electric scheme, including deficit repair contributions of £38.8m.

As part of the electricity Distribution Price Control for 2010-15, it was agreed that allowances equivalent to economically-regulated businesses' share of deficit repair contributions in respect of the

Southern Electric and Scottish Hydro Electric schemes would be included in price controlled revenue, with an incentive around ongoing pension costs.

### Tax

To assist the understanding of SSE's tax position, the adjusted current tax charge is calculated as shown in the table below.

The effective adjusted current tax rate, based on adjusted profit before tax\*, was 20.5%, compared with 21.2% in the previous year, on the same basis. The impact of SSE's higher capital expenditure programme and the changes introduced in Budget 2007 have had, and will continue to have, a positive impact on the effective current tax rate.

The Emergency Budget in June 2010 and Budget 2011 announced a series of annual reductions in the UK Corporation Tax rate for future years. The deferred tax balance has been remeasured to reflect the first of these rate reductions (from 28% to 26%) and the effect of this has been disclosed as an exceptional item. The deferred tax balances for future years will be remeasured as each subsequent rate reduction is enacted.

Budget 2011 also included an increase in Supplementary Corporation Tax, which has had an impact on SSE's recently-acquired gas production assets, the effect of which has also been disclosed as an exceptional item.

The reported tax charge for 2010/11 is £607.2m, compared with a tax charge of £403.1m in the previous year. The increase reflects the deferred tax associated with the mark to market movements on derivatives, and the impairment of fixed assets.

SSE's cash contribution to government revenues in the UK, including Corporation Tax, Employers' National Insurance Contributions and Business Rates, totalled £507.5m during 2010/11, compared with £474.6m in the previous year. The total includes joint ventures and associates. ●

| Net finance costs                                  | March 11<br>£m | March 10<br>£m |
|----------------------------------------------------|----------------|----------------|
| Reported net finance costs                         | 256.1          | 265.3          |
| add/(less):                                        |                |                |
| Share of JCE'/Associate interest                   | 139.9          | 107.1          |
| Exceptional charges                                | (8.8)          | –              |
| Movement on derivatives                            | (44.4)         | (36.5)         |
| <b>Adjusted net finance costs</b>                  | <b>342.8</b>   | <b>335.9</b>   |
| Return on pension scheme assets                    | 141.9          | 100.7          |
| Interest on pension scheme liabilities             | (150.2)        | (127.5)        |
| Finance lease interest                             | (39.7)         | (13.2)         |
| Notional interest arising on discounted provisions | (4.3)          | (3.5)          |
| <b>Adjusted interest costs<sup>2</sup></b>         | <b>290.5</b>   | <b>292.4</b>   |

<sup>1</sup> Jointly Controlled Entities.

<sup>2</sup> Adjusted finance income and costs for interest cover calculation.

| Tax charge                                      | March 11<br>£m | March 10<br>£m |
|-------------------------------------------------|----------------|----------------|
| Reported tax charge                             | 607.2          | 403.1          |
| add back:                                       |                |                |
| Share of JCE'/Associate tax                     | (3.3)          | 51.3           |
| less:                                           |                |                |
| Deferred tax                                    | (83.3)         | (69.4)         |
| Tax on exceptional items/certain remeasurements | (252.4)        | (110.9)        |
| <b>Adjusted current tax charge</b>              | <b>268.2</b>   | <b>274.1</b>   |

# Economically-regulated businesses

## Energy networks

Overview  
Strategy  
Group performance  
**Segmental performance**  
Corporate governance  
Financial statements  
Shareholder information

### Energy networks

#### Performance indicators

|                                                       | 2009        | 2010        | 2011         | Change |
|-------------------------------------------------------|-------------|-------------|--------------|--------|
| <b>Assets</b>                                         |             |             |              |        |
| Electricity network Regulated Asset Value (RAV) – £bn | 2.89        | 2.97        | <b>3.21</b>  | +8.1%  |
| Gas network RAV (share) – £bn                         | 1.82        | 1.97        | <b>2.15</b>  | +9.1%  |
| <b>Total RAV of energy network assets – £bn</b>       | <b>4.71</b> | <b>4.94</b> | <b>5.36</b>  | +8.5%  |
| Electricity network capital expenditure – £m          | 314.6       | 334.5       | <b>328.5</b> | -1.8%  |
| Gas network capital/replacement spend (share) – £m    | 191.4       | 206.4       | <b>199.7</b> | -3.2%  |
| <b>Operations</b>                                     |             |             |              |        |
| SEPD customer minutes lost                            | 66          | 65          | <b>64</b>    | -1.5%  |
| SEPD customer interruptions                           | 64          | 61          | <b>64</b>    | +4.9%  |
| SHEPD customer minutes lost                           | 75          | 74          | <b>78</b>    | +5.4%  |
| SHEPD customer interruptions                          | 76          | 78          | <b>74</b>    | -5.1%  |
| SEPD/SHEPD performance-based revenue – £m             | 18.0        | 24.0        | <b>16.3</b>  | -32.1% |
| SGN uncontrolled gas escapes attended within one hour | 98.6        | 97.9        | <b>97.2</b>  | -0.7%  |
| SGN gas mains replaced – km                           | 951         | 1,062       | <b>1,102</b> | +3.8%  |
| <b>Volume</b>                                         |             |             |              |        |
| SEPD electricity units distributed – TWh              | 34.4        | 33.7        | <b>33.6</b>  | -0.3%  |
| SHEPD electricity units distributed – TWh             | 8.5         | 8.4         | <b>8.5</b>   | +1.2%  |
| SGN gas volume transported (Scotland) – TWh           | 58.6        | 55.2        | <b>55.8</b>  | +1.1%  |
| SGN gas volume transported (Southern) – TWh           | 114.9       | 107.8       | <b>110.4</b> | +2.4%  |

#### A balanced group of energy network companies

SSE has an ownership interest in five economically-regulated energy network companies:

- Scottish Hydro Electric Transmission (100%);
- Scottish Hydro Electric Power Distribution (100%);
- Southern Electric Power Distribution (100%);
- Scotland Gas Networks (50%); and
- Southern Gas Networks (50%).

The electricity networks transmit and distribute electricity to around 3.5 million businesses, offices and homes via almost 130,000km of overhead lines and under ground cables and the gas networks distribute gas to around 5.7 million homes, offices and businesses via 75,000km of gas mains.

SSE estimates that the total Regulatory Asset Value (RAV) of its economically-regulated 'natural monopoly' businesses is now over £5.36bn, comprising:

- £515m for electricity transmission;
- £2.70bn for electricity distribution; and

- £2.15bn for gas distribution (ie 50% of the businesses' total RAV of £4.3bn).

SSE is the only energy company in the UK to be involved in electricity transmission, electricity distribution and gas distribution. Together, these lower-risk economically-regulated natural monopoly businesses, featuring RPI inflation-linked revenue, provide a financial backbone and operational focus for SSE and balance its activities in the competitive Generation and Supply markets.

#### Focus on operational and investment efficiency

The aim of economic regulation is to attract investment in electricity and gas networks and encourage companies to operate them as efficiently as possible. Against this background, SSE's objectives in energy networks are to:

- comply fully with all safety standards and environmental requirements;
- ensure that they are managed as efficiently as possible, including maintaining tight controls over operational expenditure;
- provide good performance in areas

- such as reliability of supply, customer service and innovation and thus earn additional incentive-based revenue under the various Ofgem schemes;
- deliver efficient and innovative capital expenditure programmes, so that the number and duration of power cuts and gas supply interruptions experienced by customers is kept to a minimum, and so that there is adequate capacity to meet demand on the electricity system;
  - increase the RAV of the networks businesses and so secure increased revenue from them; and
  - engage constructively with the regulator, Ofgem, to secure regulatory outcomes that meet the needs of customers and investors.

#### Financial performance in energy networks

Operating profit\* in energy networks increased by 7.1%, from £599.5m to £642.3m, contributing 38.9% of SSE's total operating profit\*. This comprised:

- £455.5m in electricity networks, compared with £415.8m in the previous year; and
- £186.8m representing SSE's share of the operating profit\* for SGN, compared with £183.7m in the previous year.

#### Electricity Distribution and Transmission

##### Performance in Southern Electric Power Distribution

In Southern Electric Power Distribution (SEPD) in 2010/11:

- operating profit\* increased by 11.9% to £287.4m;
- electricity distributed fell by 0.1TWh to 33.6TWh;
- the average number of minutes of lost supply per customer was 64, down from 65;
- the number of supply interruptions per 100 customers was 64, up from 61; and
- performance-based additional income of £10.8m is expected to be earned, compared with the final out-turn of £15.8m in the previous year.

The increase in operating profit follows changes in the price of units distributed under the electricity Distribution Price Control for 2010-15, plus a continued focus on efficiency and cost control and some benefit from the 'over-recovery' of allowed income. Performance in respect of customer interruptions was ahead of the IIS targets set by Ofgem under its Interruptions Incentive Scheme (IIS), which gives financial benefits to distribution network operators that deliver good performance for

## Economically-regulated businesses (continued)

### Energy networks

SSE has undertaken a fundamental review of all of the processes around operating and capital expenditure, looking at every step in the value chain, in order to secure the maximum possible outputs from any expenditure.

customers. Performance-based income covers a number of issues, including the quality of service provided to customers and innovation.

#### Performance in Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission

In Scottish Hydro Electric Power Distribution (SHEPD) and Scottish Hydro Electric Transmission (SHETL) in 2010/11:

- operating profit\* increased by 5.8% to £168.1m;
- electricity distributed increased by 0.1TWh to 8.5TWh;
- the average number of minutes of lost supply per customer was 78, up from 74;
- the number of supply interruptions per 100 customers was 74, down from 78; and
- performance-based additional income of £5.5m is expected to be earned, compared with the final out-turn of £8.2m in the previous year.

The increase in operating profit reflects changes in the price of units distributed under the Price Control 2010-15, increased allowed revenue in respect of the transmission network and a continued focus on efficiency and cost control. Performance in respect of interruptions was ahead of the IIS targets set by Ofgem. The position on customer minutes lost was negatively affected by the severe weather experienced in the north of Scotland in early March 2011.

#### Volume of electricity distributed

The total volume of electricity distributed by SSE during 2010/11 was 42.1TWh, unchanged from the previous year. Under the electricity Distribution Price Control for 2010-15, the volume of electricity distributed will no longer affect companies' overall allowed revenue. This has further reduced the level of risk associated with energy networks businesses.

#### Earning revenue by delivering a good quality of service

SSE's two networks earned additional revenue of £59.4m in nominal prices in the five years to March 2010 for their performance in respect of Customer Interruptions and Customer Minutes Lost. On this measure, they were ranked first (SEPD) and fourth (SHEPD) among the 14 electricity distribution companies in Great Britain. This reflects effective investment in the automation of the networks and effective operational responses to electricity supply interruptions.

#### Operating electricity networks efficiently

Efficiency is one of SSE's core values and amongst Ofgem's explicit purposes in setting Price Controls is to keep as low as possible the costs of providing secure and reliable networks. SSE has a straightforward operating model, under which the vast majority of activities are in-house. Under this model:

- customer-facing activities, such as restoring power supplies or providing new connections, are managed from a network of 14 depots in communities throughout central, southern England and the north of Scotland; and
- network management activities, such as inspections, maintenance and investment, are carried out in Operational Production Groups.

This model gives SSE a strong oversight of operations and investment, allows flexibility in responding to changed circumstances and supports a culture of efficiency, teamwork and excellence, including innovation.

#### Investing in electricity networks and securing growth in their RAV

2010/11 was the first year of the electricity Distribution Price Control for 2010-15. The new Price Control changed the framework

for operating and capital expenditure to remove the perceived bias in favour of the latter and to ensure the delivery of not only the investment itself but of agreed outputs from it. The most successful electricity distribution companies, therefore, will be those that apply efficiency and innovation to maximise outputs from agreed expenditure.

In response to this, SSE has undertaken a fundamental review of all of the processes around operating and capital expenditure, looking at every step in the value chain, in order to secure the maximum possible outputs from any expenditure. As a result, it has identified a number of solutions and interventions for wider deployment in 2010-15 to ensure its success throughout the Price Control period. This means SSE has robust and cost efficient network investment processes that deliver real value for customers. It has also identified a number of technological advancements that are delivering cost savings and minimising disruption.

For example, use of directional drilling units, a method of cable installation, is well established in SSE. The directional drill burrows under ground holes for cables, resulting in minimum disturbance to the highway and thereby reduces disruption to the public and the costs associated with ground reinstatement. This has been taken a stage further with the first use in the UK for under ground cable replacement of a 'wash-over' drill head, which injects water at high pressure to loosen soil around cabling. The old cable can then be removed and a new one installed along the same route. The idea was developed and introduced to SSE by an employee under its 'Licence to Innovate' scheme and in 2010/11 reduced open excavations/highway closures by an estimated 620 days.

Techniques such as these will be more widely deployed and developed during the new Price Control. Their deployment, plus good performance in response to Ofgem's enhanced incentive mechanisms in areas such as customer service, and the headline allowed weighted average cost of capital, should enable SSE to achieve the post-tax real return in excess of 5% which it is targeting in electricity distribution.

Against this background, capital expenditure in electricity networks (including transmission and the Beaulieu-Denny upgrade – see below) during 2010/11 was £328.5m. The need for further significant investment in Great Britain's electricity networks, to maintain and/or replace ageing assets or to provide additional capacity, is likely to mean SSE will invest in 2011/12 around:

- £250m in its electricity distribution networks; and
- £220m in its electricity transmission network, including around £180m on upgrades, such as the replacement of the Beaulieu-Denny line (around £100m in the year).

Significant distribution projects include a £40m project to install new 132kV plant at Bracknell and Camberley substations and new 132kV cables between the substations. The project will help to meet demand for electricity in a key area between the M3 and M4 motorways and should be completed in 2014.

#### **Making electricity networks smart**

Although there is no standard definition, the European Technology Platform for the Electricity Networks of the Future defines smart grids as 'electricity networks that can intelligently integrate the behaviour and actions of all users connected to it – generators, consumers and those that do both – in order to efficiently deliver sustainable, economic and secure electricity supplies'.

SSE, with Smarter Grid Solutions Ltd, an associate company, has already deployed commercially smart grid technology on SSE's power distribution network on Orkney, allowing the connection of 15MW of extra new renewable energy generation, an increase of one third, with the potential for this to grow further. The Orkney Smart Grid is based on the principle that capacity exists in real-time on the power distribution grid due to variation in demand for electricity and diversity in the output of grid-connected generators. This innovative smart grid technology permits greater numbers of renewable generators to be connected to the existing electricity network, in a much cheaper and faster way than traditional means, by allowing generators to access power network capacity not normally available under conventional network planning requirements.

SSE has two other principal projects to support smart grid developments, working with a wide range of organisations and partners:

- **Northern Isles New Energy Solutions (NINES) in Shetland:** NINES features installing 'smart' storage heaters and hot water tanks in up to 1,000 homes which can help balance the electricity network; adding a new electric boiler to the existing district heating system, which will be associated with the proposed medium-scale Gremista wind farm; deploying new technology on the network that will allow more small scale

renewable generators to connect to the network; introducing new commercial arrangements to encourage businesses to change the times at which they use most energy; and installing a 1MW battery, part-funded by the Department for Energy and Climate Change, at Lerwick Power Station; and

- **Thames Valley Vision (TVV) in and around Bracknell:** TVV aims to demonstrate that applying new technologies to Bracknell's network will provide a lower cost alternative to redeveloping the substation to meet increasing electricity demand, with the potential to significantly reduce costs to customers. TVV involves: monitoring – measuring and understanding power flows and usage patterns; modelling – taking data produced by monitoring and applying sophisticated demand prediction techniques; and managing – installing network automation and constraint management systems, energy storage technologies and automated demand response to manage network flows predicted by modelling.

SSE is committed to making sure that both areas benefit from the ideas put forward. It is working with Ofgem to ensure sufficient funding is secured under the Price Control for 2010-15 to allow NINES to move forward. SSE aims to finance TVV with sums received from Ofgem's Low Carbon Networks Fund; it will submit a bid for funding in August 2011.

#### **Supporting deployment of electric vehicles (EVs)**

Electric vehicles will be an essential part of the move towards a low-carbon transport infrastructure. The potential number of EVs on UK roads is predicted to be over one million by 2020. One study in 2010 forecast that EVs will overtake hybrids in UK market share and will reach a combined total of over 20% by the end of the decade.

Against this background, SSE has been a full participant in two EV projects –

the MINI E and the Ford Transit Connect consortia. These are pioneering trials to evaluate the psychological, social and technical aspects of living with an all-electric vehicle:

- the MINI E consortium is led by BMW and includes SSE, Oxford Brookes University, the South East England Development Agency (SEEDA), Oxford City Council and Oxfordshire County Council; and
- the Ford Transit Connect project is led by Ford and includes SSE, the University of Strathclyde and the London Borough of Hillingdon.

Financial support for both these projects has come from the Technology Strategy Board.

As part of the projects SSE completed, in January 2011, the installation of a public network of over 20 re-charging points in Oxford and a similar number in Hillingdon. In a pioneering move to further widen the availability of such charging points across the UK, the Oxford and Hillingdon networks are linked to a new 'sister' network in Milton Keynes, so drivers can charge their cars in any of these locations. This kind of interoperability between the two networks will be crucial as electric cars become more popular in the decades ahead. SSE had already installed home charging points for each driver taking part in the project. It is planning other public charging points across central southern England.

SSE is also a major partner in the Mayor of London's ambitious 'SourceLondon' scheme to install EV charging points in the capital, a major adopter of EV technology, and has already installed EV charging points in more than 20 NCP car parks as part of this project.

When their numbers become significant, EVs could change greatly the volume and pattern of electricity demand, and it is for this reason – in addition to supporting the low-carbon objectives behind them – that SSE is so actively involved in projects such as these.

**Electric vehicles will be an essential part of the move towards a low-carbon transport infrastructure. The potential number of electric vehicles on UK roads is predicted to be over one million by 2020.**

## Economically-regulated businesses (continued)

### Energy networks

#### Networks regulated asset value – £bn



#### Networks asset value 2010/11 – %

- SHEPD 10
- SEPD 17
- SHETL 32
- SGN (50% share) 41



#### Upgrading Scotland's electricity transmission network

Scottish Hydro Electric Transmission Ltd (SHETL) is responsible for operating, maintaining and investing in the transmission network in its area, which serves around 70% of the land mass of Scotland. As the licensed transmission company for the area, SHETL has to ensure there is sufficient network capacity for those seeking to generate electricity from renewable and other sources within it.

A series of major developments have the potential to transform the scale and scope of SSE's electricity transmission business:

- **Knocknagael Substation, Beaulieu-Blackhillock-Kintore and Beaulieu-Dounreay:** Ofgem has authorised pre-construction and construction funding for these three upgrades in the SHETL area, which form part of the first phase

of transmission projects to help connect renewable energy to the electricity network. These projects have a total value of almost £200m and should all be completed between 2011 and 2015;

- **Beaulieu-Denny:** Scottish Ministers granted consents, with associated conditions, in January 2010, to install a 400kV overhead electricity transmission line to replace the existing 132kV overhead transmission line between Beaulieu and Denny. The existing line will be dismantled. Construction works in line with the £58.8m of initial funding authorised by Ofgem in September 2010 are well under way. Substantive progress has also been made in satisfying conditions associated with Scottish Ministers' consent to replace the line which apply to the SSE section. Proposals were submitted to Ofgem in December 2010 for authorisation of the remainder of SSE's share of the project

expenditure (around £500m).

Independent consultants appointed by Ofgem have confirmed that SSE's submission represents 'a prudent assessment of efficient costs' and Ofgem will shortly undertake a consultation. Subject to that and to continued progress, full construction work on the replacement line, including the erection of new pylons, should begin later this year, with the replacement line being completed in 2014;

- **Beaulieu-Mossford:** SHETL has undertaken public consultations on the proposal to reinforce the existing 132kV electricity transmission infrastructure, including a new substation and a new line to accommodate a higher capacity. An application for consent to undertake the work was submitted to Scottish Ministers in January 2011. Based on early estimates, two parts of the project are likely to require total investment of around £45m;
- **Shetland:** SHETL has now secured consent for converter stations associated with the proposed 320km subsea/25km onshore under ground high voltage direct current (HVDC) transmission link between the Shetland Islands and Moray on the Scottish mainland to accommodate renewable energy developments in Shetland. The link would also connect properties in Shetland to the mainland electricity network for the first time. Related to this, in December 2009, the European Commission announced that SSE had been successful in securing a capital grant of up to €74m under the European Energy Programme for Recovery. The grant is towards the incremental cost of including an intermediate offshore HVDC hub off Caithness on the route of the proposed Shetland link and increasing the capacity of the southern section to Moray. The hub is at the centre of a potential, innovative three-ended 'Y' configuration, with legs from Caithness and Shetland to accommodate substantial planned renewable energy developments in the far north east of Scotland and the Northern isles and could be the first step towards an offshore 'super grid'; and
- **Western Isles:** In October 2010, SHETL concluded that the lack of financial underwriting from electricity generators (attributed to the level of transmission charges) relating to the link from the Western Isles to the mainland meant it would not be able to conclude a contract for the supply of the necessary electricity cable. As a result, it withdrew its request to Ofgem for authorisation to make the investment. The project remains active and SSE will prepare a new request for

With such significant investment requirements over the next few years, not least in providing the infrastructure to accommodate electricity produced from renewable sources, the scope for additional incremental growth in electricity networks is clear.

authorisation to invest in the link as soon as these issues are resolved. In practice, this is likely to take around one year.

Based on current estimates (although these will inevitably be revised) the Shetland and Western Isles links could require investment of around £900m.

The charging arrangements for electricity and gas transmission networks are currently the subject of an Ofgem-sponsored independent review named Project TransmiT which was launched in September 2010. It is designed to ensure that the framework for transmission charging promotes security of supply and a low carbon future, while keeping the cost of transmission to customers under control. The outcome of Project TransmiT will have a bearing on the amount of electricity from renewable sources that is developed in Scotland and, therefore, on the way in which the transmission network is upgraded.

Looking to the longer term, SSE has participated in the Electricity Networks Strategy Group, sponsored by Ofgem and the UK Department of Energy and Climate Change and involving all of the transmission companies in Great Britain. It has identified a potential need for sub-sea cable links between Scotland and England known as 'bootstraps'. SSE expects to be a major participant in this and other transmission developments over the next decade and beyond.

#### **'Keeping the lights on and supporting growth'**

'Keeping the lights on and supporting growth' was the name given to the public consultation issued by Scottish Hydro Electric Transmission Ltd (SHETL) in February 2011 through which it sought the views of customers and other stakeholders on the key activities and investments that should be included in its business plan for the new electricity Transmission Price Control that is due to run for eight years from 1 April 2013.

The consultation stemmed from Ofgem's new RIIO (Revenue = Incentives + Innovation + Outputs) model for economic regulation. RIIO is designed to encourage the efficient investment and innovation needed to secure energy supplies and meet environmental targets while delivering long-term value for money for customers.

In March 2011, Ofgem published its strategy for the new electricity Transmission Price Control (RIIO-T1). The financial package addressed key issues such as:

- the length of time over which assets will be depreciated, with 20 years for existing assets and 45 years for new assets;
- the allowed cost of equity, with an indicative range of 6.0-7.2%; and
- the allowed cost of debt, with the use of an index for determining companies' debt costs.

This package represented a step forward in reaching an acceptable Price Control, but extensive engagement with Ofgem and other stakeholders is required to ensure the final settlement fulfils the objectives that have been set for it. Transmission companies such as SHETL are required to develop business plans by the end of July 2011, demonstrating how they will 'meet the sustainability challenge, fund network investment and ensure continued safe and reliable operation of the networks and high levels of customer service'.

### **Electricity Distribution and Transmission priorities in 2011/12 and beyond**

During 2011/12 SSE's priorities in electricity networks are to:

- maintain safe and reliable supplies of power and to restore supplies as quickly as possible in the event of interruptions;
- respond effectively to the new arrangements in electricity distribution for allocating costs between support activities (expenses) and networks (capital);
- deliver successfully its investment plans in its electricity distribution networks;
- deploy innovative techniques to maximise the returns from good performance in electricity networks;
- make further progress in upgrading the transmission network in the north of Scotland; and
- continue to work with stakeholders to secure an acceptable outcome to the new electricity Transmission Price Control.

With such significant investment requirements over the next few years, not least in providing the infrastructure to accommodate electricity produced from renewable sources, the scope for additional incremental growth in electricity networks is clear.

## **Gas Distribution**

### **Performance in SGN**

SSE receives 50% of the distributable earnings from Scotia Gas Networks (SGN), in line with its equity holding, and also provides it with corporate and management services. In SGN in 2010/11:

- SSE's share of operating profit was £186.8m, up from £183.7m in the previous year;
- gas transported increased by 3.2TWh to 166.2TWh; and
- 97.2% of uncontrolled gas escapes were attended within one hour of notification, compared with 97.9% in the previous year.

SGN's two networks therefore both achieved the 97% standard for uncontrolled gas escapes.

The increase in operating profit for SGN is primarily due to two things:

- the impact of the price changes agreed as part of the five-year gas Distribution Price Control to March 2013; and
- underlying operational efficiencies achieved during the year.

Only 3.5% of SGN's transportation income is volume-related; the remaining 96.5% is related to the maximum capacity requirements of its customers. A small part of SGN's operating profit is derived from the non-regulated activities of its contracting, connections and commercial services operations.

### **Operating gas networks efficiently**

When SGN acquired its networks in June 2005, National Grid was contracted to provide it with services with a total value of £30m per annum. In the period since, services have been brought within SGN, and SGN's remaining service contracts with National Grid total £7m per annum. These Managed Services Agreement contracts cover transmission services, control and IT services and emergency call handling, and the process of bringing them within SGN is continuing. During 2011/12, it will stop using National Grid's Gas Transportation Management System and replace it with its new Distribution Network Control System.

### **Investing in gas networks and securing growth in their RAV**

The five-year gas Distribution Price Control, which began in April 2008, provides the opportunity for SGN to increase significantly investment in its gas distribution networks, thereby reinforcing their safety and reliability and securing

## Economically-regulated businesses (continued)

### Energy networks

SGN was awarded £1.1m under Ofgem's scheme for rewarding companies for developing and adopting best practice in serving the interests of customers, society and the environment. This was the second successive year in which SGN secured the highest award under the scheme.

another significant increase in their RAV. By 2013, SGN estimates that its total RAV will be around £4.8bn.

During 2010/11, SGN invested £399.3m in capital expenditure and mains and services replacement projects, compared with £412.8m in the previous year:

- the most high profile capital project is the £21m replacement of the under-sea gas main between the south coast mainland and the Isle of Wight, which is nearing completion. The project involves connecting Lepe and Gurnard through the longest directional drill ever undertaken (3.9km). Two tunnels have been bored, meeting around 40 metres below the seabed, to take the two 12 inch diameter pipes;
- the majority of the mains replacement expenditure was incurred under the 30:30 mains replacement programme which was started in 2002. This requires that all iron gas mains within 30 metres of homes and premises must be replaced over a 30-year period. During 2010/11, SGN replaced 1,102km of its metallic gas mains with modern polyethylene pipes; and
- SGN is also committed to making new gas connections to existing homes that are not on mains gas as affordable as possible, and is running a new Assisted Connections scheme, under which 4,700 properties were connected to its networks during 2010/11. A further 5,000 properties are expected to be connected in 2011/12.

Investment will continue to be a top priority for SGN and, in line with that, it expects to invest around £400m in capital expenditure and mains and service replacement projects during 2011/12.

#### Earning financial rewards for corporate responsibility

In September 2010, SGN was awarded £1.1m under Ofgem's scheme for rewarding companies for developing and adopting best practice in serving the interests of customers, society and the environment. This was the second successive year in which SGN secured the highest award under the scheme. Amongst other things, the award was in respect of SGN's 'Green Gas' project, to introduce biomethane from sewerage into the gas network. The scheme, which is judged by a panel of industry experts, was established as part of Ofgem's gas Distribution Price Control 2008-13.

#### Making gas networks more sustainable

In March 2011, the UK government launched the Renewable Heat Incentive 'to revolutionise the way heat is generated and used in buildings'. It will support emerging technologies and is designed to reduce dependence on heating from fossil fuels.

SGN has long recognised that renewable heat is an untapped resource. Working with a water company and a gas supplier, it began the delivery and supply of biomethane to 200 homes in Oxfordshire. Under the scheme, the first of its kind in Britain, sludge is subjected to the process of anaerobic digestion to create biogas which, after the removal of impurities, is fed into the gas distribution network. It is estimated that biomethane could account for up to 15% of domestic gas needs in the UK in 2020.

SGN is now developing this technology so that larger volumes of biomethane at other sites can be commissioned into the network and is progressing around 50 enquiries for biomethane network entry points from anaerobic digestion and landfill gas projects in Scotland and southern England.

#### Preparing for the new gas Distribution Price Control

As with electricity transmission, a new eight-year Price Control will be introduced for gas distribution from 1 April 2013 – RII0-GD1. SGN has undertaken extensive consultations with stakeholders to help determine what should be included in its business plan for the new Price Control.

In March 2011, Ofgem published its strategy for the new gas Distribution Price Control (RII0-GD1). In addition to the allowed cost of equity and allowed cost of debt (see 'Keeping the lights on and supporting growth' above) the financial package included proposals to refine the depreciation profile, so that it is entirely front loaded, and to capitalise all replacement expenditure (only 50% is capitalised at present).

As in electricity transmission this package represents a step forward in reaching an acceptable Price Control, but still requires extensive engagement with Ofgem and other stakeholders to ensure the final settlement fulfils the objectives that have been set for it.

### Gas Distribution priorities in 2011/12 and beyond

During 2011/12, SGN's priorities are to:

- deliver a safe and secure gas supply to customers;
- deliver to time and budget the 2011/12 mains replacement and capital works programmes;
- establish the new Distribution Network Control System;
- continue to work with stakeholders to secure an acceptable outcome to the new gas Distribution Price Control; and
- support sustainable developments in gas distribution.

## Market-based businesses

### Generation and Supply

Overview  
Strategy  
Group performance  
**Segmental performance**  
Corporate governance  
Financial statements  
Shareholder information

#### Performance indicators

##### Generation

|                                                             | 2009          | 2010          | 2011          | Change |
|-------------------------------------------------------------|---------------|---------------|---------------|--------|
| <b>Assets*</b>                                              |               |               |               |        |
| Gas- and oil-fired generation capacity – MW                 | 4,510         | 4,590         | <b>4,470</b>  | -2.6%  |
| Coal-fired generation capacity (inc biomass co-firing) – MW | 4,010         | 4,370         | <b>4,370</b>  | +0.0%  |
| Renewable generation capacity* (inc pumped storage) – MW    | 2,220         | 2,370         | <b>2,450</b>  | +3.4%  |
| <b>Total electricity generation capacity – MW</b>           | <b>10,740</b> | <b>11,330</b> | <b>11,290</b> | -0.4%  |
| <b>Operations</b>                                           |               |               |               |        |
| Gas power station availability – %                          | 76            | 94            | <b>88</b>     | -6.4%  |
| Coal power station availability – %                         | 89            | 92            | <b>84</b>     | -8.7%  |
| Hydro storage – %                                           | 73            | 52            | <b>61</b>     | +17.3% |
| Wind farm availability – %                                  | 96            | 97            | <b>97</b>     | +0.0%  |
| <b>Output**</b>                                             |               |               |               |        |
| Gas- and oil-fired (inc CHP) – TWh                          | 26.3          | 31.3          | <b>29.3</b>   | -6.4%  |
| Coal-fired (inc biomass co-firing) – TWh                    | 7.8           | 10.7          | <b>13.6</b>   | +27.1% |
| <b>Total output from thermal power stations – TWh</b>       | <b>23.1</b>   | <b>42.0</b>   | <b>42.9</b>   | +2.1%  |
| Conventional hydro – GWh                                    | 3,316         | 3,016         | <b>2,558</b>  | -15.2% |
| Wind energy – GWh                                           | 1,861         | 1,444         | <b>1,653</b>  | +14.5% |
| Dedicated biomass – GWh                                     | 148           | 218           | <b>200</b>    | -8.3%  |
| <b>Total output of renewable energy – GWh</b>               | <b>5,182</b>  | <b>4,678</b>  | <b>4,411</b>  | -5.7%  |
| <b>Total output from pumped storage – GWh</b>               | <b>273</b>    | <b>380</b>    | <b>370</b>    | -2.6%  |

##### Supply

|                                                            | 2009        | 2010        | 2011         | Change  |
|------------------------------------------------------------|-------------|-------------|--------------|---------|
| Electricity customer accounts (GB domestic) – millions     | 5.10        | 5.17        | <b>5.16</b>  | -0.2%   |
| Gas customer accounts (GB domestic) – millions             | 3.50        | 3.54        | <b>3.57</b>  | +0.8%   |
| Energy customers (GB business sites) – millions            | 0.45        | 0.45        | <b>0.43</b>  | -4.4%   |
| <b>Total GB energy customer accounts – millions</b>        | <b>9.05</b> | <b>9.16</b> | <b>9.16</b>  | +0.0%   |
| All-island energy market customers (Ireland) – millions    | 0.05        | 0.19        | <b>0.49</b>  | +157.9% |
| Home services customer accounts (GB) – millions            | 0.33        | 0.41        | <b>0.42</b>  | +2.4%   |
| <b>Total customer accounts (GB and Ireland) – millions</b> | <b>9.43</b> | <b>9.76</b> | <b>10.07</b> | +3.2%   |
| Electricity supplied household average (GB) – kWh          | 4,748       | 4,465       | <b>4,408</b> | -1.3%   |
| Gas supplied household average (GB) – therms               | 598         | 558         | <b>563</b>   | +0.9%   |
| Complaints to third party organisations (GB)               | N/A         | 1,231       | <b>1,161</b> | -5.7%   |

\* Wholly-owned and share of joint ventures. \*\* Electricity from power stations in which SSE has an ownership interest (output based on SSE's contractual share).

#### A vertically-integrated business

SSE operates the business of electricity generation and the supply of electricity and the supply of gas in Great Britain and Ireland as a single, vertically-integrated Generation and Supply business.

This means that SSE seeks to meet the energy requirements of its customers through the ownership and operation of

power stations, power purchase agreements with other generators and fuel supply contracts, and it is the meeting of the energy supply requirements of its customers which is the key determinant of SSE's operational and investment decisions in Generation. Under this model, customers benefit from lower exposure to wholesale price volatility and from price stability through 'smoothing'.

As at 31 March 2011, SSE supplied energy to:

- 9.16 million customer accounts in Great Britain; and
- 490,000 customer accounts in Northern Ireland and the Republic of Ireland.

Its generation capacity, including its share of joint ventures and associates, was around:

- 10,800MW in Great Britain;
- 80MW in Northern Ireland; and
- 410MW in the Republic of Ireland.

Overall, SSE seeks to maintain a well-balanced portfolio of customers, assets (also including stakes in gas production assets) and contracts, including longer-term contracts for purchasing gas and power purchase agreements. In line with this, it purchases most of the gas and some of the electricity it needs to supply customers via bilateral contracts of varying lengths and also through trading in wholesale markets. SSE also buys gas, coal, oil and biomass to use in the production of electricity from its power stations, as well as carbon dioxide emissions allowances.

Its Energy Portfolio Management team is responsible for contract management and for SSE's participation in wholesale markets for electricity and gas, as well as the markets for coal, oil and carbon dioxide emissions allowances. Through analysis of generation plant availability (in SSE's own portfolio and elsewhere in the market), customer demand and its contractual position SSE can assess, and therefore manage, its exposure to market prices.

The wholesale price of energy can fluctuate greatly, according to variables such as physical supply, customers' demand, the weather, the availability of delivery infrastructure and geopolitical issues. SSE's approach is designed to hedge its requirements in a way that minimises its costs while ensuring its exposure to market prices is not excessive. Given there are uncertainties around the volume of energy that will be required at any particular point, SSE is unlikely to be fully hedged until close to the delivery of the energy itself.

This balanced, integrated business features a diverse range of assets and contracts to support the supply of energy to customers. It therefore provides:

- lower risk from wholesale energy price volatility through reduced exposure to any single commodity;
- greater ability to manage wholesale energy price volatility and to protect customers from it; and

## Market-based businesses (continued)

### Generation and Supply

- more scope to deliver investment needed in generation because the risks associated with large-scale and long-term investments are mitigated by the income earned from supplying electricity and gas to customers.

In March 2011, Ofgem published its findings and initial proposals from the Retail Market Review it launched in November 2010. It confirmed that it 'expects efficient firms to make a profit'. At the same time, it said that 'further action is needed to make energy retail markets in Great Britain work more effectively in the interests of consumers'. The proposals include actions to 'improve further the transparency in vertically-integrated utilities'. Ofgem described its proposals as 'high-level and preliminary' and confirmed that they will be subject to 'further rounds of consultation'.

SSE believes that Ofgem's proposals would represent significant changes to the energy market in Great Britain. It believes the market is fundamentally sound, but is participating constructively in Ofgem's process of consultation and will strongly support steps which assist customers and the competitive market in general.

On 10 May 2011, in a case at Guildford Crown Court, SSE was found guilty on two counts (out of seven) relating to the use of direct sales aids in February 2009. The case was brought by Surrey County Council Trading Standards. The sales aids in question are not now in use, and SSE is confident that its sales processes continue to be fair and responsible.

SSE remains very disappointed with the verdict and is considering legal options, which include the possibility of an appeal. It has 28 days from the jury's verdict to launch an appeal.

#### Financial performance in Generation and Supply

Operating profit\* in Generation and Supply fell by 1.5%, from £896.0m to £882.8m. It contributed 53.4% of SSE's total operating profit\* in 2010/11. The reasons behind this performance are set out under 'Increasing adjusted profit before tax\* in 2010/11' on page 17.

Total revenue for Generation and Supply was £27.2bn, which accounted for 93% of SSE's total revenue in 2010/11, of which £8bn was in relation to sales of electricity and gas to industrial, commercial and domestic customers.

#### Generating and supplying electricity in Great Britain

During 2010/11, in Great Britain, SSE (previous year's numbers in brackets):

- generated 42.9TWh, based on contracted output of electricity from all thermal power stations in which it has an ownership interest (42.0TWh);
- generated 3.7TWh, based on contracted output from renewable sources of energy in which it has an ownership interest, including pumped storage (4.0TWh); and
- purchased 7.4TWh of electricity through long-term contracts with other generators (7.7TWh).

During the same period, also in Great Britain, it:

- supplied 27.7TWh of electricity to its industrial and commercial customers; and
- supplied 29.0TWh to its small business and household customers.

This means that, during the year, SSE:

- generated or purchased under long term contracts the equivalent of over 90% of the electricity needed to supply all of its customers; and
- generated over 150% of the electricity needed to supply its household and small business customers.

Any net balances were traded in the wholesale electricity market, thereby contributing to its liquidity.

#### 'Profound developments' in Generation and Supply

In its February 2011 report into future energy scenarios, 'Signals & Signposts', Royal Dutch Shell said that, over the next four decades, the world's energy system will see 'profound developments'. It also said that:

- there is a 'step change in energy use', as developing nations enter their most energy-intensive phase of economic growth, which could see underlying global demand for energy triple from its 2000 level by 2050;
- natural innovation and competition could spur improvements in energy efficiency to moderate underlying demand;
- supply will struggle to keep pace with demand – by the end of the coming decade, growth in the production of easily accessible oil and gas will not match the projected rate of demand growth; and
- even if it were possible for fossil fuels to maintain their current share of the energy mix and respond to increased demand, carbon dioxide emissions would then be on a pathway that could severely threaten human well-being.

The UK government's Annual Energy Statement 2010 predicted that demand

for electricity in the UK will double over the next 40 years as a result of the need to electrify large parts of the heat and transport sectors. It also said that for this to have the required impact on emissions, the electricity being consumed will need to be almost exclusively from low carbon sources.

The 'required impact' refers to the fact that:

- under the EU Renewable Energy Directive, the UK has a legally-binding target to meet 15% of its energy requirements from renewable sources by 2020 (for Ireland, it is 16%); and
- under the Climate Change Act 2008, the UK is required to achieve a reduction of 34% in emissions of greenhouse gases, such as carbon dioxide, by 2020 (compared with 1990 levels).

It is in this context that SSE is managing the operation of, and investment in, its Generation and Supply business. As well as being subject to a process of decarbonisation, the UK energy sector will also become more decentralised. The introduction of a Renewable Heat Incentive in the UK, from July 2011, which will in due course encourage and support installations down to the domestic level, is an example of this.

#### Consolidated Segmental Statement

Ofgem introduced a requirement on electricity generators and suppliers to publish a Consolidated Segmental Statement (CSS) showing revenue, costs and profits from electricity generation and electricity and gas supply activities. SSE published its statement for 2009/10 on 28 September 2010. The CSS required SSE to report financial information in a different way from which the Generation and Supply business is operated. SSE's next CSS will be published by 30 September 2011.

Reporting requirements may evolve in the coming years as part of Ofgem's proposals to 'improve further the transparency in vertically-integrated utilities'.

## Generation

### Principles for management of SSE's Generation portfolio

The operation of, and investment in, SSE's Generation portfolio is founded on a series of principles:

- compliance: with all safety standards and environmental requirements;
- capacity: to meet the electricity needs of domestic and small business customers;
- diversity: to avoid over-dependency on particular fuels or technologies;
- availability: to respond to customer demand and market conditions;
- flexibility: to ensure that changes in demand for electricity can be addressed; and
- sustainability: to deliver a 50% cut in the carbon dioxide content of electricity produced.

### A diverse Generation portfolio

SSE's 31 March 2011 portfolio of 11,290MW of capacity for generating electricity compares with 11,330MW the year before. During 2010/11 it:

- commissioned 90MW of new onshore wind farm capacity as a result of its investment programme;
- sold onshore wind farm capacity at Ardrossan; and
- suspended operations at 120MW of gas-fired generation capacity at Fife.

Subsequently, in April 2011, capacity totalling 96.8MW at three onshore wind farms in Scotland and Northern Ireland was sold after the end of the financial year, in April 2011, for a cash payment of £178.4m.

In line with the Generation principle of diversity, SSE currently maintains a balance between:

- gas- and coal-fired generation capacity; and
- fossil fuel and renewable sources of energy.

The practical application of this balance means that SSE's Generation portfolio comprised at 31 March 2011:

- 4,470MW of gas- and oil-fired capacity;
- 4,370MW of coal-fired capacity (with biomass co-firing capability); and
- 2,450MW of renewable (hydro, wind and dedicated biomass) capacity.

As a result of this, SSE has the greatest diversity in fuels for generating electricity among UK generators. This means it:

- avoids dependency on a single technology or commodity;
- has significant optionality in the management of its power stations; and
- can manage effectively the risks inevitably associated with primary fuel procurement.

Management of primary fuel procurement risks is also assisted by the fact that SSE is the largest generator of electricity from renewable sources across the UK and Ireland.

### Meeting longer-term energy requirements

SSE's long-term power purchase agreements with Barking Power Ltd (in which it has a 30.4% stake), Derwent Cogeneration Ltd (in which it has a 49.5% stake) and British Energy all expired during 2010/11.

In order to provide continuing long-term stability to the energy portfolio, further contractual arrangements have been agreed in recent years. These include the 15-year tolling agreement with Marchwood Power Ltd which commenced in 2009 and the re-negotiated contract for electricity output from Seabank Power Ltd entered into in 2008.

### How SSE's gas-fired power stations performed

SSE owns 4,470MW of gas- and oil-fired electricity generation capacity, including its share of joint ventures but excluding Fife Power Station (see below). Good performance in Generation and Supply is dependent on plant at power stations being available to generate electricity as and when required by customer demand and market conditions. During 2010/11, SSE's principal wholly-owned gas-fired power stations (Keadby, Medway and Peterhead) achieved 88% of their maximum availability to generate electricity, excluding planned outages, compared with 94%

availability in the previous year. The main reason for the decline in availability was a generator fault at Keadby, which was returned to service in early May 2011 after successful repair work was carried out.

From time-to-time, the stations at Peterhead, Keadby and Medway have been required to operate on a flexible 'two shift' basis. The requirement to do this is likely to increase over the medium-term, and further work is being designed by SSE's Engineering Centre to apply modifications to support more frequent 'two shifting' in the future. In addition, updated long-term gas turbine maintenance contracts are being entered into to support more flexible operations at Keadby and Medway in the future.

Marchwood, the 840MW CCGT owned by Marchwood Power Ltd, a 50:50 joint venture between SSE and ESB International, completed its first full financial year of commercial operation in 2010/11 and achieved 93% of its maximum availability to operate during the year. All of the station's output is contracted to SSE.

The amount of electricity generated by SSE at gas-fired power stations in which it has an ownership or contractual interest, including CHP, was 29.3TWh in 2010/11 (including 13.3TWh from wholly-owned stations), compared with 31.3TWh in the previous year (including 15.4TWh from wholly-owned stations).

All of SSE's power stations have to be able to operate economically over the medium term. The market for smaller gas-fired generation has become increasingly difficult. Fife Power Station was loss-making in 2010/11 and was forecast to remain so,

### Total generation capacity – MW



### Generation capacity 2010/11 composition – %

- Gas/oil 40
- Coal/biomass 39
- Renewable 21



## Market-based businesses (continued)

### Generation and Supply

particularly when the impact of the very high transmission access charges that apply in Scotland are taken into account. As a result, SSE suspended commercial operations at the plant in February 2011.

#### Investment options for gas-fired power stations

The UK government's 'Electricity Market Reform' consultation document, published in December 2010, said that gas-fired generation will 'continue to play an important role in the electricity sector – providing vital flexibility to support an increasing amount of low-carbon generation and to maintain security of supply'.

In February 2011, SSE secured consent, under Section 36 of the Electricity Act 1989, for the construction and operation of a two-unit CCGT power station of up to 870MW at the Abernedd brownfield site in South Wales. Subsequently, SSE released Transmission Entry Capacity (TEC) rights to reduce them to 450MW, and intends to pursue the development of a single CCGT unit only – the most economic option in the context of the development requirements for a two-unit site and of the medium-term outlook for gas-fired generation.

An investment decision on the scaled-back Abernedd project will not be taken until next year at the earliest and will depend, amongst other things, on the emerging shape of the electricity market following the UK government's consultation. This means that the power station, if built, will not be operational until late 2015. When SSE acquired Abernedd in May 2009, it was envisaged that a two-unit, 870MW CCGT would be developed, with the first unit becoming operational around 2013.

SSE agrees that CCGT is a cleaner fossil fuel technology, which has the necessary flexibility to support security of supplies as the presence of wind energy on the electricity system increases, but believes the right market signals need to be there if the necessary investment decisions are to be taken.

SSE has potential options for additional CCGT capacity at two other power stations:

- it has effective consent to develop 710MW of capacity at Keadby; and
- Barking Power Ltd, in which it has a 30.4% stake has consent to develop new 470MW of capacity.

#### How SSE's coal-fired power stations performed

SSE owns 4,370MW of coal-fired generation capacity at three power stations: Fiddler's Ferry, Ferrybridge and Uskmouth. The stations also co-fire fuels from renewable sources in order to displace fossil fuels. All of the capacity at Fiddler's Ferry and Uskmouth and half of the capacity at Ferrybridge (over 3,300MW in total) complies with the EU Industrial Emissions Directive and so can remain operational beyond 2015 and up to 2023.

During 2010/11, SSE generated 13.6TWh of electricity at its coal-fired power stations at Fiddler's Ferry, Ferrybridge and Uskmouth, compared with 10.7TWh in the previous year (excluding Uskmouth, which was acquired in August 2009). The stations achieved 84% of their maximum availability to generate electricity, excluding planned outages, compared with 92% in the previous year. Availability at Ferrybridge was affected by a number of technical issues which emerged during planned outages and which were subsequently resolved.

Nevertheless, all of SSE's coal-fired power stations demonstrated their ability to operate flexibly in response to customer demand and electricity market conditions during 2010/11. The value of electricity from coal-fired power stations was demonstrated following the Japanese earthquake in March 2011 and the political upheaval in the Middle East.

#### Looking to the future of coal-fired power stations

Existing coal-fired power stations still have a significant part to play in maintaining

secure supplies of electricity. Moreover, the sites they occupy benefit from key infrastructure such as:

- electricity network connections;
- access to water necessary for power generation operations; and
- established transport links.

During 2010/11, SSE decided against proceeding with the installation of Selective Catalytic Reduction (SCR) technology at Fiddler's Ferry after it was confirmed that the EU Industrial Emissions Directive (IED) means it can operate the station for 17,500 hours between 2016 and 2023, even if SCR is not fitted to meet new IED limits on emissions of nitrogen oxides. SSE does, however, retain the option of installing Selective non-Catalytic Reduction technology at Fiddler's Ferry if it is economically and environmentally viable for it to do so.

It is SSE's belief that no new coal-fired power generation plant should be built in the UK without carbon dioxide abatement and that no coal-fired plant without such abatement should remain operational beyond 2030. This is consistent with the UK Committee on Climate Change's recommendation that the UK should commit to a 60% cut in carbon dioxide emissions by 2030, with 'radical decarbonisation' of the electricity sector.

Future operations at SSE's coal-fired power stations, and the associated investment decisions, will therefore be determined by three main factors:

- the need to maintain and improve the day-to-day performance of the stations while they are operational;
- the prospects for the development of alternative sources of energy; and
- the continuing UK government commitment to the development of CCS technology.

Against this background, SSE's investment strategy for Fiddler's Ferry, Ferrybridge and Uskmouth is as follows:

- it is continuing to invest in the operation and maintenance of the three stations, with a total of £69.9m invested in the stations in 2010/11;
- it is seeking planning consent so it has the option to develop a multi-fuel facility at Ferrybridge, using predominantly refuse-derived fuels from which to generate around 65MW of electricity;
- it is developing a project at Uskmouth to repower a coal-fired generating unit into a 100MW biomass unit; and

**All of SSE's coal-fired power stations demonstrated their ability to operate flexibly in response to customer demand and electricity market conditions during 2010/11.**

- it is building Europe's largest post-combustion carbon dioxide capture trial at Ferrybridge, in collaboration with Doosan Babcock and Vattenfall, where construction work is now well under way in advance of the trial beginning later this year (see 'Making progress on Carbon Capture and Storage' below).

### **Making progress on Carbon Capture and Storage (CCS)**

Coal remains a critically important fuel for the UK, because of its flexibility, its availability and because it reduces reliance on imported gas. As a result, existing coal-fired power stations still have a crucial role to play in maintaining secure supplies of electricity but, longer term, the use of coal to generate electricity will depend on the extent to which CCS technology can be applied to abate carbon dioxide emissions.

Moreover, if long-term targets for reducing carbon dioxide emissions are to be met, CCS technology will need to be applied as widely as possible. The November 2010 decision by the UK government to include gas-fired generation plant in its CCS demonstration programme was a clear recognition of this.

Against this background, SSE has two CCS projects under way:

- **Coal at Ferrybridge:** This project is Europe's largest post-combustion carbon dioxide capture trial. The scale of the project, equivalent to 5MW of coal-fired power generating capacity producing 100 tonnes of carbon dioxide per day, bridges the gap between the various laboratory-scale trials that are under way and the larger-scale projects envisaged by the UK government. The significance of the project therefore lies in its scale and its ability to demonstrate the operational characteristics of capture plant on an actual power station and the performance of the amine solvent on real flue gas. It is due to become operational later this year; and
- **Gas at Peterhead:** The proposed project will design and develop a full chain, post-combustion CCS facility which will be capable of capturing the CO<sub>2</sub> from one 385MW combined cycle gas turbine unit. Current plans are that the CO<sub>2</sub> will then be transported via an existing underground pipeline to St Fergus for further compression and then transported via an undersea pipeline to an existing gas reservoir in the North Sea operated by Shell U.K. Limited that will have ceased production and is being redeveloped by CO<sub>2</sub> Deep Store. In May 2011, the UK

government announced that the project is one of seven CCS applications to the European Investment Bank for consideration in the next round of the EU's New Entrant Reserve scheme to support CCS and renewable energy projects across the EU. Up to three such projects may be supported per member state.

### **Securing value from ash at coal-fired power stations**

The overall sustainability of coal-fired power stations has improved in recent years. In October 2010, having previously held a 49.9% shareholding, SSE assumed 100% ownership of RockTron (Widnes) Ltd, now named SSE Mineral Solutions Ltd. It owns and operates an ash separation plant at Fiddler's Ferry, where fresh and stored ash produced by the power station is processed into marketable minerals and materials such as cement substitutes. Long-term options for the plant are currently being assessed.

### **Participating in the EU Emissions Trading Scheme**

Phase II of the EU Emissions Trading Scheme (EU ETS) began on 1 January 2008. Across its electricity generation portfolio (taking account of contractual shares), SSE now has an allocation of 18.9 million tonnes of carbon dioxide emissions allowances per calendar year, including the allowances for Marchwood and Uskmouth. SSE's emissions allowances requirement for 2010/11, beyond those allocated under EU ETS, was 5.6 million tonnes. This compares with 4.9 million tonnes in the previous year. During 2010/11, the price of allowances ranged from around €13/tonne to around €17/tonne.

From 2013, all of the carbon dioxide emissions allowances for electricity producers will be auctioned. Moreover, in Budget 2011, the UK government announced proposals for the introduction of a 'floor' for the price of allowances in the electricity sector, so that they are around £16/tonne in 2013, rising to around £30/tonne in 2020 (based on 2009 prices).

### **Tackling emissions of carbon dioxide**

In 2010/11, emissions of carbon dioxide from power stations in which SSE has an ownership or contractual interest totalled 24.5 million tonnes, compared with 23.1 million tonnes in the previous year, reflecting increased output from coal-fired power stations and the first full year of operation of Marchwood Power Station. SSE's carbon emissions data is externally verified by a UK Accreditation Service (UKAS)-accredited organisation.

SSE's target is to reduce the amount of carbon dioxide per kilowatt-hour of electricity generated at plant in which it has an ownership or contractual interest by 50%, between 2006, the first full year after it acquired coal-fired power stations, when it was just over 600g/kWh, and 2020. On this basis, its carbon intensity in 2010/11 was 504g/kWh, compared with 494g/kWh in the previous year, reflecting the increase in carbon dioxide emissions described above.

SSE expects to achieve its 2020 target by:

- reducing output of electricity from coal-fired power stations;
- optimising the efficiency with which primary fuel is converted into electricity at gas-fired power stations; and
- increasing significantly the output of electricity from renewable sources.

More broadly, SSE has joined other energy companies in Europe in calling for the EU to adopt a greenhouse gas emissions reduction target of 25% (up from 20% at present) as part of a long-term move away from fossil fuel-based electricity generation and full decarbonisation by 2050.

### **SSE's position in the Carbon Disclosure Project (CDP)**

In September 2010, SSE was commended by the CDP, which represents over 500 institutional investors with US\$64 trillion in assets under management, for its approach to climate change disclosure and for the action it is taking to reduce global emissions and mitigate the risks of climate change.

SSE is featured in:

- the Carbon Disclosure Leadership Index which highlights the constituent companies within the FTSE Global 500 which have displayed the most professional approach to corporate governance in respect of climate change disclosure practices; and
- the Carbon Performance Leadership Index which highlights those companies which have demonstrated commitment to strategy, governance, stakeholder communications and, most of all, emissions reduction in their CDP responses.

### **Renewable energy – overview**

The EU Renewable Energy Directive means that the UK has a legally-binding target to meet 15% of its energy requirements from renewable sources by 2020; for Ireland, the target is 16%. In practice, this means that over 30% of the countries' electricity requirements will have to be met from

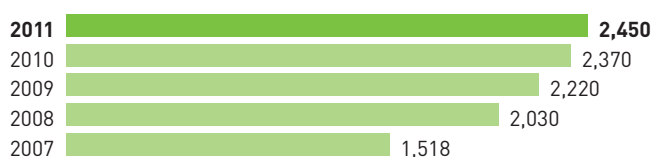
## Market-based businesses (continued)

### Generation and Supply

#### Power station CO<sub>2</sub> emissions – grams per kWh



#### Renewable generation capacity – MW



#### Renewable energy capacity 2010/11 composition – %

- Wind 38
- Hydro 59
- Biomass 3



renewable sources, up from around 6.5% and 14.5% respectively at present.

The drive for additional renewable sources of energy is supported by public policies to encourage the necessary investment by enhancing the value of the output. The key policies are:

- the **Renewables Obligation** in the UK, under which generators receive Renewable Obligation Certificates (ROCs) for electricity generated from eligible renewable sources and electricity suppliers are required to source an increasing proportion of their electricity from eligible renewable sources; and
- the **Renewable Energy Feed In Tariff (REFIT)** in the Republic of Ireland, which supports renewable energy by providing a guaranteed price for output and a 15% rebate (subject to a cap) on suppliers' purchase of REFIT energy.

The existence of these schemes is a practical demonstration of the fact that the viability of wind energy remains dependent on government-sponsored financial support. The UK government's work on Electricity Market Reform is explicitly designed to make sure that low carbon technologies such as energy from renewable sources 'become a

more attractive choice for investors'. As a result, SSE does not detect or foresee any weakening of public policy commitment to renewable energy in either the UK or Ireland. Nevertheless, it remains a key priority for SSE to avoid dependency on a single generation technology or related financial support.

#### Increasing capacity for renewable energy

At 31 March 2011, SSE had almost 2,450MW of commissioned renewable energy capacity in the UK and Ireland, including its share of joint ventures, comprising:

- 1,150MW conventional hydro;
- 910MW onshore wind;
- 5MW offshore wind;
- 80MW dedicated biomass; and
- 300MW pumped storage.

Of this, output from over 850MW qualifies for ROCs, the key financial support scheme for renewable energy in the UK, with:

- 1.0 ROCs/MWh for qualifying hydro and onshore wind;
- 1.5 ROCs/MWh for qualifying dedicated biomass; and
- 2.0 ROCs/MWh for qualifying offshore wind.

In the year to 31 March 2011, SSE has commissioned almost 90MW of new

onshore wind farm capacity. It has also disposed of capacity as follows:

- in May 2010, it sold its equity interest (which was 51% on 31 March 2010, increasing to 100% in April 2010) in the 30MW Ardrossan wind farm to Infinis, a Terra Firma company, in a transaction with a total value of £53.8m; and
- in April 2011 it sold its 100% interest in three onshore wind farms in Scotland and Northern Ireland with a total capacity of 96.8MW, also to Infinis for a cash payment of £178.4m.

All of the electricity generated from the capacity disposed of in Scotland is sold to a third party.

The net result is that SSE remains on course to own around 3,500MW of capacity for renewable energy that is in operation or under construction in the UK and Ireland by the end of 2012/13. This will mean SSE is:

- making a significant contribution to the achievement of the legally-binding 2020 targets for renewable energy in the UK and Ireland;
- harnessing water and wind, which are free and indigenous sources of primary energy; and
- reducing its exposure to volatile prices for fossil fuels, which are becoming more difficult to source while also being in much more demand around the world.

#### Producing electricity from renewable sources

Total output from all of SSE's conventional hydro electric schemes, wind farms and its dedicated biomass plant was 4,411GWh during 2010/11, compared with 4,678GWh in 2009/10. It was around 20% lower than forecast because of dry and still weather conditions experienced during the year.

#### Producing electricity from hydro electric schemes

SSE owns and operates just over 1,450MW of capacity in hydro electric schemes, including the 300MW pumped storage facility at Foyers, on Loch Ness. In the last 30 years, electricity output from conventional hydro electric schemes has ranged from a high of 3,896GWh to a low of 2,429GWh. During 2010/11 (previous year's comparison in brackets):

- total output from all of SSE's conventional hydro electric schemes was 2,558GWh (3,016GWh); and, within this,
- total output from SSE's hydro electric capacity qualifying for ROCs – just over 500MW – was 1,193GWh (1,456GWh).

As at 31 March 2011, the total amount of water

held in SSE's reservoirs which could be used to generate electricity was 61% of the maximum, compared with 52% in the previous year.

### Restoring generation at the Glendoe hydro electric scheme

In August 2009, SSE identified a blockage caused by a fall of rock in the tunnel carrying water from the reservoir to the power station at the 100MW Glendoe hydro electric scheme, thus stopping operations at the power station. The first of the two new tunnels required to by-pass the blockage in the existing tunnel has been completed and work on the second tunnel has progressed beyond the geological fault zone at the site. This work is being undertaken by BAM Nuttall.

If good momentum is maintained, the process of re-filling the reservoir at Glendoe is expected to begin this winter and electricity generation should resume in the first half of 2012. Meanwhile, SSE is continuing to make sure that the contractual and insurance issues arising from the fall of rock are dealt with satisfactorily.

### Options for investment in hydro electric schemes

Hydro electric schemes which use impounded water to generate electricity have an important part to play in meeting peak demand and also complement the variable output from the growing number of wind farms. SSE has developed four main options for new hydro electric schemes:

- **Kildermorie:** In September 2010, SSE received consent to develop a new 7.5MW hydro electric power station near Ardross in Ross-shire. It will consist of a new dam and storage reservoir, a buried pipeline and a semi-buried powerhouse with associated tailrace. Construction is likely to begin in the second half of 2012;
- **Sloy:** In September 2010, SSE secured from Scottish Ministers consent to develop a 60MW pumped storage scheme as part of its 152MW Sloy power station, near Loch Lomond. This means that, in addition to electricity produced from water collected and held in the Loch Sloy reservoir, Sloy will be able to generate an additional 100GWh of electricity in a typical year using water pumped from Loch Lomond to the reservoir. SSE now expects that developing a pumped storage facility at Sloy will require investment of around £40m, and is expecting to take a final decision on the investment after it has completed further technical and engineering studies and considered the outcome of the UK government's consultation on Electricity Market Reform;
- **Coire glas:** SSE is proposing to develop a new large scale pumped storage scheme

at Loch Lochy with an installed capacity of between 300MW and 600MW and a capability to produce in excess of 1,000GWh of electricity in a typical year. A planning application for the scheme is expected to be submitted during 2012; and

- **Balmacaan:** SSE is also proposing to develop a 300MW-600MW pumped storage scheme at Loch Ness, with a similar expected electricity output to Coire glas. While this project is entirely independent of Coire glas, it is at a similar stage, a similar timetable for submitting a planning application is envisaged and the two projects are managed by a single development team.

Construction of Coire glas and/or Balmacaan would not begin before 2014 at the earliest and, subject to planning consent, SSE will have the option to build neither, one or both of the schemes. They would be the first new pumped storage schemes to be developed in Great Britain since work began on the Dinorwig scheme in Wales in 1974.

Final decisions on these and on other renewable energy developments will also depend upon acceptable charging arrangements being in place for the use of the transmission network in Great Britain, an issue which is the subject of the Project TransmiT review launched by Ofgem in September 2010.

### Producing electricity from wind farms

At 31 March 2011, SSE owned and operated 910MW of wind farm capacity and output during 2010/11 was as follows (previous year's comparison in brackets):

- 739GWh in the UK, (615GWh); and
- 914GWh in the Republic of Ireland, (829GWh).

On average, the turbines at SSE's wind farms in the UK and Ireland achieved 97% of their maximum availability to generate electricity, the same as in the previous year. Their average load factor was lower than expected, at 24%, compared with 26% in the previous year, due to the still weather conditions experienced during much of the year.

### Developing wind farms to produce electricity

When SSE entered into the agreement to acquire Airtricity in January 2008, the combined business had just over 870MW of onshore wind farm capacity in operation, in construction or with consent for development in the UK and Ireland. At 31 March 2011, this had more than doubled, to over 1,900MW, comprising around (net):

- 910MW in operation;
- 710MW in construction or pre-construction; and
- over 300MW with consent for development.

In addition, SSE has also submitted for approval by the relevant planning authorities in the UK and Ireland proposals for onshore wind farms with a total capacity of over 800MW. This includes its share of the capacity contained in the proposal by Viking Energy, the joint venture between Viking Energy Ltd (which is 90% owned by the Shetland Charitable Trust) and SSE to develop on Shetland's Central Mainland a wind farm with a capacity expected to be around 450MW.

In addition to its onshore capacity, SSE has **offshore wind farm capacity** in operation or under construction totalling almost 350MW, comprising:

- a 50% stake in the 10MW Beatrice offshore wind farm in the Moray Firth;
- a 25.1% share of the 367MW Walney offshore wind farm now under construction in the Irish Sea; and
- a 50% share of the 500MW Greater Gabbard development now under construction in the outer Thames Estuary.

This means that SSE now has 3,750MW of renewable energy capacity (onshore wind, offshore wind, hydro and dedicated biomass) in operation, under construction or with consent for development in the UK and the Republic of Ireland. This excludes the possible Arklow wind farm scheme off the east coast of the Republic of Ireland.

### Maximising electricity output from wind farms

While capacity, as measured by megawatts, is of central importance in on- and offshore wind farm development, there are four other critical factors which help determine the electricity output from that capacity and thus the value of any development:

- site selection;
- wind analysis carried out by a specialist team;
- site optimisation to maximise output, including turbine layout; and
- turbine selection to match turbine characteristics with wind conditions and ensure reliability.

SSE has an experienced wind energy development team comprising more than 250 people with the specialist skills to make sure that these factors are rigorously applied so that the electricity output from the wind farm capacity it develops is maximised.

## Market-based businesses (continued)

### Generation and Supply

#### Onshore wind capacity – MW



#### Building new onshore wind farms

The main projects within SSE's onshore wind farm construction portfolio are Clyde (350MW) in South Lanarkshire, Griffin (156MW) in Perthshire and Gordonbush (70MW) in Sutherland:

- **Clyde:** Consent has been secured from North Lanarkshire Council for the development of a permanent new primary radar facility to provide the necessary level of coverage for the site, and construction work on the new facility has begun. It should become operational in early 2012. To ensure aviation safety in the meantime, a temporary solution is being reached following extensive discussions involving the Civil Aviation Authority and NATS (En Route) plc. As a result, the first generation of electricity is expected in the next few weeks and the most advanced of the wind farm's three sections, South (130MW), should still be completed by around the time of SSE's six-month financial results announcement in November. The wind farm as a whole is on course for completion in 2012. This is consistent with the timetable set out in SSE's Annual Report 2009. The wind farm is expected to produce over 1,000GWh of electricity in a typical year and its total construction cost is forecast to be over £500m;
- **Griffin:** Construction work is well under way at the site, and the installation of turbines at the site has started, with the first electricity being generated earlier than expected in the first week of May 2011. The wind farm should be completed in the spring of 2012. The electricity output is expected to be between 350GWh and 400GWh in a typical year and the construction cost is expected to be over £200m; and
- **Gordonbush:** Construction work is well under way at the site, with turbine delivery and installation due to begin later this year. The wind farm should be commissioned around the end of the current financial year. The electricity output is expected to be around 180GWh in a typical year and its construction cost is expected to be just over £100m.

In addition to Clyde, Griffin and Gordonbush, SSE has the following onshore wind farm projects currently under construction or pre-construction in the UK and Ireland (MW are SSE's share):

- Slieve Kirk (27MW);
- Calliacher (27MW);
- Athea (19MW);
- Glenconway (19MW);
- Rathcahill (12MW);
- Tiev (10MW);
- Balmurrie Fell (9MW);
- Tilbury (9MW); and
- Bindoo Extension (6MW).

SSE has also completed the acquisition, from RES, of a 34 turbine/68-85MW wind farm project for which consent for construction has been granted at a site close to its Keadby power station in North Lincolnshire. As a result, Keadby has become SSE's first consented wind farm in England. Subject to a final investment decision, SSE expects to begin construction of the wind farm during 2012/13, with work expected to take up to 18 months. Keadby is expected to be part of SSE's investment programme to 2015.

#### Building new offshore wind farms

SSE is developing Greater Gabbard in partnership with RWE npower renewables (through Greater Gabbard Offshore Winds Limited) and Walney in partnership with DONG Energy (through Walney (UK) Offshore Windfarms Ltd) and believes that partnerships of this kind represent the best means of managing the risks associated with offshore wind farms and maximising the development and construction capability:

- **Greater Gabbard** (500MW development; SSE stake in Greater Gabbard Offshore Winds Limited – 50%): Over 70% of the project's assets are installed. All 140 monopile foundations are in place at the wind farm and 108 turbines have been installed. Turbine installation will resume later this year; in the meantime, other work at the site will continue, including subsea cabling. The first 17 turbines have now been energised.

GGOWL remains in a contractual dispute with Fluor Limited, the principal contractor for the wind farm, relating to the need for assurance of the quality of potentially up to 52 of the turbine foundations used in the early stages of development. Despite these issues, the wind farm remains scheduled to be completed as planned in 2012, although there is some potential risk to this timetable as a result of the GGOWL/Fluor Limited dispute. The total annual electricity output is expected to be around 1,900GWh in a typical year, of which SSE will take half, and SSE's share of the construction cost is expected to be around £650m (excluding the cost of connection to the electricity grid); and

- **Walney** (367MW development; SSE stake in Walney (UK) Offshore Windfarms Ltd – 25.1%): All 51 turbines for the first phase of the wind farm have been installed and all the array cables have been put in place and connected to the turbines. The first 45 turbines have now been energised and the whole of phase one of the wind farm (183.6MW) is expected to be completed in early summer. Construction of the second phase of the wind farm is now under way, with the wind farm as a whole on schedule for full commercial operation in 2012. SSE's share of the construction cost is expected to be around £250m (excluding connection to the electricity grid).

#### Developing more new offshore wind farms

SSE's priority for the next year is the successful completion and commissioning of Greater Gabbard and Walney. These projects have given it significant experience of offshore wind farm development and construction.

SSE believes that harnessing the power of offshore wind will enable the UK to generate significant amounts of low-carbon electricity from a renewable source and therefore help meet the country's energy security and climate change objectives. Against this background, it intends to maintain an orderly, phased and continuing programme of development, with the next two offshore wind farm projects to be developed taking priority:

- the 500MW Galloper wind farm, close to the existing Greater Gabbard development, a 50:50 partnership with RWE npower renewables; and
- the 1,000MW Beatrice wind farm in the Moray Firth, a 75:25 partnership with SeaEnergy.

Planning applications in respect of these developments are expected to be submitted in the course of 2011/12. Beyond this, SSE

has secured from The Crown Estate rights for the possible development of additional offshore wind farm assets later in the decade with a total potential capacity of up to 4.8GW (net). SSE's disciplined approach to the consideration of the options that such rights have given it was demonstrated by its decision, in February 2011, to halt work on the development of its proposed offshore wind farm at Kintyre following detailed environmental studies and consultation with local stakeholders.

#### **Building a supply chain for offshore wind**

Offshore wind farms are a new and evolving technology, and fulfilling their potential requires the development of a sustainable supply chain, including design, manufacture and installation. Moreover, they are characterised by high up-front capital costs, on which it is vital to exert a downward pressure.

In response to this, SSE has:

- entered into a joint venture with Marsh Wind Technology Ltd, the UK subsidiary of Marsh Global Holdings Ltd, which has completed the purchase of the Skykon wind turbine tower manufacturing and assembly plant at Machrihanish, Campbeltown, from its Administrators, in May 2011;
- formed an alliance of companies, including Siemens, to collaborate on its offshore wind programme, with the aim of securing substantial reductions in the cost of delivered power, in February 2011;
- signed a strategic agreement with Mitsubishi to co-operate on low carbon energy developments, in July 2010; and
- acquired a 15% stake in Burntisland Fabrications (BiFab), the offshore energy structure fabricator, in April 2010. In addition to the equity stake, SSE secured an agreement with BiFab for the supply of at least 50 jacket substructures annually to support SSE's offshore wind developments.

The energy potential of offshore wind is vast, and in a resource- and carbon-constrained world it is potential that needs to be fulfilled while developing an effective supply chain and keeping costs as low as possible. SSE is aiming to do this through these initiatives, and others such as ongoing participation in the Carbon Trust's Offshore Wind Accelerator, a research and development initiative to reduce costs.

#### **Establishing an intermediate holding company for offshore renewable energy**

SSE has decided to establish a single intermediate holding company for all of its offshore renewable energy assets and

interests (mainly wind), including assets in operation, under construction or in development. It will be wholly-owned by SSE for the foreseeable future and its establishment will give SSE a company for the financing of offshore renewable energy developments. The new company is likely to be formed during 2011/12.

#### **Developing marine sources of electricity**

The UK enjoys major advantages in the development of marine energy technologies, with the huge potential resource of marine energy itself, allied to significant commitment to the operation and development of testing facilities. While marine energy could play some part in helping to meet renewable energy targets set for 2020, its longer-term potential is much more significant and it is in that context that marine energy developments should be considered.

SSE has a two-pronged approach to the development of marine energy technologies and to fulfilling the potential of marine energy resources:

- it has a 43% stake in the wave energy developer, Aquamarine Power, following further investment of £2.7m in November 2010, taking the total over the past three years to £19.8m. Aquamarine Power is currently developing an innovative wave energy converter, Oyster 2, which is expected to be deployed during 2011. Its existing Oyster device has been undergoing sea trials at the European Marine Energy Centre in Orkney; and
- it currently retains exclusive rights from The Crown Estate to develop 400MW of wave and tidal energy at sites in the Pentland Firth and Orkney Waters and a further 400MW with Aquamarine Power and OpenHydro. SSE has submitted an application to National Grid for an electricity connection relating to three

of these sites and is working closely with The Crown Estate and other stakeholders to develop applications to construct the developments.

#### **Generating electricity from alternative sources like biomass**

SSE's plant at Slough has a current generating capacity of 80MW and remains the UK's largest dedicated biomass energy facility. During 2010/11, it produced 200GWh of electricity from renewable sources, compared with 218GWh during the previous year. Qualifying output from dedicated regular biomass plants attracts 1.5 ROCs per MWh.

#### **Looking to the future of alternative energy**

The plant at Slough has given SSE practical experience which it can deploy when considering investment in biomass and other alternative fuels such as those derived from refuse (RDF). Such fuels could play a very valuable role in securing firm, controllable generation of electricity from renewable sources to complement other more variable sources such as wind. SSE has developed a diverse range of options from which to select potential investments which could deliver up to 250MW of new alternative energy capacity:

- the possible 65MW multi-fuel CHP facility at Ferrybridge (see 'Looking to the future of coal-fired power stations' on page 32);
- the possible re-powering of an entire coal-fired generating unit at Uskmouth into a 100MW biomass unit, fuelled by an industrial grade wood pellet (see page 32 also); and
- the possible re-powering of the Slough plant into a new 80MW biomass unit.

The creation of RDF for use in electricity generation is a practical means for organisations to avoid Landfill Tax, and the generator is, therefore, paid to take the fuel. At the same time, the reliability of fuel sources is often a critical issue in any

**The energy potential of offshore wind is vast, and in a resource- and carbon-constrained world it is potential that needs to be fulfilled while developing an effective supply chain and keeping costs as low as possible.**

## Market-based businesses (continued)

### Generation and Supply

alternative energy development. A major milestone in the development of the multi fuel plant at Ferrybridge was achieved in April 2011 when 3SE, the joint venture partnership between Shanks and SSE, was confirmed as preferred bidder for the waste from Barnsley, Doncaster and Rotherham Council areas (BDR). After Shanks has processed the waste, the resultant fuel will secure, locally, around one fifth of the overall requirements of the proposed plant.

In addition, Forth Energy, the joint venture between SSE and Forth Ports PLC, has now submitted planning applications to develop dedicated biomass power stations, with a total capacity of 500MW, at four sites in Scotland.

In May 2010, SSE took part in a £13.5m agreement to invest in the construction of Scotland's largest biogas plant at a former landfill site at Barkip in North Ayrshire. The investment made SSE the first energy company in the UK to commit to the construction and operation of an anaerobic digestion biogas plant of this type. The site will be capable of processing around 75,000 tonnes of waste (such as food, manures and organic effluent sludges) annually, producing around 2.5MW of renewable electricity. It has received its first loads and has entered the commissioning phase, after the successful completion of plant construction.

Biogas developments such as Barkip have the potential to provide an important sustainable energy solution, capturing the energy contained in waste. They offer opportunities beyond on-site electricity generation to include connections to the gas distribution network, an issue that will be of increasing significance in the future as changes are made to the source of heat for buildings in the UK, in line with the Renewable Heat Incentive. Progress at Barkip is, therefore, of direct interest to both SSE and SGN.

#### Investing in new ventures in energy

SSE Ventures (SSEV) was set up in 2007 to develop and grow a portfolio of investments in small and medium-sized enterprises offering renewable, sustainable and energy efficiency-enhancing products and services. Amongst other things, investments were made to help SSE anticipate, be at the forefront of and adapt to the kind of changes in energy production and consumption that are likely to occur over the next decade.

Since its establishment, SSEV has invested or committed to invest a cumulative total of £138.4m, including equity and loans in a total of 40 companies. It is now examining

its strategy to ensure the optimum approach to investment in these companies in the years ahead.

#### A cautious approach to nuclear power development

It is expected that the total capacity of the UK's nuclear power stations will fall by over 7,000MW by 2020, even if advanced gas-cooled reactor (AGR) stations are allowed by the Nuclear Installations Inspectorate to operate for five years beyond their existing planned closure dates.

In November 2010, SSE said in its six-month financial statement, that: 'the cost, development issues and timetable and operational efficacy of nuclear power stations all require the greatest possible scrutiny before a commitment to invest in new nuclear power stations can be made'. This was before the devastating events at

Fukushima, which have thrown these issues into even sharper relief.

Nevertheless, SSE continues to believe that the development of new nuclear power stations should be an option for the future. Its joint venture with GDF Suez SA and Iberdrola SA, NuGeneration Ltd (NuGen), in which it has a 25% stake, is developing plans for a new nuclear power station of up to 3.6GW on land adjacent to Sellafield in Cumbria, for which it secured an option in October 2009.

These plans will be prepared in consultation with safety authorities and local stakeholders and should be submitted for consideration by the relevant planning authorities, with the aim of a final investment decision being taken in the middle of the decade. On this basis, any new power station would not be commissioned until 2023 at the earliest.

### Generation priorities in 2011/12 and beyond

SSE's key operational objective in Generation during 2011/12 is to be consistent with its established principles and in particular:

- comply fully with all safety standards and environmental requirements;
- ensure power stations are available to respond to customer demand and market conditions; and
- operate power stations efficiently to achieve the optimum conversion of primary fuel into electricity.

During 2011/12, SSE expects to invest almost £1bn in maintaining and upgrading existing generation assets and in developing new assets. Its Engineering Centre supports the process of asset maintenance and investment. Against this background, SSE's investment priorities are to:

- complete asset maintenance and refurbishment programmes on time and on budget;
- maximise the potential for existing thermal power stations to operate flexibly;
- meet key milestones in new asset development and construction; and
- make progress in developing the diverse range of investment options it has created for the second half of this decade.

SSE's investment programme is designed to

abate the environmental impact of existing assets and extend their working lives and to deliver new assets, principally in renewable energy but also other forms of generation. All of this will support security of energy supply.

This focus on good operational performance and on effective investment is designed to give SSE a balanced portfolio of efficient electricity generation assets, with a diminishing environmental impact, in which its exposure to fossil fuel price volatility is increasingly diluted.

SSE will also actively seek to maintain optionality and diversity in the future development of its generation portfolio so that it remains on course to reduce by 50% the carbon dioxide intensity of electricity produced at power stations in which it has an ownership or contractual interest, over the period from 2006 to 2020.

The future development of its portfolio will depend to a significant extent on the outcome of the UK government's consultation on Electricity Market Reform. SSE believes a workable package of reforms can emerge from this process, based around carbon price support, a mechanism to reward all electricity capacity that is available to generate electricity, and continuing support for the production of electricity from renewable sources. The UK government is expected to publish a White Paper later this year.

## Supply

### SSE's approach to retaining and gaining customers

Long-term success in energy supply depends on the supplier's ability to retain and gain customers. SSE aims to do this by:

- offering consistently competitive prices over the medium term;
- delivering the highest possible quality of service; and
- providing market-leading products and services to help transform energy consumption.

Energy supply has one key characteristic which makes it different from almost any other sector: there are specific requirements on energy suppliers to help reduce their customers' consumption of electricity and gas. This means that sustainable performance in energy supply is about delivering services and adding value to customers in ways which support this movement towards greater energy efficiency.

### Increasing customer numbers in GB and Ireland

SSE supplies electricity and gas in Great Britain and Ireland as:

- Southern Electric and SSE (England);
- Swalec (Wales);
- Scottish Hydro (Scotland);
- Atlantic; and
- Airtricity (Northern Ireland and the Republic of Ireland).

During 2010/11, it achieved a net gain of 300,000 energy customer accounts in Great Britain and Ireland, taking the total to 9.65 million. It also achieved a small increase in the number of home services customers, taking the total to 420,000. SSE's customer accounts therefore totalled 10.07 million and at 31 March 2011 comprises:

- 5.16 million household electricity customer accounts in GB;

- 3.57 million household gas customer accounts in GB;
- 430,000 business electricity and gas sites in GB;
- 490,000 energy accounts in Northern Ireland and the Republic of Ireland (90% household and 10% industrial and commercial); and
- 420,000 home services customer accounts, including gas boiler, central heating and wiring maintenance; installation products and services; telephone line rental, calls and broadband services.

The increase in customer account numbers was therefore the result of success in Ireland where, in April 2011, SSE through Airtricity, passed the 500,000 customer accounts milestone. In contrast, there was a slight reduction in customer numbers in Great Britain in the second half of the year, reflecting the highly competitive market conditions.

Within the total, 3.05 million customer accounts in Great Britain are for loyalty products such as:

- **energyplus Argos**, which rewards customers with money-off discount vouchers;
- **energyplus Pulse**, under which customers are able to support the British Heart Foundation (which received almost £120,000 from SSE in respect of energyplus Pulse customers during 2010/11, taking the total since the product was launched to almost £1.3m); and
- **M&S Energy**, available to customers through M&S' stores and website.

SSE's customer growth is partly founded on telephone and face-to-face sales. Ofgem introduced new licence conditions to govern sales processes in 2009 and in September 2010 launched an investigation to 'establish whether' four suppliers, including SSE, are complying with the licence conditions. SSE is committed to high standards in its sales

processes and is co-operating fully with the investigation, which is ongoing.

### Customers' use of energy is continuing to decline

On a weather-corrected basis, SSE household customers have continued to reduce their use of energy, and on an actual basis in 2010/11 SSE household customers used, on average:

- 563 therms of gas, compared with 558 therms in the previous year, and 598 therms in 2008/09; and
- 4,408kWh of electricity, compared with 4,465kWh in the previous year, and 4,748kWh in 2008/09.

As a result of the underlying fall in energy consumption, households are less exposed to the impact of high unit prices than they otherwise would be.

### Helping customers use less energy

Using energy more efficiently is the fastest and most cost-effective way of reducing customers' energy costs, sustaining supplies for the long term and reducing emissions of carbon dioxide. As an energy supplier, SSE has obligations under the Carbon Emissions Reduction Target (CERT) scheme to deliver energy efficiency measures to households throughout Great Britain and in 2010/11 funded the installation of cavity wall insulation in 87,000 homes and loft insulation in 106,000 homes (excluding DIY insulation).

In its CERT Annual Report, a review of CERT in 2009/10, published in August 2010, Ofgem stated that SSE had met 78% of its overall carbon emissions reduction obligation for the three years to 2011. SSE is the energy supplier which has delivered the highest share of its CERT obligations through appliances, via a number of consumer electronics schemes. These have the benefit of helping to address directly demand for electricity.

Complementing CERT, the Community Energy Savings Programme (CESP) is an obligation placed on energy suppliers and electricity generators to make savings in customers' homes by helping to install energy efficiency measures. The programme is designed to ensure that suppliers work in the lower income areas and to incentivise a 'whole house' approach to energy savings. SSE's first CESP programmes got under way in 2010/11 at locations throughout England, Scotland and Wales.

CESP and CERT will be superseded by the 'Green Deal' and Energy Company Obligation (ECO) when they are introduced:

**Using energy more efficiently is the fastest and most cost-effective way of reducing customers' energy costs, sustaining supplies for the long term and reducing emissions of carbon dioxide.**

## Market-based businesses (continued)

### Generation and Supply

- the Green Deal is a new financing mechanism for customers seeking to install energy saving measures, featuring a Golden Rule under which the expected financial savings arising from the measures must be equal to or greater than the costs attached to the energy bill; and
- the ECO will replace the obligations arising from CERT and CESP, with suppliers expected to focus assistance on the poorest and most vulnerable households and the hardest-to-treat properties, which may not be able to take advantage of the Green Deal.

The Green Deal and ECO are subjects of the Energy Bill, which is making its way through the UK Parliament and are expected to be implemented, following extensive secondary legislation, from 2012. The Secretary of State for Energy and Climate Change will be responsible for determining what energy efficiency measures will be eligible for the Green Deal, and providing such measures could represent a significant opportunity for SSE to market products and services.

#### Helping vulnerable customers

The UK government has appointed Professor John Hills to lead an independent review of fuel poverty. A household is currently classed as being in fuel poverty if it would need to spend more than 10% of its income on fuel to keep their home warm enough. The review will examine the definition of fuel poverty and the government targets relating to it. It is expected to conclude in 2012.

SSE believes that any type of poverty, including fuel poverty, results fundamentally from an individual or household having insufficient income. Nevertheless, SSE fulfils two key responsibilities in order to help those of its customers who struggle to pay for their basic energy needs:

- under the voluntary agreement struck with the UK government in 2008, SSE operated schemes with a value of around £28m in 2010/11 to help vulnerable customers. It introduced a tiered approach to assistance, featuring its energyplus Care tariff, rebate tariffs and other services, and helped around 200,000 customers in the year. This agreement has now been replaced by the Warm Home Discount, which requires energy companies to give discounts on energy bills to vulnerable customers; and
- SSE helps customers who may be having difficulties in paying for the electricity and gas they use by offering tailor-made

payment arrangements that suit their financial and other circumstances. In March 2011, over 240,000 customers were taking advantage of these arrangements.

#### Retail energy bills in Great Britain

SSE increased its prices for household gas supply by 9.4% on 1 December 2010. Forward annual wholesale prices for gas rose by over 25% in the period between March 2010, when SSE previously announced a package of changes to prices for household gas, and October 2010, when the price change was announced. Throughout this time, domestic gas supply was a loss-making activity for SSE and its gas supply business, Southern Electric Gas, has traded at a loss for most of the past few years.

In November 2010, Ofgem adopted, for analytical and comparative purposes, a new typical annual domestic gas consumption of 16,500kWh, a reduction of 4,000kWh, following a consistent decline in average domestic gas consumption levels. This demonstrated that the co-operation seen in recent years between energy suppliers, government, Ofgem, consumer organisations, and the associated investment, is delivering a sustained reduction in the amount of gas being consumed in Britain's homes.

The distinction between the price of a unit of energy and the amount customers pay for heating and powering their homes is illustrated by the £132 difference between the cost of 20,500kWh of gas and 16,500kWh. With greater energy efficiency, households are less exposed to the impact of high unit prices than they otherwise would be, because they are using less energy, and further improvements in this area remain a top priority for SSE.

When it published its initial proposals from its Retail Market Review in March 2011, Ofgem claimed to have 'evidence that energy prices have tended to rise in response to wholesale cost increases more quickly than they have fallen with decreases'. It acknowledged that 'this finding is dependent on both the analysis techniques used, as well as how we assume suppliers hedge their energy purchases'.

In fact, Ofgem's analysis on this particularly sensitive point is flawed because it assumes a constant level of energy consumption between 2004 and 2010 when, in fact, consumption has declined. The analytical flaw arises because energy suppliers like SSE recover some of their fixed costs (such as network costs in gas) through charges on units of energy used. This means that if consumption is reduced, some fixed costs are

not recovered by suppliers who, as a result, have to ensure unit prices are at a level that enables them to recover fixed costs.

Future trends in energy prices for domestic customers will ultimately depend on what happens in wholesale electricity and gas markets, with public policy and regulatory decisions on energy production, distribution and consumption also having a significant impact. For example, the costs associated with the EU ETS, RO and CERT are all on an increasing trend, as are the costs of distributing energy. Moreover, forward annual wholesale prices for electricity and gas have risen by around one quarter and around one third respectively in the six months following SSE's 29 October 2010 announcement of a price increase for household gas supply.

#### How people pay their energy bills

A total of 61% of SSE's domestic electricity and gas accounts across Great Britain and Ireland are paid by direct debit or standing order. A further 12% are paid through pay-as-you-go (or pre-payment) meters in Great Britain and the balance (27%) are on credit terms and settled by cheque or other such payment methods.

#### Keeping customers' energy debt under control

As at 31 March 2011, the total aged debt (ie debt that is overdue by more than six months) of SSE's domestic and small business electricity and gas customers in Great Britain and Ireland was £89.2m, compared with £94.9m in March 2010. A bad debt-related charge to profits, covering both provision and write-off, of £47.4m has been made. This compares with a charge of £76.1m in the previous year.

The general economic climate meant 2010/11 posed significant debt management challenges, with the volume of work in this area for SSE's Customer Service division again increasing. SSE has sought to manage this situation by taking a number of steps, including rigorous assessment of the credit-worthiness of potential business customers, and making earlier contact with the customer (business or household) when it becomes apparent from analysis that payments are in arrears, so that the issues are more manageable from everyone's point of view. The work of office-based credit agents is supplemented by the work of field-based teams who work with customers to resolve debt.

#### Providing sector-leading service to customers

SSE's growth in energy supply has been achieved while being independently and

consistently recognised as the customer service benchmark for the rest of the energy supply industry. To provide customers with the best possible value for money, SSE believes that it needs to provide best-in-sector service and products, as well as competitive prices over the medium term.

SSE's position as the customer service benchmark for the rest of the energy supply industry is illustrated by:

- the UK Customer Satisfaction Index, published in July 2010, in which SSE achieved the top ranking in the utility sector;
- the Customer Satisfaction Report from uSwitch.com, published in September 2010, in which SSE was ranked the best energy supplier for the seventh successive time;
- the JD Power and Associates 2010 UK Electricity and Gas Supplier Customer Satisfaction Study, published in November 2010, in which three of SSE's supply brands occupied the top three places in the study of electricity suppliers; and
- the Consumer Focus customer complaints rankings, published in March 2011, in which SSE again emerged as the best, being the only company with a four star rating.

During 2010/11, there were 1,161 SSE-related complaints to the following third party organisations: the Energy Ombudsman; Consumer Focus; and Consumer Direct. This was a reduction from the 1,231 complaints in the previous year.

Although SSE maintained its best-in-sector position in customer service during 2010/11, it was a year in which the profile of the energy supply sector remained very high. In total, SSE's energy supply customers in Great Britain made just over 20 million calls to the Company's teams in Basingstoke, Cardiff, Cumbernauld, Havant and Perth during the year. These conversations allow SSE to assess, consider and respond to customers' concerns and, over time, adapt the services and products it provides accordingly.

#### Making services available online

Web and email are now firmly established as the second most common means of communication with the Company used by SSE's customers. Around one third of SSE's transactions with customers now take place online.

Moreover, SSE's customers in the Great Britain and Ireland markets now have 1.3 million online accounts, up from just over 800,000 a year before. Online customers can view their account and

payment history, submit meter readings and receive an up-to-date balance on their account, make secure payments on their account and other such services.

This, in turn, indicates that the popularity of e-services such as paperless billing is likely to continue to increase rapidly over the next few years. Enabling customers to carry out more transactions online if they choose is now one of SSE's top customer service priorities.

#### Developing new energy products and services

The energy supply market in Great Britain is evolving from the simple retailing of electricity and gas to the provision of a comprehensive range of smarter products and services, consistent with the long-term decarbonisation of energy production and consumption. This process will receive additional impetus with the introduction of the Renewable Heat Incentive from July 2011, forthcoming roll-out of smart meters in Great Britain and the introduction of the Green Deal.

SSE launched **better plan** four years ago as part of its commitment to work in partnership with its customers to help them reduce their energy use and to create a more sustainable level of energy

consumption. By the end of 2010/11, the number of **better plan** customer accounts had increased to 227,000.

**Better plan** is a practical example of SSE's commitment to product and service innovation in energy supply. It was followed in the autumn of 2010 by **iplan**, a new energy product which delivers smart energy features to customers, allowing them to track their energy usage by providing the real-time and historic information they need to change the way they use energy, thus helping to lower their energy costs.

SSE is more than just a retailer of electricity and gas. It has, for example, developed a number of products based on solar PV, solar thermal and air-source heat pumps. This reflects the fact that while Feed-in Tariffs for localised electricity generation (introduced in April 2010) and the phased introduction of the Renewable Heat Incentive will reinforce the decline in customers' electricity and gas consumption, they are also creating opportunities for SSE to broaden the range of products and services it delivers.

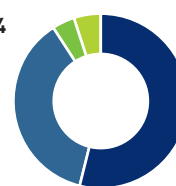
Microgeneration is a very small market at the moment, but it is growing fast. SSE's turnover in this area more than trebled during 2010/11 and milestones achieved included:

#### Energy customer numbers – millions



#### Energy customer numbers 2010/11 composition – %

- Household electricity (GB) 54
- Household gas (GB) 37
- Business sites (GB) 4
- Household/business (Ireland) 5



#### Domestic customers' payment methods 2010/11 – %

- Direct debit 61
- Pay-as-you-go 12
- Credit terms 27



## Market-based businesses (continued)

### Generation and Supply

- the completion, in March 2011, of its first social housing project for ground-source heat pumps, in conjunction with Geothermal International, an investee company of SSE Ventures;
- the installation of a solar PV installation for a housing association in Oxfordshire; and
- the alignment of SSE's domestic solar PV business with its gas and electrical installation businesses to achieve greater synergies and a better-aligned package of products and services.

In summary, SSE is aiming to build on its position as the sector leader in service provision and on the development of transition products such as **iplan** by accelerating the long-term transformation of its energy supply products and services that is already under way. This will require sustained, but disciplined and pragmatic, investment in systems and processes over the next few years and SSE is developing comprehensive plans to do this.

#### Preparing for the roll-out of smart meters

Energy supply in Great Britain will also be transformed by the installation of 53 million smart energy meters in 30 million homes and businesses. They will enable the quantity and value of electricity and gas used by the customer to be continuously monitored and allow information about its use and cost to be available to the customer and exchanged with the supplier, through two-way electronic communications.

As the UK government said in March 2011, when it published its plans for the national roll-out, smart meters will deliver a range of benefits to customers, energy suppliers and energy network companies:

- customers will have real-time information on their energy consumption to help them control energy use, and thereby save money and reduce emissions, and bring an end to estimated bills;
- energy suppliers will have access to accurate data for billing, and will be able to deliver enhanced customer service and reduced costs; and
- energy network companies will have better information with which to manage and plan current activities and the move towards smart grids.

SSE supports the two-phase approach to the smart meter roll-out which has been adopted, featuring:

- the foundation stage to enable the energy industry to build and test all the systems needed to start the roll-out, ensure positive customer engagement

and deliver energy savings and to enable the government to establish the Data Communications Company to manage smart meter communications; and

- the roll-out stage, between 2014 and 2019, during which the meters themselves will be installed.

In line with its measured and realistic approach to the roll-out, SSE installed 2,000 gas and electricity smart meters in 1,000 dual fuel customers' homes in the Midlands and Southern regional electricity areas during 2010/11. It plans to build on this with the installation of up to 10,000 smart meters during 2011/12 and by making substantive progress on the necessary IT systems to support the wider roll-out.

#### Delivering zero carbon homes

Products and services provided by energy companies have to change because the way people consume energy has to change. People are customers of energy companies, and so the only sustainable option is for companies to change also.

In line with this, SSE completed a development of 10 zero carbon homes on a brownfield site in Slough in September 2010, when it was opened by the Secretary of State for Energy and Climate Change. They feature triple glazing, mechanical ventilation systems, solar PV tiles, solar thermal panels and an energy centre with a biomass boiler and a ground source heat pump and conform to the highest specification for sustainable building, Code 6 in the Code for Sustainable Homes.

The homes are now occupied and information is being gathered about how householders adapt and respond to zero carbon living to help inform future developments in the decarbonisation of the energy sector.

### Supply priorities in 2011/12 and beyond

With smart metering and other developments, SSE is moving towards a much more dynamic, two-way relationship with customers. During 2011/12, and beyond, SSE will seek to build momentum in this direction and:

- provide consistently competitive prices;
- retain and gain customer accounts across the markets in Great Britain and Ireland;
- secure further efficiencies in day-to-day operations, including the ways in which customers are retained and gained and the ways in which they are given the services they need;
- maintain the highest standards of operations, delivering best-in-sector service, including improvements in billing, call handling times and enhancements to online and smart services;
- deliver energy efficiency improvements, principally through the CERT and CESP programmes;
- make substantive preparations for the roll-out of smart meters and related developments; and
- continue to develop the energy-related products and services provided to customers, including microgeneration and insulation.

SSE will seek to achieve all of this while engaging constructively with Ofgem as it takes forward the findings and initial proposals from its Retail Market Review.

In summary, SSE is aiming to build on its position as sector leader for the quality of service provided to electricity and gas customers and develop a broader, deeper energy services offering capable of being geared towards, and targeted at, the needs of individual customers.

## Market-based businesses (continued)

### Other energy and utility services

Overview  
Strategy  
Group performance  
**Segmental performance**  
Corporate governance  
Financial statements  
Shareholder information

### Other energy and utility services

#### Performance indicators

|                                          | 2009  | 2010  | 2011   | Change |
|------------------------------------------|-------|-------|--------|--------|
| Gas storage customer nominations met – % | 100   | 100   | 100    | +0.0%  |
| Gas storage net capacity – mcm           | 325   | 400   | 440    | +10.0% |
| SSE contracting order book – £m          | 101   | 115   | 98     | -14.8% |
| Out-of-area networks in operation        | 47    | 53    | 74     | +39.6% |
| New gas connections                      | 7,300 | 6,700 | 11,120 | +66.0% |
| Meters read – millions                   | 9.0   | 10.7  | 13.8   | +29.0% |

#### Substantial market-based businesses complementing SSE's core activities

As well as being involved in Energy Networks and Generation and Supply, SSE provides other energy and utility services:

- Gas Production;
- Gas Storage;
- Contracting, Utility Solutions and Metering; and
- Telecoms.

The operating profit of this group of businesses has grown from just over £91m to £134.7m in the five years to March 2011. This represents less than 10% of SSE's operating profit, and in SSE's financial statements they are presented as a single operating segment, in line with how they are reviewed by the Board. During 2010/11, SSE acquired its first gas production assets. Its other energy and utility services businesses are substantial in their own fields. For example:

- SSE's onshore gas storage facility at Hornsea is the largest in the UK;
- SSE's contracting business is the second largest mechanical and electrical contracting business in the UK; and
- SSE's telecoms business is the fourth largest telecoms network company in the UK.

As well as being substantial in their own fields, these businesses give SSE an important presence in areas of significance to the UK's infrastructure requirements:

- the UK government's Annual Energy Statement in July 2010 confirmed the need for more gas storage capacity;
- it also confirmed the need to modernise the UK's energy infrastructure, with much greater decentralisation; and
- telecoms networks are clearly recognised as being central to the competitiveness of any economy and the success of any substantial organisation.

The UK government's Annual Energy Statement also stated that indigenous supplies of oil and gas remain important and that the UK must 'maximise economic production while applying effective environmental and safety regulations'.

#### Gas Production

##### Securing upstream supplies of gas

SSE needs on average around 13.5 million therms of gas per day to supply its customers and to fuel its power stations. Its goal is to build up a presence in the upstream gas sector in a measured way to provide an additional source of primary fuel and a hedge for its gas-fired generation

and gas supply activities. During 2010/11 it:

- signed, in November 2010, an agreement with Faroe Petroleum plc, the independent oil and gas company, to work together to identify, assess and, where good value can be obtained, acquire producing oil and gas assets in the North Sea. It also subscribed in a placing for just over 5% of the enlarged share capital of Faroe Petroleum plc at a cost of around £18m. The partnership's combined expertise and relationships across the market provide an opportunity to acquire high quality oil and gas production and benefits from respective strengths; and
- completed, in February 2011, the acquisition from Hess Limited of North Sea natural gas and infrastructure assets. Gas delivery from the assets that are currently in production is expected to be around 200 million therms in 2011 and, subject to the success and phasing of development fields, could increase up to 300 million therms, which would provide around 6% of SSE's gas needs. Production is then forecast to decline over the next 10 years. The main production asset operators are BP and Perenco. The total cash consideration for the acquisition was £197.2m.

In the two months since SSE acquired its assets, Gas Production delivered an operating profit of £4.6m.

The acquisition and agreement represent SSE's first steps into the upstream gas sector, and it hopes to build its presence in the sector over time – but in a careful, measured way, consistent with its financial principles and, therefore, only where fair value can be secured.

#### Gas Production priorities in 2011/12 and beyond

SSE's priorities in Gas Production in 2011/12 are to:

- complete the integration of recently-acquired gas production assets into its portfolio; and
- pursue further opportunities to secure upstream gas assets, while adhering to its key financial principles.

As well as being substantial in their own fields, other energy and utility services give SSE an important presence in areas of significance to the UK's infrastructure requirements.

## Market-based businesses (continued)

### Other energy and utility services

#### Gas Storage

##### Providing capacity to store gas

As production of North Sea gas declines in the coming years, UK imports will continue to increase to meet demand from domestic customers, gas-fired power stations and other industrial and commercial users. Imports could be put at risk by periods of unusually low temperatures, operational failures in pipelines delivering gas to the UK, political disputes in gas-producing regions or high demand in other parts of the world. This is why gas storage capacity is important, and will remain so even though liquefied natural gas (LNG) has recently helped to diversify sources of gas in the UK and thereby had a negative financial impact of gas storage.

Gas storage delivered an operating profit\* of £23.7m during 2010/11, compared with £41.8m in the previous year. Profitability has been affected by a decline in the price achieved for Standard Bundled Units of capacity. This, in turn, reflects a reduction in the differentials between forward summer and winter gas prices, reflecting the increased availability of LNG.

SSE has an ownership interest in two major gas storage facilities in East Yorkshire:

- the UK's largest onshore gas storage facility, at Hornsea, in which around 325 million cubic metres (mcm) of gas can be stored in a total of nine caverns. Hornsea accounts for around 7% of the total gas storage capacity in the UK and 15% of deliverability; and
- the UK's newest onshore gas storage facility, at Aldbrough, which SSE is developing with Statoil (UK) Ltd. An initial 170mcm of capacity in six caverns is already available for commercial operation. The capacity at the Aldbrough development is divided between SSE and Statoil (UK) Ltd on a two thirds/one third basis.

To form caverns such as those at Aldbrough and Hornsea, salt deposits around 2km under ground are leached out by seawater which, in turn, is replaced (dewatered) by gas under pressure. Leaching of all nine caverns at Aldbrough has now been completed, which should allow the final three caverns to be ready for operation by the summer of 2012 and SSE's forecast total investment for the development remains around £290m.

When fully commissioned, Aldbrough will ultimately have the capacity to inject gas and store around 330mcm in nine under ground caverns (of which SSE will own two

thirds). It will have the capacity to deliver gas to the National Transmission System at a rate of up to 40mcm per day, equivalent to the average daily consumption of eight million homes, and the ability to have up to 30mcm of gas per day injected.

SSE and Statoil (UK) Ltd have consent to increase the storage capacity at the Aldbrough site beyond that currently under development but concluded during 2010 that an investment decision on the development should be deferred while the UK government develops its policy on gas security.

##### Making sure storage capacity is available

At Hornsea, gas can be injected at a rate of 2mcm per day and delivered to the National Transmission System at a rate of 18mcm per day, which is equivalent to the requirements of around four million homes. During 2010/11, Hornsea maintained its good record of dependability and was 100% available to customers, except in instances of planned maintenance. This enabled storage customers to manage their gas market risks and respond to gas trading opportunities.

The capacity which became available at Aldbrough also performed well during 2010/11, its first full year of commercial operation.

#### Gas Storage priorities in 2011/12 and beyond

SSE's operational and investment priorities in Gas Storage during 2011/12 are to:

- ensure safe and effective operation of capacity at Hornsea and Aldbrough; and
- complete construction work at Aldbrough.

#### Gas storage capacity – million cubic metres



#### Contracting, Utility Solutions and Metering

##### Overall performance in Contracting, Utility Solutions and Metering

Operating profit\* in Contracting, Utility Solutions and Metering was £88.5m during 2010/11, compared with £80.2m in the previous year, reflecting in particular the contribution from SSE's in-sourced Metering business (see below).

##### A leading mechanical and electrical contracting business

SSE Contracting has three main areas of activity:

- industrial, commercial and domestic mechanical and electrical contracting;
- electrical and instrumentation engineering; and
- public and highway lighting services.

It is one of the largest mechanical and electrical contracting businesses in the UK. It operates from regional offices throughout Great Britain.

##### Sustaining SSE Contracting through economic uncertainty

While SSE Contracting has continued to make solid progress during 2010/11, its order book ended the year at £98.3m, compared with £115m in 2010 and £101m in 2009. This reflects economic uncertainty in the UK. Nevertheless, the order book features a number of important new contracts with customers as diverse as Frimley Park Hospital and Dartford Tunnel.

A major proportion of SSE Contracting's business has historically come from public sector bodies and end-user client organisations with a high degree of repeat business or long-term contracts. In line with this, PriDE, the joint venture company between SSE Contracting and Interserve Defence Ltd, has signed a £108m, two-year extension to its South East Regional Prime Contract with the Defence Infrastructure Organisation. The contract will now run to March 2014.

With public sector budgets being curtailed following the UK Spending Review in October 2010, SSE Contracting is encouraged by the increasing number of enquiries from the private sector. It is also focusing on post-sales control, particularly in terms of costs, and maintaining strong customer relationships, with careful analysis of the markets and areas of work it should prioritise. The structure of the business is also being kept under review, with, for example, some rationalisation of depots being undertaken.

### Maintaining leadership in lighting services provision

SSE Contracting remains the UK's and Ireland's leading street-lighting contractor. It has:

- contracts with 24 local authorities in England, Wales and Scotland to maintain over 600,000 lighting units;
- contracts with 28 local authorities in the Republic of Ireland to maintain over 275,000 lighting units, through Airtricity Utility Solutions; and
- contracts with 12 local authorities, under the Private Finance Initiative, and through the wholly-owned subsidiary Tay Valley Lighting Ltd, to replace and maintain over 600,000 lighting units.

The PFI contracts include the 25-year contract awarded by Knowsley Metropolitan Council in April 2011 for the maintenance of over 24,000 lighting columns, traffic bollards and traffic signs and for the replacement of more than 70% of these during the initial four-year investment period.

Under the contract, the innovative 'Mayflower' Central Management System technology will be installed on all illuminated apparatus. Mayflower is owned by SSE and the technology enables variable light control, fault detection and energy consumption measurement to be undertaken from a central location, allowing the local authority to manage lighting levels and therefore energy consumption, throughout the contract.

Including PFI and maintenance contracts in Great Britain and the Republic of Ireland, SSE now maintains almost 1.5 million lighting units. A public tender process for street light maintenance in Northern Ireland will begin in 2012.

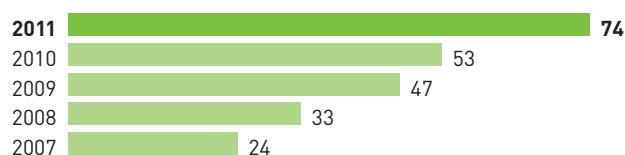
### Providing comprehensive Utility Solutions

SSE provides a comprehensive range of utility solutions. It designs, builds, owns, operates and maintains cable and pipe networks for delivering electricity, gas, water, heat and telecommunications to

existing and new commercial and residential developments in England, Wales and Scotland. It is, therefore, able to provide a one-stop solution for multi-utility infrastructure requirements to customers in the development and construction sectors.

- **Electricity Networks:** in the summer of 2010, SSE signed a contract which will result in the development of its 100th embedded electricity network outside the areas served by its economically-regulated subsidiaries Scottish Hydro Electric Power Distribution and Southern Electric Power Distribution. SSE now owns and operates 74 energised electricity networks of this kind. A further 14 are under construction and contracts have been signed for the development of an additional 29, taking the total to 117. In total, SSE has 740MW of network capacity, including almost 300MW of existing demand and 440MW of connections to be completed;
- **Gas Pipelines:** SSE is also a licensed gas transporter, installing, owning and operating gas mains and services on new housing and commercial developments throughout the UK. The total number of new premises connected to its gas networks has continued to grow, and during 2010/11, it connected a further 11,120 premises, taking the total number of connections to over 78,000;
- **Water:** SSE Water (SSEW) is the first new company to offer both water and sewerage services since privatisation in England and Wales in 1989, and

### Out-of-area networks in operation



its establishment will enable SSE to provide, over the long term, a more comprehensive multi-utility solution to customers in the property development and house-building sectors, through being able to install, own, operate and supply water and sewerage services alongside its existing electricity and gas services. An 'inset' appointment is the route by which one company replaces another as the appointed water and/or sewerage company for a specified area. SSEW now has nine such appointments and provides, or has secured contracts to provide, water and sewerage services to over 15,000 properties in England and Wales; and

- **Heat:** SSE uses a range of sustainable technical solutions, including Combined Heat and Power (CHP) generation, biomass boilers and ground- and air-source heat pumps and combines these with community heating schemes where appropriate. For example, in August 2010, it secured a contract to adopt, own and operate the new heat network for two adjacent sites totalling 750 plots in the London Borough of Hackney.

### Maintaining a national Metering business

SSE's Metering business provides services to most electricity suppliers with customers in central southern England and the north of Scotland. Previously, SSE relied on a combination of its own employees in central southern England and the north of Scotland and up to nine external agencies elsewhere in the country to read electricity and gas

**SSE supplies, installs and maintains domestic meters and carries out metering work in the commercial, industrial and generation sectors. It also offers data collection services.**

**Market-based businesses (continued)****Other energy and utility services**

meters and install and repair electricity meters. Following the successful completion of a programme of in-sourcing in March 2010, it undertakes meter reading operations and meter operator work in all other parts of Great Britain. It supplies, installs and maintains domestic meters and carries out metering work in the commercial, industrial and generation sectors. It also offers data collection services to the domestic and SME sectors.

In total, SSE owns 3.8 million meters. During 2010/11, the first full year after the completing of in-sourcing, it collected:

- 8.4 million electricity readings, up from 6.8 million in the previous year; and
- 5.4 million gas readings, up from 3.9 million.

This increase reflects the completion, during 2009/10, of the in-sourcing of its meter reading and electricity meter operation services throughout Great Britain. Longer-term, SSE's Great Britain-wide metering team will be able to support the transition to smart meters which will take place in the coming decade and will help SSE deploy other energy-related services and products during that time (see 'Preparing for the roll-out of smart meters' on page 42).

### **Contracting, Utility Solutions and Metering priorities in 2011/12 and beyond**

SSE's priorities in Contracting, Utility Solutions and Metering are to:

- deliver a high standard of service to all customers;
- focus on strong cost control and maintaining and developing customer contacts;
- increase the number of contracts secured across all activities; and
- help prepare for the roll-out of smart meters.

**SSE's telecoms business is the fourth largest telecoms network company in the UK. As a subsidiary of SSE, it is also able to position itself as one of the UK's most financially secure telecoms network operators, which gives it an important competitive advantage, especially during an economic downturn.**

**Telecoms****Operating one of the UK's largest telecoms networks**

The origins of SSE's Telecoms business lie in the installation, a decade ago, of fibre optic cable on SSE's electricity network. The business combines SSE Telecoms and Neos Networks and a number of acquisitions and now operates a 11,200km UK-wide telecoms network.

This network provides capacity and bandwidth services for companies, public sector organisations, internet service providers, application service providers and other licence operators and now comprises:

- fibre optic cabling which SSE owns (5,000km);
- leased lit fibre (2,600km); and
- microwave radio (3,600km).

As a result, this is the fourth largest telecoms network company in the UK. As a subsidiary of SSE, it is also able to position itself as one of the UK's most financially secure telecoms network operators, which gives it an important competitive advantage, especially during an economic downturn.

To complement its core telecoms network business, SSE's Fareham-based data centre provides capacity for more than 1,200 racks for the co-location of IT services within the 80,000 square feet secure site and 10MW of power in a resilient and energy efficient environment. During the summer of 2010, what is believed to be the UK's largest commercial solar PV installation was placed on the roof of the data centre. Customers for the data centre include Thomson Reuters and Kingfisher.

**Telecoms' financial performance**

SSE's combined Telecoms business achieved an operating profit\* of £17.9m during 2010/11, compared with £16.4m. The year was characterised by a challenging environment for sales in respect of the network, which made tight control on operating costs especially important.

The Telecoms business undertook capital expenditure of £34.7m in 2010/11, focused on improving network reliability and reach and on the Fareham data centre.

### **Telecoms priorities in 2011/12 and beyond**

SSE's priorities in Telecoms in 2011/12 are to:

- retain and gain customers for key services such as capacity and bandwidth; and
- add to the number of customers for its data centre business.

The achievement of these priorities should enable SSE Telecoms to continue to make progress towards becoming the UK's leading alternative telecoms network.

# Chairman's introduction to SSE corporate governance

Overview  
 Strategy  
 Group performance  
 Segmental performance  
**Corporate governance**  
 Financial statements  
 Shareholder information



**Lord Smith of Kelvin**  
 Chairman

I am pleased to introduce the corporate governance report for 2010/11. It explains our approach to corporate governance in detail by describing the SSE team, how the Board works, risk management and internal control and the work of each of the Board Committees. The Committees for the year reported on were Audit, Risk and Trading, Nomination, Safety Health and Environment, and Remuneration.

The Board's approach to corporate governance is key to running SSE as a successful, responsible and sustainable business capable of delivering increases in the dividend payable to shareholders in the short, medium, and long term.

This year's corporate governance report sets out in detail the arrangements in place. However I would like to draw particular attention to some specific points.

## **New corporate governance code**

The Board has been fully briefed on the changes in the new UK Corporate Governance Code. The new code covers in particular annual re-appointment of Directors, Board diversity, external evaluation, greater emphasis on risk, and clear explanation of business model and strategy. We welcome these changes and are committed to complying.

## **Changes to the Board**

As part of our planned and continuing refreshment of the Board, I am pleased to welcome two new non-Executive Directors to the Board – Jeremy Beeton and Katie Bickerstaffe. They bring specific experience which will be invaluable as the Company undertakes major capital projects and faces the challenges of changes in the domestic customer market.

Nick Baldwin resigned as a non-Executive Director on 1 April 2011 on his appointment as Chair of the Office for Nuclear Regulation. The Board benefitted greatly from his breadth of experience in the energy sector and we wish him well in his new role.

## **Board evaluation**

Our Board evaluation process this year built on the external independent evaluation report carried out last year. We will carry out a further external evaluation within the next two years.

## **Ethics and values**

We have reviewed and updated our ethics policy in light of the enactment of the Bribery Act 2010. SSE remains committed to the highest standards of business conduct and expects all its employees to act accordingly. The new policy has been

distributed throughout the Group and is part of the induction programme for new recruits. The SSE set of core values of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork remain our guiding principles. Safety is the overriding value, and it is addressed at every Board meeting as the first item on the agenda.

## **Commitment**

The non-Executive Directors devote time to SSE over and above attendance at Board and Committee meetings. During the year each non-Executive Director is expected to visit key business locations in the Group and receives briefings from members of the SSE management team on a range of matters.

Lastly, I was pleased that SSE won the 2010 PwC Building Public Trust Award for Executive Remuneration Reporting in the FTSE 100.

## **Lord Smith of Kelvin**

Chairman  
 19 May 2011

## Board of Directors

### The Board of Directors



01



02



03



04

#### The Board of Directors

- 01 Lord Smith of Kelvin
- 02 Lady Rice CBE
- 03 Gregor Alexander
- 04 Ian Marchant
- 05 René Médori
- 06 Colin Hood
- 07 Alistair Phillips-Davies
- 08 Thomas Thune Andersen
- 09 Richard Gillingwater CBE
- 10 Jeremy Beeton (from 1 July 2011)
- 11 Katie Bickerstaffe (from 1 July 2011)



05



06



07



08



09



10



11

### The Management Board



01



02

#### The Management Board

- 01 David Franklin
  - 02 Rob McDonald
  - 03 Jim McPhillimy
  - 04 Mark Mathieson
  - 05 Paul Smith
  - 06 Alan Young
  - 07 John Morea (in attendance)
- Ian Marchant, Colin Hood, Gregor Alexander and Alistair Phillips-Davies are also members of the Management Board.



03



04



05



06



07

## The Board of Directors

### Lord Smith of Kelvin Chairman

Robert joined the Board as a non-Executive Director in June 2003 and became Chairman in January 2005. He is also: Chairman of the Weir Group plc; a non-Executive Director of Standard Bank Group Ltd; Chairman of Glasgow 2014 Ltd, the organising committee for the Commonwealth Games; and Chancellor of the University of the West of Scotland. Robert is Chairman of the Nomination Committee and a member of the Remuneration Committee.

### Ian Marchant Chief Executive

Ian was appointed Chief Executive in 2002, having been Finance Director since 1998. He has worked in the energy industry since 1992, when he joined Southern Electric. He is also: a member of the UK Business Council for Sustainable Energy; Chairman of the Scotland 2020 Delivery Group; a member of Ofgem's Environmental Advisory Group; a member of the Energy Research Partnership; a non-Executive Director of John Wood Group plc and Maggie's Cancer Centres; and became Chairman of the Engineering Construction Forum in 2009. Ian is a member of the Nomination Committee and the Risk and Trading Committee. He has Board-level responsibility for energy networks, regulation and corporate affairs and is Lead Director for the environment.

### Colin Hood Chief Operating Officer

Colin was appointed Chief Operating Officer in 2002, having joined the Board as Power Systems Director in 2001. He has worked in the energy industry since 1977, when he joined Scottish Hydro Electric. He has Board level responsibility for SSE's large capital projects and is SSE's Lead Director for Health and Safety matters and is Chairman of the Safety, Health and Environment Advisory Committee. Colin is a Director of SGN and became a non-Executive Director of FirstGroup plc in May 2009 and non-Executive Director of Southern Water in early 2011.

### Lady Rice CBE Senior Independent Director

Susan joined the Board as non-Executive Director in July 2003 and became Senior Independent Director in 2007. She is Managing Director of Lloyds Banking Group Scotland. Susan is also a non-Executive Director of the Court of the Bank of England, where she chairs the Audit and Risk Committee, and of Scotland's Futures Forum. She chairs the Boards of the Edinburgh International Book Festival and the Edinburgh Festivals Forum. Susan chairs the Remuneration Committee and is a member of the Nomination Committee.

### Richard Gillingwater CBE Non-Executive Director

Richard joined the Board as a non-Executive Director in May 2007. He is Dean of Cass Business School and is non-Executive Chairman of CDC Group plc and a Senior Independent Director of

Hiscox Ltd. Richard is a member of the Audit, Remuneration and Nomination Committees.

### Alistair Phillips-Davies Generation and Supply Director

Alistair was appointed Generation and Supply Director in December 2010 after taking responsibility for Generation Operations; previously he was Energy Supply Director since joining the Board in 2002. He has worked in the energy industry since 1997, when he joined Southern Electric. Alistair has Board level responsibility for generation, energy trading, electricity and gas supply, energy efficiency, customer service, sales, marketing and energy services. He chairs the Risk and Trading Committee.

### René Médori Audit Committee Chairman

René joined the Board as a non-Executive Director in June 2003. He is Finance Director of Anglo American plc and is a non-Executive Director of Anglo Platinum and DB (De Beers) Investments. He is Chairman of the Audit Committee and a member of the Nomination Committee.

### Gregor Alexander Finance Director

Gregor was appointed Finance Director and joined the Board in 2002, having previously been Group Treasurer and Tax Manager. He has worked in the energy industry since 1990, when he joined Scottish Hydro Electric. He has Board-level responsibility for finance, human resources, IT, procurement and other Group services. He is also the sponsoring Board member for SSE's business development in Ireland. Gregor is a Director of SGN, and is a member of the Risk and Trading Committee.

### Thomas Thune Andersen Non-Executive Director

Thomas joined the Board as a non-Executive Director in January 2009. He is the Chairman of Lloyd's Register Group, Vice Chairman of the VKR Holding Group (VELUX) and a non-Executive Director of Petrofac Plc. He was CEO of Maersk Oil and he is a member of the Audit, Nomination, and Safety, Health and Environment Advisory Committees.

### Jeremy Beeton Non-Executive Director

Jeremy will join the Board as non-Executive Director in July 2011. He is the Director General of the UK Government Olympic Executive. He was previously Principal Vice President of Bechtel Ltd, where he had responsibility for the management and delivery of Bechtel's worldwide civil engineering projects infrastructure and aviation business lines.

### Katie Bickerstaffe Non-Executive Director

Katie will join the Board as non-Executive Director in July 2011. She is currently Group People, Marketing and Property Director of DSG international plc, a role she has held since June 2008. Katie was previously Managing Director of Kwik Save, and Group Retail Director and Group HR Director at Somerfield. Her earlier career included roles at Dyson, PepsiCo and Unilever.

## The Management Board

**David Franklin** is Managing Director, Energy Portfolio Management. He joined SSE in 1990 and is responsible for SSE's participation in wholesale markets for electricity and gas and markets for coal, oil and carbon dioxide emissions allowances.

**Rob McDonald** is Managing Director, Regulation and Strategy. He joined SSE in 1997 and is responsible for regulation, energy economics, legal services, new ventures and strategy.

**Jim McPhillimy** is Managing Director, Group Services. He joined SSE in 1995 and is responsible for the Group's corporate services including safety, human resources, IT and procurement.

**Mark Mathieson** is Managing Director, Networks. He joined SSE in 1988 as a graduate trainee and is responsible for SSE's electricity networks, lighting services and telecoms businesses.

**Paul Smith** is Managing Director, Generation. He joined SSE in 1998 and is responsible for all of SSE's operational generation and gas storage businesses, which includes coal, gas, hydro and all operational onshore and offshore wind.

**Alan Young** is Managing Director, Corporate Affairs. He joined SSE in 2001 and is responsible for corporate communications, public affairs, community programmes and research and development.

**John Morea** attends meetings of SSE's Management Board. He has 27 years' industry experience and is the Chief Executive Officer of SGN, which owns and operates gas distribution networks in Scotland and southern England and in which SSE has a 50% stake.

**Ian Marchant, Colin Hood, Gregor Alexander and Alistair Phillips-Davies** are also members of the Management Board.

## The Board of SGN

SSE is entitled to appoint four out of the eight Directors on SGN's Board (reflecting its 50% shareholding in SGN). The SSE employees who serve on the Board of SGN are: **Colin Hood**, Chief Operating Officer; **Gregor Alexander**, Finance Director; **Rob McDonald**, Managing Director, Regulation and Strategy; and **Jim McPhillimy**, Managing Director, Group Services. When Colin Hood steps down from the Board of SGN later this year, he will be replaced by **Natalie Bruce**, SSE's Head of Metering.

## The SSE team

Fundamental to the Company's success is the professionalism and enthusiasm of employees, guided by SSE's Teamwork value, which states: 'We support and value our colleagues and enjoy working together in an open and honest way.'

### The Board of Directors

The Board is accountable to SSE's shareholders for the good conduct of the Company's affairs and is collectively responsible for creating and sustaining shareholder value through the overall management of all of SSE's businesses. Of that a sound system of internal control and risk management is in place. 'How the Board works' is set out on pages 52 to 55.

### The Management Board

The Management Board is the group of Executive Directors and other senior executives which is responsible for implementing strategy and policy as agreed by the Main Board and for the operational management of all of SSE's businesses. Of the 53 senior managers who report directly to members of the Management Board, 11 are women; and of the 45 members of the four Committees of the Management Board, 12 are women.

### Other employees

The Executive Directors and senior executives and managers are among the 20,249 people directly employed by SSE on 31 March 2011. Most of these people work in the United Kingdom; around 500 are employed in the Republic of Ireland; and 18 work in mainland Europe. Of all employees, 73% are men and 27% are women. The average age of SSE's employees is 39 years. In 2010/11, there was a 9.5% turnover of employees, compared with 8.7% in the previous year.

### Participation

SSE believes that there is a commonality of interest between employees and customers and shareholders. To reinforce that it:

- encourages employees to become and remain customers by providing them with a 10% discount on its prices for electricity and gas supply, plus discounts on energy efficiency installations, central heating and wiring maintenance and telephone and broadband services;
- provides opportunities for employees to become and remain shareholders in SSE through a Share Incentive Plan and a Sharesave Scheme. Employee participation in these schemes is now 44% and 35% respectively; and
- provides opportunities for employees to

be involved in its 'Community at Heart' employee volunteering scheme, which aims to give 20,000 days of employee time to assisting worthwhile projects within the communities that SSE serves.

Within SSE, employee participation is encouraged through adherence to the Company's Teamwork value. The appraisal process for employees, including the senior management team, specifically evaluates their performance in Teamwork, along with performance in respect of SSE's other core values: Safety, Service, Efficiency, Sustainability and Excellence. In keeping with these values, SSE produced and distributed in April 2011 an updated code of business practice, 'Doing the right thing'. It highlights, summarises and complements a range of ethics-related policies which SSE has in place. It takes account of recent legislation such as the UK's Bribery Act 2010.

In addition to a wide range of internal communication media and events, employee participation in SSE is also encouraged through the Chief Executive's Blog, inter-active online forums, division- and subject-specific employee surveys, Director-led regional roadshows and the Licence to Innovate scheme, which enables employees to research, review and test-trial new ideas.

### Employee engagement

SSE recognises the value in retaining an engaged workforce and has started to run an annual survey of employee engagement with the Company and what it is trying to achieve. The results of the 2010 survey, which were shared with all employees, showed that SSE has a workforce committed to meeting business needs and that a large number of employees see their longer term future with SSE. As expected, a number of actions arose from the survey, and these are being implemented.

### Joint Negotiating and Consultative Committee

SSE benefits from a well-established Joint Negotiating and Consultative Committee which includes lay and full-time representatives from four recognised trade unions. In April 2011, SSE and the JNCC made a joint announcement stating that both parties have reached, in principle, agreement on a three-year package, featuring pay increases, performance pay, flexible working patterns, job stability, family-friendly working policies and an additional day's holiday. They have also reached agreement on the establishment of Joint Business Committees, complementing the work of the JNCC by focusing on issues that affect particular parts of SSE. Subject to acceptance of the offer, which is the subject of a full ballot

of members, it is expected that salary adjustments will be processed in July 2011 and backdated to April 2011.

Pay arrangements in SSE's Contracting division are in line with national construction agreements.

### Rights

SSE has in place a comprehensive range of policies to safeguard the interests of employees and potential employees. Like all responsible organisations it has in place an actively-managed equal opportunities policy, in keeping with the spirit as well as the letter of the law in the UK and elsewhere, designed to ensure fair and equal treatment of employees and potential employees across the seven protected characteristics, as defined in the Equality Act 2010 – sex, race, religion or belief, disability, pregnancy and maternity, sexual orientation and gender reassignment. The Employment Equality (Age) Regulations 2006 have now been incorporated into the Equality Act 2010. There were no occasions during 2010/11 when SSE was found to have failed to comply with legislation on equality.

### Responsibilities

Along with the rights summarised above, SSE also believes that employees have responsibilities, summarised in eight People Principles, adopted in 2008 and built around its core value of Teamwork:

- Take all active steps to ensure there is no intimidation or discrimination;
- Engage in safe, healthy and environmentally-friendly working practices;
- Always know and understand what is expected of you in your job;
- Maintain respect and support for colleagues at all times;
- Work continuously to improve team and individual performance;
- Obtain constructive feedback on your performance from your line manager;
- Receive appropriate training, development and rewards; and
- Know and embrace the Company's core values.

Through the application of these principles, SSE seeks to maintain a positive organisational culture and to provide a fulfilling place for people to work.

### Training and development

The skills and competencies of employees are critical to the energy sector in the UK, the Republic of Ireland and elsewhere. SSE needs to ensure the safe and efficient operation of its businesses and the reliable provision of services to customers. In addition, SSE needs to develop new skills and

flexibility to manage new technologies. It is, therefore, critical that employees of SSE have the training, development and work experience they need to fulfil their potential. In order to do this, SSE uses a range of delivery media for training.

During 2010/11, SSE invested £1.54m in externally-provided training, taking the total to £6.3m over the last three years. This helped to deliver training to 4,900 employees. In addition, SSE employs almost 100 people in its Training and Development teams and extensive in-house training was given to a large number of employees during the year. SSE has technical and general training centres at Thatcham and Perth. These centres enable people to train in the types of environment in which they will eventually work, providing a realistic experience in a safe, controlled setting.

SSE recognises that the continued success of its business requires the ongoing development of employees, as well as the effective recruitment, retention and development of talented people into its business. As part of this process, SSE has in place a succession planning process that is supported by a detailed set of development options for individuals. In addition, SSE offers a range of structured development programmes suited to the needs of school leavers, trainees, trainee engineers, graduates and apprentices. In 2010/11, 100 people were recruited through these schemes.

### **Innovation, research and development**

The SSE team of people has extensive knowledge, expertise and know-how. New ideas, improvements to process and design and innovation have been key to SSE's successes to date and are fundamental to the Company's ability to adapt to the challenges of the future. The Company's Excellence value states that: 'We strive to get better and smarter and more innovative and be the best in everything we do.'

As a spur to employee participation, idea generation, continuous improvement and operational excellence, SSE maintains and promotes a systematic approach to implementing ideas that add value. This is through the Licence to Innovate scheme, under which any employee can suggest ideas for improving the way SSE operates, consistent with its core values. People with ideas with significant potential are granted a Licence to Innovate, under which they can spend two months researching further their proposal. Subject to the outcome of the research, the idea may then be piloted prior to full implementation.

Over 1,800 Licences to Innovate were issued during 2010/11, of which over 300 were implemented. A number of Licences have created value of around £45m. Others have contributed to improved performance in specific areas, such as safety, service and sustainability. In Generation, for example, a Licence to Innovate resulted in a temporary technical solution being applied to a turbine issue at a hydro electric scheme which allowed a full outage to be deferred until the summer months, allowing the scheme to continue generating electricity during the wetter winter months.

SSE's focus on innovation complements its work in research and development, where new processes, services, products and technologies are created, enabling it to remain a successful company in the future. SSE's corporate research and development function prioritises actionable projects focused on 'the day after tomorrow' which can be delivered by employees, working with external organisations. The projects are focused on two key areas: offshore wind energy; and energy usage. In total, during 2010/11, and working with partners, SSE initiated research and development projects with a value of almost £10m.

SSE also maintains a long-term outlook through the work of its Central Research Unit, which examines in detail issues which could affect SSE and its customers over the next 10, 20 or 40 years. These range from electricity storage to developments in communication methods in energy demand management.

### **Community and charitable activities**

SSE encourages its employees to be active citizens in the communities in which they live and work. In April 2010 it launched its 'Community at Heart' employee volunteering programme. During the year almost 5,000 employees took part in the scheme, providing practical help to 320 separate community and charitable groups.

SSE's focus on safety is reflected in 'Make it Zero', which rewards business units that deliver a full year without any lost-time or reportable injuries with a donation to a charity of the business unit's choice. Through these and other schemes, such as financial support for community programmes near its wind farms, SSE set aside over £5.2m for charitable and community programmes in the UK during 2010/11.

During 2010/11 SSE expects to develop plans for new visitor facilities at some of its major sites, with enhanced educational links to partnership schools.

### **Suppliers and contractors**

SSE depends upon an extended team, of suppliers and contractors, upon whom it relies for the long-term success of its business. It aims to promote responsible practices within its supplier and contractor base. SSE's aims in this area are to:

- ensure safe working by contractors operating on sites for SSE;
- integrate human rights, labour, environmental and ethical considerations into its main procurement processes;
- raise awareness of human rights, labour, environmental and ethical concerns amongst buyers, traders and suppliers;
- understand where human rights, labour, environmental and ethical risks lie in its supply chain; and
- identify specific procurement activities where the risks and/or opportunities merit further investigation and conduct such investigations as required.

SSE provides advice and guidance to suppliers on an individual basis and to potential suppliers via the SSE website. There is an emphasis on encouraging suppliers and those involved in tender processes to propose innovative ways of meeting SSE's needs in a way that minimises environmental impact.

SSE has for several years subscribed to the Verify scheme, which is operated by an independent company, Achilles. It assesses the environmental, health and safety and quality commitment of potential suppliers and contractors. SSE expects existing and potential suppliers and contractors to co-operate fully with the Verify process. The Achilles carbon reduction programme allows suppliers to measure, manage and report their organisational footprint via CEMARS (Certified Emissions Management and Reduction Scheme). By the end of 2010/11, SSE had successfully encouraged seven of its main suppliers to sign up to the scheme. SSE also successfully completed the process itself and again achieved CEMARS certification.

SSE's Director of Procurement is the Chair of the Steering Group of the Achilles Carbon Reduction Programme, indicating SSE's commitment to improving measurement and management of carbon throughout the supply chain. During 2011/12, SSE expects to complete a series of reviews on the approach to corporate responsibility of key suppliers falling within higher risk categories such as personal protective equipment, other workwear, catering and security, especially those which have a high labour intensity. ●

## How the Board works

### The framework of corporate governance

The Board is accountable to the Company's shareholders for the good conduct of the Company's affairs. This report explains how the Company applies the principles of the Combined Code on Corporate Governance (the 2008 Code) issued by the Financial Reporting Council in June 2008.

The Board confirms that the Company has, throughout the period under review, complied with all provisions set out in Section 1 of the 2008 Code.

In May 2010, the Financial Reporting Council issued the UK Corporate Governance Code, which will apply in place of the 2008 Code to accounting periods beginning on or after 29 June 2010. The Board has agreed that each Director shall be subject to annual re-appointment with effect from the 2011 Annual General Meeting (AGM).

### Organisation and structure

#### Role of the Board

The Board is collectively responsible to the Company's shareholders for the long-term success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its business objectives whilst ensuring that a sound system of internal control and risk management is in place.

#### Articles of Association

The powers and duties of the Directors are determined by legislation and by the Company's Articles of Association, which are available on the SSE website. The Articles of Association provide that the Company may change its name by resolution of the Directors. The Directors intend to change the Company name to SSE plc later in the year.

#### Board decisions

A formal list of matters is specifically reserved to the Board for its decision, including:

- Group strategy;
- annual budget;
- approval of interim and final financial statements;
- interim dividend payments and recommendation of final dividends;
- significant changes in accounting policy and practice;
- the Group's corporate governance and system of internal control;
- Board and Committee membership;
- major acquisitions, mergers, disposals and capital expenditure;
- changes in the capital and structure

- of the Group; and
- approval of key policies such as safety, health and environment.

The list is reviewed regularly by the Board and is published on the SSE website.

The Board also has overall responsibility for risk management, which is reported in detail on pages 56 to 59.

#### Roles of Chairman and Chief Executive

The roles of the Chairman and the Chief Executive are separate and clearly defined.

#### The Chairman:

- is responsible for the operation, leadership and governance of the Board ensuring that the Board operates effectively whilst providing appropriate challenge to management;
- identifies individual Director training needs and conducts the performance evaluation; and
- meets with shareholders, analysts and other representatives of institutional investors, and participates in both the interim and annual results presentations and AGM.

The Chairman regularly meets with managers and employees at locations and key sites throughout the Group.

#### The Chief Executive:

- leads the other Executive Directors and the management team in the day-to-day running and operations of the Group;
- implements the strategy and policy as agreed by the Board; and
- represents the Company to external stakeholders, including shareholders, customers, suppliers, regulatory and government authorities, and the community.

In discharging his responsibilities, the Chief Executive is advised and assisted by the Management Board and its Committees which oversee the operational and financial performance of, and issues facing, the Company. The Management Board was set up in January 2011, and its role is explained on page 54.

Biographical information on the Chairman and Chief Executive are set out on page 49.

#### Balance of the Board

The composition of the Board and its Committees is regularly reviewed to ensure that the balance and mix of skills and experience is maintained.

As announced on 9 December 2010, Colin Hood will stand down as an Executive

Director later in the year. On 1 April 2011, Nick Baldwin resigned from his position as non-Executive Director. On 27 April 2011, it was announced that Jeremy Beeton and Katie Bickerstaffe would be joining the Board on 1 July 2011. Full biographical details are set out on page 49.

After all of these changes have taken place, the Board will comprise the Chairman, three Executive Directors and six independent non-Executive Directors. This gives the Board a good balance of independence and experience, ensuring that no one individual or group of individuals has undue influence over the Board's decision-making.

#### Non-Executive Directors

The non-Executive Directors are chosen for their wide range of skills and experience. Each non-Executive Director is appointed for a fixed term of three years. This term may then be renewed by mutual agreement. The non-Executive Directors appointment letters are available on the SSE website.

The non-Executive Directors:

- scrutinise, measure and review the performance of management;
- assist in the development of strategy;
- review the Group financial information;
- ensure systems of internal control and risk management are appropriate and effective;
- through the Audit Committee, review the relationship with the external Auditors; and
- review the remuneration of and succession planning for the Board.

The Chairman and non-Executive Directors met twice during the year without the Executive Directors being present.

#### Senior Independent Director

Lady Rice is the Senior Independent Director. She is available to meet with major shareholders on request and attended the City presentation of SSE's results. She also undertook management visits during the year. Lady Rice carried out the Chairman's performance evaluation, together with the other non-Executive Directors and with input from the Executive Directors.

#### Director independence

The Board considers that the Chairman was independent on appointment and all non-Executive Directors are independent for the purposes of the 2008 Code. The continuing independent and objective judgment of the non-Executive Directors was confirmed in the annual Board performance evaluation process.

The Board evaluation process also confirmed that the performance of the Directors standing for re-appointment continued to be effective and that they continue to demonstrate commitment in their respective roles. Biographical details for all the Directors are set out on page 49.

#### Attendance at Board and Board committee meetings

There is normally full attendance at Board and Committee meetings, although occasionally there may be non-attendance due to unforeseen circumstances or prior commitments which could not be rearranged. If unable to attend a meeting, the Director will provide comments and feedback to either the Chairman, Committee Chairman or Company Secretary who ensures that the comments received are raised at the meeting.

The Board has six scheduled Board meetings during the year. These start with an evening meeting when the Board is often given a presentation by senior management on a particular topic. Occasionally the evening is used for meetings with external stakeholders. The meeting then continues the following day and is often followed by a meeting of one of the Board Committees such as the Remuneration Committee or the Safety, Health and Environment Advisory Committee. In addition to the scheduled meetings the Board has six update conference calls which are held in the months between the bi-monthly scheduled Board meetings. These calls usually last for around one hour and are used to update the Board on the business performance and brief the Board on any current issues. A Board decision or approval may be required at the update conference call if the matter cannot wait until the following scheduled Board meeting. In these circumstances the decision of the Board is recorded by written resolution or minute. The table sets out the attendance of the Directors at the scheduled Board meetings.

#### Attendance at Board meetings

|                          | Board meetings |
|--------------------------|----------------|
| Lord Smith of Kelvin     | 6/6            |
| Gregor Alexander         | 6/6            |
| Thomas Thune Andersen    | 6/6            |
| Nick Baldwin             | 6/6            |
| Richard Gillingwater     | 6/6            |
| Colin Hood               | 6/6            |
| Ian Marchant             | 6/6            |
| René Médori              | 6/6            |
| Alistair Phillips-Davies | 6/6            |
| Lady Rice                | 6/6            |

### Board effectiveness

#### Information and professional development

The Directors receive detailed financial and operational information to allow them to monitor effectively the performance of the business. Board and Committee papers are issued for review in advance of meetings. At each Board meeting, the Chief Executive presents an update report on all aspects of the Group's business and the Finance Director presents a report on financial performance. The Board also receives regular updates on the progress and performance of investments and other decisions made by it.

During the year, the Board and Committees were kept up to date with developments through a programme where briefings are given by Executive Directors and senior management on their business areas. Additional specialist briefings and presentations were given on areas such as corporate governance, regulation, public affairs, health and safety, major projects, and the Company's major business activities generally. Separate more informal meetings were also held with senior management.

Meetings, briefings and site visits were arranged for the non-Executive Directors during the year. The briefings covered subjects such as operational activities and major projects, and the visits included wind farms and other major projects sites.

On joining the Board, Directors receive a comprehensive induction course tailored to their individual requirements which includes meetings with the Executive Directors and senior management, visits to key sites, and meetings with key stakeholders. It also covers a review of the Group's governance, policies, structure and business including details of the risks and operational issues facing SSE.

The Board believes that given the experience and skills of the Directors and the briefings and induction process referred to above, any further personal training needs can be left to the discretion of the individual. The Company makes the necessary resources available should any Director request training.

There is an agreed procedure for Directors to be able to take independent professional advice, if necessary, at the Company's expense. The prior approval of the Chairman is required where the cost of such advice is likely to exceed £10,000. Any advice obtained shall be made available to the other members of the Board, if the Board so requests. This procedure was not required to be used during the year.

All Directors have access to the advice and services of the Company Secretary.

The Company continues to operate advanced performance coaching for some of the Executive Directors and for other members of senior management which is designed to develop and enhance individual and Company performance.

#### Executive Directors' other directorships

Executive Directors may be invited to become non-Executive Directors of other companies. Approval may be given to accept such invitations recognising the benefit to the individual and to the Company. Any such appointments are included in the biographical information set out on page 49.

#### Conflicts of interest

During the year a review of the Directors' interests and appointments was carried out by the Company Secretary. The Board considered and authorised each Director's reported actual or potential conflicts of interest at the Board meeting in January 2011. In accordance with the Company's Articles of Association and relevant legislation, each Director abstained from approval of their own position. The Board continues to monitor and review potential conflicts of interest on a regular basis.

#### Performance evaluation

The Board, its Committees and the individual Directors participate in an annual evaluation of performance.

The Board evaluation process this year was carried out by internal questionnaire and individual meetings. This followed and built on the approach taken in the previous evaluation programme which last year was carried out by an external party and which was fully explained in the 2010 Annual Report. The Board was updated regularly during the year on progress with the recommendations made in the external report. This year the outcome of the questionnaire and meetings was reported at the Board meeting held in January 2011. The matters considered at the Board meeting included the process for risk oversight, succession planning arrangements throughout the Group, and the key performance indicators which are reported to the Board.

The Directors also participated in detailed reviews of individual performance which were carried out in separate meetings with the Chairman. The process for evaluating the Chairman was managed by the Senior Independent Director which involved a separate meeting with the non-Executive Directors and included feedback from the

## How the Board works (continued)

Executive Directors. The review concluded that the Board and the Committees were operating effectively. Each of the Directors continued to make an effective contribution to the work of the Board and its Committees, was well informed and demonstrated full commitment to their duties. The Board was satisfied that the performance evaluation process identified the main areas for further review and the external evaluation process will be repeated every three years as recommended by the UK Corporate Governance Code.

### Board committees

During the year, there were five principal Board committees. The terms of reference of these committees are set by the Board, are reviewed regularly, and are available on the SSE website. Membership is determined by the Board, on the recommendation of the Nomination Committee and in consultation with each committee chairman. Minutes of Board committee meetings (apart from the Remuneration Committee minutes) are included on the agenda, and reported at, the next Board meeting.

Details of each Board Committee, including membership, meetings, role and activities in 2010/11, are set out in the committee reports on pages 60 to 74.

### Management Board

Following a review of the management structure within SSE, a Management Board was set up in January 2011. The Management Board is responsible for implementing policy and strategy set by the Board and for the operational management of all SSE's businesses. The Risk and

Trading Committee now reports to the Management Board. The Management Board comprises the four Executive Directors and six Senior Executives representing the key areas of the business. The Chief Executive Officer of Scotia Gas Networks attends meetings of the Management Board. The Management Board meets monthly and the minutes of the meeting are distributed to the Directors for information. The Company Secretary is Secretary of the Management Board.

The relationship between the Board, its Committees and the management of the Company is summarised as shown in the table below.

### Engagement with shareholders and major stakeholders

#### Disclosure and Governance Committee

The Company's Disclosure and Governance Committee is responsible for overseeing the Company's framework for the identification, release and control of announcements and other information of interest to shareholders and the investment community. The Committee assists in developing the investor relations strategy and reviews and implements governance developments. The Disclosure and Governance Committee comprises the Chief Executive, Finance Director, Company Secretary, Managing Director Corporate Affairs, Head of Investor Relations and the Assistant Company Secretary. The Disclosure and Governance Committee meets when required and had seven meetings in the year.

#### Relations with shareholders

The Company continued to develop an effective dialogue with all shareholders,

based on a mutual understanding of objectives. The Board believes that this is fundamental to ensuring that the Company's strategy is understood and that any questions or issues are dealt with in a constructive way.

The Company maintains regular contact with institutional shareholders, fund managers and analysts through a programme of dialogue, meetings, presentations, events and site visits led by the Chief Executive and Finance Director. The Head of Investor Relations has day-to-day responsibility for communications with institutional shareholders. Brokers' reports and analysts' briefings are regularly distributed to Directors. The Board receives regular reports on the various issues raised by institutional shareholders, fund managers and analysts which allow Directors to form a view of the priorities and concerns of the Company's stakeholders. As part of the induction programme for Directors, arrangements are made for analysts to meet with newly appointed Directors.

The Chairman attended the Company's interim and preliminary results presentations in May 2010 and November 2010. The Chairman meets major institutional shareholders from time-to-time to gain a first-hand understanding of key issues.

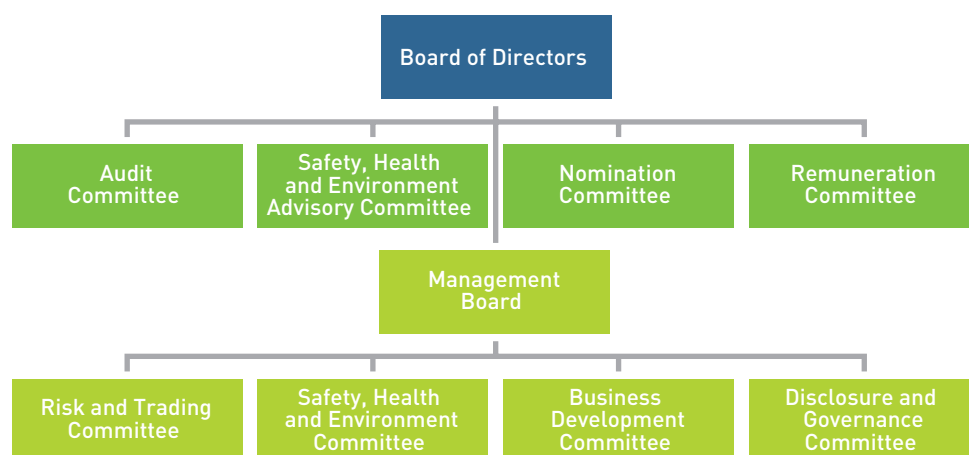
Lady Rice, the Senior Independent Director, is available to shareholders if they have concerns that contact through the normal channels has either failed to resolve or is deemed inappropriate. She attended the interim results presentation in November 2010.

SSE's website contains up-to-date information for shareholders and other interested parties including share price information, announcements and news releases, investor and analyst presentations, and a section containing information on shareholder services. The Company's Annual Report and other shareholder circulars are also published on the SSE website.

### Communications with shareholders

Shareholders have a choice of how to receive their Company communications such as the Annual Report. The Company recognises the benefit of electronic communications and encourages shareholders to receive electronic communication. As recognition of the reduced cost and environmental impact of this form of communication, the Company, on behalf of shareholders, makes a donation to the World Wildlife Fund's International Forest Programme for every shareholder that elects for email communication or receives Company documentation via the SSE website.

### Governance structure (from 1 April 2011)



The Company's objective is to ensure that it is able to perform its core purpose of providing the energy people need in a reliable and sustainable way. Its principal public policy goal at present is to ensure that there is in place a framework to enable it to invest in secure and lower-carbon supplies of energy in the UK and Ireland.

#### Annual General Meeting

The Company's AGM will be held at the Perth Concert Hall, Mill Street, Perth PH1 5HZ on Thursday, 21 July 2011 at 12 noon. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting.

The AGM provides an opportunity for the Board to communicate with shareholders and provide an update on the performance and plans of the Company. All Directors attend the AGM and shareholders are invited to ask questions and to meet with the Directors and senior managers both before and after the meeting.

#### Communications with other stakeholders

The Directors have a programme of events to meet with a range of external stakeholders representing the public sector, investment community, environmental affairs, and consumer interests. The purpose of these events is to discuss the Company's position on a range of business, policy and public interest issues and to learn more about their views, hear their suggestions and address any areas of concern.

More generally, working with public policy makers is a vital area for the Company, given the high profile of energy and environment-related issues in the UK and elsewhere. The Company engages with stakeholders in seven main ways:

- constructive engagement with Ofgem, which is responsible for promoting competition, wherever appropriate, and regulating the monopoly companies which run the gas and electricity networks;

- ongoing dialogue with Ministers and officials in government, including the devolved administrations in the UK;
- submissions to government and Parliamentary consultations and inquiries;
- meetings with, and briefings of, elected members of all parties in legislatures;
- engagement with local authority elected members and officials;
- active participation in relevant trade associations and bodies; and
- discussions and work with non-governmental organisations and other relevant organisations such as charities.

The Company's objective is to ensure that it is able to perform its core purpose of providing the energy people need in a reliable and sustainable way. Its principal public policy goal at present is to ensure that there is in place a framework to enable it to invest in secure and lower-carbon supplies of energy in the UK and Ireland. ●

# Risk management

## Risk management model



## Risk management

The Board of SSE acknowledges its clear responsibility for risk management.

Whilst good risk governance is a responsible approach, the more fundamental methodology followed by SSE is to ensure the overall business model, strategy, and culture are designed with risk firmly in mind.

### Clear and balanced business strategy

SSE has a clear strategic financial goal: to deliver sustained real growth in the dividend payable to shareholders. To attain that goal, it does not need to seek artificially high rates of growth in profitability or take operational or investment decisions which are high risk. The Board believes that this dividend goal must not be subverted for any other financial end.

SSE's view is that a sustainable business requires a clear approach to risk management in all aspects of its activities.

SSE seeks to achieve its strategic financial goal through the implementation of a well-established strategy: the efficient operation of, and investment in, a balanced range of economically-regulated and market-based energy businesses.

These businesses operate almost entirely in the UK and Ireland. This means SSE is able to focus closely on issues, giving greater experience, analysis and focus to the identification, consideration and management of risks.

The practical application of its strategy means SSE derives income and profit from:

- three separate economically-regulated activities – electricity transmission,

electricity distribution and gas distribution;

- electricity generation, using a diverse variety of fuels – gas, oil, coal, biomass, wind and water;
- energy supply – gas and electricity, plus other home services; and
- other energy-related activities such as gas storage, gas production, contracting, utility solutions, metering and telecoms.

This means that while they have a common core – energy – there is balance and diversity in the sources of SSE's income and profit.

### Culture

Central to SSE's approach to risk management is its core value of Teamwork, defined as supporting and valuing colleagues and working together in an open and honest way. This facilitates a full discussion of the risks and potential rewards associated with any major decision – discussion which involves people because of what they know, not simply who they are.

### Limited appetite for risk

The Teamwork value, combined with other factors such as the clear, moderate (but nevertheless fundamentally important) goal of sustained real growth in the dividend, mean SSE has adopted a limited appetite for risk. At the same time, its approach in respect of economically-regulated businesses, which in themselves are lower-risk, is more risk-averse than is the case in other, market-based activities. In these areas, such as electricity generation, SSE might consider taking on additional risk where the risk is very well-understood and can be mitigated and the potential returns are clearly attractive (but also credible).

Some examples of the risk averse approach are:

- energy trading – levels of exposure are strictly monitored through sophisticated models and clear reporting limits;
- major project construction – the Company has put in place a detailed governance process for all its large capital projects;
- the Company has a strict approach to acquisitions, and sets high hurdle rates for expected returns;
- in treasury and funding matters, there is a clear and prudent approach to liquidity levels, and a mix of maturities and currencies; and
- insurances are in place for all relevant major internal risks, while maintaining an appropriate balance with self insurance where appropriate.

### Limited value at risk

The limited appetite for risk and the process of risk identification, allied to the maintenance of a balanced model, in which diversity of operations and investments is a key feature, all mean that the extent of any single risk and the value associated with it is limited.

### Risk monitoring

Risks are monitored by the relevant business units within SSE, with an overview provided by the Group Audit Department for the Audit Committee meetings held in May and November of each year. The Board reviewed all aspects of risk management and internal control at its meeting in March 2011. At that meeting, the Board held a specific review of the developments within the Company during the year to ensure good risk management; it revisited the approach to risk appetite; and considered the management structure to ensure proper controls are in place. It was also agreed that this strategic review of risk should be held twice each year in future.

Following the March 2011 meeting, the Board undertook a further review of the Company's principal risks and approved the list set out opposite at its May 2011 meeting.

During 2010/11, the Group Audit department carried out over 60 separate audits of functions, activities and issues managed by SSE, providing a large number of reports to senior management throughout the year. These include environmental audits carried out by SSE's Group Environmental Auditor. Each audit report included agreed management actions to improve the overall management of risk. Group Audit reviews complement the work done by business-specific compliance functions in areas such as Energy Trading, Energy Efficiency, Domestic Sales, IT and Customer Service.

## Principal risks

| Risk                                      | How risk is managed                                                                                                                                                                                                                                                                                                                            |
|-------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Safety management</b>                  | The Safety, Health and Environment Advisory Committee of the Board is responsible for ensuring SSE's health and safety policy is adhered to. The newly-established Management Board also has a Safety Committee.                                                                                                                               |
| <b>Regulatory change</b>                  | An experienced Regulation Department manages SSE's relationships and interface with Ofgem, Ofwat, Ofcom and energy regulators in other jurisdictions.                                                                                                                                                                                          |
| <b>Legislative change</b>                 | An experienced Policy and Public Affairs team manages SSE's relationships and interface with government ministers and officials, legislators and other policy-makers.                                                                                                                                                                          |
| <b>Energy portfolio management</b>        | The Board approves levels of exposure which are strictly monitored through sophisticated models and clear reporting limits. The Management Board has a Risk and Trading Committee.                                                                                                                                                             |
| <b>Asset and plant management</b>         | A Central Engineering Team is well-established. Asset life assessment and risk-based management are applied. Regular testing, review and update of major incident handling processes takes place. Capital spending and maintenance regimes are maintained. The Risk and Trading Committee provides oversight.                                  |
| <b>Networks management</b>                | Significant upgrade and refurbishment programmes are designed to prevent network failures. Business continuity plans, supported by contingency sites and regular testing, are established throughout the Company. Clearly prepared and rehearsed approaches are in place for external relations aspects of emergency incidents and situations. |
| <b>Information security</b>               | The Company has in place an Information Protection Programme which covers all of its operations. Resilient systems and data centres are in place and there is regular testing.                                                                                                                                                                 |
| <b>Supply chain failure</b>               | The diverse business model avoids over reliance on specific supply chains. The Sustainability value ensures a long-term view is taken. Well established procurement and fuel procurement teams ensure varying supply chains are identified and counterparty exposures monitored.                                                               |
| <b>Treasury management</b>                | The Risk and Trading Committee is required to approve any major changes to treasury policy or objectives. Periodic reporting of treasury activity to Audit Committee also takes place. Strong internal controls are maintained and independent reviews take place.                                                                             |
| <b>Credit management</b>                  | There is Executive Director level representation at debt steering group meetings. Ongoing credit monitoring and reporting are supported by credit management teams throughout the Company.                                                                                                                                                     |
| <b>Pension liabilities</b>                | There are periodic formal valuations of pension schemes and contributions supported by continual monitoring of scheme investments and valuations. Performance of investment managers is reviewed regularly by pension boards of trustees.                                                                                                      |
| <b>Sector developments</b>                | There is a strong external focus to ensure developments are anticipated, including Strategy, Business Development and SSE Ventures. A foresighting capability is maintained through a Policy and Research team which includes Research and Development.                                                                                        |
| <b>Major capital projects management</b>  | Development and implementation of SSE's Large Capital Project Governance Framework is designed to ensure projects are governed, developed, approved and executed in an effective manner. The Framework itself is regularly reviewed and updated.                                                                                               |
| <b>Transformation projects management</b> | The Company works with experienced advisers and suppliers and implements a strong governance and assurance framework for all aspects of major change programmes.                                                                                                                                                                               |
| <b>Compliance management</b>              | Wide-ranging consultation and review of all relevant regulatory, legal and accounting frameworks take place. Regulation, Compliance and Group Audit teams develop and monitor compliance processes.                                                                                                                                            |
| <b>Crisis management</b>                  | Corporate crisis policy and procedure issued and updated annually. There is Executive training and regular test exercises are undertaken.                                                                                                                                                                                                      |
| <b>Succession planning</b>                | The Nomination Committee of the Board is responsible for reviewing the leadership needs of senior management and succession plans for the Executive Directors.                                                                                                                                                                                 |
| <b>Resource management</b>                | Integrated Group Services function to ensure optimum resource management, including Finance, HR, IT and Facilities Management and Property Maintenance, deployment and development of resources is in response to business needs.                                                                                                              |
| <b>Developing corporate arrogance</b>     | Board oversight and practical application, including through the performance appraisal process, of the 'SSE SET' of core values: Safety, Service, Efficiency, Sustainability, Excellence and Teamwork.                                                                                                                                         |

## Risk management (continued)

Risk is also the subject of specific regular reports to the Management Board, which was established in January 2011 (see page 54 for more information on the Management Board).

### Risk management

In summary, SSE's approach to risk management is characterised by: the clarity of its financial goal; its strategy and business model, which help to limit the value at risk; its culture and limited appetite for risk; and its work on risk identification and risk management.

### Clear and transparent decision-making

Such an approach to risk management still requires one essential feature: clear and transparent decision-making to make the overall approach effective, in support of its clear financial goal.

### Risk categories

As stated on page 56, the Board reviewed SSE's principal risk categories and the effectiveness of SSE's system of internal controls between March and May 2011. The risks are set out on the previous page.

There are three additional risks that are not specified but which could potentially affect a large number of areas of activity: geopolitical developments; the weather; and reputation.

- geopolitical developments could have an impact on a number of SSE's activities, such as energy portfolio management or the construction of large capital projects through supply chain impacts. In view of this, SSE's balanced and diverse business model, which is designed amongst other things to avoid dependence on any single technology or fuel, is a key means of seeking to ensure the impact of developments over which SSE can

**SSE's approach to risk management is characterised by: the clarity of its financial goal; its strategy and business model, which help to limit the value at risk; its culture and limited appetite for risk; and its work on risk identification and risk management.**

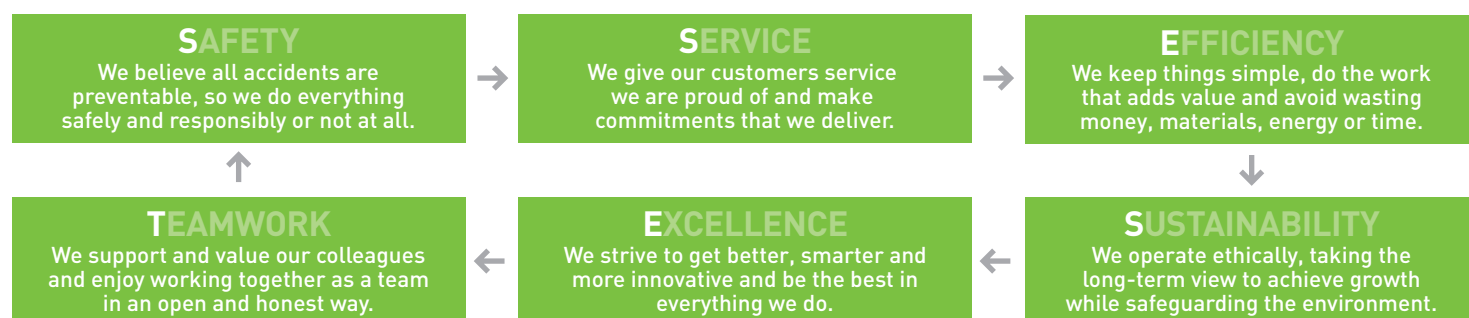
- have no control is, in practice, limited; the weather could have an impact on the production and consumption of energy in the Generation and Supply business. The extent of this risk is contained by the diversity within SSE's generation portfolio, the further diversity within its renewable energy portfolio, and the integrated nature of its generation and energy supply activities. It could also have an impact on the operation of energy networks, and management of this risk is factored into the operational planning of these networks; and
- SSE believes that the most effective way to manage risks to its reputation is to manage effectively the risks set out on page 57. Corporate reputation is very important for a long-term business such as SSE, but seeking to manage 'reputation', rather than the substance of the issues which determine a company's reputation, could lead to short-term behaviours or actions which have negative long-term implications. For this reason, SSE does not specify 'reputation' as a risk to be managed.

No list of risks can ever be totally comprehensive. Circumstances change and the unexpected happens so the extent and materiality of any risk can vary. Nevertheless, in its ongoing review of risk, SSE is confident that its assessment of the principal risk categories is correct and that its analysis of individual risks is soundly-based.

### Internal control

Risk management depends on a strong system of internal control, which is fundamental to achieving SSE's strategic objectives. The Board is responsible for the overall system of internal control and risk management, and it either directly, or through its committees, sets performance targets and policies for the management of key risks facing SSE. The system of internal control is designed to manage, rather than eliminate, risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

### SSE SET of values to manage risk



All employees are expected to adhere to the Company's code of business practice and the SSE values of – Safety, Service, Efficiency, Sustainability, Excellence and Teamwork – which are embedded in the culture. [See page 58 for full definitions]. Their consistent application are central to all activities in SSE. The Teamwork value, the emphasis on people's knowledge rather than status, and the maintenance of a very experienced team, complemented by the recruitment of additional specialist skills where necessary, are all designed to ensure that the risks associated with operations are fully understood. Reporting within the Company is structured so that the key issues are escalated through the management team, ultimately to the Board if appropriate.

The key elements of SSE's internal control and financial reporting processes are summarised below:

#### The Board:

- approves the policies, procedures and framework for the maintenance of a sound and effective system of internal control ensuring:
  - the provision of quality internal reporting to the Audit Committee and other Board Committees by management and Group Audit;
  - the provision of quality reporting by the external Auditors to the Audit Committee;
  - compliance with the Turnbull Guidance on Internal Control; and
  - compliance with statutory and regulatory obligations;
- reviews the significant risks identified by each business unit as well as the mitigating action against those risks following review by the Audit Committee;
- determines the nature and extent of the significant risks it is willing to take in achieving its strategic objectives;
- approves and regularly reviews and updates SSE's strategy and business development;
- reviews performance through a system of reporting based on annual operating and capital expenditure budgets; monthly reviews against actual results; analysis of variances and evaluation of key performance indicators;
- receives regular reports from the Chief Executive, the Finance Director and the other Executive Directors; and
- undertakes an annual evaluation of the Board, its Committees and individual Directors.

#### The Management Board:

- monitors operational and financial performance of SSE;
- develops and implements SSE strategy,

### Internal control process



- operational plans, policies, procedures and budgets;
- assesses and controls all SSE risks;
- monitors competitive forces in each area of operation;
- receives and reviews reports from its four committees including the Risk and Trading Committee and the Safety, Health, and Environment Committee; and
- receives and reviews regular presentations and reports from all the main Group businesses.

#### The Group Audit department:

- works with the business units to develop and improve risk-management tools and processes in their business operations;
- ensures that business risks are identified, managed and regularly reviewed and that the key risks are reported to the Audit Committee and Board;
- ensures that the business units carry out regular reviews on their internal controls relating to the key risks;
- monitors the effectiveness of SSE's system of internal control through the distribution of reports and, where appropriate, action plans to senior managers, Directors, the Audit Committee and external Auditors;
- monitors adherence to SSE's key policies and principles; and
- provides the Audit Committee and Board with objective assurance on SSE's control environment.

#### Role of committees

The role of the Audit Committee, Risk and Trading Committee and Safety, Health and Environment Advisory Committee in the Group's system of internal control and risk management is set out in the individual committee reports.

Reviewing the system of internal control and monitoring its effectiveness is delegated to the Audit Committee and is reviewed at least annually by the Board. The Board and the Audit Committee have reviewed the effectiveness of the internal control system in accordance with the Code for the period from 1 April 2010 to 19 May 2011 (being the last practical day prior to the printing of this Annual Report). The Board confirms that appropriate action would have been taken to address any significant failings or weaknesses identified; however, no intervention has been required. ●

## Audit Committee



**René Médori**  
Audit Committee Chairman

### Members and meetings

| Membership                          | Attendance<br>at meetings |
|-------------------------------------|---------------------------|
| René Médori<br>(Committee Chairman) | 3/3                       |
| Thomas Thune Andersen               | 3/3                       |
| Nick Baldwin                        | 3/3                       |
| Richard Gillingwater                | 3/3                       |

The Board has determined that each member of the Committee is independent and that the membership meets the requirements of the 2008 Code. René Médori is identified as having recent and relevant financial experience through his position as Finance Director of a major international listed company.

The Finance Director, Generation and Supply Director, Head of Group Internal Audit and the external Auditors normally attend and report at Audit Committee meetings. The Company Chairman also regularly attends Audit Committee meetings. Senior management including the Group Treasurer, Group Financial Controller, Managing Director, Energy Portfolio Management, Managing Director, Corporate Affairs and Director of Portfolio Support may also be invited to present reports. During the year, the Committee met privately with the external Auditors, and separately with the Head of Group Internal Audit.

The Company Secretary was Secretary to the Audit Committee during the year.

The Committee has unrestricted access to Company documents and information as well as to management and the external Auditors. The Audit Committee Chairman reports the outcome of Committee meetings to the Board.

### Role

The Audit Committee assists the Board in the effective discharge of its responsibilities for financial reporting and internal control, together with the procedures for the identification, assessment and reporting of risks. The Audit Committee's remit, which is set out in its terms of reference, includes responsibility for:

- ensuring that the Company's financial reports and formal announcements represent an accurate, clear and balanced assessment of the Company's position and prospects;
- monitoring and reviewing the effectiveness of the Company's accounting systems, internal control policies and procedures and risk management systems;
- monitoring and reviewing the

effectiveness of the Company's internal audit function;

- monitoring and reviewing the objectivity and independence of the external Auditors taking into consideration the scope of their work and fees paid for both audit and non-audit services;
- monitoring and reviewing the significant risks identified by each business unit as well as the mitigating action against those risks;
- monitoring and reviewing the arrangements by which employees can in confidence raise concerns about any possible improprieties in financial and other matters; and
- reviewing the significant financial reporting issues and judgments.

### Activities in 2010/11

The Audit Committee had three meetings in the year. The key activities of the Audit Committee during the year are set out below:

### Financial statements

- reviewed the financial statements in the 2010 report and accounts and the interim results. As part of this review the Committee received from the external Auditors a report on their audit of the annual report and accounts and their review of the interim results; and
- reviewed the annual and interim results announcements.

### Control environment and risk management

- received six-monthly reports by Group Internal Audit setting out the audit programme, its progress against the programme, the results of key audits and other significant findings, the adequacy of management's response and the timeliness of resolution of actions;
- reviewed and agreed the Group Internal Audit Plan for the year ending 31 March 2012;
- received six-monthly reports from energy trading and treasury setting out strategy, market developments, any significant risks and the controls in place to mitigate these risks;
- received six-monthly reviews from Group Internal Audit on the Internal Control Risk Assessment setting out the Group Risk Map and Residual Risk Map;
- reviewed Post-Investment Appraisal Reports; and
- received reports under the Group whistleblowing policy and reviewed the implementation of this policy.

### External audit process

- reviewed the effectiveness of the overall audit process for 2010/11, meeting with the Auditors and management separately to identify any areas of

concern in the preparation of the financial statements;

- reviewed independence and objectivity and agreed the terms of appointment, areas of responsibility, associated duties and scope of the audit as set out in the engagement letter for the forthcoming year;
- reviewed and agreed the audit fees, fees for non-recurring work and the regulatory reporting fee;
- reviewed internal control and key accounting and audit issues; and
- reviewed recommendations made by the Auditors and the adequacy of management's response.

#### Independence of Auditors

- reviewed changes in the Audit team; and
- reviewed the extent of non-audit services provided by the Auditors in accordance with the established policy where:
  - a competitive tender process is required where non-audit fees exceed a threshold of £30,000 for general advice and £75,000 for tax-related advice;
  - the Committee must be satisfied that the work was best handled by the Auditors because of their knowledge of the Group; and
  - the Committee must be satisfied that the objectivity and independence of the Auditors was not affected by the work.

The Audit Committee continued to monitor the level of non-audit work undertaken by the Auditors.

The non-audit work awarded during the year included:

- taxation advice including general consultancy, acquisitions and disposals;
- accounting due diligence; and
- regulatory accounts.

Full disclosure of the audit and non-audit fees paid during the year is made in note 4 to the Financial Statements.

KPMG Audit Plc has been the external auditor of the enlarged Group since 1999. Under its terms of reference, the Audit Committee has responsibility for recommending to the Board the appointment, re-appointment and removal of the external Auditors. The Audit Committee considers that the relationship with the Auditors is working well and remains satisfied with their effectiveness. There are no contractual obligations restricting the Company's choice of external auditor. The external Auditors are required to rotate the audit partners responsible for the Group audit every five years and the current lead partner has been in place for two years.

Upon the recommendation of the Audit Committee and approval of the Board, resolutions to re-appoint KPMG Audit Plc as Auditors, and to authorise the Directors to fix their remuneration, will be proposed at the forthcoming AGM.

**René Médori**  
 Chairman

## Risk and Trading Committee



**Alistair Phillips-Davies**  
Risk and Trading Committee Chairman

### Members and meetings

| Membership                                       | Attendance at meetings |
|--------------------------------------------------|------------------------|
| Alistair Phillips-Davies<br>(Committee Chairman) | 13/13                  |
| Gregor Alexander                                 | 13/13                  |
| Ian Marchant                                     | 12/13                  |

The membership also includes:

- the Managing Director, Energy Portfolio Management;
- the Managing Director, Generation;
- the Managing Director, Regulation and Strategy; and
- other senior managers from energy trading, electricity generation, major projects, finance and treasury.

The Assistant Company Secretary is Secretary to the Risk and Trading Committee.

During the year, two non-Executive Directors – Thomas Andersen and Richard Gillingwater – attended a meeting of the Committee.

### Role

The Risk and Trading Committee's role is to support the Company's risk management responsibilities by reviewing the strategic, market, credit, operational and liquidity risks and exposures arising from the Company's energy trading, generation and treasury operations. The Committee provides direction on strategies to mitigate these risks in accordance with financial objectives, risk appetite and control requirements set by the Board.

In addition to reviewing the wider business and economic environment in which SSE operates, the main responsibilities of the Committee include:

- reviewing current and potential future risks associated with the operation of SSE's physical power generation, and gas production and gas storage assets;

- assessing conditions in the main wholesale commodity markets in which SSE operates, and providing guidance on trading strategies that reflect market conditions, financial exposures and business objectives;
- considering reports on financial risk exposures that have arisen as a consequence of changing demand patterns, plant performance and commodity prices;
- reviewing reports on counterparty credit exposures, and approving mitigating actions where necessary;
- considering reports on wholesale trading activities and any breaches of internal limits, controls or policies that may have occurred;
- within its delegated authorities, considering requests for approval of changes to individual trading limits, counterparty credit limits and commodity exposure limits;
- considering requests to adopt new trading products or concepts that are proposed to mitigate existing and potential financial or operational risks; and
- reviewing Group funding, foreign exchange and interest rate exposure together with other key financial risks.

The Committee maintains a close relationship with the Company's Audit Committee, its external Auditors and Executive Directors.

### Activities in 2010/11

The Risk and Trading Committee met 13 times during the year. At each meeting updates were provided by Committee members and other senior staff on the status of: power generation; gas production and gas storage; major projects; wholesale market conditions; commodity exposures; energy trading strategies; counterparty credit exposures; and key corporate funding issues including interest rate movements and foreign exchange exposures.

Other activities of the Committee during the year included:

- considering a number of proposals to adopt new trading products or strategies to hedge financial or operational risks;
- approving commercial contracts within its delegated authority levels;
- reviewing retail tariff setting options in the context of forecast wholesale energy prices, customer demand patterns and competitor activity;
- considering new business strategies, especially those which may signify a move away from the Company's traditional markets and areas of operation;

- reviewing proposals to update governance, control arrangements and insurance in line with business strategy and risk appetite; and
- updating the Committee's Terms of Reference and recommending to the Board their approval and adoption.

### Review

The Risk and Trading Committee was included in the Board evaluation process. With effect from 1 April 2011, the Risk and Trading Committee reports through the Management Board. The minutes of the meeting continue to be issued to the full Board as soon as available after the meeting.

**Alistair Phillips-Davies**  
Chairman

# Nomination Committee

Overview  
 Strategy  
 Group performance  
 Segmental performance  
**Corporate governance**  
 Financial statements  
 Shareholder information



**Lord Smith of Kelvin**  
 Nomination Committee Chairman

## Members and meetings

| Membership                                             | Attendance<br>at meetings |
|--------------------------------------------------------|---------------------------|
| Lord Smith of Kelvin<br>(Committee and Board Chairman) | 2/2                       |
| Thomas Thune Andersen                                  | 2/2                       |
| Nick Baldwin                                           | 2/2                       |
| Richard Gillingwater                                   | 2/2                       |
| René Médori                                            | 1/2                       |
| Lady Rice                                              | 2/2                       |
| Ian Marchant                                           | 2/2                       |

The Committee is chaired by the Company Chairman and its membership comprises of all the non-Executive Directors and the Chief Executive.

The Company Chairman would not chair the meeting if it was dealing with any matter concerning the chairmanship of the Board. In this case the meeting would be chaired by a non-Executive Director elected by the remaining members. Members of the Committee do not take part in discussions when their own performance or when their continued appointment is being considered.

The Company Secretary is Secretary to the Nomination Committee.

## Role

The Nomination Committee's role is to review the leadership needs of the Board and senior management, with a view to ensuring SSE's continued ability to compete effectively in the marketplace. The Nomination Committee's remit, which is set out in its terms of reference, includes responsibility for:

- reviewing the structure, size and composition of the Board and its committees and making recommendations to the Board on any desired changes;
- reviewing the succession plans for the Executive Directors;
- making recommendations to the Board on suitable candidates to fill vacancies for non-Executive Directors and Executive Directors;
- ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit and against objective criteria for purpose; and
- reviewing potential conflicts of interest of Directors.

Before an appointment is made the Committee evaluates the skills, knowledge and experience of the Board to ensure that any new appointment complements these qualities. Candidates from a wide range of backgrounds are considered and the

selection process will generally involve interviews with a number of candidates, using the services of a professional search firm specialising in Board level recruitment.

The Committee also reviews succession planning and leadership needs in the course of its work taking into account the risks and opportunities facing the Company, and from this identifies the skills and expertise required from the Board and senior management team.

## Activities in 2010/11

The Nomination Committee had two meetings during the year. The Committee assessed the roles required for future non-Executive Director positions, and appointed an external search firm, which was used to identify suitable candidates for the two non-Executive Director roles announced on 27 April 2011 and referred to on page 49. The Nomination Committee also reviewed Board Committee membership, and the Directors' conflicts of interest.

**Lord Smith of Kelvin**  
 Chairman

## Safety, Health and Environment Advisory Committee



**Colin Hood**  
Safety, Health and Environment  
Advisory Committee Chairman

### Members and meetings

| Membership                      | Attendance<br>at meetings |
|---------------------------------|---------------------------|
| Colin Hood (Committee Chairman) | 3/3                       |
| Thomas Thune Andersen           | 3/3                       |

The membership also comprises certain senior executives, namely:

- the Managing Director, Group Services;
- the Managing Director, Generation; and
- the Group Safety, Health and Environment Manager.

The Chief Executive also attends when required. The Assistant Company Secretary is Secretary to the Committee.

The Safety, Health and Environment Advisory Committee has three main responsibilities. They are to:

- ensure that SSE's health and safety policy and environment policy statements are adhered to;
- set safety, health and environmental targets for improved performance; and
- monitor safety, health and environmental performance in SSE.

In exercising these responsibilities, the Committee focuses on SSE's Safety and Sustainability values:

- we believe all accidents are preventable, so we do everything safely and responsibly, or not at all; and
- we operate ethically, taking the long-term view to achieve growth while safeguarding the environment.

### Policy

People in SSE have many different working environments – from full-scale industrial processes to offices. One thing is the same, however: everyone's role in achieving safe working conditions. SSE's Safety Management System focuses on five 'Ps':

- Policy: defining how things get done;
- People: helping employees to act safely;
- Processes: managing risks and delivering safe systems of work;
- Plant: maintaining the integrity of plant and equipment; and
- Performance: managing and improving SHE performance.

### Safety performance

By SSE's standards, safety performance during 2010/11 was mixed, with progress in some areas being offset by setbacks in others (previous year's performance in brackets):

- the Lost Time/Reportable Injury Rate was 0.04 (0.03);
- the Total Recordable Injury Rate (TRIR), covering lost-time, reportable and medical treatment injuries, was 0.12 per 100,000 hours worked (0.14);
- the total number of working days lost as a result of injuries occurring in 2010/11 was 171 (73); and
- the number of dangerous or potentially dangerous road traffic accidents involving SSE employees driving Company vehicles was 0.31 per 100 vehicles (0.34).

By many other standards, however, this was a good safety performance. For example, the number of working days lost was the second lowest in the last six years. SSE's goal, however, is injury-free working and until that is achieved and maintained the Company will not be satisfied.

### Contractors' safety performance

The safety of contractors working on SSE projects and sites is fundamentally the responsibility of their employers, but SSE works closely with its contractors in increasing their safety standards. For this group, the TRIR was 0.12 per 100,000 hours worked, compared with 0.31 in the previous year.

This was, however, overshadowed by the loss of the lives of two employees of contractors to SSE. Loss of life in such circumstances has a devastating effect on families, friends and colleagues and is the starkest possible reminder of why safety is, and must be, the top priority for SSE and its contractors. Amongst the safety-related issues on which SSE is working with contractors, the construction and operation of wind farms offshore is particularly important because they present new challenges and risks. SSE is actively working with a group of other leading developers to set and implement the best possible safe working procedures.

### Health promotion

SSE's Health and Well-being Action Plan provides the basis for workplace health programmes and initiatives, all designed

to help employees be in good shape for work. SSE's policy is to deal with all sickness absence in a sympathetic and constructive way, helping people make a speedy return to health and to work by seeking and acting on medical advice. During 2010/11, the average number of days of absence from work was 5.38, compared with 5.31 in the previous year.

### Environmental management

SSE's main environmental impact is generally regarded as emissions of carbon dioxide from electricity generation (see page 33). The CEMARS (Certified Emissions Measurement and Reduction Scheme) standard adopted by Achilles is the world's first internationally-accredited greenhouse gas certification scheme to ISO14065 and, in March 2011, SSE was notified by Achilles that it had again received the CEMARS standard.

Many of the Company's day-to-day operations take place in environmentally sensitive areas. The priority is to make sure that the five 'Ps' apply to environmental management and that negative impacts such as pollution to the local environment are prevented. SSE's duty to protect the environment starts when work is first planned at a site and continues until SSE clears up that site and leaves it. The key target in any single year is to ensure there are no environmental incidents which result in SSE receiving an enforcement notice from an environment regulator such as the Environment Agency. There were no such incidents during 2010/11. Good environmental stewardship involves on-site energy efficiency and management of waste, and SSE has specialist managers responsible for these areas. A key goal is to minimise waste and unnecessary use of natural resources by re-using and recycling materials. During 2010/11, 4,639 tonnes of waste were sent from SSE's offices and depots for disposal at landfill sites, a fall of over 20%.

### Priorities for 2011/12

The priorities are to:

- support progress towards SSE's ultimate goal of injury-free working;
- promote the health and well-being of people working for SSE; and
- ensure effective environmental management throughout SSE.

The progress towards injury-free working will be supported by three specific initiatives on:

- safe working offshore;
- all employees' safety-related behaviours; and
- management of 'leading' safety indicators.

**Colin Hood**  
Chairman

# Remuneration Report

## Introduction

|                             |
|-----------------------------|
| Overview                    |
| Strategy                    |
| Group performance           |
| Segmental performance       |
| <b>Corporate governance</b> |
| Financial statements        |
| Shareholder information     |



**Lady Rice CBE**  
Remuneration Committee Chairman

### A matter of balance

At SSE, the notion of balance runs throughout the business. We balance a range of market-based and economically-regulated businesses. We try to maintain a well-balanced portfolio of assets, contracts and customers, to balance fossil fuel and renewable sources of energy, to balance independence and experience on the Board. Balance is also fundamental to remuneration policy at SSE.

We see remuneration as being about a balance between supporting the Company's over-riding financial goal – sustained real growth in the dividend – while keeping employees engaged in the short-term. It's about doing what's right for the business – which requires a long-term view – and understanding this in the context of the energy sector today.

Reward by definition reflects the responsibility and contribution of the individual. At SSE, teamwork is one of the essential elements on which individuals are rewarded, creating another aspect of balance. Reward also has to make sense in the context of companies similar to SSE even while it supports SSE's own unique business plans.

### A year of consolidation

SSE's remuneration policy was reviewed in 2009/2010 against new guidelines and best practice. This year has been a time to let recent changes bed in as well as to complete that review. The Committee stayed close to the concerns of shareholders and other stakeholders, to the guidance of government for instance on pensions, and to the views of the executives. We will continue to welcome shareholder feedback in the future and indeed now on any aspect of this Report.

The remuneration strategy is to reward the Executive Directors below market median; the same is also true for non-Executive Directors. The Committee is sensitive to

the need to maintain a balance between this strategy while still keeping employees motivated. It is also part of the strategy that remuneration principles apply Company-wide, and that reward is viewed in the context of the economic environment as well as alongside sectoral benchmarks.

Benchmarks are useful if they prompt debate about whether our remuneration strategy and our position are right for the business and where we want to take it in the future. While we continue to look at the energy companies in the UK, they are few in number, so we have now added the MSCI list of energy companies in Europe and refer to Deloitte's Complexity Index as well, to provide broader relevant benchmarks. That is also why we benchmark against FTSE 20-50 companies excluding financial services which share many characteristics with SSE.

Given the current economic background, and despite strong financial and operational performance last year, it was decided not to increase the base salaries of the Executive Directors, which remain below market median for FTSE 20-50 companies (excluding financial services). The terms of the Annual Bonus Plan were unchanged, and the terms of the Performance Share Plan which, following consultation, now include an element relating directly to SSE's primary financial objective – sustained growth in dividend – are as set out in last year's Remuneration Report. This objective is also reflected in the long-term incentive plan for the new Management Board.

### A long-term business

A feature of SSE, and an illustration of the long-term nature of the business, is the fact that the Executive Directors have all held either Board or senior management positions with the Company since it was formed in 1998. Their total Board service is 42 years with total Company service of 86 years, including their stewardship of the predecessor companies Southern Electric and Scottish Hydro Electric.

Their personal commitment to SSE is strong as is their leadership of the Company – SSE is one of just six FTSE 100 companies to have delivered above-inflation dividend growth every year since 1998, the year it was formed. Any objective analysis of Executive Director remuneration must also reflect that leadership and commitment.

At the same time, SSE has developed genuine strength amongst its other senior managers, a number of whom now sit on the newly-formed Management Board. The Remuneration Committee has continued to look closely at the linkages between

Executive Directors' remuneration and that of other senior executives, managers and employees. It was in this context that the Committee approved a scheme designed to retain the members of the new Management Board over the next five years. It recognises that they now carry broader responsibilities than other senior managers, and we are confident that each of them understands what they must do to contribute to long-term dividend growth.

### A high profile issue

Remuneration is a high profile issue, and rightly so. The Remuneration Committee and the Executive Directors welcome the transparency and accountability which the public expects and which the Remuneration Committee endorses. The Committee continues to look for ways in which reward leads to behaviours which support the culture and values of SSE throughout the organisation.

The Committee believes that the Directors are fairly remunerated, and above all, that through remuneration they are recognised. We continue to test performance targets each year and believe they are robust and that the Company has set targets which reflect equivalent stretch over the years, even though those targets may change according to the Company's activities or the economic environment.

We link reward to risk as well as to performance, and specifically to the time horizon of the major risks in the business. Reward needs to reflect both the prudence and the dynamism which are balanced within SSE and everyone who works for the Company must be crystal clear about what is expected of them.

If the Remuneration Committee had five balancing objectives this year, they would be: to develop the Company's reputation, contribute to its business results, enable stakeholder agreement to remuneration policy, link compensation to performance plus risk, and provide leadership so that reward is aligned through the organisation.

Balance is a hallmark of a dynamic and productive organisation. Balance is also a hallmark of a strong remuneration approach – the balance between short-term and long-term, between the individual and the collective, between the tactical and the strategic. The Remuneration Committee believes it has achieved that balance and will be vigilant to ensure it continues to do so in the future.

**Lady Rice CBE**  
Chairman

# Remuneration Report (continued)

## At a glance

### What are the principles of the SSE Executive Remuneration Policy?

- Attract and retain Executive Directors who run the Company effectively for the benefit of shareholders, customers and employees.
- Adopt a competitive and straight forward approach to total remuneration which meets shareholder expectation.
- Reinforce the culture and teamwork to deliver the long-term growth and sustainability of the business.
- Set Total Remuneration Policy at levels which promote the long-term development of the business and reward individuals in line with performance.

### What was new in 2010/11?

- The Performance Share Plan has two new measures: dividend per share growth and TSR performance relative to the MSCI European utility companies index. This is in addition to relative TSR based on the FTSE 100 and EPS. Each of the four performance criteria represent 25% of the grant. Dividend growth is SSE's key financial objective and the MSCI is the relevant sector focus across Europe. These new criteria were set out in the Remuneration Report in 2010 and adopted after consultation with key stakeholders.
- The Committee approved a one-off LTI five-year plan for the new Management Board which will vest in 2016 subject to performance. This plan will not apply to the Executive Directors.
- With the changing fiscal and government approaches to pension, the Committee reviewed the potential impact of these changes on a number of long-serving senior managers. It approved an option for some of these employees to reduce or limit future accrual in exchange for a cash allowance. This was done on a cost neutral basis and these employees were provided with independent financial advice. This approach did not impact Executive Directors whose pension arrangements remain unchanged.

### Remuneration glossary of terms

STI – Short Term Incentive or Bonus  
LTI – Long Term Incentive  
PSP – Performance Share Plan  
BIK – Benefits in Kind  
MSCI – Morgan Stanley Capital Index  
TSR – Total Shareholder Return  
EPS – Earnings Per Share

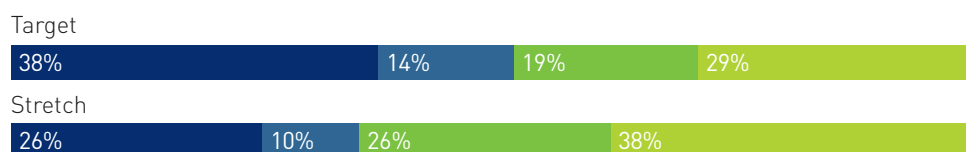
### What is SSE's Total Executive Remuneration Policy?

#### Summary of remuneration policy

| Fixed remuneration                                         | Variable remuneration                                                                                                                                                                  |                                                                                                                                                                                               |
|------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Base salary                                                | <b>Short-term – annual</b><br>Annual Bonus Plan – 75% maximum cash and 25% deferred shares<br>Linked to individual and team performance, corporate, financial and operational measures | <b>Long-term – three years</b><br>Performance Share Plan (PSP) – 3 years<br>25% linked to relative FTSE 100 TSR, 25% MSCI Eur. Utilities, 25% Dividend Growth, 25% adjusted annual EPS growth |
| Pension – final salary                                     |                                                                                                                                                                                        |                                                                                                                                                                                               |
| Benefits in kind – car, private medical                    |                                                                                                                                                                                        |                                                                                                                                                                                               |
| Minimum shareholding requirement equal to 100% Base Salary |                                                                                                                                                                                        |                                                                                                                                                                                               |

### How is the remuneration package structured?

#### Total Remuneration Policy (% each component element)



● Base salary/BIK ● Pension ● Bonus ● PSP

- Base salary includes 1% to cover benefits in kind namely a car allowance and private medical plan.
- The pension element is the average of the present value of providing a single year of pension for the Executive Directors.
- Target performance comprises annual bonus awarded at target level (ie 50% of base salary) and, for the Performance Share Plan, an assumption that 50% of shares under award will vest.
- Stretch performance is based on a bonus of 100% of base salary with exceptional targets being met and the Performance Share Plan is calculated based on the maximum grant at 150% salary which gives a range between 48% – 64% in variable pay to recognise exceptional performance.

### What were the Executive Directors paid for the year ending 31 March 2011?

|                          | Base salary<br>£000s | Benefits<br>£000s | Cash bonus<br>£000s | Total<br>£000s | Total (2010)<br>£000s |
|--------------------------|----------------------|-------------------|---------------------|----------------|-----------------------|
| Ian Marchant             | 840                  | 19                | 378                 | 1,237          | 1,231                 |
| Colin Hood               | 646                  | 17                | 291                 | 954            | 926                   |
| Gregor Alexander         | 495                  | 16                | 223                 | 734            | 713                   |
| Alistair Phillips-Davies | 495                  | 16                | 223                 | 734            | 713                   |
| Total Remuneration       | 2,476                | 68                | 1,115               | 3,659          | 3,583                 |

During 2010/11, Executive Directors also received shares vesting from the Performance Share Plan. Details are set out in Table D on page 74.

# Remuneration Report (continued)

## Remuneration explained

|                             |
|-----------------------------|
| Overview                    |
| Strategy                    |
| Group performance           |
| Segmental performance       |
| <b>Corporate governance</b> |
| Financial statements        |
| Shareholder information     |

### Executive Directors' salary and incentive plans 2010/11

| Performance measure                                                                                                                                                                                                                                                                                                         | Purpose – link to strategy                                                                                                                                                                                                                                                                                                        | Policy and decisions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Base salary</b>                                                                                                                                                                                                                                                                                                          |                                                                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
|                                                                                                                                                                                                                                                                                                                             | Reflects market data, role, business and individual performance measured against SSE's strategy as set out on pages 10 to 15.                                                                                                                                                                                                     | Following the annual review in March 2011 the salary for the Chief Executive and the three Executive Directors remained unchanged.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| <b>Short term – Annual Bonus</b>                                                                                                                                                                                                                                                                                            |                                                                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| The Annual Bonus is determined by the Remuneration Committee's assessment of the performance of SSE during the year, based on three key areas.                                                                                                                                                                              | The performance targets are clearly linked to SSE's strategy in three key ways: financial performance; teamwork; and personal objectives relating to the Company's priorities.                                                                                                                                                    | Maximum award of up to 100% of base salary: 75% in cash (non-pensionable); 25% compulsorily deferred into shares which only vest, subject to continued service, after three years.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| <b>Financial performance (60%)</b><br>Group financial performance is measured by adjusted profit before tax, which reflects the underlying profits of SSE's business.                                                                                                                                                       | <b>Financial performance (60%)</b><br>Adjusted profit before tax is a key means of achieving SSE's first responsibility to shareholders: sustained real growth in the dividend.                                                                                                                                                   | <b>Financial performance (max 60%)</b><br>During 2010/11, SSE delivered a 1.6% increase in adjusted profit before tax – resulting in a target payment at 50% of maximum.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Teamwork (20%)</b><br>Teamwork is measured by performance against the 'SSE SET' of core values: Safety; Service; Efficiency; Sustainability; Excellence; and Teamwork. Performance against these values is assessed through SSE's performance management process.                                                        | <b>Teamwork (20%)</b><br>SSE believes it will only be successful financially if it exercises a wider corporate responsibility to others, such as customers and employees, on whom its success ultimately depends. Its core values summarise this approach.                                                                        | <b>Teamwork (max 20%)</b><br><b>Safety:</b> Total Recordable Injury Rate again improved but below stretch target. <b>Service:</b> Rated number one in almost all key independent surveys. <b>Efficiency:</b> Additional cost savings achieved during the year and other efficiencies secured in specific areas such as credit management. <b>Sustainability:</b> Renewable energy development and smart home project goals achieved. <b>Excellence:</b> Culture of innovation reinforced with diverse successes such as the hybrid bond issue and zero carbon homes development. <b>Teamwork:</b> It is clear to all of the non-Executive Directors that the Executive Directors continue to perform strongly as a team with no evidence of a culture of individualism within SSE. All of this resulted in an above-target payment of 75% of the maximum. |
| <b>Personal objectives (20%)</b><br>In keeping with its Teamwork value, and to avoid setting Executive Directors potentially conflicting personal objectives, SSE believes personal objectives should form a part of the Annual Bonus. They are designed to support achievement of SSE's strategy and reinforce its values. | <b>Personal objectives (20%)</b><br>Personal objectives set during the year include: management of political and regulatory issues (Ian Marchant); generation availability (Colin Hood); improving working capital management (Gregor Alexander); and energy trading risk levels and fuel procurement (Alistair Phillips-Davies). | <b>Personal objectives (max 20%)</b><br>Overall, the Remuneration Committee concluded that progress was made in each of these areas during 2010/11 and that individually and collectively the Executive Directors delivered strong performance during the year – resulting in an above target payment of 75% of maximum.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <b>Long term – Performance Share Plan 2008-2011</b>                                                                                                                                                                                                                                                                         |                                                                                                                                                                                                                                                                                                                                   |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| For awards granted in 2008 performance is measured against the following two elements over a three-year period.                                                                                                                                                                                                             | The two elements of TSR and EPS reflect relative and absolute measures of performance.                                                                                                                                                                                                                                            | Maximum award of 150% of base salary each year. Awards are released to the extent performance conditions are met.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| <b>Total Shareholder Return (TSR)</b><br>→ 100% vests at or above 75th percentile<br>→ 25% vests at median<br>→ straight-line basis between median and 75th percentile<br>→ no vesting of award if median performance not achieved                                                                                          | The relative TSR measure is dependent on SSE's relative long-term share price performance and dividend return (sustained real growth is SSE's first financial responsibility to shareholders). Further vesting of this element requires the Remuneration Committee to be satisfied with SSE's underlying financial performance.   | <b>TSR (max 50%)</b><br>Out-turn below median of FTSE 100 so 0% TSR element awarded; the graph on page 70 reflects performance over a five-year period.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   |
| <b>Adjusted Earnings per Share (EPS)</b><br>→ 100% vests where EPS is 9% RPI<br>→ 25% vests where EPS is 3% above RPI<br>→ straight-line basis between 3% and 9% above RPI<br>→ no vesting if EPS minimum growth of RPI +3% is not achieved                                                                                 | Adjusted EPS is used to monitor SSE's performance over the medium term because it is straightforward: it defines the amount of profit after tax that has been earned for each Ordinary Share.                                                                                                                                     | <b>EPS (max 50%)</b><br>Out-turn growth below the EPS minimum growth target RPI+3% so 0% of EPS element awarded.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |

# Remuneration Report (continued)

## Remuneration explained

### Remuneration agenda 2010/11

|                 | Regular items                                                                                                                                                                                               | Other items                                                                                                                                                                                                                                                                                                                                     |
|-----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>May</b>      | Directors Remuneration Report.<br>Approval of Performance Share Targets and 2010 Grants.<br>Approval of Vesting Awards.                                                                                     |                                                                                                                                                                                                                                                                                                                                                 |
| <b>November</b> | Review of Total Remuneration Policy for Executive Directors and Chairman. External governance environment. Review STI and LTI performance results.                                                          | Long-term Incentive Review.                                                                                                                                                                                                                                                                                                                     |
| <b>February</b> |                                                                                                                                                                                                             | Review of new Management Board contract and salary levels. Salaries were increased only for the roles which contained a significant increase in responsibility and scope. Approval of new one-off five-year LTI plan 2011-2016 for the Management Board excluding Executive Directors. Overview of succession issues for remuneration purposes. |
| <b>March</b>    | Review of Directors and Senior Executives Salaries and Total Remuneration. Chairman's Remuneration Review. Establishment of the 2010/11 Bonus Performance targets. Performance Share Plan Forecast Results. | Changes to the implementation of pension policy. Application of new FSA remuneration code. Update on shareholder communications.                                                                                                                                                                                                                |

The Remuneration Committee's composition, responsibilities and operation comply with Section B of the Corporate Governance Code. In forming remuneration policy, the Committee has given full consideration to the best practice provisions set out in the Code.

This report sets out the Company's policy on Executive Directors' remuneration for the year ended 31 March 2011 and complies with the regulations made under the Companies Act 2006. The report will be presented at the AGM on 21 July 2011 for approval and shareholders will be able to ask questions on the report at the AGM.

### How the Remuneration Committee works

#### Members and meetings

| Membership                     | Attendance at meetings |
|--------------------------------|------------------------|
| Lady Rice (Committee Chairman) | 4/4                    |
| Nick Baldwin                   | 4/4                    |
| Richard Gillingwater           | 4/4                    |
| Lord Smith of Kelvin           | 3/4                    |

Informal consultation takes place outwith the scheduled meetings as necessary.

#### Terms of reference

- sets the total remuneration policy on behalf of the Board;
- approves the detailed remuneration terms of the Executive Directors including their service contract and the impact on senior management remuneration;
- approves the remuneration of the Chairman;
- approves the design and performance targets of incentive schemes;
- grants awards under the Company's Long-term Incentive Plans; and
- reviews the total remuneration of the Management Board and other Senior Executives below Board level.

#### Advisors

- the Chief Executive and the Director of Human Resources advised the Committee on matters relating to the appropriateness of awards for the Executive Directors and Senior Executives although they were not present for discussions on their own remuneration;
- in addition the Director of Human Resources advised on HR strategy and the application of policies across the organisation;
- the Company Secretary advised the Committee on corporate governance guidelines;
- Deloitte LLP provided market information drawn from published surveys and advice on appropriate awards of bonuses, long-term incentives, and comparator group pay and performance. Deloitte LLP were appointed by the Committee; and
- Bank of America Merrill Lynch provided advice on shareholder views. They were appointed by the Committee for these services.

### Total Remuneration Policy

Total Remuneration Policy is integral to overall HR Strategy and the SSE set of core values are supported in the objectives, plan design and application of the policy.

#### The principles

The core principles of the Company's remuneration policy are outlined in the 'At a glance' section as shown on page 66 together with policy details and diagrams which illustrate the degree of stretch in the target and maximum values of the packages.

The policy comprises:

- base salary;
- benefits, including a defined benefit pension plan;
- a short-term incentive plan; and
- a long-term incentive plans.

The current short- and long-term incentive plans are shown in the chart on page 66.

#### Total Remuneration Policy

Remuneration policy for Executive Directors is to remain below median of the FTSE 20-50 excluding financial services. For peer group comparison, the Committee takes account of total remuneration in specific UK listed companies in related sectors and their reported financial results. SSE's goal is to retain Executive Directors who are motivated by the long-term success of the Company, rather than short-term remuneration.

This policy and goal reflect SSE culture in which Executive Directors and Senior Managers are motivated by developing the Company for the future, and explains why long-term growth and sustainability of the business are of such importance when determining remuneration policy.

- The Committee reviews regularly the total compensation, including pensions, of the Chief Executive and the Executive Directors compared to FTSE benchmarks to make sure that the Company is not disadvantaged by the current position nor are there any adverse consequences stemming from the long service of the leadership team.

- A number of institutional shareholders were consulted on the implications of the changes to the Performance Share Plan measures and other aspects of the Total Remuneration Policy as part of a regular dialogue between shareholders and the Remuneration Committee.
- During the year the Committee discussed succession issues across a broader spectrum of management levels and takes account of these factors when making any remuneration decisions both in the interests of the Company and the individuals.
- As a matter of policy the Committee takes account of any changing or increasing responsibilities when determining the appropriate remuneration.

#### **The balance of fixed and variable remuneration**

Taking into account the SSE business profile, the Remuneration Committee believes that around 50% of the total remuneration should be performance-related, increasing up to around two thirds for exceptional performance as shown in the table on page 66 as this rewards performance sufficiently without causing undue risk taking.

#### **Senior Executives, managers and employees**

The Committee is aware of the importance of an appropriate relationship between the remuneration levels of the Executive Directors, Senior Executives, managers and other employees within the Group. As outlined on page 54, this year has seen the appointment of the Management Board reporting to the Chief Executive which consists of operational and functional Managing Directors. The Committee received and approved a paper which benchmarked their total remuneration to the relevant marketplace and introduced a new, one-off five-year LTI 2011-2016 featuring the key measure of dividend growth. The Executive Directors will not participate in this scheme.

There is a wider group of Senior Executives who have a significant influence on Group performance. The Committee seeks assurance that there is a consistency of approach to remuneration and that remuneration is of sufficient value to attract and retain key executives for the longer term.

#### **Base salary**

The Committee is mindful of the remuneration of different groups of employees and considers wider internal pay arrangements and other relevant external indices such as inflation in the process of reviewing base salary for the Executive Directors.

The Committee conducted its regular review of salaries for Executive Directors in March

2011. It considered the following factors in the light of recent market and governance trends:

- total remuneration and basic salary, when benchmarked where relevant to FTSE 20-50 excluding Financial Services, remain behind market median for the Executive Directors;
- the Executive Directors continue to deliver a strong financial performance with significant results to shareholders in a difficult trading year as dividend growth has exceeded RPI inflation for the twelfth consecutive year; and
- management and Collective Agreements.

Despite continued solid performance, after taking careful consideration of all factors, the Committee decided not to increase salaries for the Executive Directors including the Chief Executive for the year 2011/12.

#### **Current incentive plans**

##### **Short-term incentive – Annual Bonus Plan**

The purpose of the Annual Bonus Plan is to reward Executive Directors' performance during the year, based on an analysis of financial results, team working and personal objectives. Performance is considered in the context of targets set in each of the areas at the start of the financial year. In addition, the Remuneration Committee considers Executive Directors' management of, and performance in, all of the business issues that arose during the year.

For 2010/11, the total Annual Bonus paid to the Executive Directors was 60% of salary, compared to 59% in the previous year and with the maximum payable of 100%. Around half of the bonus was payable in respect of financial performance and around half in respect of team working and performance against personal objectives. 'Executive Directors' salary and incentive plans 2010/11', on page 67, sets out performance metrics used in the assessment of the Annual Bonus for the year.

For 2011/12, the structure of the Annual Bonus will remain the same as in 2010/11. The maximum bonus payable will be 100% of salary, split between:

- financial performance (60%);
- team working (20%); and
- personal objectives (20%).

In any single year, it is expected that the Annual Bonus paid will be around 50% of Executive Directors' salary for on-target performance. The Annual Bonus is paid 75% in cash, and 25% deferred into shares which vest after three years, subject to continued service.

For the Management Board and other Senior Executives, the Committee approved

the introduction of a safety modifier to any STI awards as safety is of paramount importance to SSE. This modifier applies to team working and personal objectives. This modifier does not apply to the Executive Directors' short-term bonus, which already takes account of the Company's safety performance.

#### **Long-term incentives – Performance Share Plan**

The Performance Share Plan is the main scheme to reward Executive Directors and other Senior Executives over a three-year period for the continued profitable growth of SSE as measured, up to 2010/11, by Earnings per Share and the Total Shareholder Return compared to the FTSE 100. Since 2007, awards equivalent to 150% of salary have been granted to Executive Directors and at lower rates to other Senior Executives.

Awards will be released after three years subject to the meeting of demanding performance conditions relating to the Company's relative total shareholder return (TSR) performance and the Company's adjusted EPS growth. Further details of the performance targets are in the table on page 67. The TSR performance measure is dependent on the Company's relative long-term share price performance within the FTSE 100 bringing a market perspective to the plan. The vesting of this element requires the Committee to be satisfied with the underlying financial performance of the Company. The TSR measure is balanced by a key internal measure, adjusted EPS growth, which is critical to the Company's long-term success and ties in with the Group's strategic goals.

The Committee considered that the achievement of real annual adjusted EPS growth of 9% above RPI per annum was a demanding target for maximum vesting in light of the regulatory regime applicable to the Company.

The 2007 PSP award vested in May 2010. The TSR out-turn was below median for FTSE 100 so this part of the PSP award did not vest. EPS growth was 3.6% above inflation per annum, and accordingly 32.4% of the EPS element in the 2007 award vested. The overall award was 16.2%.

The 2008 PSP award will vest shortly after the announcement of the preliminary results in May 2011. It is envisaged that the TSR out-turn will be below median so this part of the PSP will not vest. EPS growth was 1.1% below inflation per annum which is below the minimum of RPI plus 3%. Therefore this award will lapse this year. Achievement of this performance criterion is independently reviewed each year by the auditors.

## Remuneration Report (continued)

### Remuneration explained

#### Changes to performance share plan 2010 awards

As outlined in last year's Remuneration Report, the Committee approved a number of changes; from the 2010/11 award, there are now four performance criteria of 25% each as follows:

- relative TSR performance compared to FTSE 100;
- relative TSR performance compared to a dedicated peer group of UK and other European utilities;
- EPS growth of RPI plus 2% (threshold vesting) to 8% (full vesting); and
- dividend per share growth of RPI plus 2% (threshold vesting) to 6% (full vesting).

TSR performance compared to a dedicated peer group of UK and other European utilities (the MSCI Europe Utilities) thereby provides sector emphasis and market perspective to the plan.

The Dividend per share growth target reflects the fact that the Company's core financial objective is to deliver continued real dividend growth in the future whilst maintaining a dividend cover around the established range.

The reasons for the two new measures are that the Committee believes that these new criteria provide a focus on the performance of SSE's wider competitive group, its key financial goals and the level of dividend paid. For these reasons, the Committee intends to discuss with shareholders and other stakeholders the application of these criteria to the 2009 Performance Share Plan award, which is due to vest in 2012. More broadly, the Committee will continue to review all targets for relevance and stretch in line with the financial forecasts and prevailing business and economic environment.

#### Share ownership policy

Employee share ownership is a key part

of total Remuneration policy and is designed to help maintain long-term commitment and business understanding, offering the opportunity to benefit from any growth in shareholder value.

- The interests of the Executive Directors and other Senior Executives are closely aligned with those of other shareholders. The Performance Share Plan, the deferral of 25% of the Annual Bonus award and employee share schemes facilitate this alignment.
- The Executive Directors and certain other Senior Executives are required to maintain a shareholding equivalent to one year's salary built up within a reasonable timescale. Consent to sell shares is not normally given (unless in exceptional circumstances or to fund a connected tax liability) until this level of shareholding is reached.
- It is also expected that all non-Executive Directors should hold a minimum of 2,000 shares in the Company.
- As reported on page 50, 44% of SSE employees are members of the Share Incentive Plan.
- 35% of employees are members of the Share Save Scheme.

#### Directors' shareholdings as percentage of annual salary

|                          | 2011<br>% salary | 2010<br>% salary |
|--------------------------|------------------|------------------|
| Ian Marchant             | 338              | 286              |
| Colin Hood               | 270              | 221              |
| Gregor Alexander         | 230              | 191              |
| Alistair Phillips-Davies | 256              | 210              |

Based on a share price at 31 March 2011 of £12.61.

#### All-employee share schemes

Executive Directors are eligible to participate in the Company's all-employee share schemes on the same terms as other

employees. These schemes comprise:

- the Sharesave Scheme which allows employees options to acquire shares using the proceeds of a monthly savings contract of up to £250 per month. Exercise of the options is not subject to satisfaction of any performance target. The option price is set at a discount maximum of 20% to market value;
- the Share Incentive Plan (the SIP) which allows employees to allocate part of their pre-tax salary to purchase shares up to a maximum of £125 per month. Participants receive two free matching shares monthly for each share purchased up to a maximum of six free shares; and
- the long service award scheme which purchases 10, 20, 30, 40 or 50 shares on behalf of an employee on the occasion of the employee reaching 10, 20, 30, 40 or 50 years' service respectively with the Group.

#### Funding of share schemes and dilution

Shares are purchased in the market to satisfy the exercise of awards under the Deferred Bonus Plan, the Performance Share Plan, and the Share Incentive Plan.

The Company's Sharesave Scheme uses unissued shares to satisfy the exercise of share options. As at 31 March 2011, there were approximately 6 million share options outstanding under this scheme, and if all the outstanding options were exercised this would amount to 0.64% of the issued share capital of the Company at that date.

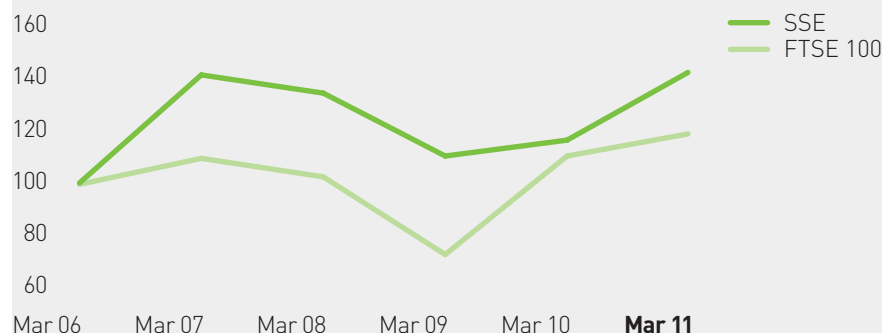
#### Pensions policy

Pension planning is an important part of the remuneration strategy because it is consistent with the long-term goals and horizons of the business. Each employee is encouraged to join the relevant pension plan. In response to recent government and fiscal changes, the Company has provided cash allowance options in exchange for reduced accrual at no extra cost to the Company.

Overall the Executive Directors have no right to any special or preferential pension benefit terms upon leaving. However, in common with all members of the pension schemes who joined at the same time as the Executive Directors, the following provisions relating to leaving the Company apply:

- for retirement through ill-health an unreduced pension based on service to expected retirement is paid;
- in the event of any reorganisation or redundancy an unreduced accrued pension is paid to a member who is aged 50 or above, with at least five years' service or, for a member who

#### SSE TSR performance: 31 March 2006 to 31 March 2011



The graph above charts the cumulative TSR (Total Shareholder Return) of SSE since 1 April 2006, compared to the FTSE 100 Index over the same period. The Company is a member of the FTSE 100 and it was considered to be the most relevant benchmark for comparison purposes.

- has not yet reached that age, it will be payable with effect from 50; and
- from the age of 55, a scheme member is entitled to leave the Company and receive a pension, reduced for early payment, unless the Company gives consent and funds this pension being paid on an unreduced basis.

All the Executive Directors remain members of either the Southern Electric Pension Scheme or the Scottish Hydro Electric Pension Scheme and their plan membership predates their Board appointments. These are both funded final salary pension schemes and the terms of these schemes apply equally to all members.

The Directors' service contracts provide for a possible maximum pension of two thirds final salary from the age of 60. In relation to Executive Directors who are subject to the scheme-specific salary cap (which mirrors the provisions of the previous HM Revenue and Customs cap arrangements) the Company provides top-up (unfunded) arrangements which are designed to provide an equivalent pension on retirement from the age of 60 to that which they would have earned if they had not been subject to the salary cap. There are no arrangements to compensate members for any change in their personal tax liability.

Full details of the Executive Directors' pension plans can be found in Table B of the audited information on page 72.

### Service contracts

It is the Company's policy that Executive Directors should have service contracts with the Company which can be terminated on 12 months' notice given by either party.

The current Executive Directors' service contracts contain the key items shown in the table above.

The Company may at its discretion terminate any Executive Director's contract by making a payment in lieu of notice equal to the basic salary which would have been received during the notice period (excluding any bonus and any other emolument referable to the employment). Payment may be made in staged payments, and will either reduce or cease completely where the departing Executive Director gains new employment.

If an Executive Director retires or is made redundant, the PSP shares will be reduced to reflect the point during the three year performance period when the Director leaves. If the Executive Director leaves for any other reason, PSP share awards will lapse.

### Service contract key items

| Provision           | Detailed terms                                                                                                                                                                                                                                                              |
|---------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Notice period       | → 12 months by either Company or Director                                                                                                                                                                                                                                   |
| Termination payment | → Up to 12 months salary (excluding any bonus or other enhancement)<br>→ Payment in lieu of notice in staged payments subject to the Executive gaining new employment<br>→ No special change of control provisions<br>→ Obligation on departing Executives to mitigate loss |
| Remuneration        | → Salary, pension and benefits<br>→ Company car or cash allowance<br>→ Participation in bonus scheme, employee share schemes and Executive incentive plans<br>→ Private Health Insurance                                                                                    |
| Non competition     | → During employment and for six months after leaving                                                                                                                                                                                                                        |
| Contract dates      | → All four contracts dated 11 March 2005                                                                                                                                                                                                                                    |

### Length of service

|                          | Industry service | Length of Board service |
|--------------------------|------------------|-------------------------|
| Ian Marchant             | 19               | 15 years*               |
| Gregor Alexander         | 20               | 8 years                 |
| Colin Hood               | 33               | 10 years                |
| Alistair Phillips-Davies | 14               | 9 years                 |

\* Including two years as Finance Director of Southern Electric plc.

In the event of a change of control of the Company, performance in the PSP will be measured to that date and will normally be scaled down to the period prior to reflect the change of control.

### Outside appointments

Executive Directors are entitled to accept a non-Executive appointment outside the Company with the consent of the Board, as such appointments can enhance Directors' experience and value to the Company. Any fees received are retained by the Director.

In 2010/11 Ian Marchant held a non-Executive Director position with the John Wood Group plc, and received £45,000 in fees; and Colin Hood held a position as non-Executive Director of FirstGroup plc, receiving £45,000 in fees and accepted a position in Southern Water Services Ltd and received £16,667 in fees.

### Non-Executive Directors

- The non-Executive Directors have letters of appointment, and are appointed for fixed terms of three years, subject to retirement by rotation and re-appointment at AGMs.
- They do not participate in the Bonus Scheme, Deferred Bonus Plan, any of the share option schemes, or contribute to any Group pension scheme although as indicated above are required to hold

2,000 Company shares.

- The fees of the independent non-Executive Directors are agreed by the Board, with the non-Executive Directors concerned not participating in this process.
- The fees are reviewed against companies of similar size and complexity. To be consistent with wider remuneration policy, fees are set at below median.

The non-Executive Directors do not receive any additional fees for Committee Membership, only for Chairmanship of the Committees. Reasonable travelling and other expenses for costs incurred in the course of their duties are reimbursed.

### Fee history

|                             | 2011<br>£000s | 2010<br>£000s |
|-----------------------------|---------------|---------------|
| Board                       | 54            | 52            |
| Audit Committee             |               |               |
| Chairmanship                | 12            | 12            |
| Remuneration Committee      |               |               |
| Chairmanship                | 10            | 10            |
| Senior Independent Director | 10            | 10            |
| Company Chairman            | 341           | 332           |

From April 1 2011, the fees for the roles of Committee Chair have both increased by £2,000 per annum to £14,000 for the Audit and to £12,000 for the Remuneration Committee Chairmen.

# Remuneration Report (continued)

## Remuneration in detail

The Auditors are required to report on the information contained in Tables A, B and D.

**Table A – Directors' remuneration excluding LTIP and pension information**

|                                 | Salary/fee<br>£000s | Cash bonuses<br>£000s | 2011<br>Benefits<br>£000s | Total<br>£000s | 2010<br>Total<br>£000s |
|---------------------------------|---------------------|-----------------------|---------------------------|----------------|------------------------|
| <b>Executive Directors</b>      |                     |                       |                           |                |                        |
| Ian Marchant                    | 840                 | 378                   | 19                        | 1,237          | 1,231                  |
| Gregor Alexander                | 495                 | 223                   | 16                        | 734            | 713                    |
| Colin Hood                      | 646                 | 291                   | 17                        | 954            | 926                    |
| Alistair Phillips-Davies        | 495                 | 223                   | 16                        | 734            | 713                    |
| <b>Non-Executive Directors</b>  |                     |                       |                           |                |                        |
| Thomas Thune Andersen           | 54                  | –                     | –                         | 54             | 52                     |
| Nick Baldwin                    | 54                  | –                     | –                         | 54             | 52                     |
| Richard Gillingwater            | 54                  | –                     | –                         | 54             | 52                     |
| René Médori                     | 66                  | –                     | –                         | 66             | 64                     |
| Lady Rice                       | 74                  | –                     | –                         | 74             | 72                     |
| Lord Smith of Kelvin (Chairman) | 341                 | –                     | –                         | 341            | 332                    |
|                                 | <b>3,119</b>        | <b>1,115</b>          | <b>68</b>                 | <b>4,302</b>   | <b>4,207</b>           |

### Notes

In addition to the annual cash bonus amount for this year, Ian Marchant, Gregor Alexander, Colin Hood and Alistair Phillips-Davies will be awarded £126,000, £74,250, £97,000 and £74,250 respectively in the form of deferred shares in respect of the bonus due to them for 2010/11. These share awards will not be made until June 2011 and therefore the number of shares to which the Executive Directors will be entitled will not be known until that date. These shares will, subject to continued employment, be released on the third anniversary of grant in June 2014.

**Table B – Directors' pension information**

|                          | Years of<br>industry<br>service | At 31 March<br>2011<br>£000s | Accrued benefit                                     |                                                     | At 31 March<br>2011<br>£000s | At 31 March<br>2010<br>£000s | Transfer value of accrued benefit                     |                                                     |
|--------------------------|---------------------------------|------------------------------|-----------------------------------------------------|-----------------------------------------------------|------------------------------|------------------------------|-------------------------------------------------------|-----------------------------------------------------|
|                          |                                 |                              | Increase in year<br>including<br>inflation<br>£000s | Increase in year<br>excluding<br>inflation<br>£000s |                              |                              | Increase less<br>Directors'<br>contributions<br>£000s | Increase in year<br>excluding<br>inflation<br>£000s |
| Ian Marchant             | 19                              | 369                          | 20                                                  | 4                                                   | 6,191                        | 5,683                        | 490                                                   | 305                                                 |
| Gregor Alexander         | 20                              | 213                          | 15                                                  | 5                                                   | 3,545                        | 3,038                        | 489                                                   | 60                                                  |
| Colin Hood               | 33                              | 355                          | 19                                                  | 3                                                   | 7,267                        | 6,891                        | 358                                                   | 274                                                 |
| Alistair Phillips-Davies | 14                              | 161                          | 14                                                  | 7                                                   | 2,394                        | 2,154                        | 222                                                   | 187                                                 |

Members of the scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table above. If a member's accrued fund exceeds the new lifetime allowance (LTA), the benefits payable by the scheme from that excess will be subject to a higher rate of income tax. The Company is maximising the use of the new allowance thereby providing Executive Directors with more of their existing benefits via registered schemes. In the case of Colin Hood, who was not subject to the previous earnings cap but is now limited by the LTA, further accrual is via an unfunded arrangement.

The following is information relating to the pension of Gregor Alexander as a participant in the HM Revenue & Customs approved Scottish Hydro Electric Pension Scheme.

- (i) Dependents' pensions on death are half of members' pension entitlements, together with a capital sum equal to four times pensionable pay. On death in retirement, the Director's spouse will receive a pension equal to half of that payable to the Director. In addition, on death within the first five years of retirement, a lump sum is payable equal to the balance outstanding of the first five years' pension payments.
- (ii) All benefit payments are guaranteed to increase annually by the same percentage as state pensions, which are linked to the UK Retail Price Index.

The following is information relating to the Directors' pensions of Colin Hood, Ian Marchant and Alistair Phillips-Davies, as participants in the HM Revenue & Customs approved Southern Electric Group of the Electricity Supply Pension Scheme.

- (i) Dependents' pensions on death are four-ninths of the member's pensionable pay, together with a capital sum equal to four times pensionable pay. If death occurs after attaining the age of 55 an additional lump sum between three to five times notional pension is payable dependent upon age and length of service.
- (ii) On death in retirement, the Director's spouse will receive a pension equal to two-thirds of that payable to the Director. In addition, on death within the first five years of retirement, a lump sum is payable equal to the balance outstanding of the first five years' pension payments.

(iii) Post retirement increases are expected to be in line with inflation (guaranteed up to the level of 5% per annum and discretionary above that level).

All the Executive Directors have unfunded retirement benefits which are included in their pension benefits above with provision in respect of their accrued value included in the Company's Balance Sheet.

**Table C – Directors' share interests**

|                          | 31 March 2011 |                     | 31 March 2010 |                     |
|--------------------------|---------------|---------------------|---------------|---------------------|
|                          | Shares held   | Shares under option | Shares held   | Shares under option |
| Gregor Alexander         | 90,504        | 193,304             | 85,917        | 161,936             |
| Thomas Thune Andersen    | 2,000         | –                   | 2,000         | –                   |
| Nick Baldwin             | 2,387         | –                   | 2,244         | –                   |
| Richard Gillingwater     | 2,000         | –                   | 2,000         | –                   |
| Colin Hood               | 138,659       | 250,056             | 129,376       | 211,984             |
| Ian Marchant             | 225,773       | 334,522             | 218,500       | 281,166             |
| René Médori              | 2,050         | –                   | 2,050         | –                   |
| Alistair Phillips-Davies | 100,703       | 191,738             | 94,631        | 162,220             |
| Lady Rice                | 5,216         | –                   | 4,904         | –                   |
| Lord Smith of Kelvin     | 22,600        | –                   | 22,600        | –                   |

**Notes**

From 31 March 2011 to 19 May 2011, the following changes to the interests of Directors took place:

Under a standing order for reinvestment of an ISA, on 6 April 2011 Gregor Alexander acquired 13 shares.

Under the Share Incentive Plan, on 3 May 2011, Ian Marchant, Colin Hood, Gregor Alexander and Alistair Phillips-Davies each acquired 15 shares.

The Register of Directors' Interests (which is open to shareholders' inspection) contains full details of Directors' shareholdings and options to subscribe for shares.

Table D (page 74) shows the interests of the Executive Directors in awards granted under the Deferred Bonus Plan 2006 and the Performance Share Plan (PSP) and in options granted under the Sharesave Scheme during the year ended 31 March 2011.

**Remuneration Report (continued)****Remuneration in detail****Table D – Directors' long term incentive plan interests**

|                          | Share plan            | Date of award | Normal exercise period<br>(or vesting date) | No. of shares<br>under award at<br>1 April 2010 | Option<br>exercise<br>price | Additional<br>shares awarded<br>during the year | No. of shares<br>realised during<br>the year | No. of shares<br>under award at<br>31 March 2011 |
|--------------------------|-----------------------|---------------|---------------------------------------------|-------------------------------------------------|-----------------------------|-------------------------------------------------|----------------------------------------------|--------------------------------------------------|
| Ian Marchant             | DBP 2006 <sup>2</sup> | 10/06/08      | 10/06/11                                    | 9,709                                           |                             |                                                 |                                              | 9,709                                            |
|                          | DBP 2006 <sup>2</sup> | 02/06/09      | 02/06/12                                    | 10,730                                          |                             |                                                 |                                              | 10,730                                           |
|                          | DBP 2006 <sup>2</sup> | 02/06/10      | 02/06/13                                    |                                                 |                             | 11,482 <sup>3</sup>                             |                                              | 11,482                                           |
|                          | PSP <sup>1</sup>      | 26/07/07      | May 2010                                    | 75,313                                          |                             |                                                 | 12,201 <sup>5</sup>                          |                                                  |
|                          | PSP <sup>1</sup>      | 10/06/08      | May 2011                                    | 77,670                                          |                             |                                                 |                                              | 77,670                                           |
|                          | PSP <sup>1</sup>      | 02/06/09      | May 2012                                    | 107,302                                         |                             |                                                 |                                              | 107,302                                          |
|                          | PSP <sup>1</sup>      | 02/06/10      | May 2013                                    |                                                 |                             | 116,774 <sup>3</sup>                            |                                              | 116,774                                          |
|                          | Sharesave             | 01/10/08      | 01/10/11-31/03/12                           | 442                                             | 1274p                       |                                                 |                                              | 442                                              |
| Colin Hood               | Sharesave             | 01/10/10      | 01/10/13-31/03/14                           |                                                 | 871p                        | 413 <sup>4</sup>                                |                                              | 413                                              |
|                          | DBP 2006 <sup>2</sup> | 10/06/08      | 10/06/11                                    | 7,087                                           |                             |                                                 |                                              | 7,087                                            |
|                          | DBP 2006 <sup>2</sup> | 02/06/09      | 02/06/12                                    | 8,047                                           |                             |                                                 |                                              | 8,047                                            |
|                          | DBP 2006 <sup>2</sup> | 02/06/10      | 02/06/13                                    |                                                 |                             | 8,612 <sup>3</sup>                              |                                              | 8,612                                            |
|                          | PSP <sup>1</sup>      | 26/07/07      | May 2010                                    | 56,485                                          |                             |                                                 | 9,150 <sup>5</sup>                           |                                                  |
|                          | PSP <sup>1</sup>      | 10/06/08      | May 2011                                    | 58,253                                          |                             |                                                 |                                              | 58,253                                           |
|                          | PSP <sup>1</sup>      | 02/06/09      | May 2012                                    | 80,476                                          |                             |                                                 |                                              | 80,476                                           |
|                          | PSP <sup>1</sup>      | 02/06/10      | May 2013                                    |                                                 |                             | 87,581 <sup>3</sup>                             |                                              | 87,581                                           |
| Gregor Alexander         | Sharesave             | 01/10/05      | 01/10/10-31/03/11                           | 1,492                                           | 886p                        |                                                 | 1,492 <sup>6</sup>                           |                                                  |
|                          | Sharesave             | 01/10/07      | 01/10/10-31/03/11                           | 144 <sup>9</sup>                                | 1306p                       |                                                 |                                              |                                                  |
|                          | DBP 2006 <sup>2</sup> | 10/06/08      | 10/06/11                                    | 5,493                                           |                             |                                                 |                                              | 5,493                                            |
|                          | DBP 2006 <sup>2</sup> | 02/06/09      | 02/06/12                                    | 6,169                                           |                             |                                                 |                                              | 6,169                                            |
|                          | DBP 2006 <sup>2</sup> | 02/06/10      | 02/06/13                                    |                                                 |                             | 6,602 <sup>3</sup>                              |                                              | 6,602                                            |
|                          | PSP <sup>1</sup>      | 26/07/07      | May 2010                                    | 42,364                                          |                             |                                                 | 6,863 <sup>5</sup>                           |                                                  |
|                          | PSP <sup>1</sup>      | 10/06/08      | May 2011                                    | 44,661                                          |                             |                                                 |                                              | 44,661                                           |
|                          | PSP <sup>1</sup>      | 02/06/09      | May 2012                                    | 61,698                                          |                             |                                                 |                                              | 61,698                                           |
| Alistair Phillips-Davies | PSP <sup>1</sup>      | 02/06/10      | May 2013                                    |                                                 |                             | 67,145 <sup>3</sup>                             |                                              | 67,145                                           |
|                          | Sharesave             | 01/10/05      | 01/10/10-31/03/11                           | 298                                             | 886p                        |                                                 | 298 <sup>8</sup>                             |                                                  |
|                          | Sharesave             | 01/10/09      | 01/10/14-31/03/15                           | 1,253                                           | 1042p                       |                                                 |                                              | 1,253                                            |
|                          | Sharesave             | 01/10/10      | 01/10/15-31/03/16                           |                                                 | 871p                        | 283 <sup>4</sup>                                |                                              | 283                                              |
|                          | DBP 2006 <sup>2</sup> | 10/06/08      | 10/06/11                                    | 5,463                                           |                             |                                                 |                                              | 5,463                                            |
|                          | DBP 2006 <sup>2</sup> | 02/06/09      | 02/06/12                                    | 6,169                                           |                             |                                                 |                                              | 6,169                                            |
|                          | DBP 2006 <sup>2</sup> | 02/06/10      | 02/06/13                                    |                                                 |                             | 6,602 <sup>3</sup>                              |                                              | 6,602                                            |
|                          | PSP <sup>1</sup>      | 26/07/07      | May 2010                                    | 42,364                                          |                             |                                                 | 6,863 <sup>5</sup>                           |                                                  |
| Alistair Phillips-Davies | PSP <sup>1</sup>      | 10/06/08      | May 2011                                    | 44,661                                          |                             |                                                 |                                              | 44,661                                           |
|                          | PSP <sup>1</sup>      | 02/06/09      | May 2012                                    | 61,698                                          |                             |                                                 |                                              | 61,698                                           |
|                          | PSP <sup>1</sup>      | 02/06/10      | May 2013                                    |                                                 |                             | 67,145 <sup>3</sup>                             |                                              | 67,145                                           |
|                          | Sharesave             | 01/10/05      | 01/10/10-31/03/11                           | 1,865                                           | 886p                        |                                                 | 1,865 <sup>7</sup>                           |                                                  |

Shares which are released under the DBP 2006 and PSP attract additional shares in respect of the notional reinvestment of dividends. In addition to the shares released under the PSP, as indicated in the table above, the following shares were realised arising from such notional reinvestment of dividends: Ian Marchant – 1,900 shares, Colin Hood – 1,425 shares, Gregor Alexander – 1,069 shares, Alistair Phillips-Davies – 1,069 shares.

1. The performance conditions applicable to awards under the PSP since 2007 are described on page 69. The 2007 award under the PSP vested in respect of 16.2% of the total award.
2. Since 2007, 25% of annual bonus payable to Executive Directors and Senior Managers has been satisfied as a conditional award of shares under the DBP 2006. Vesting of shares is dependent on continued service over a three year period. In view of the linkage to annual bonus, no further performance condition applies to the vesting of DBP 2006 awards.
3. The market value of a share on the date on which these awards were made was 1087p.
4. The market value of a share on the date on which these awards were granted was 1119p.
5. The market value of a share on the date on which these awards were realised was 1087p.
6. The market value of a share on the date on which these awards were exercised was 1125p.
7. The market value of a share on the date on which these awards were exercised was 1181p.
8. The market value of a share on the date on which these awards were exercised was 1219p.
9. This option lapsed on 31 March 2011.

The closing market price of shares at 31 March 2011 was 1261p and the range for the year was 1010p to 1267p. Awards granted during the year were granted under the DBP 2006 and the PSP. Options were granted under the Sharesave scheme. The aggregate amount of gains made by the Directors on the exercise of share options and realisation of awards during the year was £446,596.65 (2010 – £5,832,166.48).

**This report was approved by the Board and signed on its behalf by:**

**Lady Rice CBE** Remuneration Committee Chairman, 19 May 2011

## Other statutory information

Overview  
 Strategy  
 Group performance  
 Segmental performance  
**Corporate governance**  
 Financial statements  
 Shareholder information

### Principal activities

Scottish and Southern Energy plc is the holding company of the Group. Its subsidiaries are organised into the main businesses of:

- the generation, transmission, distribution and supply of electricity;
- the production, storage, distribution and supply of gas; and
- the provision of other energy-related services.

### Business review

The Company is required to set out a fair review of the business of the Group and a description of the principal risks and uncertainties facing the Group (known as a Business Review). The Business Review is required to set out a balanced and comprehensive analysis of the development and performance of the Group's business during the financial year ended 31 March 2011 and of the position of the Group at the end of that financial year. The information that fulfils these requirements, and is deemed to be the Directors' Report, is contained within pages 1 to 76 of this Annual Report. The management report for the year, as required by the Disclosure and Transparency Rules, is incorporated by reference within the Directors' Report.

### Directors

The Directors during the year and at the date of this report are:

#### Executive

Ian Marchant (Chief Executive)  
 Gregor Alexander  
 Colin Hood  
 Alistair Phillips-Davies

#### Non-Executive

Lord Smith of Kelvin (Chairman)  
 Thomas Thune Andersen  
 Nick Baldwin (resigned on 1 April 2011)  
 Richard Gillingwater  
 René Médori  
 Lady Rice (Senior Independent Director)

Jeremy Beeton and Katie Bickerstaffe join the Board on 1 July 2011.

At the 2011 AGM all of the current Directors will retire and offer themselves for re-appointment. As announced on 9 December 2010, Colin Hood will stand down as an Executive Director later in the year.

Biographical details of all Directors are set out on page 49. Details of the service contracts for the Executive Directors and the letters of appointment for the non-Executive Directors are set out in the Remuneration Report on page 71.

The interests of the Directors in the Ordinary Shares of the Company at 31 March 2011

are set out in the Remuneration Report on pages 73 to 74.

### Directors' insurance and indemnities

The Directors have the benefit of the indemnity provision contained in the Company's Articles of Association. The Directors of the Company have been granted a qualifying third party indemnity provision which was in force throughout the financial year and remains in force. The Company also purchased and maintained throughout the financial year directors' and officers' liability insurance in respect of itself and for its Directors and Officers.

### Results and dividends

The Group profit attributable to shareholders for the financial year amounted to £1,504.5m. The Directors recommend a final dividend of 52.6p per Ordinary Share which, subject to approval at the AGM, will be payable on 23 September 2011 to shareholders on the Register of Members at close of business on 29 July 2011. With the interim dividend of 22.4p per Ordinary Share paid on 25 March 2011, this makes a total dividend of 75p per Ordinary Share.

### Going concern

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. The Financial Statements are therefore prepared on a going concern basis. Further details of the Group's liquidity position and going concern review are provided in note 31 to the Financial Statements.

### Share capital

The Companies Act 2006 abolishes the requirement for a company to have an authorised share capital and the Articles of Association as approved and adopted by the Company's shareholders at the 2010 AGM reflect this. Details of the Company's issued share capital at 31 March 2011, which includes options granted under the Group's employee share option schemes, are set out in notes 26 and 30 to the Financial Statements.

### Authority to purchase shares

The Company was authorised at the 2010 AGM to purchase its own shares within certain limits. During 2010/11, SSE did not purchase any shares under this authority. The Directors will, however, seek renewal of their authority to purchase in the market the Company's own shares at the AGM on 21 July 2011, and this remains a benchmark against which financial decisions are taken.

### Annual General Meeting 2011

The 22nd AGM of the Company will be held on 21 July 2011 at 12 noon in the Perth Concert Hall, Mill Street, Perth PH1 5HZ. The Notice of Annual General Meeting 2011, which contains full explanations of the business to be conducted at the AGM, is set out in a separate shareholder circular.

### Substantial shareholdings

At 19 May 2011, the interests in the issued Ordinary Share capital of the Company have been disclosed in accordance with the requirements of the UK Listing Authority's Disclosure and Transparency Rules, as shown in the table below.

### Creditor payment policy

It is the Company's policy that payment terms are agreed at the outset of a transaction and are adhered to; that bills are paid in accordance with the contract; and that there are no alterations to payment terms without prior agreement. The number of suppliers' days represented by trade creditors was 39 days at 31 March 2011.

### Accounting policies, financial instruments and risk

Details of the Group's accounting policies, together with details of financial instruments and risk, are provided in notes 1 and 31 to the Financial Statements.

### Additional information

Where not provided elsewhere in the Directors' Report, the following provides the information required to be disclosed by Section 992 of the Companies Act 2006.

Each Ordinary Share of the Company carries one vote at general meetings of the Company.

### Substantial shareholdings

| Entity                                  | Number of shares* | Percentage* | Nature of holding |
|-----------------------------------------|-------------------|-------------|-------------------|
| Capital Research and Management Company | 46,267,405        | 5.02%       | Indirect          |
| Legal & General Group Plc               | 37,426,851        | 3.99%       | Direct            |

\* At date of disclosure by relevant entity.

Since the date of disclosure to the Company, the interests of the shareholders listed above may have increased or decreased.

## Other statutory information (continued)

There are no restrictions on the transfer of Ordinary Shares in the capital of the Company other than certain restrictions which may from time-to-time be imposed by law (for example, insider trading law). In accordance with the Listing Rules of the Financial Services Authority, certain employees are required to seek the approval of the Company to deal in its shares.

Employees who participate in the Share Incentive Plan whose shares remain in the schemes' trusts give directions to the trustees to vote on their behalf by way of a Form of Direction.

The Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

The rules governing the appointment of Directors are set out in the Corporate Governance Report on page 52. The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

The Company is not aware of any significant agreements to which it is party that take effect, alter or terminate upon a change of control of the Company following a takeover. The Company is not aware of any contractual or other agreements which are essential to its business which ought to be disclosed in this Directors' Report.

Details of any post balance sheet events are provided in note 34 to the Financial Statements.

### Auditors

Upon the recommendation of the Audit Committee and approval of the Board, resolutions to re-appoint KPMG Audit Plc as Auditors, and to authorise the Directors to fix their remuneration, will be proposed at the forthcoming AGM.

Each of the Directors who held office at the date of approval of this Directors' Report confirms that, so far as each Director is aware, there is no relevant audit information of which the Company's Auditors is unaware and each Director has taken all the steps that ought to have been taken in his or her duty as a Director to make himself or herself aware of any relevant audit information and to establish that the Company's Auditors is aware of that information.

By Order of the Board

**Vincent Donnelly**  
Company Secretary  
19 May 2011

### Statement of Directors' responsibilities in respect of the annual report and the financial statements

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

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 Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

For and on behalf of the Board

**Ian Marchant**  
Chief Executive  
19 May 2011

**Gregor Alexander**  
Finance Director

# Financial statements

Overview  
 Strategy  
 Group performance  
 Segmental performance  
 Corporate governance  
**Financial statements**  
 Shareholder information

## Contents

### Financial statements

|            |                                                      |
|------------|------------------------------------------------------|
| <b>78</b>  | Independent auditors' report                         |
| <b>79</b>  | Consolidated income statement                        |
| <b>80</b>  | Statement of comprehensive income                    |
| <b>81</b>  | Balance sheets                                       |
| <b>82</b>  | Statement of changes in equity                       |
| <b>84</b>  | Cash flow statements                                 |
| <b>86</b>  | Notes on the financial statements                    |
| <b>86</b>  | 1. Significant accounting policies                   |
| <b>95</b>  | 2. Reclassification of comparative amounts           |
| <b>96</b>  | 3. Segmental information                             |
| <b>99</b>  | 4. Other operating income and expense                |
| <b>100</b> | 5. Exceptional items and certain remeasurements      |
| <b>101</b> | 6. Directors and employees                           |
| <b>102</b> | 7. Finance income and costs                          |
| <b>103</b> | 8. Taxation                                          |
| <b>105</b> | 9. Dividends                                         |
| <b>105</b> | 10. Earnings per share                               |
| <b>106</b> | 11. Intangible assets                                |
| <b>110</b> | 12. Property, plant and equipment                    |
| <b>111</b> | 13. Biological assets                                |
| <b>112</b> | 14. Investments                                      |
| <b>115</b> | 15. Subsidiary undertakings                          |
| <b>117</b> | 16. Acquisitions, disposals and held for sale assets |
| <b>119</b> | 17. Inventories                                      |
| <b>120</b> | 18. Trade and other receivables                      |
| <b>120</b> | 19. Cash and cash equivalents                        |
| <b>120</b> | 20. Trade and other payables                         |
| <b>121</b> | 21. Current tax liabilities                          |
| <b>121</b> | 22. Construction contracts                           |
| <b>121</b> | 23. Loans and other borrowings                       |
| <b>124</b> | 24. Deferred taxation                                |
| <b>125</b> | 25. Provisions                                       |
| <b>126</b> | 26. Share capital                                    |
| <b>126</b> | 27. Reserves                                         |
| <b>126</b> | 28. Hybrid capital                                   |
| <b>127</b> | 29. Retirement benefit obligations                   |
| <b>130</b> | 30. Employee share-based payments                    |
| <b>135</b> | 31. Financial instruments and risk                   |
| <b>149</b> | 32. Related party transactions                       |
| <b>150</b> | 33. Commitments and contingencies                    |
| <b>151</b> | 34. Post balance sheet events                        |

### Shareholder information

|            |                         |
|------------|-------------------------|
| <b>152</b> | Shareholder information |
|------------|-------------------------|

# Independent auditors' report to the members of Scottish and Southern Energy plc

We have audited the financial statements of Scottish and Southern Energy plc for the year ended 31 March 2011 set out on pages 79 to 151. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 76, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

## Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at [www.frc.org.uk/apb/scope/private.cfm](http://www.frc.org.uk/apb/scope/private.cfm).

## Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2011 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

## Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006;
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- information given in the Corporate Governance Statement set out on pages 47 to 76 with respect to internal control and risk management systems in relation to financial reporting processes and about share capital structures is consistent with the financial statements.

## Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

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

Under the Listing Rules we are required to review:

- the Directors' Report in relation to going concern, set out on page 75;
- the part of the Corporate Governance Statement on pages 47 to 76 relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

## John Luke (Senior Statutory Auditor)

For and on behalf of KPMG Audit Plc, Statutory Auditor  
Chartered Accountants

Saltire Court  
20 Castle Terrace  
Edinburgh  
EH1 2EG  
19 May 2011

# Consolidated income statement for the year ended 31 March

Overview  
Strategy  
Group performance  
Segmental performance  
Corporate governance  
**Financial statements**  
Shareholder information

|                                                                               | Note | 2011                                                               |                                                                      |                 | 2010                                                                                    |                                                                                           |                                  |
|-------------------------------------------------------------------------------|------|--------------------------------------------------------------------|----------------------------------------------------------------------|-----------------|-----------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|----------------------------------|
|                                                                               |      | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>(note 5)<br>£m | Total<br>£m     | Before<br>exceptional<br>items and certain<br>remeasurements<br>Restated (note 2)<br>£m | Exceptional<br>items and certain<br>remeasurements<br>(note 5)<br>Restated (note 2)<br>£m | Total<br>Restated (note 2)<br>£m |
| <b>Revenue</b>                                                                | 3    | <b>28,334.2</b>                                                    | <b>–</b>                                                             | <b>28,334.2</b> | 21,550.4                                                                                | –                                                                                         | 21,550.4                         |
| Cost of sales                                                                 |      | (26,094.1)                                                         | 948.8                                                                | (25,145.3)      | (19,466.3)                                                                              | 432.2                                                                                     | (19,034.1)                       |
| <b>Gross profit</b>                                                           |      | <b>2,240.1</b>                                                     | <b>948.8</b>                                                         | <b>3,188.9</b>  | 2,084.1                                                                                 | 432.2                                                                                     | 2,516.3                          |
| Operating costs                                                               | 4    | (886.0)                                                            | –                                                                    | (886.0)         | (722.2)                                                                                 | –                                                                                         | (722.2)                          |
| <b>Operating profit before jointly<br/>controlled entities and associates</b> |      | <b>1,354.1</b>                                                     | <b>948.8</b>                                                         | <b>2,302.9</b>  | 1,361.9                                                                                 | 432.2                                                                                     | 1,794.1                          |
| Jointly controlled entities and associates:                                   |      |                                                                    |                                                                      |                 |                                                                                         |                                                                                           |                                  |
| Share of operating profit                                                     |      | 298.8                                                              | (103.2)                                                              | 195.6           | 264.1                                                                                   | –                                                                                         | 264.1                            |
| Share of interest                                                             |      | (139.9)                                                            | –                                                                    | (139.9)         | (107.1)                                                                                 | –                                                                                         | (107.1)                          |
| Share of movement on derivatives                                              |      | –                                                                  | 5.9                                                                  | 5.9             | –                                                                                       | 4.1                                                                                       | 4.1                              |
| Share of tax                                                                  |      | (58.2)                                                             | 61.5                                                                 | 3.3             | (50.1)                                                                                  | (1.2)                                                                                     | (51.3)                           |
| <b>Share of profit on jointly controlled<br/>entities and associates</b>      | 14   | <b>100.7</b>                                                       | <b>(35.8)</b>                                                        | <b>64.9</b>     | 106.9                                                                                   | 2.9                                                                                       | 109.8                            |
| <b>Operating profit</b>                                                       | 3    | <b>1,454.8</b>                                                     | <b>913.0</b>                                                         | <b>2,367.8</b>  | 1,468.8                                                                                 | 435.1                                                                                     | 1,903.9                          |
| Finance income                                                                | 7    | 250.2                                                              | –                                                                    | 250.2           | 203.2                                                                                   | –                                                                                         | 203.2                            |
| Finance costs                                                                 | 7    | (453.1)                                                            | (53.2)                                                               | (506.3)         | (432.0)                                                                                 | (36.5)                                                                                    | (468.5)                          |
| <b>Profit before taxation</b>                                                 |      | <b>1,251.9</b>                                                     | <b>859.8</b>                                                         | <b>2,111.7</b>  | 1,240.0                                                                                 | 398.6                                                                                     | 1,638.6                          |
| Taxation                                                                      | 8    | (354.8)                                                            | (252.4)                                                              | (607.2)         | (292.2)                                                                                 | (110.9)                                                                                   | (403.1)                          |
| <b>Profit for the year</b>                                                    |      | <b>897.1</b>                                                       | <b>607.4</b>                                                         | <b>1,504.5</b>  | 947.8                                                                                   | 287.7                                                                                     | 1,235.5                          |
| <b>Attributable to:</b>                                                       |      |                                                                    |                                                                      |                 |                                                                                         |                                                                                           |                                  |
| Equity holders of the parent                                                  |      | 897.1                                                              | 607.4                                                                | 1,504.5         | 947.6                                                                                   | 287.7                                                                                     | 1,235.3                          |
| Non-controlling interest                                                      |      | –                                                                  | –                                                                    | –               | 0.2                                                                                     | –                                                                                         | 0.2                              |
| Basic earnings per share (pence)                                              | 10   |                                                                    |                                                                      | <b>162.2p</b>   |                                                                                         |                                                                                           | 134.0p                           |
| Diluted earnings per share (pence)                                            | 10   |                                                                    |                                                                      | <b>162.0p</b>   |                                                                                         |                                                                                           | 133.9p                           |
| Dividends in the year (£m)                                                    | 9    |                                                                    |                                                                      | <b>£659.8m</b>  |                                                                                         |                                                                                           | £618.5m                          |

The accompanying notes are an integral part of these financial statements.

# Statement of comprehensive income

## for the year ended 31 March

|                                                                     | Consolidated   |            |
|---------------------------------------------------------------------|----------------|------------|
|                                                                     | 2011<br>£m     | 2010<br>£m |
| <b>Profit for the year</b>                                          | <b>1,504.5</b> | 1,235.5    |
| <b>Other comprehensive income:</b>                                  |                |            |
| Gain/(losses) on effective portion of cash flow hedges              | <b>32.3</b>    | (26.6)     |
| Transferred to assets and liabilities on cash flow hedges           | <b>(7.0)</b>   | –          |
| Taxation on cash flow hedges                                        | <b>(5.9)</b>   | 2.1        |
|                                                                     | <b>19.4</b>    | (24.5)     |
| Exchange difference on translation of foreign operations            | <b>(78.3)</b>  | 0.4        |
| Gains/(losses) on net investment hedge                              | <b>4.3</b>     | (47.2)     |
| Taxation on net investment hedge                                    | <b>(1.2)</b>   | 13.2       |
|                                                                     | <b>(75.2)</b>  | (33.6)     |
| Actuarial losses on retirement benefit schemes                      | <b>(8.8)</b>   | (508.8)    |
| Taxation on actuarial losses on defined benefit pension schemes     | <b>(7.9)</b>   | 142.5      |
|                                                                     | <b>(16.7)</b>  | (366.3)    |
| Jointly controlled entities and associates:                         |                |            |
| Share of (loss) on effective portion of cash flow hedges            | <b>(4.1)</b>   | (30.0)     |
| Share of taxation on cash flow hedges                               | <b>(0.3)</b>   | 19.1       |
|                                                                     | <b>(4.4)</b>   | (10.9)     |
| Share of actuarial (losses) on retirement benefit schemes           | <b>(11.6)</b>  | (82.1)     |
| Share of taxation of actuarial losses on retirement benefit schemes | <b>1.8</b>     | 23.0       |
|                                                                     | <b>(9.8)</b>   | (59.1)     |
| <b>Net share from jointly controlled entities and associates</b>    | <b>(14.2)</b>  | (70.0)     |
| <b>Other comprehensive income, net of taxation</b>                  | <b>(86.7)</b>  | (494.4)    |
| <b>Total comprehensive income for the period</b>                    | <b>1,417.8</b> | 741.1      |
| <b>Attributable to:</b>                                             |                |            |
| Equity holders of the parent                                        | <b>1,417.8</b> | 740.9      |
| Non-controlling interest                                            | <b>–</b>       | 0.2        |
|                                                                     | <b>1,417.8</b> | 741.1      |

## Balance sheets as at 31 March

Overview  
Strategy  
Group performance  
Segmental performance  
Corporate governance  
**Financial statements**  
Shareholder information

|                                                                  |      | Consolidated    |                                    | Company         |                                    |
|------------------------------------------------------------------|------|-----------------|------------------------------------|-----------------|------------------------------------|
|                                                                  | Note | 2011<br>£m      | 2010<br>Restated<br>(note 2)<br>£m | 2011<br>£m      | 2010<br>Restated<br>(note 2)<br>£m |
| <b>Assets</b>                                                    |      |                 |                                    |                 |                                    |
| Property, plant and equipment                                    | 12   | 8,513.1         | 8,204.2                            | –               | –                                  |
| Biological assets                                                | 13   | 4.4             | 4.4                                | –               | –                                  |
| Intangible assets:                                               |      |                 |                                    |                 |                                    |
| Goodwill                                                         | 11   | 685.3           | 726.3                              | –               | –                                  |
| Other intangible assets                                          | 11   | 287.8           | 288.2                              | –               | –                                  |
| Equity investments in associates and jointly controlled entities | 14   | 760.8           | 635.2                              | 190.0           | 207.0                              |
| Loans to associates and jointly controlled entities              | 14   | 1,124.6         | 970.5                              | 1,029.5         | 835.3                              |
| Other investments                                                | 14   | 39.6            | 9.2                                | 18.0            | –                                  |
| Investments in subsidiaries                                      | 15   | –               | –                                  | 2,318.4         | 2,172.1                            |
| Trade and other receivables                                      | 18   | –               | –                                  | 3,661.2         | 3,456.1                            |
| Deferred tax assets                                              | 24   | 161.7           | 157.1                              | 122.1           | 116.9                              |
| Derivative financial assets                                      | 31   | 990.1           | 466.3                              | 48.0            | 47.5                               |
| <b>Non-current assets</b>                                        |      | <b>12,567.4</b> | <b>11,461.4</b>                    | <b>7,387.2</b>  | <b>6,834.9</b>                     |
| Other intangible assets                                          | 11   | 325.6           | 213.3                              | –               | –                                  |
| Inventories                                                      | 17   | 217.5           | 272.5                              | –               | –                                  |
| Trade and other receivables                                      | 18   | 5,068.1         | 4,450.4                            | 2,285.9         | 1,859.6                            |
| Cash and cash equivalents                                        | 19   | 476.9           | 261.7                              | 319.1           | 99.7                               |
| Derivative financial assets                                      | 31   | 2,525.5         | 1,468.3                            | 30.0            | 56.6                               |
| Current assets held for sale                                     | 16   | 269.4           | –                                  | –               | –                                  |
| <b>Current assets</b>                                            |      | <b>8,883.0</b>  | <b>6,666.2</b>                     | <b>2,635.0</b>  | <b>2,015.9</b>                     |
| <b>Total assets</b>                                              |      | <b>21,450.4</b> | <b>18,127.6</b>                    | <b>10,022.2</b> | <b>8,850.8</b>                     |
| <b>Liabilities</b>                                               |      |                 |                                    |                 |                                    |
| Loans and other borrowings                                       | 23   | 446.5           | 903.7                              | 106.8           | 815.6                              |
| Trade and other payables                                         | 20   | 5,078.0         | 4,064.5                            | 2,792.3         | 2,619.3                            |
| Current tax liabilities                                          | 21   | 268.2           | 216.9                              | 22.9            | 4.0                                |
| Provisions                                                       | 25   | 9.9             | 6.5                                | –               | –                                  |
| Derivative financial liabilities                                 | 31   | 2,307.5         | 2,020.7                            | 15.5            | 45.2                               |
| <b>Current liabilities</b>                                       |      | <b>8,110.1</b>  | <b>7,212.3</b>                     | <b>2,937.5</b>  | <b>3,484.1</b>                     |
| Loans and other borrowings                                       | 23   | 5,159.9         | 5,143.3                            | 3,756.9         | 3,341.4                            |
| Deferred tax liabilities                                         | 24   | 1,068.3         | 624.0                              | –               | –                                  |
| Trade and other payables                                         | 20   | 304.2           | 324.5                              | –               | –                                  |
| Provisions                                                       | 25   | 169.2           | 83.2                               | –               | –                                  |
| Retirement benefit obligations                                   | 29   | 668.6           | 720.3                              | 239.8           | 251.1                              |
| Derivative financial liabilities                                 | 31   | 769.3           | 899.0                              | 136.7           | 82.8                               |
| <b>Non-current liabilities</b>                                   |      | <b>8,139.5</b>  | <b>7,794.3</b>                     | <b>4,133.4</b>  | <b>3,675.3</b>                     |
| <b>Total liabilities</b>                                         |      | <b>16,249.6</b> | <b>15,006.6</b>                    | <b>7,070.9</b>  | <b>7,159.4</b>                     |
| <b>Net assets</b>                                                |      | <b>5,200.8</b>  | <b>3,121.0</b>                     | <b>2,951.3</b>  | <b>1,691.4</b>                     |
| <b>Equity:</b>                                                   |      |                 |                                    |                 |                                    |
| Share capital                                                    | 26   | 468.4           | 461.5                              | 468.4           | 461.5                              |
| Share premium                                                    |      | 859.8           | 857.5                              | 859.8           | 857.5                              |
| Capital redemption reserve                                       |      | 22.0            | 22.0                               | 22.0            | 22.0                               |
| Hedge reserve                                                    |      | (1.2)           | (16.2)                             | 19.2            | 21.0                               |
| Translation reserve                                              |      | 38.2            | 113.4                              | –               | –                                  |
| Retained earnings                                                |      | 2,652.2         | 1,686.6                            | 420.5           | 329.4                              |
| Hybrid capital                                                   | 28   | 1,161.4         | –                                  | 1,161.4         | –                                  |
| <b>Total equity attributable to equity holders of the parent</b> |      | <b>5,200.8</b>  | <b>3,124.8</b>                     | <b>2,951.3</b>  | <b>1,691.4</b>                     |
| Non-controlling interest                                         |      | –               | (3.8)                              | –               | –                                  |
| <b>Total equity</b>                                              |      | <b>5,200.8</b>  | <b>3,121.0</b>                     | <b>2,951.3</b>  | <b>1,691.4</b>                     |

These financial statements were approved by the Board of Directors on 19 May 2011 and signed on their behalf by:

**Gregor Alexander**  
Finance Director

**Lord Smith of Kelvin**  
Chairman

Scottish and Southern Energy plc, Registered No: SC117119

## Statement of changes in equity for the year ended 31 March

### Consolidated

#### Reconciliation of movement in reserves

|                                                                                   | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Hedge reserve<br>£m | Translation reserve<br>£m | Retained earnings<br>£m | Non-controlling interest<br>£m | Hybrid capital<br>£m | Total<br>£m    |
|-----------------------------------------------------------------------------------|---------------------|-----------------------------|----------------------------------|---------------------|---------------------------|-------------------------|--------------------------------|----------------------|----------------|
| At 1 April 2010                                                                   | 461.5               | 857.5                       | 22.0                             | (16.2)              | 113.4                     | 1,686.6                 | (3.8)                          | –                    | 3,121.0        |
| Profit for the year                                                               | –                   | –                           | –                                | –                   | –                         | 1,504.5                 | –                              | –                    | 1,504.5        |
| Effective portion of changes in fair value of cash flow hedges (net of tax)       | –                   | –                           | –                                | 26.4                | –                         | –                       | –                              | –                    | 26.4           |
| Transferred to balance sheet on cash flow hedges (net of tax)                     | –                   | –                           | –                                | (7.0)               | –                         | –                       | –                              | –                    | (7.0)          |
| Effective net investment hedge (net of tax)                                       | –                   | –                           | –                                | –                   | 3.1                       | –                       | –                              | –                    | 3.1            |
| Exchange differences on translation of foreign operation                          | –                   | –                           | –                                | –                   | (78.3)                    | –                       | –                              | –                    | (78.3)         |
| Actuarial losses on retirement benefit schemes (net of tax)                       | –                   | –                           | –                                | –                   | –                         | (16.7)                  | –                              | –                    | (16.7)         |
| Jointly controlled entities and associates:                                       |                     |                             |                                  |                     |                           |                         |                                |                      |                |
| Share of change in fair value of effective cash flow hedges                       | –                   | –                           | –                                | (4.4)               | –                         | –                       | –                              | –                    | (4.4)          |
| Share of actuarial losses on retirement benefit schemes (net of tax)              | –                   | –                           | –                                | –                   | –                         | (9.8)                   | –                              | –                    | (9.8)          |
| Total comprehensive income for the year                                           | –                   | –                           | –                                | 15.0                | (75.2)                    | 1,478.0                 | –                              | –                    | 1,417.8        |
| Dividends to shareholders                                                         | –                   | –                           | –                                | –                   | –                         | (659.8)                 | –                              | –                    | (659.8)        |
| Scrip dividend related share issue                                                | 6.4                 | (6.4)                       | –                                | –                   | –                         | 146.1                   | –                              | –                    | 146.1          |
| Issue of hybrid capital                                                           | –                   | –                           | –                                | –                   | –                         | –                       | –                              | 1,161.4              | 1,161.4        |
| Issue of shares                                                                   | 0.5                 | 8.7                         | –                                | –                   | –                         | –                       | –                              | –                    | 9.2            |
| Transactions with shareholders                                                    | –                   | –                           | –                                | –                   | –                         | –                       | 3.8                            | –                    | 3.8            |
| Credit in respect of employee share awards                                        | –                   | –                           | –                                | –                   | –                         | 9.9                     | –                              | –                    | 9.9            |
| Investment in own shares                                                          | –                   | –                           | –                                | –                   | –                         | (9.2)                   | –                              | –                    | (9.2)          |
| Current and deferred tax recognised in equity in respect of employee share awards | –                   | –                           | –                                | –                   | –                         | 0.6                     | –                              | –                    | 0.6            |
| <b>At 31 March 2011</b>                                                           | <b>468.4</b>        | <b>859.8</b>                | <b>22.0</b>                      | <b>(1.2)</b>        | <b>38.2</b>               | <b>2,652.2</b>          | <b>–</b>                       | <b>1,161.4</b>       | <b>5,200.8</b> |

### Company

#### Reconciliation of movement in reserves

|                                                                                   | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Hedge reserve<br>£m | Retained earnings<br>£m | Hybrid capital<br>£m | Total<br>£m    |
|-----------------------------------------------------------------------------------|---------------------|-----------------------------|----------------------------------|---------------------|-------------------------|----------------------|----------------|
| At 1 April 2010                                                                   | 461.5               | 857.5                       | 22.0                             | 21.0                | 329.4                   | –                    | 1,691.4        |
| Profit for the year                                                               | –                   | –                           | –                                | –                   | 627.3                   | –                    | 627.3          |
| Effective portion of changes in fair value of cash flow hedges (net of tax)       | –                   | –                           | –                                | (1.8)               | –                       | –                    | (1.8)          |
| Transferred to balance sheet on cash flow hedges (net of tax)                     | –                   | –                           | –                                | –                   | –                       | –                    | –              |
| Actuarial losses on retirement benefit schemes (net of tax)                       | –                   | –                           | –                                | –                   | (23.8)                  | –                    | (23.8)         |
| Total comprehensive income for the year                                           | –                   | –                           | –                                | (1.8)               | 603.5                   | –                    | 601.7          |
| Dividends to shareholders                                                         | –                   | –                           | –                                | –                   | (659.8)                 | –                    | (659.8)        |
| Scrip dividend related share issue                                                | 6.4                 | (6.4)                       | –                                | –                   | 146.1                   | –                    | 146.1          |
| Issue of hybrid capital                                                           | –                   | –                           | –                                | –                   | –                       | 1,161.4              | 1,161.4        |
| Issue of shares                                                                   | 0.5                 | 8.7                         | –                                | –                   | –                       | –                    | 9.2            |
| Increase in investment in subsidiaries                                            | –                   | –                           | –                                | –                   | 9.9                     | –                    | 9.9            |
| Investment in own shares                                                          | –                   | –                           | –                                | –                   | (9.2)                   | –                    | (9.2)          |
| Current and deferred tax recognised in equity in respect of employee share awards | –                   | –                           | –                                | –                   | 0.6                     | –                    | 0.6            |
| <b>At 31 March 2011</b>                                                           | <b>468.4</b>        | <b>859.8</b>                | <b>22.0</b>                      | <b>19.2</b>         | <b>420.5</b>            | <b>1,161.4</b>       | <b>2,951.3</b> |

**Consolidated  
Reconciliation of movement in reserves**

|                                                                                   | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Equity reserve<br>£m | Hedge reserve<br>£m | Translation reserve<br>£m | Retained earnings<br>£m | Non-controlling interest<br>£m | Total<br>£m    |
|-----------------------------------------------------------------------------------|---------------------|-----------------------------|----------------------------------|----------------------|---------------------|---------------------------|-------------------------|--------------------------------|----------------|
| At 1 April 2009                                                                   | 460.2               | 835.3                       | 22.0                             | 0.8                  | 19.6                | 146.6                     | 1,492.7                 | (2.3)                          | <b>2,974.9</b> |
| Profit for the year                                                               | –                   | –                           | –                                | –                    | –                   | –                         | 1,235.3                 | 0.2                            | <b>1,235.5</b> |
| Effective portion of changes in fair value of cash flow hedges (net of tax)       | –                   | –                           | –                                | –                    | (24.5)              | –                         | –                       | –                              | <b>(24.5)</b>  |
| Effective net investment hedge (net of tax)                                       | –                   | –                           | –                                | –                    | –                   | (34.0)                    | –                       | –                              | <b>(34.0)</b>  |
| Exchange differences on translation of foreign operation                          | –                   | –                           | –                                | –                    | (0.4)               | 0.8                       | –                       | –                              | <b>0.4</b>     |
| Actuarial losses on retirement benefit schemes (net of tax)                       | –                   | –                           | –                                | –                    | –                   | –                         | (366.3)                 | –                              | <b>(366.3)</b> |
| Jointly controlled entities and associates:                                       |                     |                             |                                  |                      |                     |                           |                         |                                |                |
| Share of change in fair value of effective cash flow hedges                       | –                   | –                           | –                                | –                    | (10.9)              | –                         | –                       | –                              | <b>(10.9)</b>  |
| Share of actuarial losses on retirement benefit schemes (net of tax)              | –                   | –                           | –                                | –                    | –                   | –                         | (59.1)                  | –                              | <b>(59.1)</b>  |
| Total comprehensive income for the year                                           | –                   | –                           | –                                | –                    | (35.8)              | (33.2)                    | 809.9                   | 0.2                            | <b>741.1</b>   |
| Dividends to shareholders                                                         | –                   | –                           | –                                | –                    | –                   | –                         | (618.5)                 | (1.7)                          | <b>(620.2)</b> |
| Convertible bond converted to equity                                              | 0.9                 | 15.8                        | –                                | (0.8)                | –                   | –                         | –                       | –                              | <b>15.9</b>    |
| Issue of shares                                                                   | 0.4                 | 6.4                         | –                                | –                    | –                   | –                         | –                       | –                              | <b>6.8</b>     |
| Credit in respect of employee share awards                                        | –                   | –                           | –                                | –                    | –                   | –                         | 17.9                    | –                              | <b>17.9</b>    |
| Investment in own shares                                                          | –                   | –                           | –                                | –                    | –                   | –                         | (15.8)                  | –                              | <b>(15.8)</b>  |
| Current and deferred tax recognised in equity in respect of employee share awards | –                   | –                           | –                                | –                    | –                   | –                         | 0.4                     | –                              | <b>0.4</b>     |
| <b>At 31 March 2010</b>                                                           | <b>461.5</b>        | <b>857.5</b>                | <b>22.0</b>                      | <b>–</b>             | <b>(16.2)</b>       | <b>113.4</b>              | <b>1,686.6</b>          | <b>(3.8)</b>                   | <b>3,121.0</b> |

**Company  
Reconciliation of movement in reserves**

|                                                                             | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Equity reserve<br>£m | Hedge reserve<br>£m | Retained earnings<br>£m | Total<br>£m    |
|-----------------------------------------------------------------------------|---------------------|-----------------------------|----------------------------------|----------------------|---------------------|-------------------------|----------------|
| At 1 April 2009                                                             | 460.2               | 835.3                       | 22.0                             | 0.8                  | 43.3                | 576.8                   | <b>1,938.4</b> |
| Profit for the year                                                         | –                   | –                           | –                                | –                    | –                   | 575.9                   | <b>575.9</b>   |
| Effective portion of changes in fair value of cash flow hedges (net of tax) | –                   | –                           | –                                | –                    | (22.3)              | –                       | <b>(22.3)</b>  |
| Actuarial losses on retirement benefit schemes (net of tax)                 | –                   | –                           | –                                | –                    | –                   | (206.9)                 | <b>(206.9)</b> |
| Total comprehensive income for the year                                     | –                   | –                           | –                                | –                    | (22.3)              | 369.0                   | <b>346.7</b>   |
| Dividends to shareholders                                                   | –                   | –                           | –                                | –                    | –                   | (618.5)                 | <b>(618.5)</b> |
| Convertible bond converted to equity                                        | 0.9                 | 15.8                        | –                                | (0.8)                | –                   | –                       | <b>15.9</b>    |
| Issue of shares                                                             | 0.4                 | 6.4                         | –                                | –                    | –                   | –                       | <b>6.8</b>     |
| Increase in investment in subsidiaries                                      | –                   | –                           | –                                | –                    | –                   | 17.9                    | <b>17.9</b>    |
| Investment in own shares                                                    | –                   | –                           | –                                | –                    | –                   | (15.8)                  | <b>(15.8)</b>  |
| <b>At 31 March 2010</b>                                                     | <b>461.5</b>        | <b>857.5</b>                | <b>22.0</b>                      | <b>–</b>             | <b>21.0</b>         | <b>329.4</b>            | <b>1,691.4</b> |

## Cash flow statements

### for the year ended 31 March

|                                                                                    | Consolidated     |                        | Company        |                        |
|------------------------------------------------------------------------------------|------------------|------------------------|----------------|------------------------|
|                                                                                    | 2011<br>£m       | 2010<br>Restated<br>£m | 2011<br>£m     | 2010<br>Restated<br>£m |
| <b>Cash flows from operating activities</b>                                        |                  |                        |                |                        |
| Profit for the year after tax                                                      | 1,504.5          | 1,235.5                | 627.3          | 575.9                  |
| Taxation                                                                           | 607.2            | 403.1                  | 15.9           | (0.6)                  |
| Movement on financing and operating derivatives                                    | (1,417.4)        | (395.7)                | 47.3           | 44.9                   |
| Finance costs                                                                      | 453.1            | 432.0                  | 204.3          | 235.6                  |
| Finance income                                                                     | (250.2)          | (203.2)                | (291.1)        | (259.7)                |
| Share of profit/loss of jointly controlled entities and associates                 | (64.9)           | (109.8)                | –              | –                      |
| Income from investment in subsidiaries, jointly controlled entities and associates | –                | –                      | (601.9)        | (577.5)                |
| Pension service charges less contributions paid                                    | (68.9)           | (88.8)                 | (48.5)         | (44.2)                 |
| Exceptional impairment of assets                                                   | 521.8            | –                      | 13.7           | –                      |
| Depreciation of assets                                                             | 496.7            | 394.9                  | –              | –                      |
| Amortisation and impairment of intangible assets                                   | 21.5             | 22.2                   | –              | –                      |
| Impairment of inventories                                                          | 6.6              | 3.0                    | –              | –                      |
| Release of provisions                                                              | (6.0)            | (7.1)                  | –              | –                      |
| Release of deferred income                                                         | (19.6)           | (15.2)                 | –              | –                      |
| Decrease in inventories                                                            | 48.4             | 97.2                   | –              | –                      |
| (Increase)/decrease in receivables                                                 | (95.4)           | 914.3                  | (88.3)         | 100.7                  |
| Increase/(decrease) in payables                                                    | 371.3            | (486.8)                | (214.3)        | 119.4                  |
| Increase in provisions                                                             | 6.2              | 5.9                    | –              | –                      |
| Charge in respect of employee share awards (before tax)                            | 9.9              | 17.9                   | –              | –                      |
| (Profit) on disposal of property, plant and equipment                              | (5.8)            | (5.7)                  | –              | –                      |
| Loss on disposal of fixed asset investment                                         | –                | 0.1                    | –              | –                      |
| Profit on disposal of business and subsidiaries (note 16)                          | (10.2)           | –                      | –              | –                      |
| <b>Cash generated from operations</b>                                              | <b>2,108.8</b>   | <b>2,213.8</b>         | <b>(335.6)</b> | <b>194.5</b>           |
| Dividends received from jointly controlled entities                                | 81.7             | 23.7                   | 30.0           | –                      |
| Dividends paid to minority investment holders                                      | –                | (1.7)                  | –              | –                      |
| Dividends received from subsidiaries                                               | –                | –                      | 571.9          | 577.5                  |
| Finance income                                                                     | 109.7            | 102.5                  | 252.5          | 223.0                  |
| Finance costs                                                                      | (387.1)          | (341.4)                | (181.9)        | (206.4)                |
| Income taxes paid                                                                  | (172.6)          | (307.7)                | (205.8)        | (300.6)                |
| Payment for consortium relief                                                      | (21.2)           | –                      | (21.2)         | –                      |
| <b>Net cash from operating activities</b>                                          | <b>1,719.3</b>   | <b>1,689.2</b>         | <b>109.9</b>   | <b>488.0</b>           |
| <b>Cash flows from investing activities</b>                                        |                  |                        |                |                        |
| Purchase of property, plant and equipment                                          | (1,079.0)        | (1,033.5)              | –              | –                      |
| Purchase of other intangible assets                                                | (40.3)           | (4.2)                  | –              | –                      |
| Deferred income received                                                           | 28.5             | 18.7                   | –              | –                      |
| Proceeds from sale of property, plant and equipment                                | 7.9              | 40.2                   | –              | –                      |
| Proceeds from sale of fixed asset investment                                       | –                | 0.9                    | –              | –                      |
| Proceeds from sale of business and subsidiaries (note 16)                          | 31.9             | –                      | –              | –                      |
| Other loans to jointly controlled entities and associates (note 14)                | (204.4)          | (336.4)                | (194.2)        | (278.6)                |
| Purchase of businesses and subsidiaries (note 16)                                  | (241.3)          | (67.8)                 | –              | –                      |
| Cash acquired in purchases                                                         | –                | 9.7                    | –              | –                      |
| Cash included in disposals                                                         | (5.5)            | –                      | –              | –                      |
| Cash included in assets held for sale                                              | (23.0)           | –                      | –              | –                      |
| Investment in jointly controlled entities and associates                           | (176.3)          | (61.8)                 | (35.1)         | (17.0)                 |
| Loans and equity repaid by jointly controlled entities                             | 13.3             | 34.5                   | –              | 16.6                   |
| Increase in other investments                                                      | (30.4)           | (1.1)                  | –              | –                      |
| <b>Net cash from investing activities</b>                                          | <b>(1,718.6)</b> | <b>(1,400.8)</b>       | <b>(229.3)</b> | <b>(279.0)</b>         |

|                                                               | Consolidated |                        | Company      |                        |
|---------------------------------------------------------------|--------------|------------------------|--------------|------------------------|
|                                                               | 2011<br>£m   | 2010<br>Restated<br>£m | 2011<br>£m   | 2010<br>Restated<br>£m |
| <b>Cash flows from financing activities</b>                   |              |                        |              |                        |
| Proceeds from issue of share capital                          | 9.2          | 6.8                    | 9.2          | 6.8                    |
| Dividends paid to Company's equity holders                    | (513.7)      | (618.5)                | (513.7)      | (618.5)                |
| Issue of hybrid capital                                       | 1,161.4      | –                      | 1,161.4      | –                      |
| Employee share awards share purchase                          | (9.2)        | (15.8)                 | (9.2)        | (15.8)                 |
| New borrowings                                                | 765.1        | 1,338.3                | 506.7        | 1,299.7                |
| Repayment of borrowings                                       | (1,187.1)    | (1,035.3)              | (815.6)      | (916.6)                |
| <b>Net cash from financing activities</b>                     | <b>225.7</b> | <b>(324.5)</b>         | <b>338.8</b> | <b>(244.4)</b>         |
| <b>Net increase/(decrease) in cash and cash equivalents</b>   | <b>226.4</b> | <b>(36.1)</b>          | <b>219.4</b> | <b>(35.4)</b>          |
| Cash and cash equivalents at the start of year (note 19)      | 252.5        | 293.6                  | 99.7         | 135.1                  |
| Net increase/(decrease) in cash and cash equivalents          | 226.4        | (36.1)                 | 219.4        | (35.4)                 |
| Effect of foreign exchange rate changes                       | (7.3)        | (5.0)                  | –            | –                      |
| <b>Cash and cash equivalents at the end of year (note 19)</b> | <b>471.6</b> | <b>252.5</b>           | <b>319.1</b> | <b>99.7</b>            |

The accompanying notes are an integral part of these financial statements.

# Notes on the financial statements

## for the year ended 31 March

### 1. SIGNIFICANT ACCOUNTING POLICIES

#### General information

Scottish and Southern Energy plc (the Company) is a company domiciled in Scotland. The address of the registered office is given on the back cover. The Group's operations and its principal activities are set out earlier in this Report at pages 6 to 46. The consolidated financial statements for the year ended 31 March 2011 comprise those of the Company and its subsidiaries (together referred to as the Group). The Company financial statements present information about the Company as a separate entity and not about the Group. Under section 408 of the Companies Act 2006 the Company is exempt from the requirement to present its own income statement and related notes.

#### Basis of preparation

##### Statement of compliance

The financial statements were authorised for issue by the Directors on 19 May 2011. The financial statements have been prepared in accordance with International Financial Reporting Standards and its interpretations as adopted by the European Union (adopted IFRS).

##### Going concern

The Directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future. The financial statements are therefore prepared on a going concern basis. Further details of the Group's liquidity position and going concern review are provided in note 31 of the Financial Statements on page 140.

#### Basis of measurement

The financial statements of the Group and the Company are prepared on the historical cost basis except for derivative financial instruments, biological assets and the assets of the Group pension scheme which are stated at their fair value, and the liabilities of the Group pension schemes which are measured using the projected unit credit method. The Directors believe the financial statements present a true and fair view. The financial statements of the Group and Company are presented in pounds sterling. Operations and transactions conducted in currencies other than pounds sterling are included in the consolidated financial statements in accordance with the Group's foreign currencies accounting policy.

#### Use of estimates and judgements

The preparation of financial statements conforming with adopted IFRS requires the use of certain accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. The areas involving a higher level of judgement or estimation are summarised at pages 94 and 95.

#### Exceptional items and certain remeasurements

As permitted by IAS 1 *Presentation of Financial Statements*, the Group has disclosed additional information in respect of jointly controlled entities and associates, exceptional items and certain remeasurements on the face of the income statement to aid understanding of the Group's financial performance. An item is treated as exceptional if it is considered unusual by nature and scale and of such significance that separate disclosure is required for the financial statements to be properly understood. Certain remeasurements are remeasurements arising on certain commodity, interest rate and currency contracts which are accounted for as held for trading or as fair value hedges in accordance with the Group's policy for such financial instruments. This excludes commodity contracts not treated as financial instruments under IAS 39 where held for the Group's own use requirements.

#### Standards, amendments and interpretations

The following standards, amendments and interpretations have been adopted by the Group from 1 April 2010:

- IFRS 3 (revised), Business Combinations. The revised standard applies to business combinations entered into by the Group completing on or after 1 April 2010. There is no requirement to restate previous business combinations. The revised standard continues to apply the acquisition method to business combinations but with some significant changes compared with IFRS 3. All payments to purchase a business are recorded at fair value at the acquisition date, with contingent payments classified as a liability subsequently remeasured through the income statement. There is a choice on an acquisition by acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. Pre-existing relationships require to be recognised and all acquisition-related costs are expensed.
- As the Group has adopted IFRS 3 (revised), it is required to adopt IAS 27 (revised), Consolidated and Separate Financial Statements, at the same time. IAS 27 (revised) requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. In the financial statements to 31 March 2011, non-controlling interests of £3.8m were recorded in equity.
- IFRIC 18, Transfers of Assets from Customers, is effective for transfer of assets received on or after 1 November 2009. This interpretation clarifies the requirements for agreements in which an entity receives assets from a customer in return for connection to a network or ongoing access to a supply of goods or services. The contributed assets will be recognised initially at fair value and related revenue will be recognised immediately, unless there is a future service obligation, in which case revenue is deferred and recognised over the service period. By adopting this interpretation, the Group recognised £28.5m of revenue in the current financial year which would previously have been deferred. A compensating depreciation charge has been recognised against the related capital addition. As a consequence, the adoption of the interpretation did not have a material impact on the Group's reported performance. The impact of adopting the interpretation on the previous year's results is commented upon at note 2.

The following amendments to existing standards and interpretations were also effective for the current period, but the adoption of these amendments to existing standards and interpretations did not have a material impact on the financial statements of the Group:

- IFRIC 16, Hedges of Net Investment in a Foreign Operation.
- IFRIC 17, Distributions of Non-Cash Assets to Owners, effective for annual periods beginning on or after 1 July 2009.
- Improvements to International Financial Reporting Standards 2009 were issued in April 2009. The effective dates vary standard by standard but most are effective 1 January 2010.
- IFRS 2 (Amendment), Share Based Payment – Group Cash-settled Share-based Payment Transactions, effective for annual periods commencing on or after 1 January 2010.

At the date of authorisation of these financial statements, the following standards, amendments to existing standards and interpretations issued by the IASB and IFRIC, which have not been adopted in these condensed interim statements, were in issue but not yet effective:

- Revised IAS 24, Related Party Disclosures, issued in November 2009.
- Amendment to IFRIC 14, Prepayments of a Minimum Funding Requirement issued in November 2009. The amendment corrects an unintended consequence of IFRIC 14. Without the amendment, entities are not permitted to recognise as an asset some voluntary prepayments for minimum funding contributions. The amendment is effective for annual periods beginning 1 January 2011.
- Improvements to International Financial Reporting Standards 2010, issued in May 2010. IAS 39 (Amendment), Financial Instruments: Recognition and Measurement – Eligible Hedged Items, effective for annual periods beginning on or after 1 July 2009.
- IFRIC 19, Extinguishing Financial Liabilities with Equity Instruments, effective for annual periods beginning on or after 1 July 2010, although this has not been endorsed by the EU.

The above have not been early adopted by the Group and the impact of adopting these standards and amendments to existing standards is currently being assessed.

### **Basis of consolidation**

The financial statements consolidate the financial statements of the Company and its subsidiaries together with the Group's share of the results and net assets of its jointly controlled entities and associates.

### **Subsidiaries**

Subsidiaries (including special purpose entities) are those entities controlled by the Group or the Company. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity in order to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries acquired are consolidated in the financial statements of the Group from the date that control commences until the date control ceases. All business combinations are accounted for by applying the purchase method of accounting.

The special purpose entities referred to relate to entities in which the Group has a 50% shareholding but whose activities the Group is deemed to control under SIC-12 Consolidation – Special Purpose Entities.

In the Company, investments in subsidiaries are carried at cost less any impairment charges.

### **Associates**

Associates are those entities in which the Group has significant influence but not control over the financial and operating policies, namely where the Group has a shareholding of between 20% and 50% of the voting rights. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases.

### **Joint ventures**

Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement. In the consolidated financial statements, investments are accounted for under the equity method of accounting. Jointly controlled operations are businesses which use assets and liabilities that are separable from the rest of the Group. In these arrangements, the Group accounts for its own share of property, plant and equipment, carries its own inventories, incurs its own expenses and liabilities and raises its own finance.

In the Company, investments in jointly controlled entities are carried at cost less any impairment charges.

### **Transactions eliminated on consolidation**

Intra-Group balances and any unrealised gains and losses or income and expenses arising from Intra-Group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains and losses arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Group's interest in the entity.

### **Accounting policies**

#### **Revenue recognition: energy, services and goods relating to the sale of energy**

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and that the revenue can be reliably measured. Revenue comprises sales of energy, use of system income, gas production revenue, gas storage facility revenue, the value of contracted services and facilities provided and goods sold during the year in the normal course of business.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue on energy sales comprises sales to retail end-user customers including an estimate of the value of electricity and gas supplied to customers between the date of the last meter reading and the year end. Revenue on energy sales also includes monies received from the electricity and gas balancing markets in the UK and other wholesale market energy sales. Unread energy sales are estimated using historical consumption patterns taking account of industry volume reconciliation processes.

Revenue from sales and optimisation trades in physical and financial energy and commodity contracts is recognised gross in the income statement. Revenue associated with business interruption insurance claims is recognised as revenue in the income statement only when it is virtually certain that the claim will be successful.

Revenue from use of energy systems includes an estimation of the volume of electricity distributed or transmitted by customers based on independently procured electricity settlement systems data. Annual revenue is dependent on being approved by the industry regulator, Ofgem. Certain circumstances may result in the regulatory 'allowed' income being over- or under-recovered in the financial year. Any over- or under-recovery is included in the calculation of the following year's regulatory use of system revenue within agreed parameters. No adjustment is made for over- or under-recoveries in the year that they arise.

Revenue from the production of natural gas, crude oil and condensates is recognised when title passes to the customer. The Group has an interest with other producers in jointly controlled operations for the production of such products. Revenue under these arrangements is recognised based on the entitlement method in reference to the Group's interest and the relevant production sharing terms. Where there are differences between the Group's share of production and the volume sold, an overlift or underlift is recorded (see below).

Where the Group has an ongoing obligation to provide services, revenues are recognised as the service is performed and amounts billed in advance are treated as deferred income and excluded from current revenue. For network connections activity from 1 November 2009, the revenue recognition rules of IFRIC 18 have been applied, whereby income is recognised over the course of completion of the associated capital works unless there is a future service obligation, in which case revenue is recognised over the service period. Revenue from fixed-fee service contracts is recognised over the life of the contract, in relation to the benefit received by the customer.

Gas storage facilities revenues are recognised evenly over the contract period, whilst revenues for the injection and withdrawal of gas are recognised at the point of gas flowing into or out of the storage facilities.

Sales of goods are recognised when goods are delivered and title has passed, along with the risks and rewards of ownership.

#### Overlift and underlift

It is often not practical for each participant to receive or sell its precise share of the overall production from a jointly controlled operation under the contractual offtake arrangements in any given period. These short-term imbalances between cumulative production entitlement and cumulative sales are referred to as overlift and underlift. An overlift payable, or underlift receivable, is recognised at the balance sheet date and measured at market value, with movements in the period recognised within cost of sales.

#### Exploration, evaluation and production assets

The Group uses the successful efforts method of accounting for exploration and evaluation expenditure associated with exploration wells or 'prospects'. This expenditure will be capitalised initially within intangible assets and will include licence acquisition costs associated with the prospects. If the prospects are subsequently determined to be successful on completion of the evaluation period, the relevant expenditure will be transferred to property, plant and equipment and depreciated on a unit of production basis. If the prospects are subsequently determined to be unsuccessful on completion of the evaluation period, the intangible asset will be expensed in the period in which that determination is made.

All field development costs, including rights and concessions related to production activities, are capitalised as property, plant and equipment. Capitalised costs relate to the acquisition and installation of production assets and facilities and includes specialist engineering, drilling and technical services costs. These property, plant and equipment assets are depreciated from the commencement of production in the fields concerned, using the unit of production method, based on the proven and probable reserves of those fields. Changes in these estimates are dealt with prospectively.

The carrying value of exploration prospects is regularly compared on an individual field basis with the expected discounted future net revenues associated with the remaining commercial reserves. An impairment loss will be recognised where it is considered that recorded amounts are unlikely to be fully recovered from the net present value of future net revenues. All exploration and production assets are reviewed annually for indicators of impairment.

#### Government grants

A government grant is recognised in the balance sheet initially as deferred income when there is reasonable assurance that it will be received and that the Group will comply with the conditions attaching to it. Grants that compensate the Group for expenses incurred are recognised in the income statement on a systematic basis in the same years in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognised in the income statement on a systematic basis over the useful life of the asset to match the depreciation charge.

## Leases

The determination of whether an arrangement contains a lease is dependent on whether the arrangement relates to use and control of a specific asset. Leases are classified as finance leases if the arrangement transfers substantially all the risks and rewards of ownership to the lessee. All other leases are categorised as operating leases.

### (i) Operating lease obligations

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

### (iii) Finance lease obligations

Assets held under finance leases are capitalised and held as part of property, plant and equipment. The accounting policy for such arrangements is described on page 90.

## Foreign currencies

The consolidated financial statements are presented in pounds sterling, which is the functional currency of the Company and the Group's presentational currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured accordingly.

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. Any gain or loss arising on the restatement of such items is taken to the income statement with the exception of exchange gains or losses on foreign currency borrowings that provide a hedge against a net investment in a foreign entity or exchange gains or losses incurred as part of a qualifying cash flow hedge. Exchange gains or losses on net investment hedges are taken against the consolidated translation reserve, a separate component of equity, to the extent the hedge is effective. Non-monetary assets that are measured in terms of historical cost in a foreign currency are translated at the historic rate at the date of transaction.

For the purpose of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into pounds sterling at the balance sheet closing rate. The results of these operations are translated at the average rate in the relevant period. Exchange differences on retranslation of the opening net assets and the results are transferred to the translation reserve and are reported in the statement of recognised income and expense. Exchange differences on foreign currency borrowings, foreign exchange contracts or foreign currency swaps used as part of a hedge against net investment in a foreign entity are transferred to the translation reserve.

## Finance income and costs

Finance income comprises interest receivable on funds invested and expected returns on pension scheme assets recognised in the income statement. Finance costs comprise interest payable on borrowings and finance leases, the release of discounting on provisions, interest on pension scheme liabilities and accretion of the debt component on the convertible loan less capitalised interest.

Interest on the funding attributable to major capital projects is capitalised during the years of construction and depreciated as part of the total cost over the useful life of the asset.

Interest income and costs are recognised in the income statement as they accrue, on an effective interest method. The issue costs and interest payable on bonds and all other interest payable and receivable is reflected in the income statement on the same basis.

## Taxation

Taxation on the profit for the year comprises current and deferred tax. Taxation is recognised in the income statement unless it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities other than in business combinations that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

Deferred tax assets and liabilities are offset where there is a legally enforceable right of offset within the same tax authority and where the Company intends to either settle them on a net basis, or to realise the asset and settle the liability simultaneously. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

## Dividends

Dividend income is recognised on the date the Group's right to receive payments is established. Dividend liabilities are recognised on the date the Group's obligation to pay dividends is established.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

##### Property, plant and equipment

##### (i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairments. The cost of self-constructed assets includes the cost of materials, direct labour and other directly attributable costs. All items of property, plant and equipment are accounted for under the cost model within IAS 16. The purchase price of an asset will include the fair value of the consideration paid to acquire the asset.

Where an item of property, plant and equipment comprises major components having different useful lives, the components are accounted for as separate items of property, plant and equipment, and depreciated accordingly.

##### (ii) Leased assets

Leases where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Assets held under finance leases are recognised as part of the property, plant and equipment of the Group at the fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs.

Benefits received and receivable as an incentive to enter into an operating lease are also allocated on a straight line basis over the lease term.

##### (iii) Hydro civil assets

The Group is obliged under the Reservoirs Act 1975 to maintain its hydro infrastructure network, including its dams, tunnels and other hydro civil engineering structures (hydro civil assets). All items of property, plant and equipment within hydro civil assets, with the exception of land, are subject to depreciation.

In accordance with the transition provisions of IFRS 1, the Group identified the carrying value of these assets at privatisation and has treated this value as deemed cost. Following this assessment, the assets, and all subsequent enhancement and replacement expenditure, has been subject to depreciation over a useful economic life of 100 years. All subsequent maintenance expenditure is chargeable directly to the income statement.

##### (iv) Depreciation

Depreciation is charged to the income statement to write off cost, less residual values, on a straight line basis over their estimated useful lives with the exception of gas production assets which are depreciated on the Units of Production basis. Depreciation policy, useful lives and residual values are reviewed at least annually, for all asset classes to ensure that the current method is the most appropriate. Depreciation commences following the asset commissioning period and when the asset is available for commercial operation. The estimated useful lives for assets depreciated on a straight line basis are as follows:

|                                                                               | Years    |
|-------------------------------------------------------------------------------|----------|
| Hydro civil assets                                                            | 100      |
| Thermal and hydro power stations including electrical and mechanical assets   | 20 to 60 |
| Operating wind farms                                                          | 20 to 25 |
| Overhead lines, under ground cables and other network assets                  | 40 to 80 |
| Gas storage facilities                                                        | 25 to 50 |
| Other transmission and distribution buildings, plant and equipment            | 10 to 45 |
| Office buildings                                                              | 30 to 50 |
| Shop and office refurbishment, fixtures, IT assets, vehicles and mobile plant | 3 to 10  |

Heritable and freehold land is not depreciated.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

##### (v) Subsequent expenditure

It is the Group policy to capitalise qualifying replacement expenditure and depreciate it over the expected useful life of the replaced asset. Replaced assets are derecognised at this point and the costs recorded as costs of disposal. Where an item of property, plant and equipment is replaced and it is not practicable to determine the carrying amount of the replaced part, the cost of the replacement adjusted for inflation will be used as an approximation of the cost of the replaced part at the time it was acquired or constructed.

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits of the item of property, plant and equipment to which it relates.

## Biological assets

Biological assets, such as living trees, are measured at their fair value less estimated point of sale costs. The valuation of forest assets is based on discounted cash flow models whereby the fair value of the biological asset is calculated using cash flows from continuous operations, that is, each forest asset is split into an appropriate grouping based on the maturity and/or type of trees. An expected future volume of Timber that will be produced from each of these groups is then derived. The expected volume is used to apply a market value to the groups of trees based on the market value of Standing Timber. These market values are discounted based on the time to full maturity to appropriately value each grouping.

Periodic changes resulting from growth, felling prices, discount rate, costs and other premise changes are included in operating profit on the income statement.

## Business Combinations

The acquisition of subsidiaries is accounted for under the purchase method. The acquired business is measured at the date of acquisition as the aggregate fair value of assets, liabilities and contingent liabilities as required under IFRS 3 Business Combinations. The excess of the cost of acquisition over the fair value of the acquired business is represented as goodwill. For combinations taking place from 1 April 2010, contingent consideration classified as a liability will be subsequently remeasured through the income statement under the requirements of the revised IFRS 3. Pre-existing relationships require to be recognised and all acquisition-related costs are expensed.

## Intangible assets

### (i) Goodwill and impairment testing

Goodwill arising on a business combination represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment at least on an annual basis.

For the purpose of impairment testing, goodwill is allocated to those cash-generating units expected to benefit from the combination's synergies. The cash-generating units used for goodwill impairment testing purposes are the operating units one level below the Group's segmental businesses. The cash-generating units are therefore representative of how goodwill was recognised but do not represent business segments as reported to management.

If the carrying amount of the cash-generating unit exceeds its recoverable amount, an impairment charge will be recognised immediately in the income statement and, in relation to the impairment of goodwill, will not be subsequently reversed. The recoverable amount is the higher of the cash-generating unit's fair value less costs to sell and its value-in-use. The impairment charge will initially be adjusted against the goodwill allocated to the cash-generating unit. Thereafter, the remaining assets of the cash-generating unit will be written-down proportionately.

Goodwill may also arise upon investments in jointly-controlled entities and associates. Such goodwill is recorded within the carrying amount of the Group's investment and any impairment loss is included within the share of result from jointly-controlled entities and associates.

On disposal or closure of a previously acquired business, any attributed goodwill will be included in determining the profit or loss on disposal.

### (ii) Research and development

Expenditure on research activities is charged to the income statement as incurred. Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products or processes, is capitalised if the product or process is considered to be technically and commercially feasible and the Group intends to complete the intangible asset for use or for sale.

### (iii) Allowances and emissions

The European Emissions trading scheme (EU ETS) has been in operation since 1 January 2005. The IASB withdrew IFRIC 3 *Emission Rights* in June 2005 and it has not been replaced with definitive guidance or interpretation for CO<sub>2</sub> ('carbon') emissions trading. The Group recognises carbon allowances granted in a period at nominal value (nil value). Carbon allowances purchased are recorded at cost within intangible assets. A liability is recognised when the level of emissions in any compliance period exceeds the level of allowances held and this is recorded as a current liability. Up to the level of allowances held the liability is measured at the cost of purchased allowances. When the carbon emission liability exceeds the carbon allowances held, the net liability is measured at the anticipated selling price. Movements in the market value of the liability are recognised in operating profit. Forward carbon contracts are measured at fair value with gains or losses arising on remeasurement being recognised in the income statement.

The intangible asset is surrendered at the end of the compliance period reflecting the consumption of the economic benefit and is derecognised at its carrying value. As a result, no amortisation is booked but an impairment charge may be recognised should the carrying value exceed market value. Where allowances granted are used to settle a liability relating to a previous period, a creditor balance is recorded for the increased liability in the current period.

Under the Renewable Obligations Certificates (ROCs) scheme, certificates obtained from own generation are awarded by a third party, Ofgem. Self-generated certificates are recorded at market value and purchased certificates are recognised at cost, both within intangible assets. The liability under the renewables obligation is recognised based on electricity supplied to customers, the percentages set by Ofgem and the prevailing market price. The intangible asset is surrendered at the end of the compliance period reflecting the consumption of economic benefit. As a result no amortisation is recorded during the period.

# Notes on the financial statements (continued)

## for the year ended 31 March

### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

#### (iv) Development assets

Costs capitalised as development intangibles represent the costs incurred in bringing individual projects to the consented stage. These are principally wind farm developments but will also include other generation or gas storage projects. Costs associated with reaching the consent stage include options over land rights, planning application costs and environmental impact studies. These may be costs incurred directly or part of the fair value exercise on acquisition of a controlling interest in a project. The asset is subject to impairment testing on an annual basis until this time. At the point that the project reaches the consent stage and is approved by the Board, the carrying value of the project is transferred to property, plant and equipment as assets under construction. The asset is derecognised on disposal, or when no future economic benefits are expected from their use.

#### (v) Other intangible assets

Other intangible assets that have been acquired by the Group including brands are stated at cost less accumulated amortisation and impairment losses. Software licenses are stated at cost less accumulated amortisation. Expenditure on internally generated brands is expensed as incurred. Amortisation is charged to the income statement on a straight-line basis over the estimated useful life of these other intangible assets. The amortisation periods utilised are as follows:

|                               | Years                         |
|-------------------------------|-------------------------------|
| Brand values                  | 10                            |
| Application software licences | 5                             |
| Customer lists                | 5                             |
| Contracts                     | Shorter of contract term or 5 |

#### Impairment testing

The carrying amounts of the Group's assets, other than inventories or deferred tax, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If there is evidence of impairment, the recoverable amount, being the higher of the fair value less costs to sell and the value-in-use of the asset, is estimated to determine the extent of any such impairment. For goodwill and other intangible assets with an indefinite life or which are not ready for use, the test for impairment is carried out annually. For financial assets measured at amortised cost the impairment is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate.

#### Inventories and work in progress

Inventories are valued at the lower of cost (on a first-in, first-out basis) and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of fuel stocks is based on the weighted average principle. The valuation of work in progress is based on the cost of labour, the cost of contractors, the cost of materials plus other directly attributable costs.

#### Recognition of revenue and profit on construction contracts

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured as the proportion of cost incurred on work performed to date compared to the estimated total contract cost, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. When it becomes probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately in the income statement.

#### Employee benefit obligations

##### (i) Defined benefit pension schemes

The Group operates two defined benefit pension schemes, one of which is operated by the Company. Pension scheme assets are measured using bid market values. Pension scheme liabilities are measured using the projected unit credit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

Any increase in the present value of liabilities within the Group's defined benefit pension schemes expected to arise from employee service in the year is charged as service costs to operating profit.

The expected return on the schemes' assets and the increase during the year in the present value of the schemes' liabilities arising from the passage of time are included in finance income and finance costs, respectively. Actuarial gains and losses are recognised in full in the consolidated statement of comprehensive income. Pension scheme surpluses, to the extent that they are considered recoverable, or deficits are recognised in full and presented on the face of the balance sheet.

##### (ii) Defined contribution pension schemes

The Group also operates a number of defined contribution pension schemes. The assets of the schemes are held separately from those of the Group in independently administered funds. The amounts charged represent the contributions payable to the schemes in the year and are charged directly to the income statement.

### (iii) Equity and equity-related compensation benefits

The Group operates a number of employee share schemes as described in the Remuneration Report and note 30. These schemes enable Group employees to acquire shares of the Company.

The exercise prices of the sharesave scheme are set at a discount to market price at the date of the grant. The fair value of the sharesave scheme option granted is measured at the grant date by use of a Black-Scholes model. The fair value of the options granted is recognised as an expense on a straight-line basis over the period that the scheme vests. Estimates are updated for non-market conditions at each balance sheet date with any adjustment in respect of the current and prior years being recognised in the income statement.

The costs associated with the other main employee schemes are recognised over the period to which they relate.

The charge related to the equity shares in the Company awarded under the share schemes is treated as an increase in the cost of investment held by the Company in the subsidiary companies of the Group.

### Financial instruments

The Group uses a range of financial instruments to hedge exposures to financial risks, such as interest rate, foreign exchange and energy price fluctuations in its normal course of business and in accordance with the Group's risk management policies. The Group's risk management policies are further explained in note 31.

### Accounting policies under IAS 32 and 39

#### (i) Interest rate and foreign exchange derivatives

Financial derivative instruments are used by the Group to hedge interest rate and currency exposures. All such derivatives are recognised at fair value and are remeasured to fair value each reporting period. Certain derivative financial instruments are designated as being held for hedging purposes. The designation of the hedge relationship is established at the inception of the hedge and procedures are applied to ensure the derivative is highly effective in achieving its objective and that the effectiveness of the hedge can be reliably measured. The treatment of gains and losses on remeasurement is dependent on the classification of the hedge and whether the hedge relationship is designated as either a 'fair value' or 'cash flow' hedge. Derivatives that are not designated as hedges are treated as if held for trading, with all fair value movements being recorded through the income statement.

A derivative classified as a 'fair value' hedge recognises gains and losses from remeasurement immediately in the income statement. Loans and borrowings are measured at cost except where they form the underlying transaction in an effective fair value hedge relationship. In such cases, the carrying value of the loan or borrowing is adjusted to reflect fair value movements with the gain or loss being reported in the income statement.

A derivative classified as a 'cash flow' hedge recognises the portion of gains or losses on the derivative which are deemed to be effective directly in equity in the hedge reserve. Any ineffective portion of the gains or losses is recognised in the consolidated income statement. When hedged cash flows result in the recognition of a non-financial asset or liability, the associated gains or losses previously recognised in equity are included in the initial measurement of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same period in which the hedged cash flows affect the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At the point of discontinuation, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecast transaction affects profit or loss. On settlement, the cumulative gain or loss recognised in equity is recognised in the income statement.

#### (ii) Commodity derivatives

Within its regular course of business, the Group routinely enters into sale and purchase derivative contracts for commodities such as electricity, gas, coal and oil. Where the contract was entered into and continues to be held for the purpose of receipt or delivery in accordance with the Group's expected sale, purchase or usage requirements, the contracts are designated as 'own use' contracts and are measured at cost. These contracts are not within the scope of IAS 39.

Derivative commodity contracts which are not designated as own use contracts are accounted for as trading derivatives and are recognised in the balance sheet at fair value. Where a hedge accounting relationship is designated and is proven to be effective, the changes in fair value will be recognised in accordance with the rules noted in part (i) to this note.

Other commodity contracts, where own use is not established and a hedge accounting relationship is not designated, are measured at fair value with gains and losses on remeasurement being recognised in the income statement in cost of sales.

#### (iii) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives where the characteristics of the derivatives are not closely related to those of the host contracts.

#### (iv) Net investment hedges

Hedges of net investments in foreign operations are accounted in a manner similar to effective cash flow hedges. Any gain or loss on the effective portion of the hedge is recognised in equity, in the translation reserve, and any gain or loss on the ineffective portion of the hedge is recognised in the income statement. On disposal of the foreign operation, the cumulative value of any gains or losses recognised directly in equity is transferred to the income statement.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

##### (v) Convertible bond

The Group issued a convertible bond which had a liability component, which was accounted for as a compound financial instrument, net of transaction costs and an equity component, which was calculated as the discounted excess of the issue proceeds over the present value of the future interest and principal payments. The bond was fully converted at 24 October 2009.

##### (vi) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

##### (vii) Trade receivables

Trade receivables do not carry any interest and are measured at cost less an appropriate allowance for irrecoverable receivables.

##### (viii) Interest-bearing loans and borrowings

All such loans and borrowings are initially recognised at fair value including transaction costs and are subsequently measured at amortised cost, except where the loan or borrowing is the hedged item in an effective fair value hedge relationship.

##### (ix) Share capital

Ordinary Shares are accounted for as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds received.

##### (x) Hybrid capital

The Group issued hybrid capital in the year ended 31 March 2011. Hybrid capital comprises issued bonds that qualify for recognition as equity. Accordingly, any coupon payments are accounted for as dividends and are recognised directly in equity at the time the payment obligation arises. This is because the coupon payments are discretionary and relate to equity. Coupon payments consequently do not have any impact on the income statement. Coupon payments are recognised in the cash flow statement in the same way as dividends to ordinary shareholders.

#### Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

#### Decommissioning costs

The estimated cost of decommissioning at the end of the useful lives of certain assets is reviewed periodically. Provision is made for the net present value of the estimated cost of decommissioning gas production facilities at the end of the producing lives of fields, and gas storage facilities and power stations at the end of the useful life of the facilities. The estimates are based on technology and prices at the balance sheet date. A corresponding decommissioning asset is recognised and is included within property, plant and equipment when the provision gives access to future economic benefits. Changes in these provisions are recognised prospectively. For offshore wind assets, power stations and gas storage facilities the unwinding of the discount on the provision is included in finance costs and the depreciation for the asset is straight-line over the expected useful life of the asset. For gas production facilities the decommissioning asset is amortised using the unit of production method, based on proven and probable reserves.

#### Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, management necessarily makes judgements and estimates that have a significant effect on the amounts recognised in the financial statements. Changes in the assumptions underlying the estimates could result in a significant impact to the financial statements. The most critical of these accounting judgement and estimation areas are noted.

##### (i) Revenue recognition

Revenue on energy sales includes an estimate of the value of electricity or gas supplied to customers between the date of the last meter reading and the year end. This will have been estimated by using historical consumption patterns and takes into consideration industry reconciliation processes for total consumption by supplier. At the balance sheet date, the estimated consumption by customers will either have been billed (estimated billed revenue) or accrued (unbilled revenue). Management apply judgement to the measurement of the quantum of the estimated consumption and to the valuation of that consumption. The judgements applied, and the assumptions underpinning these judgements are considered to be appropriate. However, a change in these assumptions would impact upon the amount of revenue recognised.

##### (ii) Retirement benefits

The assumptions in relation to the cost of providing post-retirement benefits during the period are set after consultation with qualified actuaries. While these assumptions are believed to be appropriate, a change in these assumptions would impact the earnings of the Group. The value of scheme assets is impacted by the asset ceiling test which restricts the surplus that can be recognised to assets that can be recovered fully through refunds or reductions in future contributions.

### (iii) Impairment testing

The Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that the value of those assets is impaired. In assessing for impairment, assets that do not generate independent cash flows are allocated to an appropriate cash generating unit (CGU). The recoverable amount of the assets, or the appropriate CGU, is measured as the higher of their fair value less costs to sell and value in use. Value in use calculations require the estimation of future cash flows to be derived from the respective CGUs and to select an appropriate discount rate in order to calculate their present value. The fair value less costs to sell methodology used for the wind farms CGUs also requires the discounting of cash flows from the projects within the respective CGUs. The estimation of the timing and value of underlying projected cash flows and the selection of appropriate discount rates involves management judgement. Subsequent changes to these estimates or judgements may impact the carrying value of the assets within the respective CGUs. Gas production and development assets are assessed under the fair value less costs method for the respective CGUs. This is deemed more appropriate as it is based on post-tax cash flows arising from each field within the respective CGUs, which is consistent with the approach taken by management in determining the economic value of the underlying assets. This is determined by discounting the post-tax cash flows expected to be generated by the CGU, net of associated selling costs, and takes into account assumptions market participants would use in estimating fair value.

### (iv) Provisions and contingencies

The assessments undertaken in recognising provisions and contingencies have been made in accordance with IAS 37. The evaluation of the likelihood of the contingent events has required best judgement by management regarding the probability of exposure to potential loss. Should circumstances change following unforeseeable developments, this likelihood could alter.

### (v) Decommissioning costs

The estimated cost of decommissioning at the end of the useful lives of assets is reviewed periodically. Decommissioning costs in relation to gas exploration and production assets are based on expected lives of the fields and costs of decommissioning and are currently expected to be incurred predominantly between 2017 and 2030.

### (vi) Financial Instruments – fair values

The valuation of the financial instruments is based upon published price quotations in active markets and valuation techniques where such information is not available. Energy commodity contracts are classified as either derivative contracts under IAS 39 or as contracts for the Group's own use requirements. Only IAS 39 derivatives are accounted for on a fair value basis. More detail on this is included in note 31.

### (vii) Gas and liquids reserves

The volume of proven and probable gas and liquids reserves is an estimate that affects the unit of production depreciation of producing gas and liquids property, plant and equipment. This is also a significant input estimate to the associated impairment and decommissioning calculations. The impact of a change in estimated proven and probable reserves is dealt with prospectively by depreciating the remaining book value of producing assets over the expected future production. If proven and probable reserves estimates are revised downwards, earnings could be affected by higher depreciation expense or an immediate write-down (impairment) of the asset's book value.

### (viii) Exceptionals and remeasurements

The criteria for identifying what constitutes an exceptional item are outlined in note 1 Exceptional items and certain remeasurements.

## 2. RECLASSIFICATION OF COMPARATIVE AMOUNTS

The Group's Investments in Jointly Controlled Entities and Associates were previously disclosed including the value of long-term shareholder loans. While this represents the substance of the Group's net investment in its Jointly Controlled Entities and Associates, such interests are not recorded under the equity method of accounting under IAS 27 and 31 but instead are recorded initially at fair value under IAS 39 and are subsequently measured at amortised cost. Consequently, all such long-term shareholder loans will be shown separately as non-current financial assets and not as part of the equity investment in Jointly Controlled Entities and Associates.

In addition to this, the Group holds interest-bearing long-term commercial loans with certain Jointly Controlled Entities (Greater Gabbard Offshore Winds Limited and Marchwood Power Limited) which were previously recorded as part of current other receivables. These have been reclassified as non-current financial assets. Note 14 has been restated to show both the equity and loan investments in the Jointly Controlled Entities and Associates as this is the basis of review used by management. No further restatement has been considered necessary to aid understanding of the Group's financial position.

The impact of these changes are as follows:

### (i) Reclassification of long-term shareholder loans

|                                                          | Company                         |                                 | Consolidated                    |                                 |
|----------------------------------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
|                                                          | Reported<br>31 March 2010<br>£m | Restated<br>31 March 2010<br>£m | Reported<br>31 March 2010<br>£m | Restated<br>31 March 2010<br>£m |
| Investment in Associates and Jointly Controlled Entities | 473.9                           | 207.0                           | 1,037.3                         | 635.2                           |
| Loans to Associates and Jointly Controlled Entities      | –                               | 266.9                           | –                               | 402.1                           |
|                                                          | 473.9                           | 473.9                           | 1,037.3                         | 1,037.3                         |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 2. RECLASSIFICATION OF COMPARATIVE AMOUNTS (continued)

##### (ii) Reclassification of long-term commercial loans

|                                                     | Company                         |                                 | Consolidated                    |                                 |
|-----------------------------------------------------|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
|                                                     | Reported<br>31 March 2010<br>£m | Restated<br>31 March 2010<br>£m | Reported<br>31 March 2010<br>£m | Restated<br>31 March 2010<br>£m |
| Current other receivables                           | 623.4                           | 55.0                            | 857.5                           | 289.1                           |
| Loans to Associates and Jointly Controlled Entities | –                               | 568.4                           | –                               | 568.4                           |
|                                                     | 623.4                           | 623.4                           | 857.5                           | 857.5                           |

Following the adoption of IFRIC 18, the Group has restated the income statement of the previous year to recognise an increase in the depreciation of property, plant and equipment of £38.5m and a corresponding reduction in cost of sales. This has also had an impact on certain cash flow statement classifications.

#### 3. SEGMENTAL INFORMATION

The Group's operating segments are those used internally by the Board of Directors to run the business, allocate resources and make strategic decisions. The Group's operating segments are the distribution and transmission of electricity in the North of Scotland, the distribution of electricity in the South of England (together referred to as Power Systems), and the generation and supply of electricity and sale of gas in Great Britain and Ireland (Generation and Supply) and other businesses identified below which are not required to be reported separately. In addition to this the Group's 50% equity share in Scotia Gas Networks Limited, a business which distributes gas in Scotland and the South of England (refer note 14), is included as a separate segment where appropriate due to its significance.

The types of products and services from which each reportable segment derives its revenues are:

| Segment                                              | Geographical location             | Description                                                                                                                                                                                                                                                                                                                                                                            |
|------------------------------------------------------|-----------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>Power Systems</b>                                 | UK                                | Transmits and distributes electricity to over 3 million businesses, offices and homes.                                                                                                                                                                                                                                                                                                 |
| <b>Generation and Supply</b>                         | Great Britain, Ireland and Europe | The Group views this as a single value chain within a vertically-integrated business. It generates and supplies electricity to domestic, commercial and industrial customers in Great Britain and Ireland. In addition, it also supplies gas to customers in the same locations. Generation is provided by a portfolio of thermal power stations and from renewable sources of energy. |
| <b>Other businesses:</b>                             |                                   |                                                                                                                                                                                                                                                                                                                                                                                        |
| Contracting, Utility Solutions and Lighting Services | UK and Ireland                    | Mechanical and electrical contracting services, public and highway lighting and electrical and instrumentation engineering; electricity and gas connections for homes, offices and businesses, out-of-area electricity networks, licenced gas transportation and water and sewerage services.                                                                                          |
| Metering                                             | UK                                | Supplies, installs and maintains electricity meters and provides data collection services.                                                                                                                                                                                                                                                                                             |
| Gas Storage                                          | UK                                | Develops, owns and operates under ground onshore gas storage facilities.                                                                                                                                                                                                                                                                                                               |
| Exploration and Production                           | UK                                | Production and processing of North Sea gas and oil and the development of new gas and oil fields.                                                                                                                                                                                                                                                                                      |
| Telecoms                                             | UK                                | Provides network capacity, data centre and bandwidth services to customers.                                                                                                                                                                                                                                                                                                            |

The activities of the acquired Exploration and Production business (note 16) are reported within Other businesses.

The measure of profit used by the Board is adjusted operating profit which is before exceptional items, remeasurements arising from IAS 39 and after the removal of taxation and interest on profits from jointly controlled entities and associates.

Analysis of revenue, operating profit, assets and other items by segment is provided below. All revenue and profit before taxation arise from operations within Great Britain, Ireland and mainland Europe.

**(a) Revenue by segment**

|                              | Total revenue |            | Intra-segment revenue (i) |            | External revenue |            |
|------------------------------|---------------|------------|---------------------------|------------|------------------|------------|
|                              | 2011<br>£m    | 2010<br>£m | 2011<br>£m                | 2010<br>£m | 2011<br>£m       | 2010<br>£m |
| <b>Power Systems</b>         |               |            |                           |            |                  |            |
| Scotland                     | 356.7         | 309.1      | 111.0                     | 105.5      | 245.7            | 203.6      |
| England                      | 517.2         | 473.5      | 214.1                     | 212.2      | 303.1            | 261.3      |
|                              | 873.9         | 782.6      | 325.1                     | 317.7      | 548.8            | 464.9      |
| <b>Generation and Supply</b> |               |            |                           |            |                  |            |
| Retail                       | 8,044.4       | 8,234.4    | –                         | –          | 8,044.4          | 8,234.4    |
| Wholesale and Trading        | 18,899.9      | 12,000.3   | 17.1                      | 12.0       | 18,882.8         | 11,988.3   |
| Other                        | 222.9         | 216.4      | 15.8                      | 7.8        | 207.1            | 208.6      |
|                              | 27,167.2      | 20,451.1   | 32.9                      | 19.8       | 27,134.3         | 20,431.3   |
| <b>Other businesses</b>      | 1,219.9       | 1,173.9    | 568.8                     | 519.7      | 651.1            | 654.2      |
|                              | 29,261.0      | 22,407.6   | 926.8                     | 857.2      | 28,334.2         | 21,550.4   |

(i) Intra-segment revenue is derived from use of system income received by the Power Systems businesses from Generation and Supply, provision of Contracting, Metering services, use of Gas Storage facilities, sale of gas from producing North Sea gas production assets to the Generation and Supply business, Telecoms infrastructure charges, internal heat and light charges and other Corporate services. All are provided at arm's length basis.

Revenue within Generation and Supply includes retail sales from energy supply customers, wholesale and trading revenue and other sales. Wholesale and Trading revenue includes revenues from generation plant output and the gross value of all wholesale power and gas sales including settled physical and financial trades. These are entered into to optimise the performance of the generation plants and to support the energy supply business. Purchase trades are included in cost of sales.

Revenue from the Group's investment in Scotia Gas Networks Limited (SSE share being: 2011 – £392.5m; 2010 – £373.5m) is not recorded in the revenue line in the income statement.

Revenue by geographical location is as follows:

|                                 | 2011<br>£m | 2010<br>£m |
|---------------------------------|------------|------------|
| UK                              | 27,666.6   | 21,123.2   |
| Ireland plus Continental Europe | 667.6      | 427.2      |
|                                 | 28,334.2   | 21,550.4   |

**(b) Operating profit by segment**

|                              | 2011                                                      |                                                   |                                                           |                                                    |             |
|------------------------------|-----------------------------------------------------------|---------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------|
|                              | Adjusted operating profit reported to the Board (i)<br>£m | JCE/Associate share of interest and tax (i)<br>£m | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>£m | Total<br>£m |
| <b>Power Systems</b>         |                                                           |                                                   |                                                           |                                                    |             |
| Scotland                     | 168.1                                                     | –                                                 | 168.1                                                     | –                                                  | 168.1       |
| England                      | 287.4                                                     | –                                                 | 287.4                                                     | –                                                  | 287.4       |
|                              | 455.5                                                     | –                                                 | 455.5                                                     | –                                                  | 455.5       |
| Scotia Gas Networks          | 186.8                                                     | (150.7)                                           | 36.1                                                      | 38.4                                               | 74.5        |
| <b>Energy Systems</b>        | 642.3                                                     | (150.7)                                           | 491.6                                                     | 38.4                                               | 530.0       |
| <b>Generation and Supply</b> | 882.8                                                     | (47.1)                                            | 835.7                                                     | 874.6                                              | 1,710.3     |
| <b>Other businesses</b>      | 136.8                                                     | (0.3)                                             | 136.5                                                     | –                                                  | 136.5       |
|                              | 1,661.9                                                   | (198.1)                                           | 1,463.8                                                   | 913.0                                              | 2,376.8     |
| Unallocated expenses (iii)   | (9.0)                                                     | –                                                 | (9.0)                                                     | –                                                  | (9.0)       |
|                              | 1,652.9                                                   | (198.1)                                           | 1,454.8                                                   | 913.0                                              | 2,367.8     |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 3. SEGMENTAL INFORMATION (continued)

|                              | 2010                                                      |                                                   |                                                           |                                                    |             |
|------------------------------|-----------------------------------------------------------|---------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------|
|                              | Adjusted operating profit reported to the Board (i)<br>£m | JCE/Associate share of interest and tax (i)<br>£m | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>£m | Total<br>£m |
| <b>Power Systems</b>         |                                                           |                                                   |                                                           |                                                    |             |
| Scotland                     | 158.9                                                     | –                                                 | 158.9                                                     | –                                                  | 158.9       |
| England                      | 256.9                                                     | –                                                 | 256.9                                                     | –                                                  | 256.9       |
|                              | 415.8                                                     | –                                                 | 415.8                                                     | –                                                  | 415.8       |
| Scotia Gas Networks          | 183.7                                                     | (130.5)                                           | 53.2                                                      | 2.4                                                | 55.6        |
| <b>Energy Systems</b>        | 599.5                                                     | (130.5)                                           | 469.0                                                     | 2.4                                                | 471.4       |
| <b>Generation and Supply</b> | 896.0                                                     | (26.5)                                            | 869.5                                                     | 432.7                                              | 1,302.2     |
| <b>Other businesses</b>      | 140.3                                                     | (0.2)                                             | 140.1                                                     | –                                                  | 140.1       |
|                              | 1,635.8                                                   | (157.2)                                           | 1,478.6                                                   | 435.1                                              | 1,913.7     |
| Unallocated expenses (ii)    | (9.8)                                                     | –                                                 | (9.8)                                                     | –                                                  | (9.8)       |
|                              | 1,626.0                                                   | (157.2)                                           | 1,468.8                                                   | 435.1                                              | 1,903.9     |

(i) The adjusted operating profit of the Group is reported after removal of the Group's share of interest, fair value movements on financing derivatives and tax from jointly controlled entities and associates. The share of Scotia Gas Networks Limited interest includes loan stock interest payable to the consortium shareholders. The Group has accounted for its 50% share of this, £33.4m (2010 – £33.8m), as finance income (note 7).

(ii) Unallocated expenses comprise corporate office costs which are not directly allocable to particular segments.

The Group's share of operating profit from jointly controlled entities and associates has been recognised in the Generation and Supply segment other than that for Scotia Gas Networks Limited, which is recorded in a separate segment, and PriDE (South East Regional Prime), which is recognised in Other businesses (£1.0m before tax; 2010 – £0.9m before tax).

#### (c) Capital expenditure

|                                  | Capital additions to Intangible Assets (note 11) |            | Capital additions to Property, Plant and Equipment (note 12) |                        |
|----------------------------------|--------------------------------------------------|------------|--------------------------------------------------------------|------------------------|
|                                  | 2011<br>£m                                       | 2010<br>£m | 2011<br>£m                                                   | 2010<br>Restated<br>£m |
| <b>Power Systems</b>             |                                                  |            |                                                              |                        |
| Scotland                         | –                                                | –          | 216.2                                                        | 145.7                  |
| England                          | –                                                | –          | 207.9                                                        | 227.3                  |
|                                  | –                                                | –          | 424.1                                                        | 373.0                  |
| Scotia Gas Networks              | –                                                | –          | –                                                            | –                      |
| <b>Energy Systems</b>            | –                                                | –          | 424.1                                                        | 373.0                  |
| <b>Generation and Supply</b>     | 432.7                                            | 484.7      | 560.4                                                        | 487.9                  |
| <b>Other businesses</b>          | –                                                | –          | 175.0                                                        | 164.8                  |
| <b>Corporate and unallocated</b> | 1.3                                              | 1.6        | –                                                            | –                      |
|                                  | 434.0                                            | 486.3      | 1,159.5                                                      | 1,025.7                |

Capital additions do not include assets acquired in acquisitions or assets acquired under finance leases. Capital additions to Intangible Assets includes the purchase of emissions allowances and certificates (2011 – £399.3m; 2010 – £470.9m).

No segmental analysis of assets requires to be disclosed as this is not presented to the Board.

**(d) Included within operating profit**

|                                  | Depreciation/impairment on Property, Plant and Equipment (note 12) |                                      |                     | 2010<br>Restated<br>£m | Amortisation/impairment<br>of Intangible Assets (note 11) |            |
|----------------------------------|--------------------------------------------------------------------|--------------------------------------|---------------------|------------------------|-----------------------------------------------------------|------------|
|                                  | Before<br>exceptional<br>items<br>2011<br>£m                       | Exceptional<br>charges<br>2011<br>£m | Total<br>2011<br>£m |                        | 2011<br>£m                                                | 2010<br>£m |
| <b>Power Systems</b>             |                                                                    |                                      |                     |                        |                                                           |            |
| Scotland                         | 108.6                                                              | –                                    | 108.6               | 58.4                   | –                                                         | –          |
| England                          | 149.3                                                              | –                                    | 149.3               | 108.3                  | –                                                         | –          |
|                                  | 257.9                                                              | –                                    | 257.9               | 166.7                  | –                                                         | –          |
| <b>Generation and Supply</b>     | 175.9                                                              | 442.7                                | 618.6               | 182.4                  | 98.9                                                      | 15.8       |
| <b>Other businesses</b>          | 62.9                                                               | –                                    | 62.9                | 45.8                   | 1.1                                                       | 2.6        |
|                                  | 496.7                                                              | 442.7                                | 939.4               | 394.9                  | 100.0                                                     | 18.4       |
| <b>Corporate and unallocated</b> | –                                                                  | –                                    | –                   | –                      | 3.7                                                       | 3.8        |
|                                  | 496.7                                                              | 442.7                                | 939.4               | 394.9                  | 103.7                                                     | 22.2       |

The Group's share of Scotia Gas Networks Limited depreciation (2011 – £52.3m; 2010 – £48.3m) and amortisation (2011 – £4.8m; 2010 – £4.8m) is not included within operating costs. Exceptional impairments of intangible assets of £82.2m were recognised in 2011 (2010 – nil) all relating to the Generation and Supply segment.

**4. OTHER OPERATING INCOME AND EXPENSE**

Group operating costs can be analysed thus:

|                      | 2011<br>£m | 2010<br>Restated<br>(note 2)<br>£m |
|----------------------|------------|------------------------------------|
| Distribution costs   | 371.1      | 259.0                              |
| Administration costs | 514.9      | 463.2                              |
|                      | 886.0      | 722.2                              |

Group operating profit is stated after charging (or crediting) the following items:

|                                                                                              | 2011<br>£m | 2010<br>£m |
|----------------------------------------------------------------------------------------------|------------|------------|
| Depreciation of property, plant and equipment (note 12) (i)                                  | 496.7      | 394.9      |
| Exceptional impairment charges (note 5)                                                      | 524.9      | –          |
| Impairment of inventories (note 17)                                                          | 6.6        | 3.0        |
| Research and development costs                                                               | 9.0        | 3.7        |
| Operating lease rentals (note 33)                                                            | 219.7      | 271.2      |
| Release of deferred income in relation to capital grants and historic customer contributions | (19.6)     | (15.2)     |
| (Gain) on disposal of property, plant and equipment                                          | (5.8)      | (5.7)      |
| (Gain)/loss on disposal of fixed asset investments                                           | (10.2)     | 0.1        |
| Amortisation of brand costs (note 11)                                                        | 0.9        | 1.0        |
| Amortisation and impairment of intangible assets (note 11) (i)                               | 20.6       | 21.2       |

(i) Does not include exceptional impairment charges.

**Auditor's remuneration**

|                                                          | 2011<br>£m | 2010<br>£m |
|----------------------------------------------------------|------------|------------|
| Statutory audit services – audit of the Group's accounts | 0.3        | 0.2        |
| Statutory audit of subsidiary accounts                   | 0.7        | 0.7        |
| Audit of parent and subsidiary entities                  | 1.0        | 0.9        |
| Tax services                                             | 0.2        | 0.2        |
| Other services                                           | 0.1        | 0.1        |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 4. OTHER OPERATING INCOME AND EXPENSE (continued)

Tax service fees incurred in the year were £0.2m (2010 – £0.2m). Other service fees include fees incurred in relation to regulatory accounts and returns required by Ofgem. A description of the work of the Audit Committee is set out on pages 60 and 61 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

Amounts paid to the Company's auditor in respect of services to the Company other than the audit of the Company's financial statements have not been disclosed as the information is required instead to be disclosed on a consolidated basis.

#### 5. EXCEPTIONAL ITEMS AND CERTAIN REMEASUREMENTS

##### (i) Exceptional items

In the year to 31 March 2011 the following exceptional items have been recorded:

Impairment of thermal and renewable generation portfolio assets arising from changing market conditions. Exceptional charges have been recognised in relation to the impairment of goodwill (£42.5m), property, plant and equipment (£442.7m), development intangible assets (£39.7m) and financial assets (£7.4m). In addition, related net credits of £10.5m have been recognised, including £8.8m relating to finance costs.

These were recognised as a consequence of changing regulatory and economic conditions, in particular, (i) the impact of the Industrial Emissions Directive on station running hours and useful economic lives at certain plants including the Fiddler's Ferry and Ferrybridge power stations; (ii) the consequential impact on the ash remediation plant at Fiddler's Ferry, (iii) changes in the economic prospects of certain older, less flexible thermal plants, and, (iv) the decision to concentrate continental Europe wind generation activities on the Sweden and Netherlands markets.

Impairment of Investments in Associates. Exceptional impairment charges have been recognised in relation to the Group's investments in Barking Power Limited and Derwent Cogeneration Limited following the expiry of long-term power purchase agreements at both stations. In addition, certain other investments have been impaired. The combined impairment charges are £76.3m net of deferred tax.

Changes in UK corporation tax rates. The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate will reduce from 28% to 24% over a period of four years from 2011. The first change from 28% to 27% was substantially enacted in July 2010 and applies from 1 April 2011. The March 2011 Budget further reduced the tax rate from 1 April 2011 to 26%. This was substantively enacted on 29 March 2011. These changes will reduce the Group's future current tax charge accordingly. As this rate change has been substantively enacted it has the effect of reducing the Group's net deferred tax liabilities recognised at 31 March 2011 by £49.4m. It has not yet been possible to quantify the full anticipated effect of the announced further 3% rate reduction (the rate now being reduced to 23%) due to legislation not being enacted, although this will further reduce the Company's future current tax charge and reduce the Company's deferred tax liabilities/assets accordingly.

In addition, the March 2011 Budget increased the rate of supplementary corporation tax (SCT) from 20% to 32% and was also substantively enacted on 29 March 2011. This had the effect of increasing the Group's deferred tax liabilities and assets in relation to the Group's Exploration and Production (E&P) business to which this supplementary tax applies. The impact on the Group's net deferred tax liabilities was an increase of £31.7m.

##### (ii) Certain remeasurements

Certain remeasurements arising from IAS 39 are disclosed separately to aid understanding of the underlying performance of the Group. This category includes the movement on derivatives as described in note 31.

**(iii) Taxation**

The Group has separately recognised the tax effect of the exceptional items and certain remeasurements summarised above.

These transactions can be summarised thus:

|                                                                                                                                   | 2011<br>£m     | 2010<br>£m     |
|-----------------------------------------------------------------------------------------------------------------------------------|----------------|----------------|
| Exceptional items (i)                                                                                                             |                |                |
| Impairments and other charges:                                                                                                    |                |                |
| Impairment of Generation assets arising from changing market conditions                                                           | (521.8)        | —              |
| Impairment of Investments in Associates (share of result, net of tax)                                                             | (76.3)         | —              |
| Share of effect of change in UK corporation tax on deferred tax liabilities and assets of associate and joint venture investments | 36.3           | —              |
|                                                                                                                                   | (561.8)        | —              |
| Certain remeasurements (ii)                                                                                                       |                |                |
| Movement on operating derivatives (note 31)                                                                                       | 1,461.8        | 432.2          |
| Movement on financing derivatives (note 31)                                                                                       | (44.4)         | (36.5)         |
| Share of movement on derivatives in jointly controlled entities (net of tax)                                                      | 4.2            | 2.9            |
|                                                                                                                                   | 1,421.6        | 398.6          |
| <b>Gain before taxation</b>                                                                                                       | <b>859.8</b>   | <b>398.6</b>   |
| Exceptional items                                                                                                                 |                |                |
| Effect of change in UK corporation tax rate on deferred tax liabilities and assets                                                | 49.4           | —              |
| Effect of change in UK supplementary corporation tax rate                                                                         | (31.7)         | —              |
| Taxation on other exceptional items                                                                                               | 126.1          | —              |
|                                                                                                                                   | 143.8          | —              |
| Taxation on certain remeasurements                                                                                                | (396.2)        | (110.9)        |
| <b>Taxation</b>                                                                                                                   | <b>(252.4)</b> | <b>(110.9)</b> |
| Impact on profit for the year                                                                                                     | <b>607.4</b>   | <b>287.7</b>   |

**6. DIRECTORS AND EMPLOYEES****(i) Staff costs**

|                                                    | Consolidated |              |
|----------------------------------------------------|--------------|--------------|
|                                                    | 2011<br>£m   | 2010<br>£m   |
| Staff costs:                                       |              |              |
| Wages and salaries                                 | 609.4        | 574.9        |
| Social security costs                              | 63.1         | 53.8         |
| Share-based remuneration (note 30)                 | 9.9          | 17.9         |
| Pension costs (note 29)                            | 54.6         | 37.9         |
|                                                    | 737.0        | 684.5        |
| Less: capitalised as property, plant and equipment | (108.6)      | (87.4)       |
|                                                    | <b>628.4</b> | <b>597.1</b> |

Employee numbers:

|                              | Consolidated   |                | Company        |                |
|------------------------------|----------------|----------------|----------------|----------------|
|                              | 2011<br>Number | 2010<br>Number | 2011<br>Number | 2010<br>Number |
| Numbers employed at 31 March | <b>20,249</b>  | 20,177         | <b>4</b>       | 4              |

# Notes on the financial statements (continued)

## for the year ended 31 March

### 6. DIRECTORS AND EMPLOYEES (continued)

The average number of people employed by the Group (including Executive Directors) during the year was:

|                                         | Consolidated   |                | Company        |                |
|-----------------------------------------|----------------|----------------|----------------|----------------|
|                                         | 2011<br>Number | 2010<br>Number | 2011<br>Number | 2010<br>Number |
| Power Systems:                          |                |                |                |                |
| Scotland                                | 791            | 789            | –              | –              |
| England                                 | 1,347          | 1,299          | –              | –              |
| Generation and Supply                   | 9,334          | 9,007          | –              | –              |
| Other businesses and corporate services | 8,794          | 8,213          | 4              | 4              |
|                                         | 20,266         | 19,308         | 4              | 4              |

The costs associated with the employees of the Company, who are the Executive Directors of the Group, are borne by Group companies. No amounts are charged to the Company.

#### (ii) Directors' remuneration and interests

Information concerning Directors' remuneration, shareholdings, options, long term incentive schemes and pensions is shown in the Remuneration Report on pages 65 to 74. No Director had, during or at the end of the year, any material interest in any other contract of significance in relation to the Group's business.

### 7. FINANCE INCOME AND COSTS

#### Recognised in income statement

|                                                                                                          | 2011                                                               |                                                          |                | 2010                                                               |                                                          |                |
|----------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------|----------------------------------------------------------|----------------|--------------------------------------------------------------------|----------------------------------------------------------|----------------|
|                                                                                                          | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>£m | Total<br>£m    | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>£m | Total<br>£m    |
| <b>Finance income:</b>                                                                                   |                                                                    |                                                          |                |                                                                    |                                                          |                |
| Return on pension scheme assets                                                                          | 141.9                                                              | –                                                        | 141.9          | 100.7                                                              | –                                                        | 100.7          |
| Interest income from short term deposits                                                                 | 2.7                                                                | –                                                        | 2.7            | 3.5                                                                | –                                                        | 3.5            |
| Other interest receivable:                                                                               |                                                                    |                                                          |                |                                                                    |                                                          |                |
| Scotia Gas Networks loan stock                                                                           | 33.4                                                               | –                                                        | 33.4           | 33.8                                                               | –                                                        | 33.8           |
| Other jointly controlled entities and associates                                                         | 23.1                                                               | –                                                        | 23.1           | 20.1                                                               | –                                                        | 20.1           |
| Other receivable                                                                                         | 49.1                                                               | –                                                        | 49.1           | 35.1                                                               | –                                                        | 35.1           |
|                                                                                                          | 105.6                                                              | –                                                        | 105.6          | 89.0                                                               | –                                                        | 89.0           |
| Foreign exchange translation of monetary assets and liabilities                                          | –                                                                  | –                                                        | –              | 10.0                                                               | –                                                        | 10.0           |
| <b>Total finance income</b>                                                                              | <b>250.2</b>                                                       | <b>–</b>                                                 | <b>250.2</b>   | <b>203.2</b>                                                       | <b>–</b>                                                 | <b>203.2</b>   |
| <b>Finance costs:</b>                                                                                    |                                                                    |                                                          |                |                                                                    |                                                          |                |
| Bank loans and overdrafts                                                                                | (58.1)                                                             | –                                                        | (58.1)         | (49.9)                                                             | –                                                        | (49.9)         |
| Other loans and charges                                                                                  | (247.1)                                                            | (8.8)                                                    | (255.9)        | (284.1)                                                            | –                                                        | (284.1)        |
| Interest on pension scheme liabilities                                                                   | (150.2)                                                            | –                                                        | (150.2)        | (127.5)                                                            | –                                                        | (127.5)        |
| Notional interest arising on discounted provisions                                                       | (4.3)                                                              | –                                                        | (4.3)          | (3.5)                                                              | –                                                        | (3.5)          |
| Finance lease charges                                                                                    | (39.7)                                                             | –                                                        | (39.7)         | (13.2)                                                             | –                                                        | (13.2)         |
| Foreign exchange translation of monetary assets and liabilities                                          | (13.2)                                                             | –                                                        | (13.2)         | –                                                                  | –                                                        | –              |
| Less: interest capitalised (i)                                                                           | 59.5                                                               | –                                                        | 59.5           | 46.2                                                               | –                                                        | 46.2           |
| <b>Total finance costs</b>                                                                               | <b>(453.1)</b>                                                     | <b>(8.8)</b>                                             | <b>(461.9)</b> | <b>(432.0)</b>                                                     | <b>–</b>                                                 | <b>(432.0)</b> |
| Changes in fair value of financing derivative assets or liabilities at fair value through profit or loss | –                                                                  | (44.4)                                                   | (44.4)         | –                                                                  | (36.5)                                                   | (36.5)         |
| <b>Net finance costs</b>                                                                                 | <b>(202.9)</b>                                                     | <b>(53.2)</b>                                            | <b>(256.1)</b> | <b>(228.8)</b>                                                     | <b>(36.5)</b>                                            | <b>(265.3)</b> |
| Finance income                                                                                           | 250.2                                                              | –                                                        | 250.2          | 203.2                                                              | –                                                        | 203.2          |
| Finance costs                                                                                            | (453.1)                                                            | (53.2)                                                   | (506.3)        | (432.0)                                                            | (36.5)                                                   | (468.5)        |
| <b>Net finance costs</b>                                                                                 | <b>(202.9)</b>                                                     | <b>(53.2)</b>                                            | <b>(256.1)</b> | <b>(228.8)</b>                                                     | <b>(36.5)</b>                                            | <b>(265.3)</b> |

(i) The capitalisation rate applied in determining the amount of borrowing costs to capitalise in the period was 5.74% (2010 – 6.62%).

## Recognised in equity

|                                                                                                  | 2011<br>£m   | 2010<br>£m |
|--------------------------------------------------------------------------------------------------|--------------|------------|
| Gain/(loss) on effective portion of cash flow hedges (i)                                         | <b>32.3</b>  | (26.6)     |
| Share of jointly controlled entity/associate (loss) on effective portion of cash flow hedges (i) | <b>(4.1)</b> | (30.0)     |
|                                                                                                  | <b>28.2</b>  | (56.6)     |

(i) Before deduction of tax.

Adjusted net finance costs are arrived at after the following adjustments:

|                                                                    | 2011<br>£m     | 2010<br>£m |
|--------------------------------------------------------------------|----------------|------------|
| Net finance costs                                                  | <b>(256.1)</b> | (265.3)    |
| (add)/less:                                                        |                |            |
| Share of interest from jointly controlled entities and associates: |                |            |
| Scotia Gas Networks loan stock                                     | <b>(33.4)</b>  | (33.8)     |
| Other jointly controlled entities and associates                   | <b>(106.5)</b> | (73.3)     |
|                                                                    | <b>(139.9)</b> | (107.1)    |
| Exceptional charges                                                | <b>8.8</b>     | –          |
| Movement on financing derivatives                                  | <b>44.4</b>    | 36.5       |
| <b>Adjusted finance income and costs</b>                           | <b>(342.8)</b> | (335.9)    |
| (add)/less:                                                        |                |            |
| Return on pension scheme assets                                    | <b>(141.9)</b> | (100.7)    |
| Interest on pension scheme liabilities                             | <b>150.2</b>   | 127.5      |
| Notional interest arising on discounted provisions                 | <b>4.3</b>     | 3.5        |
| Finance lease charges                                              | <b>39.7</b>    | 13.2       |
| Adjusted finance income and costs for interest cover calculations  | <b>(290.5)</b> | (292.4)    |

## 8. TAXATION

Analysis of charge recognised in the income statement:

|                                          | 2011                                                               |                                                          |               | 2010                                                               |                                                          |             |
|------------------------------------------|--------------------------------------------------------------------|----------------------------------------------------------|---------------|--------------------------------------------------------------------|----------------------------------------------------------|-------------|
|                                          | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>£m | Total<br>£m   | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>£m | Total<br>£m |
| <b>Current tax</b>                       |                                                                    |                                                          |               |                                                                    |                                                          |             |
| UK corporation tax                       | <b>270.2</b>                                                       | –                                                        | <b>270.2</b>  | 277.4                                                              | –                                                        | 277.4       |
| Adjustments in respect of previous years | <b>(25.0)</b>                                                      | –                                                        | <b>(25.0)</b> | (19.1)                                                             | –                                                        | (19.1)      |
| Total current tax                        | <b>245.2</b>                                                       | –                                                        | <b>245.2</b>  | 258.3                                                              | –                                                        | 258.3       |
| <b>Deferred tax</b>                      |                                                                    |                                                          |               |                                                                    |                                                          |             |
| Current year                             | <b>60.8</b>                                                        | <b>234.7</b>                                             | <b>295.5</b>  | 32.2                                                               | 110.9                                                    | 143.1       |
| Effect of change in tax rates            | –                                                                  | <b>17.7</b>                                              | <b>17.7</b>   | –                                                                  | –                                                        | –           |
| Adjustments in respect of previous years | <b>48.8</b>                                                        | –                                                        | <b>48.8</b>   | 1.7                                                                | –                                                        | 1.7         |
| Total deferred tax                       | <b>109.6</b>                                                       | <b>252.4</b>                                             | <b>362.0</b>  | 33.9                                                               | 110.9                                                    | 144.8       |
| Total taxation charge                    | <b>354.8</b>                                                       | <b>252.4</b>                                             | <b>607.2</b>  | 292.2                                                              | 110.9                                                    | 403.1       |

# Notes on the financial statements (continued)

## for the year ended 31 March

### 8. TAXATION (continued)

The charge for the year can be reconciled to the profit per the income statement as follows:

|                                                                                              | 2011<br>£m     | 2011<br>%   | 2010<br>£m     | 2010<br>%   |
|----------------------------------------------------------------------------------------------|----------------|-------------|----------------|-------------|
| Group profit before tax                                                                      | 2,111.7        |             | 1,638.6        |             |
| Less: share of results of associates and jointly controlled entities                         | (64.9)         |             | (109.8)        |             |
| <b>Profit before tax</b>                                                                     | <b>2,046.8</b> |             | <b>1,528.8</b> |             |
| Tax on profit on ordinary activities at standard UK corporation tax rate of 28% (2010 – 28%) | 573.1          | 28.0        | 428.1          | 28.0        |
| Tax effect of:                                                                               |                |             |                |             |
| Change in rate of UK corporation tax                                                         | (49.4)         | (2.4)       | –              | –           |
| Change in rate of UK supplementary corporation tax                                           | 31.7           | 1.5         | –              | –           |
| Expenses not deductible for tax purposes                                                     | 27.6           | 1.3         | 7.6            | 0.5         |
| Impact of supplementary corporation tax                                                      | 2.2            | 0.1         | –              | –           |
| Non taxable income                                                                           | (4.3)          | (0.2)       | (2.3)          | (0.2)       |
| Impact of foreign tax rates and foreign dividends                                            | 6.4            | 0.3         | (0.2)          | –           |
| Adjustments to tax charge in respect of previous years                                       | 23.8           | 1.2         | (17.4)         | (1.1)       |
| Consortium relief not paid for                                                               | (9.0)          | (0.4)       | (9.8)          | (0.6)       |
| Other items                                                                                  | 5.1            | 0.3         | (2.9)          | (0.2)       |
| <b>Group tax charge and effective rate</b>                                                   | <b>607.2</b>   | <b>29.7</b> | <b>403.1</b>   | <b>26.4</b> |

The adjusted current tax charge is arrived at after the following adjustments:

|                                                                      | 2011<br>£m   | 2011<br>%   | 2010<br>£m   | 2010<br>%   |
|----------------------------------------------------------------------|--------------|-------------|--------------|-------------|
| Total taxation charge                                                | 607.2        | 29.7        | 403.1        | 26.4        |
| Effect of adjusting items (see below)                                | –            | 16.6        | –            | 4.8         |
| Total taxation charge on adjusted basis (add)/less:                  | 607.2        | 46.3        | 403.1        | 31.2        |
| Share of current tax from jointly controlled entities and associates | 23.0         | 1.8         | 15.8         | 1.2         |
| Exceptional items                                                    | 143.8        | 11.0        | –            | –           |
| Tax on movement on derivatives                                       | (396.2)      | (30.2)      | (110.9)      | (8.6)       |
| Deferred tax (excluding share of jointly controlled entities)        | (109.6)      | (8.4)       | (33.9)       | (2.6)       |
| <b>Adjusted current tax charge and effective rate</b>                | <b>268.2</b> | <b>20.5</b> | <b>274.1</b> | <b>21.2</b> |

The adjusted effective rate is based on adjusted profit before tax being:

|                                                              | 2011<br>£m     | 2010<br>£m     |
|--------------------------------------------------------------|----------------|----------------|
| Profit before tax                                            | 2,111.7        | 1,638.6        |
| (add)/less:                                                  |                |                |
| Exceptional items and certain remeasurements                 | (859.8)        | (398.6)        |
| Share of tax from jointly controlled entities and associates | 58.2           | 50.1           |
| <b>Adjusted profit before tax</b>                            | <b>1,310.1</b> | <b>1,290.1</b> |

Tax charge/(credit) recognised directly in equity

|                                              | 2011<br>£m  | 2010<br>£m     |
|----------------------------------------------|-------------|----------------|
| Relating to:                                 |             |                |
| Pension scheme actuarial movements           | 7.9         | (142.5)        |
| Cash flow and net investment hedge movements | 7.1         | (15.3)         |
| Share based payments                         | 0.6         | 0.4            |
|                                              | <b>15.6</b> | <b>(157.4)</b> |

All tax recognised directly in equity is deferred tax.

## 9. DIVIDENDS

### Ordinary dividends

|                                    | Year ended<br>31 March 2011<br>Total<br>£m | Settled<br>via Scrip<br>£m | Pence per<br>Ordinary Share | Year ended<br>31 March 2010<br>Total<br>£m | Pence per<br>Ordinary Share |
|------------------------------------|--------------------------------------------|----------------------------|-----------------------------|--------------------------------------------|-----------------------------|
| Interim – year ended 31 March 2011 | 208.3                                      | 61.7                       | 22.4                        | –                                          | –                           |
| Final – year ended 31 March 2010   | 451.5                                      | 84.4                       | 49.0                        | –                                          | –                           |
| Interim – year ended 31 March 2010 | –                                          | –                          | –                           | 193.4                                      | 21.0                        |
| Final – year ended 31 March 2009   | –                                          | –                          | –                           | 425.1                                      | 46.2                        |
|                                    | <b>659.8</b>                               | <b>146.1</b>               |                             | 618.5                                      |                             |

The final dividend of 49.0p per Ordinary Share declared in the financial year ended 31 March 2010 (2009 – 46.2p) was approved at the Annual General Meeting on 22 July 2010 and was paid to shareholders on 24 September 2010. Shareholders were able to elect to receive Ordinary Shares credited as fully paid instead of the cash dividend under the terms of the Company's scrip dividend scheme.

An interim dividend of 22.4p per Ordinary Share (2010 – 21.0p) was declared and paid on 25 March 2011 to those shareholders on the Scottish and Southern Energy plc share register on 28 January 2011. Shareholders were able to elect to receive Ordinary Shares credited as fully paid instead of the interim cash dividend under the terms of the Company's scrip dividend scheme.

The proposed final dividend of 52.6p per Ordinary Share is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

## 10. EARNINGS PER SHARE

### Basic earnings per share

The calculation of basic earnings per Ordinary Share at 31 March 2011 is based on the net profit attributable to equity shareholders and a weighted average number of Ordinary Shares outstanding during the year ended 31 March 2011. All earnings are from continuing operations.

### Adjusted earnings per share

Adjusted earnings per share has been calculated by excluding the charge for deferred tax, items disclosed as exceptional, and the impact of certain remeasurements as described in note 5.

|                                                                               | Year ended<br>31 March 2011<br>Earnings (i)<br>£m | Year ended<br>31 March 2011<br>Earnings<br>per share<br>pence | Year ended<br>31 March 2010<br>Earnings (i)<br>£m | Year ended<br>31 March 2010<br>Earnings<br>per share<br>pence |
|-------------------------------------------------------------------------------|---------------------------------------------------|---------------------------------------------------------------|---------------------------------------------------|---------------------------------------------------------------|
| <b>Basic</b>                                                                  | <b>1,504.5</b>                                    | <b>162.2</b>                                                  | 1,235.3                                           | 134.0                                                         |
| Exceptional items and certain remeasurements (note 5)                         | (607.4)                                           | (65.5)                                                        | (287.7)                                           | (31.2)                                                        |
| Basic excluding exceptional items and certain remeasurements                  | 897.1                                             | 96.7                                                          | 947.6                                             | 102.8                                                         |
| Adjusted for:                                                                 |                                                   |                                                               |                                                   |                                                               |
| Deferred tax (note 8)                                                         | 109.6                                             | 11.8                                                          | 33.9                                              | 3.7                                                           |
| Deferred tax from share of jointly controlled entities and associates results | 35.2                                              | 3.8                                                           | 34.3                                              | 3.7                                                           |
| <b>Adjusted</b>                                                               | <b>1,041.9</b>                                    | <b>112.3</b>                                                  | 1,015.8                                           | 110.2                                                         |
| <b>Basic</b>                                                                  | <b>1,504.5</b>                                    | <b>162.2</b>                                                  | 1,235.3                                           | 134.0                                                         |
| Dilutive effect of convertible debt and outstanding share options             | –                                                 | (0.2)                                                         | –                                                 | (0.1)                                                         |
| <b>Diluted</b>                                                                | <b>1,504.5</b>                                    | <b>162.0</b>                                                  | 1,235.3                                           | 133.9                                                         |
| Exceptional items and certain remeasurements                                  | (607.4)                                           | (65.4)                                                        | (287.7)                                           | (31.2)                                                        |
| Diluted excluding exceptional items and certain remeasurements                | 897.1                                             | 96.6                                                          | 947.6                                             | 102.7                                                         |

(i) Earnings attributable to equity holders of the parent.

# Notes on the financial statements (continued)

## for the year ended 31 March

### 10. EARNINGS PER SHARE (continued)

The weighted average number of shares used in each calculation is as follows:

|                                           | 31 March 2011<br>Number of<br>shares<br>(millions) | 31 March 2010<br>Number of<br>shares<br>(millions) |
|-------------------------------------------|----------------------------------------------------|----------------------------------------------------|
| For basic and adjusted earnings per share | 927.6                                              | 921.9                                              |
| Effect of exercise of share options       | 1.1                                                | 0.4                                                |
|                                           | 928.7                                              | 922.3                                              |
| Effect of dilutive convertible debt       | –                                                  | 0.7                                                |
| For diluted earnings per share            | 928.7                                              | 923.0                                              |

### 11. INTANGIBLE ASSETS

#### Consolidated

|                                                        | Goodwill<br>£m | Allowances and<br>certificates<br>(i)<br>£m | Development<br>assets<br>(ii)<br>£m | Exploration and<br>evaluation<br>expenditure<br>(iii)<br>£m | Brands<br>(iv)<br>£m | Other<br>intangibles<br>(v)<br>£m | Total<br>£m    |
|--------------------------------------------------------|----------------|---------------------------------------------|-------------------------------------|-------------------------------------------------------------|----------------------|-----------------------------------|----------------|
| <b>Cost:</b>                                           |                |                                             |                                     |                                                             |                      |                                   |                |
| At 1 April 2009                                        | 724.0          | 220.3                                       | 220.3                               | –                                                           | 11.8                 | 59.8                              | 1,236.2        |
| Additions                                              | –              | 470.9                                       | 13.8                                | –                                                           | –                    | 1.6                               | 486.3          |
| Acquisitions (note 16)                                 | 18.5           | –                                           | 49.0                                | –                                                           | –                    | 2.0                               | 69.5           |
| Transfer to property, plant and<br>equipment (note 12) | –              | –                                           | (11.7)                              | –                                                           | –                    | –                                 | (11.7)         |
| Disposals                                              | –              | (461.5)                                     | –                                   | –                                                           | –                    | –                                 | (461.5)        |
| Exchange adjustments                                   | (16.2)         | –                                           | (7.3)                               | –                                                           | –                    | –                                 | (23.5)         |
| At 31 March 2010                                       | 726.3          | 229.7                                       | 264.1                               | –                                                           | 11.8                 | 63.4                              | 1,295.3        |
| Additions                                              | 3.8            | 399.3                                       | 29.6                                | –                                                           | –                    | 1.3                               | 434.0          |
| Acquisitions (note 16)                                 | 39.9           | –                                           | 6.4                                 | 50.0                                                        | –                    | –                                 | 96.3           |
| Transfer to property, plant and<br>equipment (note 12) | –              | –                                           | (3.8)                               | –                                                           | –                    | –                                 | (3.8)          |
| Transfer to assets held for sale (note 16)             | –              | –                                           | (10.7)                              | –                                                           | –                    | –                                 | (10.7)         |
| Disposals                                              | –              | (287.0)                                     | (0.6)                               | –                                                           | –                    | –                                 | (287.6)        |
| Exchange adjustments                                   | (42.2)         | –                                           | (11.5)                              | –                                                           | –                    | 0.1                               | (53.6)         |
| <b>At 31 March 2011</b>                                | <b>727.8</b>   | <b>342.0</b>                                | <b>273.5</b>                        | <b>50.0</b>                                                 | <b>11.8</b>          | <b>64.8</b>                       | <b>1,469.9</b> |
| <b>Aggregate amortisation and impairment:</b>          |                |                                             |                                     |                                                             |                      |                                   |                |
| At 1 April 2009                                        | –              | (6.4)                                       | (4.2)                               | –                                                           | (4.8)                | (29.9)                            | (45.3)         |
| Charge for the year                                    | –              | (10.0)                                      | (3.1)                               | –                                                           | (1.0)                | (8.1)                             | (22.2)         |
| At 31 March 2010                                       | –              | (16.4)                                      | (7.3)                               | –                                                           | (5.8)                | (38.0)                            | (67.5)         |
| Charge for the year                                    | –              | –                                           | (15.1)                              | –                                                           | (0.9)                | (5.5)                             | (21.5)         |
| Exceptional impairment (note 5)                        | (42.5)         | –                                           | (39.7)                              | –                                                           | –                    | –                                 | (82.2)         |
| <b>At 31 March 2011</b>                                | <b>(42.5)</b>  | <b>(16.4)</b>                               | <b>(62.1)</b>                       | <b>–</b>                                                    | <b>(6.7)</b>         | <b>(43.5)</b>                     | <b>(171.2)</b> |
| <b>Carrying amount:</b>                                |                |                                             |                                     |                                                             |                      |                                   |                |
| <b>At 31 March 2011</b>                                | <b>685.3</b>   | <b>325.6</b>                                | <b>211.4</b>                        | <b>50.0</b>                                                 | <b>5.1</b>           | <b>21.3</b>                       | <b>1,298.7</b> |
| At 31 March 2010                                       | 726.3          | 213.3                                       | 256.8                               | –                                                           | 6.0                  | 25.4                              | 1,227.8        |
| At 1 April 2009                                        | 724.0          | 213.9                                       | 216.1                               | –                                                           | 7.0                  | 29.9                              | 1,190.9        |

The Company does not hold intangible assets.

Intangible assets have been analysed as current and non-current as follows:

|              | 2011<br>£m     | 2010<br>£m     |
|--------------|----------------|----------------|
| Current      | 325.6          | 213.3          |
| Non-current: |                |                |
| Goodwill     | 685.3          | 726.3          |
| Other        | 287.8          | 288.2          |
|              | <b>1,298.7</b> | <b>1,227.8</b> |

**(i) Allowances and Certificates**

Allowances and Certificates consist of purchased carbon emissions allowances and generated or purchased renewable obligations certificates (ROCs).

**(ii) Development assets**

Development costs relate to the design, construction and testing of thermal and renewable generation sites and devices, including wind farms, which the Group believes will generate probable future economic benefits. Costs capitalised as development intangibles include options over land rights, planning application costs, environmental impact studies and other costs incurred in bringing wind farm and other projects to the consented stage. These may be costs incurred directly or at cost as part of the fair value attribution on acquisition.

At the point the development reaches the consented stage and is approved for construction, the carrying value is transferred to Property, Plant and Equipment (note 12). At the point a project is no longer expected to reach the consented stage, the carrying amount of the project is impaired. The acquisitions in the year are summarised in note 16. An exceptional impairment was recognised in the year in relation to European Wind Farms (£39.7m) and this is commented upon further below and in notes 5 and 12.

**(iii) Exploration and evaluation expenditure**

The Group's accounting policies for exploration and evaluation expenditure in relation to exploration wells are explained in note 1. The assets acquired in the year were from the acquisition of the Hess exploration and production assets (note 16).

**(iv) Brands**

Included within brands are the acquired brands of Atlantic Electric and Gas and the Airtricity supply brand used in Ireland. The Group has assessed the economic life of brands to be 10 years and the brands are being amortised over this period. The charge is reported as part of operating costs.

**(v) Other intangible assets**

Included within other intangible assets are customer lists, contracts, application software license fees, software development work, software upgrades and purchased PC software packages. Amortisation is over the shorter of the contract term or five years.

**Impairment review of goodwill**

Goodwill is allocated to those cash-generating units (CGUs) expected to benefit from the respective business combination for impairment testing purposes. Certain goodwill valuations have changed in the current year following retranslation.

A summary of the goodwill allocated to CGUs and the Group's operating segments is presented below:

| Cash-generating unit       | Operating Segment     | 2011<br>£m   | 2010<br>£m   |
|----------------------------|-----------------------|--------------|--------------|
| Ireland wind farms         | Generation and Supply | 155.9        | 160.3        |
| UK wind farms              | Generation and Supply | 199.9        | 232.0        |
| European wind farms        | Generation and Supply | 24.3         | 24.4         |
| UK Supply                  | Generation and Supply | 187.0        | 187.0        |
| UK Generation              | Generation and Supply | 10.1         | 52.6         |
| Gas Storage                | Other Businesses      | 56.2         | 56.2         |
| Exploration and Production | Other Businesses      | 38.1         | –            |
| Other (i)                  | Other Businesses      | 13.8         | 13.8         |
|                            |                       | <b>685.3</b> | <b>726.3</b> |

(i) Represents goodwill balances across a number of business units primarily Contracting and Telecoms. The amount of goodwill allocated to these units is not significant compared to the aggregate carrying value of the business units or the aggregate value of goodwill held by the Group. The conclusion of the impairment tests conducted is that no impairment is required.

The recoverable amount of the UK Supply, UK Generation, Gas Storage, Exploration and Production and Other CGUs is determined by reference to value-in-use calculations. These calculations use, as a starting point, pre-tax cash flow projections based on the Group's five-year business model as approved by the Board. The Group's business model is based on past experience and reflects the Group's view of markets, prices, risks and its strategic objectives. Commodity prices used are based on observable market data and, where this is not available, on internal estimates. The recoverable amount of the wind farm CGUs is based on the fair value less costs to sell methodology.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 11. INTANGIBLE ASSETS (continued)

The basis applied has been deemed appropriate as it is consistent with the way in which the economic value of the individual CGUs are assessed by management and would be by other market participants. The method applied is to determine fair value by assessing the discounted pre-tax cash flows expected to be earned by the individual wind farm projects within the respective CGUs. The three identified CGUs (Ireland wind farms, UK wind farms, European wind farms) share many of the same risk factors and are discounted accordingly.

The key assumptions used for the main value-in-use calculations are as follows:

| Cash-generating unit                  | 2011<br>Discount rate<br>[%] | 2010<br>Discount rate<br>[%] | 2011 and 2010<br>Cash flow<br>projection<br>period (years) |
|---------------------------------------|------------------------------|------------------------------|------------------------------------------------------------|
| All wind farms (onshore and offshore) | 7.0%-9.0%                    | 7.0%-9.0%                    | 25                                                         |
| UK Supply                             | 8.3%                         | 7.7%                         | 5                                                          |
| UK Generation (excluding wind)        | 8.3%                         | 8.3%                         | 15                                                         |
| Gas Storage                           | 8.3%                         | 8.3%                         | 20                                                         |
| Exploration and Production            | 8.0%-10.0%                   | –                            | Life of field                                              |

Management have determined the pre-tax cash flows of each CGU based on past performance and its expectations of market development. Further detail on how the cash flow projections have been derived is included in the specific commentaries. The discount rates used are pre-tax real and reflect specific risks attributable to the relevant operating segments. The discount rates used have been benchmarked against externally published rates used by comparable quoted companies operating in the respective market sectors. The recoverable amount derived from the value-in-use calculation is compared to the carrying amount of each CGU to determine whether the respective CGUs require to be impaired.

Specific comments on the key value-in-use and fair value less costs to sell calculations for the main CGUs and the results of the tests conducted follow:

#### All wind farm CGUs

For goodwill impairment testing purposes, all wind farm CGUs were established following the acquisition of the SSE Renewables (formerly Airtricity) group in 2008. In order to assess the respective recoverable amounts against an appropriate carrying value, goodwill has been allocated to the main geographic regions in which the business operates. The established CGUs (Ireland, UK, rest of Europe) are then assessed by considering the specific market attributes of those regions. Currency cash flows are set at the exchange rate at the time the impairment test is conducted. Aside from these specific market factors, the basis of review of the respective CGUs is identical.

Wind farm projects have an estimated useful life of up to 25 years and it is considered appropriate by management to assess the carrying amount against cash flow projections covering this period. The Ireland and UK wind CGUs include wind farms in operation and all CGUs include projects in the construction phase or in the development portfolio phase. These development projects are those which have not received consent or have not concluded all environmental or planning studies and as a consequence the associated cash flows have been probability adjusted.

Cash inflows for all projects are based on expected generation output from projects based on wind studies and past experience and are valued at forward power prices based on market information, where available, continuing government support for wind ROCs and internal model assumptions.

Cash outflows are based on planned capital expenditure and expected maintenance costs. The power prices and costs of operation are the most significant distinguishing factors in the respective CGU regions. Growth is based on the expected output of the respective wind farms at their available operational capacity over their life cycle.

#### Outcome of tests

Following the disposal of certain European assets and the exceptional impairment of certain intangible assets following restructuring of the European wind portfolio (£39.7m), no impairment of the related goodwill balance is required.

The recoverable amounts of the UK and Ireland wind farm CGUs exceeded the respective carrying values at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the fair value less costs-to-sell would not cause a change to the conclusion reached.

#### UK Supply

Goodwill carried in relation to the acquisition, in 2001, of Swalec is attributed to the Group's UK retail electricity and gas supply business CGU. The Group manages its UK Generation and Supply activities as one integrated business but for the purposes of the value-in-use calculation only, the projected cash flows of the Supply business are considered independently. This is reliant on judgement being applied in relation to the margin being earned by the Supply business. The margin assumed is based on current contractual terms and historic gross margin percentages earned. Revenues are based on the expected market share derived from the market share at the time of the approval of the business model adjusted for forecasted growth. Growth in customer numbers is anticipated at around 2.6% per annum over the forecast period and cash outflows associated with increased customer service are incorporated accordingly. This growth rate is supported

by reference to both past performance and management expectation. Margins also take account of forward wholesale energy price curves for both electricity and gas. The CGU excludes the Airtricity supply business in Ireland, which did not have goodwill attributed to it in any event.

#### Outcome of test

The recoverable amount of the UK Supply CGU exceeded the respective carrying value at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the value-in-use would not cause a change to the conclusion reached.

#### UK Generation (excluding wind)

Goodwill recognised on the Group's acquisitions of the Fiddler's Ferry and Ferrybridge (FFF), Uskmouth, Abernethy and Medway power stations and developments was attributed to the UK Generation portfolio CGU. These plants are operated as part of the integrated Generation and Supply business segment. For the purpose of the value-in-use calculation only, the projected cash flows of the main UK Generation plants have been considered as an independent CGU. The plants included in this CGU include all gas, coal and hydro generation plants but excludes cash flows from contract energy plants, combined heat and power plants and embedded generation plants, as these plants operate independently of the main generation production portfolio. Most of the goodwill was derived from deferred tax temporary differences on the recognition of the fair value of assets acquired.

Assumptions on market prices are made by reference to forward market prices and published market estimations, where available, and to internal model inputs beyond the observable period. Prices forecast include wholesale power prices and input costs such as wholesale gas prices, coal and oil prices as well as carbon emissions costs. Forecasts of availability and efficiency are based on management expectation and past performance. Historic average temperatures and rainfall have been assumed. The period of the cash flow projections applied is between 5 and 10 years but it should be noted that the assets which are the basis of the review have remaining useful economic lives of between 15 and, in the case of hydro civil assets, 100 years. The discount rates applied have been standardised at a pre-tax real rate of 8.3%, in line with the previous year. Growth has been assumed to follow the expected operational availability of the plants within the CGU over the period noted.

#### Outcome of test

Following the specific impairment exercises carried out in relation to the thermal generation plant referred to in note 12, all related goodwill has been written off. This has resulted in a charge of £42.5m. This impairment is part of the exceptional item in note 5.

Following the specific asset impairment adjustments, the recoverable amount of assets included in the main UK Generation CGU exceeded the carrying value at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the value-in-use would not cause a change to test outcome.

#### Gas Storage

Goodwill was recognised on the acquisition of the Hornsea gas storage facility in 2002/03. Initial cash flow projections are based on gross margins expected to be achieved in the period of the five-year business model. Beyond this period, cash flows have been extrapolated at a growth rate lower than the long-term growth rate of the economy for a further period of 15 years, which takes the CGU toward the end of its expected economic life. This longer period more accurately reflects the long-term infrastructure nature of these assets and the returns that can be expected to be earned. Assumptions on margin for the business plan period are based on expected demand for gas storage and take into account published and projected gas wholesale prices, planned capital expenditure required to maintain the value of the facility and estimated operating costs.

#### Outcome of test

The recoverable amount of the gas storage CGU exceeded its carrying value at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the value-in-use would not cause a change to the conclusion reached.

#### Exploration and Production

Goodwill was recognised on the purchase of the North Sea gas exploration and production assets in 2010/11 (note 16). Goodwill has been attributed to three cash generating units being the three main field development areas (Bacton, Easington Catchment Area (ECA) and Lomond/Everest) and their supporting infrastructure assets. Indications of impairment at asset/field level are investigated separately. All goodwill was derived from the recognition of deferred tax temporary liabilities.

The impairment test assumptions are based on forward prices of gas or oil, timing of cash flows including capital and abandonment costs, reserves information and discount rates.

#### Outcome of test

The recoverable amount of all Exploration and Production CGUs exceeded its carrying value at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the recoverable amount would not cause a change to the test outcome.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 12. PROPERTY, PLANT AND EQUIPMENT

##### Consolidated

|                                               | Power<br>generation<br>assets (i)<br>£m | Gas storage<br>and production<br>assets (ii)<br>£m | Land and<br>buildings<br>£m | Network<br>assets<br>£m | Vehicles and<br>miscellaneous<br>equipment (iii)<br>£m | Total<br>£m     |
|-----------------------------------------------|-----------------------------------------|----------------------------------------------------|-----------------------------|-------------------------|--------------------------------------------------------|-----------------|
| <b>Cost:</b>                                  |                                         |                                                    |                             |                         |                                                        |                 |
| At 31 March 2009                              | 4,636.0                                 | 331.2                                              | 211.3                       | 5,239.7                 | 294.9                                                  | 10,713.1        |
| Additions                                     | 485.0                                   | 46.5                                               | 29.2                        | 425.7                   | 39.3                                                   | 1,025.7         |
| Recognition of finance leases (vii)           | 387.8                                   | –                                                  | –                           | –                       | –                                                      | 387.8           |
| Acquisitions (note 16) (iv)                   | 6.4                                     | –                                                  | 7.3                         | 7.5                     | 5.2                                                    | 26.4            |
| Transfer from Intangible Assets (note 11) (v) | 11.7                                    | –                                                  | –                           | –                       | –                                                      | 11.7            |
| Disposals                                     | (67.1)                                  | (0.8)                                              | –                           | (2.2)                   | (65.5)                                                 | (135.6)         |
| Exchange rate adjustments                     | (35.2)                                  | –                                                  | –                           | –                       | (0.7)                                                  | (35.9)          |
| At 31 March 2010                              | 5,424.6                                 | 376.9                                              | 247.8                       | 5,670.7                 | 273.2                                                  | 11,993.2        |
| Additions                                     | 554.7                                   | 52.6                                               | 12.4                        | 489.5                   | 50.3                                                   | 1,159.5         |
| Acquisitions (note 16) (iv)                   | 63.9                                    | 305.2                                              | 19.5                        | –                       | –                                                      | 388.6           |
| Change in decommissioning asset values        | 32.7                                    | –                                                  | –                           | –                       | –                                                      | 32.7            |
| Transfer from Intangible Assets (note 11) (v) | 3.8                                     | –                                                  | –                           | –                       | –                                                      | 3.8             |
| Transfer to Held for Sale                     | (253.6)                                 | –                                                  | –                           | –                       | –                                                      | (253.6)         |
| Disposals (iii)                               | (73.2)                                  | –                                                  | (0.8)                       | (0.7)                   | (3.1)                                                  | (77.8)          |
| Exchange rate adjustments                     | (72.0)                                  | –                                                  | –                           | –                       | –                                                      | (72.0)          |
| <b>At 31 March 2011</b>                       | <b>5,680.9</b>                          | <b>734.7</b>                                       | <b>278.9</b>                | <b>6,159.5</b>          | <b>320.4</b>                                           | <b>13,174.4</b> |
| <b>Depreciation:</b>                          |                                         |                                                    |                             |                         |                                                        |                 |
| At 1 April 2009                               | 1,127.7                                 | 48.4                                               | 31.6                        | 2,078.1                 | 195.1                                                  | 3,480.9         |
| Charge for the year                           | 179.8                                   | 4.0                                                | 5.7                         | 183.5                   | 21.9                                                   | 394.9           |
| Disposals                                     | (46.0)                                  | (0.1)                                              | –                           | (0.7)                   | (35.8)                                                 | (82.6)          |
| Exchange rate adjustments                     | (3.7)                                   | –                                                  | –                           | –                       | (0.5)                                                  | (4.2)           |
| At 31 March 2010                              | 1,257.8                                 | 52.3                                               | 37.3                        | 2,260.9                 | 180.7                                                  | 3,789.0         |
| Charge for the year                           | 176.3                                   | 14.2                                               | 7.3                         | 279.9                   | 19.0                                                   | 496.7           |
| Exceptional impairments (vi)                  | 442.7                                   | –                                                  | –                           | –                       | –                                                      | 442.7           |
| Transfer to Held for Sale                     | (48.7)                                  | –                                                  | –                           | –                       | –                                                      | (48.7)          |
| Disposals (iii)                               | (13.3)                                  | –                                                  | (0.8)                       | (0.1)                   | (3.1)                                                  | (17.3)          |
| Exchange rate adjustments                     | (1.1)                                   | –                                                  | –                           | –                       | –                                                      | (1.1)           |
| <b>At 31 March 2011</b>                       | <b>1,813.7</b>                          | <b>66.5</b>                                        | <b>43.8</b>                 | <b>2,540.7</b>          | <b>196.6</b>                                           | <b>4,661.3</b>  |
| <b>Net book value</b>                         |                                         |                                                    |                             |                         |                                                        |                 |
| <b>At 31 March 2011</b>                       | <b>3,867.2</b>                          | <b>668.2</b>                                       | <b>235.1</b>                | <b>3,618.8</b>          | <b>123.8</b>                                           | <b>8,513.1</b>  |
| At 31 March 2010                              | 4,166.8                                 | 324.6                                              | 210.5                       | 3,409.8                 | 92.5                                                   | 8,204.2         |
| At 1 April 2009                               | 3,508.3                                 | 282.8                                              | 179.7                       | 3,161.6                 | 99.8                                                   | 7,232.2         |

- (i) Power generation assets comprise thermal and renewable generating stations, related buildings, plant and machinery and include all hydro civil and operating wind farm assets. Previous accounts included gas storage assets with power generation assets. These are now disclosed separately along with North Sea gas production assets. The net book value of generation assets includes decommissioning costs with a net book value of £62.3m (2010 – £22.0m). This increase was offset by a corresponding increase in the level of decommissioning provisions (note 25).
- (ii) Gas storage and production assets include decommissioning costs with a net book value of £81.7m (2010 – £6.9m). The decommissioning asset relating to the office and computer equipment (included in Vehicles and Miscellaneous Equipment) was £3.8m (2010 – £3.8m). This arises from the Group's obligations under the EU Waste Electrical and Electronic Equipment (WEEE) directive.
- (iii) Assets disposed includes the Ardrossan and Butendiek wind assets (see note 16) and assets which have been replaced after damage or obsolescence in the year.
- (iv) In the year to 31 March 2011, assets acquired in business combinations included North Sea gas production assets and the Waterloo Street, Glasgow office building. In the previous year, business combination acquired assets included coal fired generation assets at Uskmouth, the network assets at Atlasconnect, Cantono telecom data centre assets and the operational assets of the ESBC Streetlighting business. See note 16.
- (v) Represents the carrying value of development assets transferred from intangible assets (note 11) which have reached the consent stage and have been approved for construction.
- (vi) A number of Power Generation assets were impaired due to a combination of the effect of the Industrial Emissions Directive on station running hours and other economic factors.

(vii) This relates to the recognition of Marchwood Power Ltd as a finance lease asset.

At the balance sheet date the cumulative amounts capitalised in respect of assets in the course of construction were as follows:

|                                   | 2011<br>£m   | 2010<br>£m   |
|-----------------------------------|--------------|--------------|
| Power Generation assets           | 647.0        | 519.6        |
| Gas storage and production assets | 120.4        | 264.4        |
| Network assets                    | 188.2        | 204.7        |
| Corporate Land and Buildings      | 5.7          | 1.9          |
|                                   | <b>961.3</b> | <b>990.6</b> |

Included within property, plant and equipment are the following assets held under finance leases:

|                                              | Power<br>generation<br>assets<br>£m | Network<br>assets<br>£m | Vehicles and<br>miscellaneous<br>equipment<br>£m | Total<br>£m  |
|----------------------------------------------|-------------------------------------|-------------------------|--------------------------------------------------|--------------|
| <b>Cost</b>                                  |                                     |                         |                                                  |              |
| At 1 April 2009                              | –                                   | 5.0                     | 7.0                                              | 12.0         |
| Additions                                    | 387.8                               | –                       | –                                                | 387.8        |
| <b>At 31 March 2010 and at 31 March 2011</b> | <b>387.8</b>                        | <b>5.0</b>              | <b>7.0</b>                                       | <b>399.8</b> |
| <b>Depreciation</b>                          |                                     |                         |                                                  |              |
| At 1 April 2009                              | –                                   | 5.0                     | 7.0                                              | 12.0         |
| Charge for the year                          | 11.3                                | –                       | –                                                | 11.3         |
| At 31 March 2010                             | 11.3                                | 5.0                     | 7.0                                              | 23.3         |
| Charge for the year                          | 18.5                                | –                       | –                                                | 18.5         |
| <b>At 31 March 2011</b>                      | <b>29.8</b>                         | <b>5.0</b>              | <b>7.0</b>                                       | <b>41.8</b>  |
| <b>Net book value</b>                        |                                     |                         |                                                  |              |
| <b>At 31 March 2011</b>                      | <b>358.0</b>                        | <b>–</b>                | <b>–</b>                                         | <b>358.0</b> |
| At 31 March 2010                             | 376.5                               | –                       | –                                                | 376.5        |
| At 1 April 2009                              | –                                   | –                       | –                                                | –            |

The Company does not hold any property, plant or equipment.

### 13. BIOLOGICAL ASSETS

The Group acquired approximately 2,394 hectares of forest land including planted trees during the previous financial year. The living trees are accounted for as biological assets and are subject to a fair value reassessment each year.

|                                   | 2011<br>£m |
|-----------------------------------|------------|
| At 1 April 2009                   | –          |
| Purchased in the year             | 4.4        |
| At 1 April 2010 and 31 March 2011 | <b>4.4</b> |

The pre-tax discount rate used in determining the fair value in 2011 was 8% (2010 – 8%). A 2.0% decrease/(increase) in the discount rate would increase/(decrease) the fair value of biological assets by approximately £0.6m (2010 – £0.6m). No trees were harvested during the year. The Company does not hold any biological assets.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 14. INVESTMENTS

##### (a) Associates and Joint Ventures

##### Consolidated

|                                     | Equity       |              |                  |                       | Loans        |              |                  |                      |                |
|-------------------------------------|--------------|--------------|------------------|-----------------------|--------------|--------------|------------------|----------------------|----------------|
|                                     | SGN<br>£m    | JCEs<br>£m   | Associates<br>£m | Equity<br>total<br>£m | SGN<br>£m    | JCEs<br>£m   | Associates<br>£m | Loans<br>total<br>£m | Total<br>£m    |
| <b>Share of net assets/cost</b>     |              |              |                  |                       |              |              |                  |                      |                |
| At 31 March 2009                    | 157.6        | 257.1        | 138.7            | <b>553.4</b>          | 266.9        | 401.9        | 3.0              | <b>671.8</b>         | <b>1,225.2</b> |
| Transfer (out)/in (i)               | –            | (8.6)        | 18.8             | <b>10.2</b>           | –            | –            | –                | <b>–</b>             | <b>10.2</b>    |
| Disposal                            | –            | (1.0)        | –                | <b>(1.0)</b>          | –            | –            | –                | <b>–</b>             | <b>(1.0)</b>   |
| New equity investments              | –            | 16.8         | 45.0             | <b>61.8</b>           | –            | –            | –                | <b>–</b>             | <b>61.8</b>    |
| Increase in shareholder loans       | –            | –            | –                | <b>–</b>              | 16.6         | 273.3        | 46.5             | <b>336.4</b>         | <b>336.4</b>   |
| Repayment of shareholder loans      | –            | –            | –                | <b>–</b>              | (16.6)       | (17.9)       | –                | <b>(34.5)</b>        | <b>(34.5)</b>  |
| Conversion of loan to equity        | –            | –            | 3.2              | <b>3.2</b>            | –            | –            | (3.2)            | <b>(3.2)</b>         | <b>–</b>       |
| Dividends received                  | –            | (8.5)        | (15.2)           | <b>(23.7)</b>         | –            | –            | –                | <b>–</b>             | <b>(23.7)</b>  |
| Share of profit after tax           | 55.6         | 28.9         | 25.3             | <b>109.8</b>          | –            | –            | –                | <b>–</b>             | <b>109.8</b>   |
| Share of other reserves adjustments | (57.8)       | (14.0)       | –                | <b>(71.8)</b>         | –            | –            | –                | <b>–</b>             | <b>(71.8)</b>  |
| Exchange rate adjustments           | –            | (6.7)        | –                | <b>(6.7)</b>          | –            | –            | –                | <b>–</b>             | <b>(6.7)</b>   |
| At 31 March 2010                    | 155.4        | 264.0        | 215.8            | <b>635.2</b>          | 266.9        | 657.3        | 46.3             | <b>970.5</b>         | <b>1,605.7</b> |
| New equity investments              | –            | 24.0         | 176.3            | <b>200.3</b>          | –            | –            | –                | <b>–</b>             | <b>200.3</b>   |
| Increase in shareholder loans       | –            | –            | –                | <b>–</b>              | –            | 199.8        | 4.6              | <b>204.4</b>         | <b>204.4</b>   |
| Repayment of shareholder loans      | –            | –            | –                | <b>–</b>              | –            | (13.3)       | –                | <b>(13.3)</b>        | <b>(13.3)</b>  |
| Conversion of loan to equity        | –            | –            | 37.0             | <b>37.0</b>           | –            | –            | (37.0)           | <b>(37.0)</b>        | <b>–</b>       |
| Transfer to Held For Sale           | –            | (63.7)       | –                | <b>(63.7)</b>         | –            | –            | –                | <b>–</b>             | <b>(63.7)</b>  |
| Dividends received                  | (30.0)       | (26.5)       | (25.2)           | <b>(81.7)</b>         | –            | –            | –                | <b>–</b>             | <b>(81.7)</b>  |
| Share of profit after tax           | 74.5         | 56.0         | (65.6)           | <b>64.9</b>           | –            | –            | –                | <b>–</b>             | <b>64.9</b>    |
| Share of other reserves adjustments | (8.9)        | (5.2)        | –                | <b>(14.1)</b>         | –            | –            | –                | <b>–</b>             | <b>(14.1)</b>  |
| Disposal                            | –            | (13.7)       | –                | <b>(13.7)</b>         | –            | –            | –                | <b>–</b>             | <b>(13.7)</b>  |
| Exchange rate adjustments           | –            | (3.4)        | –                | <b>(3.4)</b>          | –            | –            | –                | <b>–</b>             | <b>(3.4)</b>   |
| <b>At 31 March 2011</b>             | <b>191.0</b> | <b>231.5</b> | <b>338.3</b>     | <b>760.8</b>          | <b>266.9</b> | <b>843.8</b> | <b>13.9</b>      | <b>1,124.6</b>       | <b>1,885.4</b> |

Investments in Jointly Controlled Entities (JCEs) and Associates have been presented in a different format (see note 2).

- (i) Transfers (out)/in in the previous financial year represented £8.6m of investment in Aquamarine Power Limited which was reclassified as an associate from a joint venture following a reduction in our shareholding from 50.0% to 47.8%, £10.0m in relation to RockTron (Widnes) Limited where there was a subsequent £7.0m increase in stakeholding from 17.5% to 49.9%, and £0.2m in relation to Smarter Grid Solutions Limited, which was transferred to associates following an increase in the Group's shareholding from 12.5% to 29.9%.

The investment in Scotia Gas Networks is disclosed separately to aid understanding of the Group's financial performance.

##### Company

|                                 | Equity       |                                       |                       | Loans        |                                       |                      |
|---------------------------------|--------------|---------------------------------------|-----------------------|--------------|---------------------------------------|----------------------|
|                                 | SGN<br>£m    | Other<br>JCEs and<br>Associates<br>£m | Equity<br>total<br>£m | SGN<br>£m    | Other<br>JCEs and<br>Associates<br>£m | Loans<br>total<br>£m |
| <b>Share of net assets/cost</b> |              |                                       |                       |              |                                       |                      |
| At 31 March 2009                | 190.0        | –                                     | <b>190.0</b>          | 266.9        | 306.4                                 | <b>573.3</b>         |
| Transfer (out)/in (i)           | –            | 10.0                                  | <b>10.0</b>           | –            | –                                     | <b>–</b>             |
| New equity investments          | –            | 7.0                                   | <b>7.0</b>            | –            | –                                     | <b>–</b>             |
| Increase in shareholder loans   | –            | –                                     | <b>–</b>              | 16.6         | 262.0                                 | <b>278.6</b>         |
| Repayment of shareholder loans  | –            | –                                     | <b>–</b>              | (16.6)       | –                                     | <b>(16.6)</b>        |
| At 31 March 2010                | 190.0        | 17.0                                  | <b>207.0</b>          | 266.9        | 568.4                                 | <b>835.3</b>         |
| Increase in shareholder loans   | –            | –                                     | <b>–</b>              | –            | 194.2                                 | <b>194.2</b>         |
| Disposal                        | –            | (17.0)                                | <b>(17.0)</b>         | –            | –                                     | <b>–</b>             |
| <b>At 31 March 2011</b>         | <b>190.0</b> | <b>–</b>                              | <b>190.0</b>          | <b>266.9</b> | <b>762.6</b>                          | <b>1,029.5</b>       |

Details of the principal jointly controlled entities, operations and associates are as follows:

|                                             | Country of incorporation | 31 March 2011<br>Holding % | 31 March 2010<br>Holding % | Principal activity         |
|---------------------------------------------|--------------------------|----------------------------|----------------------------|----------------------------|
| <b>Jointly Controlled Entities</b>          |                          |                            |                            |                            |
| Scotia Gas Networks Limited (v)             | England and Wales        | 50.0                       | 50.0                       | Gas distribution networks  |
| Greater Gabbard Offshore Winds Limited (vi) | England and Wales        | 50.0                       | 50.0                       | Offshore wind development  |
| Marchwood Power Limited (i)                 | England and Wales        | 50.0                       | 50.0                       | Electricity generation     |
| PriDE (SERP) Limited (ii)                   | England and Wales        | 50.0                       | 50.0                       | Defence estates contractor |
| Seabank Power Limited (iii)                 | England and Wales        | 50.0                       | 50.0                       | Electricity generation     |
| <b>Associates</b>                           |                          |                            |                            |                            |
| Walney (UK) Offshore Windfarms Limited (vi) | England and Wales        | 25.1                       | 25.1                       | Offshore wind development  |
| Barking Power Limited (i)                   | England and Wales        | 30.4                       | 30.4                       | Electricity generation     |
| Derwent Co-generation Limited (i)           | England and Wales        | 49.5                       | 49.5                       | Electricity generation     |
| Aquamarine Power Limited (iv)               | Scotland                 | 43.2                       | 47.8                       | Marine energy conversion   |

|                                                       | Location of operations | 31 March 2011<br>Holding % | 31 March 2010<br>Holding % | Principal activity                  |
|-------------------------------------------------------|------------------------|----------------------------|----------------------------|-------------------------------------|
| <b>Jointly Controlled Operations (unincorporated)</b> |                        |                            |                            |                                     |
| Aldbrough                                             | England                | 66.7                       | 66.7                       | Development of gas storage facility |

The above companies' shares consist of Ordinary Shares only except for Aquamarine Power Limited, which has deferred shares. All companies operate in Great Britain and Ireland. Seabank Power Limited and Marchwood Power Limited have accounting periods ending on 31 December. All other companies have accounting periods ending on 31 March. The Group has a number of other joint and associate investments that are not considered significant in relation to the results or position in these financial statements.

- (i) Shares held by SSE Generation Limited
- (ii) Shares held by Southern Electric Contracting Limited
- (iii) Shares held by SSE Seabank Investments Limited
- (iv) Shares held by SSE Venture Capital Limited
- (v) Shares held by Scottish and Southern Energy plc
- (vi) Shares held by SSE Renewables Holdings Limited (or subsidiaries)

The material significance of the Scotia Gas Networks Limited investment warrants separate disclosure from other jointly controlled entities. Accordingly, the result from the Group's share of these businesses is included as a separate segment in the analysis of Group operating profit (note 3). The results of Scotia Gas Networks Limited, of which the Group has a 50% share, can be illustrated thus:

|                                       | 2011                                                      |                                                    |             | 2010                                                      |                                                    |             |
|---------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------|-----------------------------------------------------------|----------------------------------------------------|-------------|
|                                       | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>£m | Total<br>£m | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>£m | Total<br>£m |
| Operating profit                      | 373.6                                                     | –                                                  | 373.6       | 367.3                                                     | –                                                  | 367.3       |
| Finance costs: excluding loan stock   | (180.9)                                                   | 12.8                                               | (168.1)     | (126.0)                                                   | 6.8                                                | (119.2)     |
| Finance costs: interest on loan stock | (66.7)                                                    | –                                                  | (66.7)      | (67.5)                                                    | –                                                  | (67.5)      |
| Profit before tax                     | 126.0                                                     | 12.8                                               | 138.8       | 173.8                                                     | 6.8                                                | 180.6       |
| Taxation                              | (53.9)                                                    | 64.1                                               | 10.2        | (67.5)                                                    | (1.9)                                              | (69.4)      |
| Profit for the year                   | 72.1                                                      | 76.9                                               | 149.0       | 106.3                                                     | 4.9                                                | 111.2       |
| SSE share of profit                   | 36.1                                                      | 38.4                                               | 74.5        | 53.2                                                      | 2.4                                                | 55.6        |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 14. INVESTMENTS (continued)

As an investor, Scottish and Southern Energy plc received £33.4m (2010 – £33.8m) in relation to loan stock interest payable to the Group.

The balance sheet of Scotia Gas Networks Limited can be summarised as follows (100%):

|                                    | Non-current<br>assets<br>£m | Current<br>assets<br>£m | Current<br>liabilities<br>£m | Non-current<br>liabilities<br>£m |
|------------------------------------|-----------------------------|-------------------------|------------------------------|----------------------------------|
| <b>Scotia Gas Networks Limited</b> |                             |                         |                              |                                  |
| <b>31 March 2011</b>               | <b>5,603.4</b>              | <b>110.3</b>            | <b>(416.6)</b>               | <b>(4,914.6)</b>                 |
| 31 March 2010                      | 5,331.3                     | 271.6                   | (672.6)                      | (4,619.4)                        |

The financial statements of the Group's other jointly controlled entities and associates can be summarised as follows (100%):

|                                    | Current<br>assets<br>£m | Non-current<br>assets<br>£m | Current<br>liabilities<br>£m | Non-current<br>liabilities<br>£m | Revenues<br>£m | Profit<br>after tax<br>£m |
|------------------------------------|-------------------------|-----------------------------|------------------------------|----------------------------------|----------------|---------------------------|
| <b>Jointly Controlled Entities</b> |                         |                             |                              |                                  |                |                           |
| <b>31 March 2011</b>               | <b>170.8</b>            | <b>1,430.2</b>              | <b>(131.3)</b>               | <b>(1,239.6)</b>                 | <b>1,053.7</b> | <b>117.0</b>              |
| 31 March 2010                      | 166.0                   | 1,179.8                     | (135.3)                      | (1,002.8)                        | 415.3          | 68.8                      |
| <b>Associates</b>                  |                         |                             |                              |                                  |                |                           |
| <b>31 March 2011</b>               | <b>144.9</b>            | <b>277.7</b>                | <b>(62.6)</b>                | <b>(44.6)</b>                    | <b>313.4</b>   | <b>46.9</b>               |
| 31 March 2010                      | 188.2                   | 438.5                       | (116.6)                      | (110.6)                          | 451.2          | 74.6                      |

#### (b) Other investments

##### Consolidated

|                                     | Faroe Petroleum<br>£m | BiFab<br>£m | Solar Century<br>£m | Sigma<br>£m | RockTron<br>£m | Other<br>£m | Total<br>£m |
|-------------------------------------|-----------------------|-------------|---------------------|-------------|----------------|-------------|-------------|
| At 1 April 2009                     | –                     | –           | 4.1                 | 2.4         | 10.0           | 1.8         | 18.3        |
| Additions in the year               | –                     | –           | –                   | 0.5         | –              | 0.6         | 1.1         |
| Transfers to Associates in the year | –                     | –           | –                   | –           | (10.0)         | (0.2)       | (10.2)      |
| At 31 March 2010                    | –                     | –           | 4.1                 | 2.9         | –              | 2.2         | 9.2         |
| Additions in the year (i)           | 18.0                  | 11.0        | –                   | 0.3         | –              | 1.1         | 30.4        |
| <b>At 31 March 2011</b>             | <b>18.0</b>           | <b>11.0</b> | <b>4.1</b>          | <b>3.2</b>  | <b>–</b>       | <b>3.3</b>  | <b>39.6</b> |

(i) Additions in the year include equity stakes in Faroe Petroleum plc (5%) and Burntisland Fabrications Limited ('BiFab') (15%).

##### Company

|                         | Faroe Petroleum<br>£m | Total<br>£m |
|-------------------------|-----------------------|-------------|
| At 31 March 2010        | –                     | –           |
| Addition in the year    | 18.0                  | 18.0        |
| <b>At 31 March 2011</b> | <b>18.0</b>           | <b>18.0</b> |

## 15. SUBSIDIARY UNDERTAKINGS

Details of the principal subsidiary undertakings are as follows:

|                                                         | Country of incorporation | 2011<br>Holding % | 2010<br>Holding % | Principal activity             |
|---------------------------------------------------------|--------------------------|-------------------|-------------------|--------------------------------|
| SSE Services plc (i)                                    | England and Wales        | 100               | 100               | Corporate support services     |
| SSE Energy Supply Limited (i)                           | England and Wales        | 100               | 100               | Electricity supply             |
| SSE Generation Limited (i)                              | England and Wales        | 100               | 100               | Electricity generation         |
| Medway Power Limited (iii)                              | England and Wales        | 100               | 100               | Electricity generation         |
| Keadby Generation Limited (viii)                        | England and Wales        | 100               | 100               | Electricity generation         |
| Southern Electric Gas Limited (vi)                      | England and Wales        | 100               | 100               | Gas supply                     |
| SSE Renewables Holdings Limited (i)                     | Ireland                  | 100               | 100               | Renewables holding company     |
| SSE Renewables Holdings (UK) Limited (x)                | Northern Ireland         | 100               | 100               | Renewables holding company     |
| SSE Renewables Developments (UK) Limited (ix)           | Northern Ireland         | 100               | 100               | Wind generation development    |
| SSE Renewables (Ireland) Limited (iii)                  | Ireland                  | 100               | 100               | Wind generation development    |
| Airtricity Limited (iii)                                | Ireland                  | 100               | 100               | Energy supply                  |
| Airtricity Energy Supply (Northern Ireland) Limited (x) | Northern Ireland         | 100               | 100               | Energy supply                  |
| Scottish Hydro Electric Transmission Limited (iv)       | Scotland                 | 100               | 100               | Transmission of electricity    |
| Scottish Hydro Electric Power Distribution plc (iv)     | Scotland                 | 100               | 100               | Distribution of electricity    |
| Southern Electric Power Distribution plc (iv)           | England and Wales        | 100               | 100               | Distribution of electricity    |
| S+S Limited (iv)                                        | Scotland                 | 100               | 100               | Electricity connections        |
| SSE Metering Limited (i)                                | Scotland                 | 100               | 100               | Meter reader and operator      |
| Southern Electric Contracting Limited (v)               | England and Wales        | 100               | 100               | Electrical contractor          |
| SSE Hornsea Limited (i)                                 | England and Wales        | 100               | 100               | Gas storage                    |
| SSE E&P UK Limited (i)                                  | Scotland                 | 100               | –                 | Gas exploration and production |
| SSE Telecommunications Limited (i)                      | Scotland                 | 100               | 100               | Telecommunication services     |
| Neos Networks Limited (vii)                             | England and Wales        | 100               | 100               | Telecommunication services     |

The above companies' shares consist of Ordinary Shares only. All principal subsidiaries operate in Great Britain and Ireland. All companies have accounting periods ending on 31 March. The Group has other subsidiary undertakings which do not significantly affect the results and position disclosed in these financial statements. A full list of the subsidiary undertakings will be included in the Company's annual return.

Shares in the above subsidiaries are held by:

- (i) Scottish and Southern Energy plc
- (ii) SSE Generation Limited
- (iii) SSE Renewables Holdings Limited
- (iv) SSE Power Distribution Limited
- (v) SSE Contracting Group Limited
- (vi) SSE Energy Supply Limited
- (vii) SSE Telecommunications Limited
- (viii) Keadby Power Limited
- (ix) SSE Renewables Holdings (UK) Limited
- (x) SSE Renewables Group (UK) Limited

### Investment in subsidiaries

#### Company

|                                      | Total<br>£m    |
|--------------------------------------|----------------|
| At 1 April 2009                      | 2,154.2        |
| Increase in existing investments     | 17.9           |
| At 31 March 2010                     | 2,172.1        |
| Increase in existing investments (i) | 13.6           |
| Transfers in (ii)                    | 132.7          |
| <b>At 31 March 2011</b>              | <b>2,318.4</b> |

- (i) The increase in existing investments held by the Company relates to equity shares in the Company awarded to the employees of the subsidiaries of the Group under the Group's share schemes, which are recognised as an increase in the cost of investment in those subsidiaries as directed by IFRS 2. This also includes an additional £3.8m paid in relation to the acquisition of Airtricity Holdings Limited.
- (ii) SSE Hornsea Limited was transferred from SSE Energy Supply Limited at book value during the year.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 15. SUBSIDIARY UNDERTAKINGS (continued)

##### Service concession arrangements

In 50:50 partnership with Royal Bank Leasing Limited, the Group has established three companies to provide street lighting services to councils under the Private Finance Initiative (PFI). These services are thereafter sub-contracted to Southern Electric Contracting Limited, a wholly owned subsidiary. The companies established are as follows:

| Company                                                    | Council                              |
|------------------------------------------------------------|--------------------------------------|
| Tay Valley Lighting (Stoke on Trent) Limited               | Stoke-on-Trent Council               |
| Tay Valley Lighting (Newcastle and North Tyneside) Limited | Newcastle and North Tyneside Council |
| Tay Valley Lighting (Leeds) Limited                        | Leeds City Council                   |

Under SIC-12 Consolidation – Special Purpose Entities, despite being 50% owned, the Tay Valley Lighting companies are categorised as subsidiaries and are accounted for accordingly since the Group bears the majority of the risks and rewards. The debt associated with these companies is non-recourse to the Group. The arrangements for all three companies are materially similar.

The Group also owns 100% of the share capital of entities which perform similar services under seven PFI contracts. The terms of the service concession arrangement are similar to those operated by the companies noted above. The council and contract holder within the acquired group are as follows:

| Company                                   | Council                     |
|-------------------------------------------|-----------------------------|
| Dorset Lighting Limited                   | Dorset County Council       |
| Ealing Lighting Limited                   | London Borough of Ealing    |
| Islington Lighting Limited                | London Borough of Islington |
| Tay Valley Lighting (Hampshire) Limited   | Hampshire County Council    |
| Tay Valley Lighting (Southampton) Limited | Southampton City Council    |
| Tay Valley Lighting (West Sussex) Limited | West Sussex County Council  |
| Tay Valley Lighting (Nottingham) Limited  | Nottingham City Council     |

The service commencement date for Tay Valley Lighting (Nottingham) Limited was 1 September 2010.

##### Characteristics of the arrangements

##### Description

The contracts are 25 year arrangements to replace ageing street-lighting stock and to subsequently maintain the new assets throughout each of the Councils' areas.

##### Significant terms

The cash flows under the PFI arrangements come from the unitary charge for these services paid by the Councils. The unitary charge can only be adjusted if performance under the contract falls below the required standards. Any significant change to the services proposed by either party is subject to a formal change procedure and agreement to such a change is required by the other party.

##### Nature and extent of rights and obligations

The assets are part of the public highway and ownership of the assets remains with the Councils. The contract holding companies are licensed to replace and maintain the assets for the period of the contract. This obligation is passed down to Southern Electric Contracting Limited or to other companies within the Seeboard Trading group through the operating sub-contract. Any failure to provide the services to the required standards will result in financial penalties which are taken from the unitary charge.

The companies have 25 year contracts with no extension options. Termination during this period can be initiated through a number of routes including service provider default, force majeure or the event of a risk becoming uninsurable, authority default, voluntary authority termination, or termination for a prohibited act or breach of refinancing provisions. In all cases, a formula exists for calculating compensation payments to the service provider.

Throughout the contract period there are a number of circumstances under which the companies could potentially be required to provide additional services:

##### (i) Changes in the law

If circumstances arise where by a change in legislation would mean a change in the way the services are to be provided the companies would be liable for part of the cost of this change. This liability is capped.

##### (ii) Final survey

The Councils have the ability to deduct a percentage of the unitary charge in the last two years if an independent survey indicates the assets are unlikely to have a 5-year residual life.

## 16. ACQUISITIONS, DISPOSALS AND HELD FOR SALE ASSETS

### (a) Exploration and Production assets acquisition

On 2 February 2011, the Group, through its subsidiary SSE E&P UK Limited, concluded the acquisition of joint operating interests in various North Sea natural gas and infrastructure assets in three main geographical areas (Bacton, Easington Catchment Area (ECA) and Lomond/Everest) from Hess Limited following a completion period where partner and regulatory approvals were received. The acquisition will provide the Group with a new source of primary fuel and an economic hedge for the Generation and Supply business. The acquisition will also mean the Group has involvement throughout the gas supply chain. Goodwill primarily reflects deferred tax liabilities recognised. The completion period included a mechanism to adjust values for incurred and earned cash flows between the economic date of the agreement and the completion date. Cash consideration of £200.4m was paid on the date of acquisition which includes the impact of effective cash flow hedge arrangements for the transaction. At 14 April 2011, a final cash settlement of £3.2m was received in relation to the completion adjustments. Professional fees of £0.9m were incurred and expensed.

The assets and liabilities acquired can be summarised thus:

|                                                | Agreement<br>valuations<br>£m | Completion<br>adjustments<br>£m | Fair value<br>adjustments<br>£m | Total<br>£m    |
|------------------------------------------------|-------------------------------|---------------------------------|---------------------------------|----------------|
| Goodwill                                       | –                             | –                               | 38.1                            | <b>38.1</b>    |
| Production and infrastructure assets (note 12) | 165.1                         | (17.0)                          | 157.1                           | <b>305.2</b>   |
| Exploration and evaluation assets              | 53.8                          | (4.7)                           | 0.9                             | <b>50.0</b>    |
| Decommissioning provision                      | –                             | –                               | (71.5)                          | <b>(71.5)</b>  |
| Accruals and provisions                        | –                             | –                               | (11.4)                          | <b>(11.4)</b>  |
| Deferred tax asset                             | –                             | –                               | 22.9                            | <b>22.9</b>    |
| Deferred tax liability                         | –                             | –                               | (136.1)                         | <b>(136.1)</b> |
|                                                | 218.9                         | (21.7)                          | –                               | <b>197.2</b>   |
| Consideration:                                 |                               |                                 |                                 |                |
| Cash                                           |                               |                                 |                                 | <b>200.4</b>   |
| Debtor                                         |                               |                                 |                                 | <b>(3.2)</b>   |
|                                                |                               |                                 |                                 | <b>197.2</b>   |

The exploration and production business recorded an operating profit of £4.6m in the period from acquisition. The majority of the revenue earned by the business was internal under arm's length trading arrangements with the Generation and Supply business (SSE Energy Supply Limited). Had the business been owned from 1 April 2010, the estimated operating profit before depreciation and amortisation would have been £42.6m from an estimated revenue of £68.4m. The accounting policies associated with this business are summarised in note 1.

### (b) Ardrossan acquisition and disposal

On 21 April 2010, the Group acquired the residual 49% of Ardrossan Wind Farm (Scotland) Limited, an operating wind farm company based in Scotland, for a cash consideration of £13.0m. This took the Group's investment in the company to 100%. Non-controlling interests of £3.8m were derecognised on completion of the acquisition. On 20 May 2010, the Group disposed of its 100% holding in Ardrossan Wind Farm (Scotland) Limited to Wind Acquisitions 1 (Infinis) for cash proceeds of £28.1m. The net result of the acquisition on 21 April and the disposal on 20 May was a gain of £8.3m.

The transactions can be summarised thus:

|                                 | £m           |
|---------------------------------|--------------|
| Assets disposed of:             |              |
| Goodwill                        | 7.4          |
| Property, plant and equipment   | 60.3         |
| Current assets                  | 6.8          |
| Current liabilities             | (27.6)       |
| Deferred tax                    | (13.9)       |
| <b>Net assets</b>               | <b>33.0</b>  |
| Proceeds of disposal:           |              |
| Cash consideration received     | 28.1         |
| <b>Net proceeds of disposal</b> | <b>28.1</b>  |
| <b>Loss on disposal</b>         | <b>(4.9)</b> |
| Gain on acquisition             | 13.2         |
| <b>Net gain on transactions</b> | <b>8.3</b>   |

No significant profit or loss was recognised from this businesses prior to disposal.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 16. ACQUISITIONS, DISPOSALS AND HELD FOR SALE ASSETS (continued)

##### (c) Other acquisitions in the year

In addition to the transactions above, the Group acquired the following companies and businesses in the year:

| Entity acquired                 | Country of incorporation | Date of acquisition | Principal activity | Shareholding acquired | Consideration<br>£m |
|---------------------------------|--------------------------|---------------------|--------------------|-----------------------|---------------------|
| I&H Brown (Calliacher) Limited  | Scotland                 | 21 September 2010   | Wind development   | 100%                  | 6.4                 |
| RockTron (Widnes) Limited       | England & Wales          | 1 October 2010      | Ash remediation    | 100%                  | 33.5                |
| Stockland (Shaftesbury) Limited | Scotland                 | 19 October 2010     | Office building    | 100%                  | 19.5                |
|                                 |                          |                     |                    |                       | 59.4                |

The assumption of ownership of RockTron (Widnes) Limited took the Group's interest in the business from 49.9% to 100% following the Group stepping in to acquire the remaining shareholding under the terms of its loan agreement. The fair value of the Group's interest at 1 October 2010 was £31.5m. As a result of remeasuring the fair value of the 49.9% stake in the Company, the Group recognised a loss on acquisition of £6.7m which was offset by negative goodwill of £6.4m recognised on the acquisition of the 100% shareholding, as noted in the table below. The company was subsequently renamed SSE Mineral Solutions Limited. Professional fees incurred in relation to these acquisitions of £0.2m were expensed. The table below shows the book values and fair values of the assets and liabilities acquired in the combinations in the table above:

|                                               | Carrying value<br>of acquired<br>entities<br>£m | Fair value of<br>acquired<br>entities<br>£m |
|-----------------------------------------------|-------------------------------------------------|---------------------------------------------|
| Goodwill                                      | –                                               | 1.8                                         |
| Intangible development assets                 | 6.4                                             | 6.4                                         |
| Property, plant and equipment                 | 85.3                                            | 57.0                                        |
| Other net current liabilities                 | (5.6)                                           | (0.5)                                       |
| Loans and borrowings                          | (2.0)                                           | –                                           |
| Deferred tax                                  | 4.5                                             | 1.1                                         |
| <b>Net assets</b>                             | <b>88.6</b>                                     | <b>65.8</b>                                 |
| Consideration:                                |                                                 |                                             |
| Cash                                          |                                                 | 27.9                                        |
| Fair value of investment in RockTron (Widnes) |                                                 | 31.5                                        |
|                                               |                                                 | 59.4                                        |
| Negative goodwill recognised                  |                                                 | 6.4                                         |

No significant profit or loss was recognised from these acquisitions in the period to 31 March 2011.

##### (d) Disposals

On 16 September 2010, the Group disposed of its investment in Butendiek Offshore Winpark Holding GmbH and its subsidiaries to wpd AG for cash proceeds of £1.0m less £0.3m costs of disposal. No profit or loss was recognised on this disposal. The disposal of Butendiek may result in additional proceeds being received dependent on certain contingent events. The contingent consideration, which is a financial asset, has been deemed to have a fair value of zero, due to the Group's assessment of the likelihood of the contingent events taking place. In addition, the Group disposed of other minor investments in Germany for cash proceeds of £3.1m and recorded a gain on disposal of £1.9m.

##### (e) Held for sale assets

At 31 March 2011, a number of wind generation and development assets have been presented as held for sale following the decision of the Group's management to sell the respective companies and their related assets. The assets and liabilities classified as held for sale are as follows:

|                                                  | £m           |
|--------------------------------------------------|--------------|
| Property, plant and equipment                    | 204.9        |
| Intangible development assets                    | 10.7         |
| Equity investment in jointly controlled entities | 63.7         |
| Cash and cash equivalents                        | 23.0         |
| Other net current liabilities                    | (9.6)        |
| Deferred tax                                     | (23.3)       |
|                                                  | <b>269.4</b> |

There were no significant cash flows or amounts recognised in the statement of comprehensive income relating to the above assets held for sale. Of these assets held for sale, three wind farms were disposed of in April 2011 for a consideration of £178.4m (see note 34).

#### (f) Acquisitions in the previous year

In the previous year, the Group acquired the following companies and businesses:

| Entity acquired                       | Country of incorporation | Date of acquisition | Shareholding acquired | Consideration £m |
|---------------------------------------|--------------------------|---------------------|-----------------------|------------------|
| Abernedd Power Company Limited (i)    | England and Wales        | 21 May 2009         | 100%                  | 39.3             |
| Slieve Divena Wind Farm No 2 Ltd (ii) | Northern Ireland         | 22 May 2009         | 100%                  | 7.3              |
| Cantono Data Centre (Business) (iii)  | Unincorporated           | 16 June 2009        | 100%                  | 5.8              |
| Uskmouth Power Company Limited (iv)   | England and Wales        | 13 August 2009      | 100%                  | 27.5             |
| Munkflohogen Airtricity Vind AB (ii)  | Sweden                   | 17 September 2009   | 97%                   | 1.9              |
| Gaxsjohojden Airtricity Vind AB (ii)  | Sweden                   | 17 September 2009   | 97%                   | 1.2              |
| ESBC Streetlighting (Business) (v)    | Unincorporated           | 30 November 2009    | 100%                  | 5.8              |
| Atlasconnect Limited (iii)            | Scotland                 | 09 March 2010       | 100%                  | 0.8              |
| Veddige Vindkraft AB (ii)             | Sweden                   | 15 March 2010       | 100%                  | 2.2              |
|                                       |                          |                     |                       | <b>91.8</b>      |

The acquired businesses conduct the following activities: (i) thermal generation development, (ii) construction and development of wind farms, (iii) telecoms services, (iv) thermal power station, (v) streetlighting maintenance contractor.

The provisional book values and fair values of the assets and liabilities acquired were as follows:

|                                | Carrying value of acquired entities £m | Fair value of acquired entities £m |
|--------------------------------|----------------------------------------|------------------------------------|
| Goodwill                       | 4.1                                    | 18.5                               |
| Intangible assets              | 0.5                                    | 51.0                               |
| Property, plant and equipment  | 93.4                                   | 26.4                               |
| Cash and cash equivalents      | 9.7                                    | 9.7                                |
| Other net current liabilities  | (2.0)                                  | (21.2)                             |
| Deferred tax                   | –                                      | 7.5                                |
| <b>Net assets</b>              | <b>105.7</b>                           | <b>91.9</b>                        |
| Less: Non controlling interest |                                        | (0.1)                              |
| <b>Total consideration</b>     |                                        | <b>91.8</b>                        |

The non-controlling interest values were calculated by taking a proportionate share of the recognised amounts of the acquiring companies identifiable net assets at the respective acquisition dates. The total consideration was represented by £67.8m cash including fees on the Group's behalf and £24.0m deferred consideration.

No significant profit or loss was recognised from these acquisitions in the period to 31 March 2010.

#### 17. INVENTORIES

|                       | Consolidated  |         |
|-----------------------|---------------|---------|
|                       | 2011 £m       | 2010 £m |
| Fuel and consumables  | <b>190.5</b>  | 248.9   |
| Work in progress      | <b>37.1</b>   | 30.7    |
| Goods for resale      | <b>2.9</b>    | 2.4     |
| Less: provisions held | <b>(13.0)</b> | (9.5)   |
|                       | <b>217.5</b>  | 272.5   |

The Group has recognised £718.2m within cost of sales in the year (2010 – £612.4m) and have also recognised £6.6m (2010 – £3.0m) relating to stock write-downs and increases in provisions held. The Company does not hold any inventories.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 18. TRADE AND OTHER RECEIVABLES

|                                         | Consolidated |                        | Company    |                        |
|-----------------------------------------|--------------|------------------------|------------|------------------------|
|                                         | 2011<br>£m   | 2010<br>Restated<br>£m | 2011<br>£m | 2010<br>Restated<br>£m |
| <b>Current assets</b>                   |              |                        |            |                        |
| Retail debtors                          | 563.7        | 596.3                  | –          | –                      |
| Wholesale trade receivables             | 2,226.9      | 1,381.6                | –          | –                      |
| Other trade receivables                 | 541.1        | 528.3                  | –          | –                      |
| Trade receivables                       | 3,331.7      | 2,506.2                | –          | –                      |
| Amounts owed by subsidiary undertakings | –            | –                      | 2,220.9    | 1,804.6                |
| Other receivables                       | 330.8        | 289.1                  | 65.0       | 55.0                   |
| Cash held as collateral                 | –            | 71.2                   | –          | –                      |
| Prepayments and accrued income          | 1,405.6      | 1,583.9                | –          | –                      |
|                                         | 5,068.1      | 4,450.4                | 2,285.9    | 1,859.6                |
| <b>Non-current assets</b>               |              |                        |            |                        |
| Amounts owed by subsidiary undertakings | –            | –                      | 3,661.2    | 3,456.1                |
|                                         | 5,068.1      | 4,450.4                | 5,947.1    | 5,315.7                |

Wholesale trade receivables includes a balance of £28.1m (2010 – £37.5m) in relation to contractual balances due from British Energy. Other receivables includes financial assets totalling £93.4m (2010 – £72.1m). Cash held as collateral relates to amounts deposited on commodity trading exchanges. Other receivables have been restated as explained in note 2.

Trade receivables and other financial assets are part of the Group's financial exposure to credit risk as explained in note 31.

#### 19. CASH AND CASH EQUIVALENTS

|                           | Consolidated |            | Company    |            |
|---------------------------|--------------|------------|------------|------------|
|                           | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| Bank balances             | 123.2        | 132.7      | 4.6        | 3.8        |
| Call deposits             | 353.7        | 129.0      | 314.5      | 95.9       |
| Cash and cash equivalents | 476.9        | 261.7      | 319.1      | 99.7       |

Cash and cash equivalents (which are presented as a single class of assets in the face of the balance sheet) comprise cash at bank and short term highly liquid investments with a maturity of three months or less.

|                                                          | Consolidated |            | Company    |            |
|----------------------------------------------------------|--------------|------------|------------|------------|
|                                                          | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| Cash and cash equivalents (from above)                   | 476.9        | 261.7      | 319.1      | 99.7       |
| Bank overdraft (note 23)                                 | (5.3)        | (9.2)      | –          | –          |
| Cash and cash equivalents in the statement of cash flows | 471.6        | 252.5      | 319.1      | 99.7       |

#### 20. TRADE AND OTHER PAYABLES

|                                        | Consolidated |            | Company    |            |
|----------------------------------------|--------------|------------|------------|------------|
|                                        | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| <b>Current liabilities</b>             |              |            |            |            |
| Amounts due to subsidiary undertakings | –            | –          | 2,757.0    | 2,569.0    |
| Trade payables                         | 3,197.2      | 2,161.6    | –          | –          |
| Other creditors                        | 1,227.8      | 1,207.3    | 35.3       | 50.3       |
| Accruals and deferred income (i)       | 653.0        | 695.6      | –          | –          |
|                                        | 5,078.0      | 4,064.5    | 2,792.3    | 2,619.3    |
| <b>Non-current liabilities</b>         |              |            |            |            |
| Accruals and deferred income (ii)      | 304.2        | 324.5      | –          | –          |
|                                        | 5,382.2      | 4,389.0    | 2,792.3    | 2,619.3    |

(i) Current accruals and deferred income includes customer contributions of £15.4m (2010 – £19.5m) and government grants of £0.6m (2010 – £0.6m).

(ii) Non-current accruals and deferred income includes customer contributions of £234.7m (2010 – £251.3m) and government grants of £5.6m (2010 – £6.3m).

## 21. CURRENT TAX LIABILITIES

|                 | Consolidated |            | Company    |            |
|-----------------|--------------|------------|------------|------------|
|                 | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| Corporation tax | 268.2        | 216.9      | 22.9       | 4.0        |

## 22. CONSTRUCTION CONTRACTS

|                                                                                       | 2011<br>£m | 2010<br>£m |
|---------------------------------------------------------------------------------------|------------|------------|
| <b>Contracts in progress at balance sheet date:</b>                                   |            |            |
| Amounts due from contract customers included in trade and other receivables (note 18) | 37.7       | 39.3       |
| Amounts due to contract customers included in trade and other payables (note 20)      | (17.7)     | (21.8)     |
| Contract costs incurred plus recognised profits less recognised losses to date        | 196.2      | 183.1      |
| Less: Progress billings                                                               | (200.0)    | (184.0)    |
|                                                                                       | (3.8)      | (0.9)      |

In the year to 31 March 2011, contract revenue of £468.9m (2010 – £460.1m) was recognised.

At 31 March 2011, retentions held by customers for contract work amounted to £1.3m (2010 – £1.6m). Advances received from customers for contract work amounted to £4.7m (2010 – £4.1m).

The Company does not hold any construction contracts.

## 23. LOANS AND OTHER BORROWINGS

|                                         | Consolidated |            | Company    |            |
|-----------------------------------------|--------------|------------|------------|------------|
|                                         | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| <b>Current</b>                          |              |            |            |            |
| Bank overdraft                          | 5.3          | 9.2        | –          | –          |
| Other short-term loans                  | 428.4        | 882.3      | 106.8      | 815.6      |
|                                         | 433.7        | 891.5      | 106.8      | 815.6      |
| Obligations under finance leases        | 12.8         | 12.2       | –          | –          |
|                                         | 446.5        | 903.7      | 106.8      | 815.6      |
| <b>Non-current</b>                      |              |            |            |            |
| Loans including convertible debt        | 4,800.5      | 4,771.1    | 3,499.5    | 3,101.2    |
| Obligations under finance leases        | 359.4        | 372.2      | –          | –          |
| Amounts owed to subsidiary undertakings | –            | –          | 257.4      | 240.2      |
|                                         | 5,159.9      | 5,143.3    | 3,756.9    | 3,341.4    |
| <b>Total loans and borrowings</b>       | 5,606.4      | 6,047.0    | 3,863.7    | 4,157.0    |
| Cash and cash equivalents (note 19)     | (476.9)      | (261.7)    | (319.1)    | (99.7)     |
| Net Debt                                | 5,129.5      | 5,785.3    | 3,544.6    | 4,057.3    |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 23. LOANS AND OTHER BORROWINGS (continued)

##### (i) Borrowings

##### Borrowing facilities

The Group has an established €1.5bn Euro Commercial Paper programme. Paper can be issued in a range of currencies and is swapped back into sterling. During the year the Group has extended its existing £900m revolving credit facility and its £100m bilateral facility on reduced pricing and both facilities now mature in August 2015. These facilities continue to provide a liquidity backstop to the Group's commercial paper issuance. As at 31 March 2011 there were no outstanding drawings on either facility.

In the year, the Group borrowed £100m at a fixed rate of 3.725% for 10 years and £300m at a floating rate of GBP 6 month LIBOR plus 50.2 basis points for 10 years from the £400m loan facility with the European Investment Bank.

##### Analysis of borrowings

##### Loans and borrowings

|                                                        | 2011<br>Weighted<br>average interest<br>rate (vi) | 2011<br>Face value<br>£m | 2011<br>Fair value<br>£m | 2011<br>Carrying<br>amount<br>£m |
|--------------------------------------------------------|---------------------------------------------------|--------------------------|--------------------------|----------------------------------|
| <b>Current</b>                                         |                                                   |                          |                          |                                  |
| Bank overdrafts (i)                                    | 0.50%                                             | 5.3                      | 5.3                      | 5.3                              |
| Other short-term loans – amortising (ii)               | 6.63%                                             | 8.2                      | 8.8                      | 8.2                              |
| Other short-term loans – non-amortising (iii)          | 2.73%                                             | 408.1                    | 408.4                    | 408.0                            |
| Non-recourse funding (iv)                              | 5.63%                                             | 12.2                     | 12.2                     | 12.2                             |
| <b>Total current</b>                                   |                                                   | <b>433.8</b>             | <b>434.7</b>             | <b>433.7</b>                     |
| <b>Non-current</b>                                     |                                                   |                          |                          |                                  |
| Bank loans – amortising (ii)                           | 5.98%                                             | 5.5                      | 6.0                      | 5.5                              |
| Bank loans – non-amortising (v)                        | 4.86%                                             | 470.2                    | 491.4                    | 471.0                            |
| 6.125% Eurobond repayable on 29 July 2013              | 6.13%                                             | 530.0                    | 557.0                    | 528.9                            |
| 5.75% Eurobond repayable 5 February 2014               | 5.75%                                             | 700.0                    | 749.4                    | 697.3                            |
| Non-recourse funding (iv)                              | 5.76%                                             | 54.7                     | 54.7                     | 54.7                             |
| <b>Between two and five years</b>                      |                                                   | <b>1,760.4</b>           | <b>1,858.5</b>           | <b>1,757.4</b>                   |
| Bank loans – non-amortising (v)                        | 2.15%                                             | 400.0                    | 395.1                    | 400.0                            |
| Non-recourse funding (iv)                              | 5.95%                                             | 150.0                    | 150.0                    | 150.0                            |
| 5.000% Eurobond repayable on 1 October 2018            | 5.00%                                             | 500.0                    | 510.1                    | 495.9                            |
| 5.875% Eurobond repayable on 26 September 2022         | 5.88%                                             | 300.0                    | 318.7                    | 296.8                            |
| 8.375% Eurobond repayable on 20 November 2028          | 8.38%                                             | 500.0                    | 652.3                    | 492.6                            |
| 5.50% Eurobond repayable on 19 June 2032               | 5.50%                                             | 350.0                    | 351.5                    | 350.2                            |
| 4.625% Eurobond repayable on 20 February 2037          | 4.63%                                             | 325.0                    | 284.9                    | 323.5                            |
| 6.25% Eurobond repayable on 27 August 2038             | 6.25%                                             | 350.0                    | 379.7                    | 345.6                            |
| 4.454% Index linked loan repayable on 27 February 2044 | 4.46%                                             | 105.0                    | 137.1                    | 104.4                            |
| 1.429% Index linked bond repayable on 20 October 2056  | 1.66%                                             | 112.7                    | 115.8                    | 112.7                            |
| <b>Over five years</b>                                 |                                                   | <b>3,092.7</b>           | <b>3,295.2</b>           | <b>3,071.7</b>                   |
| Fair value adjustment (note 31)                        |                                                   | –                        | –                        | (28.6)                           |
| <b>Total non-current</b>                               |                                                   | <b>4,853.1</b>           | <b>5,153.7</b>           | <b>4,800.5</b>                   |
| <b>Total</b>                                           |                                                   | <b>5,286.9</b>           | <b>5,588.4</b>           | <b>5,234.2</b>                   |

## Loans and borrowings

|                                                        | 2010<br>Weighted<br>average interest<br>rate (vi) | 2010<br>Face value<br>£m | 2010<br>Fair value<br>£m | 2010<br>Carrying<br>amount<br>£m |
|--------------------------------------------------------|---------------------------------------------------|--------------------------|--------------------------|----------------------------------|
| <b>Current</b>                                         |                                                   |                          |                          |                                  |
| Bank overdrafts (i)                                    | 0.50%                                             | 9.2                      | 9.2                      | 9.2                              |
| Other short-term loans – amortising (ii)               | 6.62%                                             | 7.7                      | 8.6                      | 7.7                              |
| Other short-term loans – non-amortising (iii)          | 1.14%                                             | 841.5                    | 843.1                    | 840.7                            |
| Non-recourse funding (iv)                              | 6.22%                                             | 33.9                     | 35.4                     | 33.9                             |
| <b>Total current</b>                                   |                                                   | 892.3                    | 896.3                    | 891.5                            |
| <b>Non-current</b>                                     |                                                   |                          |                          |                                  |
| Bank loans – amortising (ii)                           | 6.37%                                             | 13.7                     | 15.4                     | 13.7                             |
| Bank loans – non-amortising (v)                        | 4.14%                                             | 595.2                    | 638.6                    | 596.5                            |
| 6.125% Eurobond repayable on 29 July 2013              | 6.13%                                             | 534.4                    | 594.2                    | 532.7                            |
| 5.75% Eurobond repayable 5 February 2014               | 5.75%                                             | 700.0                    | 747.4                    | 696.3                            |
| Non-recourse funding (iv)                              | 6.02%                                             | 137.5                    | 143.2                    | 137.6                            |
| <b>Between two and five years</b>                      |                                                   | 1,980.8                  | 2,138.8                  | 1,976.8                          |
| Bank loans – non-amortising (v)                        |                                                   |                          |                          |                                  |
| Non-recourse funding (iv)                              | 5.79%                                             | 312.6                    | 325.6                    | 312.6                            |
| 5.000% Eurobond repayable on 1 October 2018            | 5.00%                                             | 500.0                    | 501.5                    | 495.3                            |
| 5.875% Eurobond repayable on 26 September 2022         | 5.88%                                             | 300.0                    | 313.0                    | 296.6                            |
| 8.375% Eurobond repayable on 20 November 2028          | 8.38%                                             | 500.0                    | 664.5                    | 492.2                            |
| 5.50% Eurobond repayable on 19 June 2032               | 5.50%                                             | 350.0                    | 352.4                    | 350.2                            |
| 4.625% Eurobond repayable on 20 February 2037          | 4.63%                                             | 325.0                    | 283.2                    | 323.4                            |
| 6.25% Eurobond repayable on 27 August 2038             | 6.25%                                             | 350.0                    | 382.5                    | 345.5                            |
| 4.454% Index linked loan repayable on 27 February 2044 | 4.46%                                             | 100.3                    | 133.4                    | 99.6                             |
| 1.429% Index linked bond repayable on 20 October 2056  | 1.57%                                             | 107.6                    | 110.2                    | 107.6                            |
| <b>Over five years</b>                                 |                                                   | 2,845.5                  | 3,066.3                  | 2,823.0                          |
| Fair value adjustment (note 31)                        |                                                   | –                        | –                        | (28.7)                           |
| <b>Total non-current</b>                               |                                                   | 4,826.3                  | 5,205.1                  | 4,771.1                          |
| <b>Total</b>                                           |                                                   | 5,718.6                  | 6,101.4                  | 5,662.6                          |

(i) Bank overdrafts are repayable on demand.

(ii) Balances under amortising loans are adjusted for capital repayments or drawings in the financial year. These are held with the European Investment Bank (EIB) in a combination of fixed and floating rates.

(iii) Balances include commercial paper, term loans and EIB debt.

(iv) The Tay Valley Lighting companies formed under 50:50 partnership with Royal Bank Leasing Limited to provide street-lighting services are categorised as subsidiaries under SIC-12 (note 15). The debt held by these companies is included on consolidation but is non-recourse to the Group.

(v) The floating rate European Investment Bank advances are either reset quarterly or semi-annually. Other loans include a mixture of fixed and floating debt repayable between 2012 and 2015.

(vi) The weighted average interest rates are as noted. The weighted average interest rates for the Group (including swaps) for the year ended 31 March 2011 was 5.43% (2010 – 5.35%).

### Convertible bond

The Group issued a convertible bond in 2004 which was fully converted into Ordinary Shares by 24 October 2009. Conversion was at the option of the bond holder.

For the purpose of diluted Earnings per Share (EPS), the number of potential Ordinary Shares to be issued should include the following in respect of the bond:

|                                   | 2011<br>Number of<br>shares | 2010<br>Number of<br>shares |
|-----------------------------------|-----------------------------|-----------------------------|
| Weighted average number of shares | –                           | 709,719                     |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 23. LOANS AND OTHER BORROWINGS (continued)

##### (ii) Finance lease liabilities

Future finance lease commitments are as follows:

|                                    | Minimum lease payments |                | Present value of minimum lease payments |              |
|------------------------------------|------------------------|----------------|-----------------------------------------|--------------|
|                                    | 2011<br>£m             | 2010<br>£m     | 2011<br>£m                              | 2010<br>£m   |
| Amounts payable:                   |                        |                |                                         |              |
| Within one year                    | 52.2                   | 52.8           | 12.8                                    | 12.2         |
| Between one and five years         | 202.5                  | 205.7          | 61.1                                    | 57.4         |
| After five years                   | 488.4                  | 537.7          | 298.3                                   | 314.8        |
|                                    | <b>743.1</b>           | <b>796.2</b>   | <b>372.2</b>                            | <b>384.4</b> |
| Less: future finance charge        | <b>(370.9)</b>         | <b>(411.8)</b> |                                         |              |
| Present value of lease obligations | <b>372.2</b>           | <b>384.4</b>   |                                         |              |

The Group entered into a power purchase agreement categorised as a finance lease with Marchwood Power Company Ltd in the year ended March 2010. The lease is for use of their main asset, a 840MW Gas powered CCGT Electricity Generating Plant. The term of the lease is 15 years with the Group having the option for a further 5 years extension at the end of this period. £20.3m (2010 – £6.5m) of contingent rents under the lease were included within cost of sales for the period. Contingent rent consists of £/MWh charges for availability of the plant for energy production and a £/MWh charge for actual 'nominated' energy produced.

Of the remaining finance leases held by the Group, the average term of the telecom leases is 7.5 years. No arrangements have been entered into for contingent rental payments for these leases.

The fair value of the Group's lease obligations approximates their carrying amount. The Group's obligations under finance leases are secured by the lessors' rights over the leased assets. The Company does not have any obligations under finance leases.

#### 24. DEFERRED TAXATION

The following are the deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting periods:

|                                     | Accelerated capital allowances<br>£m | Fair value gains/(losses) on derivatives<br>£m | Convertible bond<br>£m | Retirement benefit obligations<br>£m | Share based payments<br>£m | Other (i)<br>£m | Total<br>£m  |
|-------------------------------------|--------------------------------------|------------------------------------------------|------------------------|--------------------------------------|----------------------------|-----------------|--------------|
| <b>Consolidated</b>                 |                                      |                                                |                        |                                      |                            |                 |              |
| At 1 April 2009                     | 887.5                                | (369.6)                                        | 0.4                    | (76.6)                               | (1.5)                      | 54.4            | 494.6        |
| Acquisitions                        | –                                    | –                                              | –                      | –                                    | –                          | (7.5)           | (7.5)        |
| Charge/(credit) to Income Statement | 17.2                                 | 113.1                                          | (0.4)                  | 17.4                                 | –                          | (2.5)           | 144.8        |
| Credit to equity                    | –                                    | (2.1)                                          | –                      | (142.5)                              | (0.4)                      | (8.6)           | (153.6)      |
| Exchange adjustments                | –                                    | –                                              | –                      | –                                    | –                          | (11.4)          | (11.4)       |
| At 1 April 2010                     | 904.7                                | (258.6)                                        | –                      | (201.7)                              | (1.9)                      | 24.4            | 466.9        |
| Acquisitions (note 16)              | (22.9)                               | –                                              | –                      | –                                    | –                          | 142.4           | 119.5        |
| Disposals (note 16)                 | (6.5)                                | –                                              | –                      | –                                    | –                          | (7.4)           | (13.9)       |
| Transfer to assets held for sale    | (23.3)                               | –                                              | –                      | –                                    | –                          | –               | (23.3)       |
| (Credit)/charge to Income Statement | (84.1)                               | 384.2                                          | –                      | 20.0                                 | –                          | 41.9            | 362.0        |
| Charge to equity                    | –                                    | 5.9                                            | –                      | 7.9                                  | 0.6                        | 1.2             | 15.6         |
| Exchange adjustments                | –                                    | –                                              | –                      | –                                    | –                          | (20.2)          | (20.2)       |
| <b>At 31 March 2011</b>             | <b>767.9</b>                         | <b>131.5</b>                                   | <b>–</b>               | <b>(173.8)</b>                       | <b>(1.3)</b>               | <b>182.3</b>    | <b>906.6</b> |

|                                     | Accelerated capital allowances<br>£m | Fair value gains/(losses) on derivatives<br>£m | Convertible bond<br>£m | Retirement benefit obligations<br>£m | Share based payments<br>£m | Other<br>£m   | Total<br>£m    |
|-------------------------------------|--------------------------------------|------------------------------------------------|------------------------|--------------------------------------|----------------------------|---------------|----------------|
| <b>Company</b>                      |                                      |                                                |                        |                                      |                            |               |                |
| At 1 April 2009                     | –                                    | 22.5                                           | 0.4                    | –                                    | 0.9                        | (56.5)        | (32.7)         |
| (Credit)/charge to Income Statement | –                                    | (12.6)                                         | (0.4)                  | 10.2                                 | –                          | 7.8           | 5.0            |
| (Credit)/charge to equity           | –                                    | (8.7)                                          | –                      | (80.5)                               | (0.4)                      | 0.4           | (89.2)         |
| At 1 April 2010                     | –                                    | 1.2                                            | –                      | (70.3)                               | 0.5                        | (48.3)        | (116.9)        |
| (Credit)/charge to Income Statement | –                                    | (10.7)                                         | –                      | 9.7                                  | –                          | (2.7)         | (3.7)          |
| (Credit)/charge to equity           | –                                    | (0.4)                                          | –                      | (1.7)                                | 0.6                        | –             | (1.5)          |
| <b>At 31 March 2011</b>             | <b>–</b>                             | <b>(9.9)</b>                                   | <b>–</b>               | <b>(62.3)</b>                        | <b>1.1</b>                 | <b>(51.0)</b> | <b>(122.1)</b> |

(i) Includes deferred tax on fair value items recognised in business combinations.

Certain deferred tax assets and liabilities have been offset, including the asset balances analysed the tables above. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

|                                       | Consolidated   |            | Company        |            |
|---------------------------------------|----------------|------------|----------------|------------|
|                                       | 2011<br>£m     | 2010<br>£m | 2011<br>£m     | 2010<br>£m |
| Deferred tax liabilities              | <b>1,068.3</b> | 624.0      | –              | –          |
| Deferred tax assets                   | <b>(161.7)</b> | (157.1)    | <b>(122.1)</b> | (116.9)    |
| Net deferred tax liabilities/(assets) | <b>906.6</b>   | 466.9      | <b>(122.1)</b> | (116.9)    |

The deferred tax assets disclosed relate to the Group's pension scheme liabilities.

Temporary differences arising in connection with interests in associates and jointly controlled entities are recorded as part of the Group's share of investment in those entities. The aggregate amount of these is a charge of £35.2m (2010 – £34.3m charge).

A deferred tax asset has been recognised on £42.7m of trading losses (2010 – £25.0m) due to uncertainty around the availability of future profits in the companies concerned.

## 25. PROVISIONS

|                                           | Decommissioning<br>(i)<br>£m | Contracting provisions<br>(ii)<br>£m | Other<br>(iii)<br>£m | Total<br>£m  |
|-------------------------------------------|------------------------------|--------------------------------------|----------------------|--------------|
| <b>Consolidated</b>                       |                              |                                      |                      |              |
| At 1 April 2010                           | 58.5                         | 5.2                                  | 26.0                 | 89.7         |
| Charged in the year                       | –                            | 5.0                                  | 0.2                  | 5.2          |
| Increase in decommissioning provision (i) | 32.7                         | –                                    | –                    | 32.7         |
| Acquired in the year (note 16)            | 71.5                         | –                                    | 2.5                  | 74.0         |
| Unwind of discount                        | 3.6                          | –                                    | 0.7                  | 4.3          |
| Released during the year                  | (17.5)                       | –                                    | (6.0)                | (23.5)       |
| Utilised during the year                  | –                            | (0.5)                                | (2.8)                | (3.3)        |
| <b>At 31 March 2011</b>                   | <b>148.8</b>                 | <b>9.7</b>                           | <b>20.6</b>          | <b>179.1</b> |
| <b>At 31 March 2011</b>                   |                              |                                      |                      |              |
| Non-current                               | 148.8                        | 1.2                                  | 19.2                 | 169.2        |
| Current                                   | –                            | 8.5                                  | 1.4                  | 9.9          |
|                                           | <b>148.8</b>                 | <b>9.7</b>                           | <b>20.6</b>          | <b>179.1</b> |
| At 31 March 2010                          |                              |                                      |                      |              |
| Non-current                               | 58.5                         | 4.4                                  | 20.3                 | 83.2         |
| Current                                   | –                            | 0.8                                  | 5.7                  | 6.5          |
|                                           | 58.5                         | 5.2                                  | 26.0                 | 89.7         |

The presentation of this note has changed to improve understanding of the financial statements.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 25. PROVISIONS (continued)

- (i) Provision has been made for the estimated net present cost of decommissioning the acquired North Sea exploration and production assets and certain generation and gas storage assets. Estimates are based on forecasted clean-up costs at the time of decommissioning discounted for the time value of money. The timing of costs provided is dependent on the lives of the facilities. Decommissioning provisions in relation to the assets subject to impairment review have been increased. A corresponding increase to value of property, plant and equipment was also made (note 12). A release of £17.5m was recognised in relation to the decommissioning provision at the coal plant at Uskmouth and was reported as part of Exceptional items in note 5.
- (ii) The Group hold provisions in relation to long-term construction contracts including street-lighting PFIs. These relate to contract costs that are not guaranteed to be recovered under the respective contracts.
- (iii) Other provisions include balances held in relation to onerous contracts, insurance and warranty claims. In addition, the Group has an employer financed retirement benefit provision for pensions for certain Directors and former Directors and employees, which is valued in accordance with IAS 19. The onerous contracts provision relates to future losses on specific contracts. These contract losses will be incurred over a maximum period to 2019.

The Company does not hold provisions.

#### 26. SHARE CAPITAL

|                                     | Number<br>(millions) | £m           |
|-------------------------------------|----------------------|--------------|
| Allotted, called up and fully paid: |                      |              |
| At 1 April 2010                     | 923.1                | 461.5        |
| Issue of shares (i)                 | 13.8                 | 6.9          |
| <b>At 31 March 2011</b>             | <b>936.9</b>         | <b>468.4</b> |

The Company has one class of Ordinary Share which carries no right to fixed income. The holders of Ordinary Shares are entitled to receive dividends as declared and are entitled to one vote per share at meetings of the Company.

- (i) Shareholders were able to elect to receive Ordinary Shares in place of the final dividend of 49p per Ordinary Share (in relation to year ended 31 March 2010) and the interim dividend of 22.4p (in relation to the current year) under the terms of the Company's scrip dividend scheme. This resulted in the issue of 7,524,682 and 5,264,873 new fully paid Ordinary Shares, respectively. In addition, the Company issued 1.0 million (2010 – 0.9 million) shares during the year under the savings-related share option schemes, and discretionary share option schemes for a consideration of £9.2m (2010 – £6.8m).

During the year, on behalf of the Company, the employee share trust purchased 0.8 million shares for a total consideration of £9.2m (2010 – 0.9 million shares, consideration of £15.8m). At 31 March 2011, the trust held 5.1 million shares (2010 – 4.3 million) which had a market value of £64.4m (2010 – £47.7m).

#### 27. RESERVES

The movement in reserves is reported in the Statement of Changes in Equity which is included as part of the primary statements (pages 82 and 83).

The capital redemption reserve comprises the value of shares redeemed or purchased by the Company from distributable profits.

The hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedge derivative instruments related to hedged transactions that have not yet occurred.

The equity reserve comprised the equity component of the Group's convertible bond which was fully converted by 24 October 2009 (note 23).

The translation reserve comprises exchange translation differences on foreign currency net investments offset by exchange translation differences on borrowings and derivatives classified as net investment hedges under IAS 39.

The profit for the year attributable to shareholders dealt with in the financial statements of the Company was £627.3m (2010 – £575.9m). As allowed by section 408 of the Companies Act 2006, the Company has not presented its own income statement.

#### 28. HYBRID CAPITAL

|                                                           | 2011<br>£m     | 2010<br>£m |
|-----------------------------------------------------------|----------------|------------|
| GBP 750m 5.453% perpetual subordinated capital securities | <b>744.5</b>   | –          |
| EUR 500m 5.025% perpetual subordinated capital securities | <b>416.9</b>   | –          |
|                                                           | <b>1,161.4</b> | –          |

On 20 September 2010 the Company issued €500m EUR and £750m Sterling bonds (hybrid capital). They have no fixed redemption date but the Group may, at its sole discretion, redeem all (but not part) of these bonds at their principal amount on 1 October 2015 or 1 October 2020 or any subsequent coupon payment date after this. In addition, under certain circumstances defined in the terms and conditions of the issue, the Group may at its sole discretion redeem all (but not part of) the bonds at their principal amount at any time prior to 1 October 2015.

The Company has the option to defer coupon payments on the bonds on any relevant payment date, as long as a dividend on the Ordinary Shares has not been declared. Deferred coupons shall be satisfied only in the following circumstances, all of which occur at the sole option of the Company:

- redemption; or
- dividend payment on Ordinary Shares.

Interest will accrue on any deferred coupon.

Coupon payments are expected to be made annually in arrears on 1 October in each year from 1 October 2011. Coupon payments are accounted for as dividends and are recognised in equity at the time the payment obligation arises. The purpose of the issue was to strengthen SSE's capital base and to fund the Group's ongoing capital investment and acquisitions.

## 29. RETIREMENT BENEFIT OBLIGATIONS

### Defined Benefit Schemes

The Group has two funded final salary pension schemes which provide defined benefits based on final pensionable pay. The schemes are subject to independent valuations at least every three years. The future benefit obligations are valued by actuarial methods on the basis of an appropriate assessment of the relevant parameters. The Company operates one of these schemes, being the Scottish Hydro-Electric scheme.

The Group also has an Employer Financed Retirement Benefit scheme and a Group Personal Pension Plan. The Group Personal Pension Plan operates on a money purchase basis and has been arranged with Friends Provident. The Company matches employee contributions up to a specified limit, in most circumstances this is set at 6%. The Company may also provide additional contributions of 3% after five years and a further 3% after ten year's continuous Company service.

Pension summary:

|                                                  | Scheme type     | Net gain/(loss) recognised in respect of the pension liability in the Statement of Comprehensive Income |            | Net pension (liability) |            |
|--------------------------------------------------|-----------------|---------------------------------------------------------------------------------------------------------|------------|-------------------------|------------|
|                                                  |                 | 2011<br>£m                                                                                              | 2010<br>£m | 2011<br>£m              | 2010<br>£m |
| Scottish Hydro Electric (Company)                | Defined benefit | 92.3                                                                                                    | (161.6)    | (239.8)                 | (251.1)    |
| Southern Electric                                | Defined benefit | 16.8                                                                                                    | (221.4)    | (428.8)                 | (469.2)    |
|                                                  |                 | 109.1                                                                                                   | (383.0)    | (668.6)                 | (720.3)    |
| IFRIC 14 movement/liability                      |                 | (117.9)                                                                                                 | (125.8)    |                         |            |
| Net actuarial gain/(loss) and IFRIC 14 liability |                 | (8.8)                                                                                                   | (508.8)    |                         |            |

The Scottish Hydro Electric Pension Scheme net liability of £239.8m (2010 – £251.1m) is presented after an IFRIC 14 minimum funding requirement of £374.2m (2010 – £256.3m).

The individual pension scheme details based on the latest formal actuarial valuations are as follows:

|                                         | Scottish Hydro Electric      | Southern Electric       |
|-----------------------------------------|------------------------------|-------------------------|
| Latest formal actuarial valuation       | 31 March 2009                | 31 March 2007           |
| Valuation carried out by                | Hymans Robertson             | Hewitt, Bacon & Woodrow |
| Value of assets based on valuation      | £860.0m                      | £1,101.5m               |
| Value of liabilities based on valuation | £1,189.3m                    | £1,361.3m               |
| Valuation method adopted                | Projected Unit               | Projected Unit          |
| Average salary increase                 | Inflation curve plus 2.3% pa | 5.2%                    |
| Average pension increase                | 2.7%                         | 3.2%                    |
| Value of fund assets/accrued benefits   | 72.3%                        | 80.9%                   |

An actuarial valuation of the Southern Electric Pension Scheme as at 31 March 2010 remains in progress and is due to be completed in the year to 31 March 2012.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 29. RETIREMENT BENEFIT OBLIGATIONS (continued)

Both schemes have been updated to 31 March 2011 by qualified independent actuaries. The valuations have been prepared for the purposes of meeting the requirements of IAS 19. The major assumptions used by the actuaries in both schemes were:

|                                          | At 31 March 2011 | At 31 March 2010 |
|------------------------------------------|------------------|------------------|
| Rate of increase in pensionable salaries | 5.0%             | 5.2%             |
| Rate of increase in pension payments     | 3.5%             | 3.7%             |
| Discount rate                            | 5.5%             | 5.5%             |
| Inflation rate                           | 3.5%             | 3.7%             |

The assumptions relating to longevity underlying the pension liabilities at 31 March 2011 are based on standard actuarial mortality tables, and include an allowance for future improvements in longevity. The assumptions equivalent to future longevity for members in normal health at age 65 are as follows:

|                   | At 31 March 2011<br>Male | At 31 March 2011<br>Female | At 31 March 2010<br>Male | At 31 March 2010<br>Female |
|-------------------|--------------------------|----------------------------|--------------------------|----------------------------|
| Currently aged 65 | 24                       | 25                         | 23                       | 24                         |
| Currently aged 45 | 26                       | 28                         | 25                       | 27                         |

The impact on the schemes liabilities of changing certain of the major assumptions is as follows:

|               | At 31 March 2011                       |                                    | At 31 March 2010                       |                                    |
|---------------|----------------------------------------|------------------------------------|----------------------------------------|------------------------------------|
|               | Increase/<br>decrease in<br>assumption | Effect on<br>scheme<br>liabilities | Increase/<br>decrease in<br>assumption | Effect on<br>scheme<br>liabilities |
| Discount rate | 0.1%                                   | +/- 1.7%                           | 0.1%                                   | +/- 1.8%                           |
| Longevity     | 1 year                                 | +/- 2.8%                           | 1 year                                 | +/- 3.0%                           |

#### Valuation of combined Pension Schemes

|                                             | Consolidated                                                     |                                    |                                                                  |                                    | Company                                                          |                                    |                                                                  |                                    |
|---------------------------------------------|------------------------------------------------------------------|------------------------------------|------------------------------------------------------------------|------------------------------------|------------------------------------------------------------------|------------------------------------|------------------------------------------------------------------|------------------------------------|
|                                             | Long-term<br>rate of return<br>expected at<br>31 March 2011<br>% | Value at<br>31 March<br>2011<br>£m | Long-term<br>rate of return<br>expected at<br>31 March 2010<br>% | Value at<br>31 March<br>2010<br>£m | Long-term<br>rate of return<br>expected at<br>31 March 2011<br>% | Value at<br>31 March<br>2011<br>£m | Long-term<br>rate of return<br>expected at<br>31 March 2010<br>% | Value at<br>31 March<br>2010<br>£m |
| Equities                                    | 7.8                                                              | 1,032.5                            | 8.0                                                              | 1,063.4                            | 7.8                                                              | 402.9                              | 8.0                                                              | 458.7                              |
| Government bonds                            | 4.3                                                              | 743.8                              | 4.5                                                              | 563.4                              | 4.3                                                              | 500.7                              | 4.5                                                              | 335.6                              |
| Corporate bonds                             | 5.5                                                              | 471.0                              | 5.5                                                              | 449.0                              | 5.5                                                              | 207.6                              | 5.5                                                              | 201.4                              |
| Other investments                           | 4.4                                                              | 216.3                              | 4.1                                                              | 222.5                              | 4.5                                                              | 109.9                              | 3.9                                                              | 123.1                              |
| Total fair value of plan assets             |                                                                  | 2,463.6                            |                                                                  | 2,298.3                            |                                                                  | 1,221.1                            |                                                                  | 1,118.8                            |
| IFRIC 14 liability                          |                                                                  | (374.2)                            |                                                                  | (256.3)                            |                                                                  | (374.2)                            |                                                                  | (256.3)                            |
| Present value of defined benefit obligation |                                                                  | (2,758.0)                          |                                                                  | (2,762.3)                          |                                                                  | (1,086.7)                          |                                                                  | (1,113.6)                          |
| <b>Deficit in the scheme</b>                |                                                                  | <b>(668.6)</b>                     |                                                                  | <b>(720.3)</b>                     |                                                                  | <b>(239.8)</b>                     |                                                                  | <b>(251.1)</b>                     |
| Deferred tax thereon                        |                                                                  | 173.8                              |                                                                  | 201.7                              |                                                                  | 62.3                               |                                                                  | 70.3                               |
| Net pension liability                       |                                                                  | <b>(494.8)</b>                     |                                                                  | <b>(518.6)</b>                     |                                                                  | <b>(177.5)</b>                     |                                                                  | <b>(180.8)</b>                     |

#### Movements in the defined benefit obligation during the year:

|                                        | Consolidated |            | Company    |            |
|----------------------------------------|--------------|------------|------------|------------|
|                                        | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| At 1 April                             | (2,762.3)    | (1,929.8)  | (1,113.6)  | (729.5)    |
| Movements in the year:                 |              |            |            |            |
| Service costs                          | (37.7)       | (21.4)     | (18.7)     | (9.8)      |
| Member contributions                   | (7.8)        | (8.1)      | (3.1)      | (3.4)      |
| Benefits paid                          | 105.6        | 101.6      | 40.2       | 39.1       |
| Interest on pension scheme liabilities | (150.2)      | (127.5)    | (60.7)     | (48.0)     |
| Actuarial gains/(losses)               | 94.4         | (777.1)    | 69.2       | (362.0)    |
| At 31 March                            | (2,758.0)    | (2,762.3)  | (1,086.7)  | (1,113.6)  |

### Movements in scheme assets during the year:

|                                          | Consolidated |            | Company    |            |
|------------------------------------------|--------------|------------|------------|------------|
|                                          | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| At 1 April                               | 2,042.0      | 1,656.3    | 862.5      | 729.5      |
| Movements in the year:                   |              |            |            |            |
| Expected return on pension scheme assets | 141.9        | 100.7      | 67.9       | 49.9       |
| Assets distributed on settlement         | (105.7)      | (101.6)    | (40.3)     | (39.1)     |
| Employer contributions                   | 106.6        | 110.2      | 48.5       | 44.2       |
| Member contributions                     | 7.8          | 8.1        | 3.1        | 3.4        |
| Actuarial gains                          | 14.7         | 394.1      | 23.1       | 200.4      |
| IFRIC 14 liability                       | (117.9)      | (125.8)    | (117.9)    | (125.8)    |
| At 31 March                              | 2,089.4      | 2,042.0    | 846.9      | 862.5      |

### Charges/(credits) recognised:

|                                                    | Consolidated |            | Company    |            |
|----------------------------------------------------|--------------|------------|------------|------------|
|                                                    | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| Current service cost (charged to operating profit) | 37.7         | 21.4       | 18.7       | 9.8        |
|                                                    | 37.7         | 21.4       | 18.7       | 9.8        |
| Charged/(credited) to finance costs:               |              |            |            |            |
| Expected return on pension scheme assets           | (141.9)      | (100.7)    | (67.9)     | (49.9)     |
| Interest on pension scheme liabilities             | 150.2        | 127.5      | 60.7       | 48.0       |
|                                                    | 8.3          | 26.8       | (7.2)      | (1.9)      |

### History of (deficit)/surplus

|                                             | Consolidated   |                |                |               |               | Company        |                |            |             |              |
|---------------------------------------------|----------------|----------------|----------------|---------------|---------------|----------------|----------------|------------|-------------|--------------|
|                                             | 2011<br>£m     | 2010<br>£m     | 2009<br>£m     | 2008<br>£m    | 2007<br>£m    | 2011<br>£m     | 2010<br>£m     | 2009<br>£m | 2008<br>£m  | 2007<br>£m   |
| Total fair value of plan assets             | 2,463.6        | 2,298.3        | 1,786.8        | 2,081.0       | 2,110.4       | 1,221.1        | 1,118.8        | 860.0      | 1,005.6     | 990.2        |
| IFRIC 14 liability                          | (374.2)        | (256.3)        | (130.5)        | (210.6)       | –             | (374.2)        | (256.3)        | (130.5)    | (210.6)     | –            |
| Present value of defined benefit obligation | (2,758.0)      | (2,762.3)      | (1,929.8)      | (1,919.5)     | (2,202.3)     | (1,086.7)      | (1,113.6)      | (729.5)    | (709.2)     | (862.1)      |
| <b>(Deficit)/surplus in the scheme</b>      | <b>(668.6)</b> | <b>(720.3)</b> | <b>(273.5)</b> | <b>(49.1)</b> | <b>(91.9)</b> | <b>(239.8)</b> | <b>(251.1)</b> | <b>–</b>   | <b>85.8</b> | <b>128.1</b> |

### Return on assets

As required by IAS 19, the expected return on assets is based on the long-term expectation of returns for each asset class at the beginning of the year. The return on equities is 3.5% per annum in excess of the yield on government bonds. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation at 31 March 2011.

The actual return on Pension Scheme assets is as follows:

|                                        | Consolidated |            | Company    |            |
|----------------------------------------|--------------|------------|------------|------------|
|                                        | 2011<br>£m   | 2010<br>£m | 2011<br>£m | 2010<br>£m |
| Actual return on Pension Scheme assets | 156.6        | 494.8      | 91.0       | 250.3      |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 29. RETIREMENT BENEFIT OBLIGATIONS (continued)

##### History of experience gains and losses

|                                                                                                                       | Consolidated |            |            |            |            | Company    |            |            |            |            |
|-----------------------------------------------------------------------------------------------------------------------|--------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
|                                                                                                                       | 2011<br>£m   | 2010<br>£m | 2009<br>£m | 2008<br>£m | 2007<br>£m | 2011<br>£m | 2010<br>£m | 2009<br>£m | 2008<br>£m | 2007<br>£m |
| Total actuarial gains and (losses) recognised in the Statement of Comprehensive Income before adjustment for taxation | 109.1        | (383.0)    | (359.0)    | 185.0      | 47.4       | 92.3       | (161.6)    | (188.4)    | 146.3      | 17.6       |
| Experience gains/(losses) on scheme liabilities                                                                       | 52.7         | (59.8)     | 0.8        | (50.6)     | (7.7)      | 26.9       | (49.7)     | –          | –          | –          |
| Experience gains/(losses) on scheme assets                                                                            | 14.7         | 394.1      | (412.2)    | (153.4)    | 27.8       | 23.1       | 200.4      | (190.0)    | (31.2)     | (9.7)      |

The cumulative actuarial losses and IFRIC 14 movement recognised in the Statement of Comprehensive Income before adjustment for taxation since the adoption of IAS 19 is £966.6m losses (2010 – £957.8m).

##### Defined contribution scheme

The total contribution paid by the Group to defined contribution schemes was £16.9m (2010 – £16.5m).

##### Employer financed retirement benefit (EFRB) pension costs

The increase in the year in relation EFRB was £0.2m (2010 – £2.9m). This is included in other provisions (note 25).

##### Staff costs analysis

The pension costs in note 6 can be analysed thus:

|                                      | 2011<br>£m | 2010<br>£m |
|--------------------------------------|------------|------------|
| Service costs                        | 37.7       | 21.4       |
| Defined contribution scheme payments | 16.9       | 16.5       |
|                                      | 54.6       | 37.9       |

##### Expected contribution in the year to 31 March 2012

The Group currently expects to make contributions of £48.4m (2010 – £47.8m) and £59.9m (2010 – £61.0m) to the Scottish Hydro Electric Pension Scheme and the Southern Electric Pension Scheme in the year to 31 March 2012, respectively. However, this is subject to finalisation of the actuarial valuation of the Southern Electric Pension Scheme.

#### 30. EMPLOYEE SHARE-BASED PAYMENTS

The Scottish and Southern Energy Group operates a number of share schemes for the benefit of its employees. Details of these schemes, all of which are equity-settled, are as follows:

##### (i) Savings-related share option schemes ('Sharesave')

This scheme gives employees the option to purchase shares in the Company at a discounted market price, subject to the employees remaining in employment for the term of the agreement. Employees may opt to save between £5 and £250 per month for a period of 3 and/or 5 years. At the end of these periods employees have six months to exercise their options by using the cash saved (including any bonus equivalent to interest). If the option is not exercised, the funds may be withdrawn by the employee and the option expires.

##### (ii) Share Incentive Plan (SIP)

This scheme allows employees the opportunity to purchase shares in the Company on a monthly basis. Employees may nominate an amount between £10 and £125 to be deducted from their gross salary. This is then used to purchase shares ('Partnership' shares) in the market each month. These shares are held in trust and become free of liability to income tax and national insurance on their fifth anniversary. These shares may be withdrawn at any point during the 5 years, but tax and national insurance would become payable on any shares withdrawn.

In addition to the shares purchased on behalf of the employee, the Company will also match the purchase up to a maximum of 6 (previously 5) shares ('Matching' shares) per month. These shares are held in trust and become free of liability to income tax and national insurance on their fifth anniversary. If an employee leaves during the first three years, or removes his/her 'Partnership' shares, these 'Matching' shares are forfeited.

In addition to the above, the following special awards of free shares have been made:

| Award made                                                                                  | 31 March 2005  | 31 March 2007 | 31 March 2008 |
|---------------------------------------------------------------------------------------------|----------------|---------------|---------------|
| Free shares per employee                                                                    | 50             | 20            | 10            |
| Date at which employee must still be employed to receive award<br>(in addition to 31 March) | 20 August 2005 | 30 May 2007   | 1 August 2008 |

These awards were made to all employees in recognition of their contribution to the success of the Group. Under the arrangements for the awards, the shares are held in trust for five years and become free of liability to income tax and national insurance on their fifth anniversary. These shares may be withdrawn at any point during years four and five, but income tax and national insurance would become payable on any shares withdrawn.

### (iii) Deferred bonus scheme

This scheme applied to senior managers and Executive Directors. Those eligible were awarded shares based on performance in the year. Shares purchased under this agreement were held in trust on behalf of the employee for a period of three years, at which point the employee became entitled to exercise the award. In addition to shares purchased under the adjusted bonus award, additional shares were also purchased by the Trustee in respect of amounts equivalent to dividends which would have been payable on the shares held by the Trust. If the employee resigns, they lose all outstanding awards.

This scheme has been replaced by the current Annual Bonus Scheme. Under this scheme, 25% of all eligible employees' annual bonus is deferred into shares which only vest after three years, subject to continued service. The number of shares awarded is determined by dividing the relevant pre-tax bonus amount by the share price shortly after the announcement of the results for the financial year to which the bonus relates.

### (iv) Performance Share Plan

This scheme applies to Executive Directors and senior executives. Shares granted under this arrangement vest subject to the attainment of performance conditions over the relevant three year performance period as set out below:

| Award made                                   | 10 June 2008 | 02 June 2009 | 02 June 2010 |
|----------------------------------------------|--------------|--------------|--------------|
| Maximum value of award as a % of base salary | 150          | 150          | 150          |

#### Performance conditions

| Total shareholder return (i)    | Full vesting<br>25% vesting | ≥ 75th percentile<br>median | ≥ 75th percentile<br>median | ≥ 75th percentile<br>median |
|---------------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Earnings per share (ii)         | Full vesting<br>25% vesting | RPI + 9%<br>RPI + 3%        | RPI + 9%<br>RPI + 3%        | RPI + 8%<br>RPI + 2%        |
| Dividend per share growth (iii) | Full vesting<br>25% vesting | –<br>–                      | –<br>–                      | RPI + 6%<br>RPI + 2%        |

These awards will vest after three years to the extent that the relevant performance conditions are met.

- (i) Total Shareholder Return (TSR) target relative to other FTSE 100 companies (awards granted in 2008 and 2009) and Total Shareholder Return (TSR) target relative to other FTSE 100 companies and MSCI Europe Utilities Index (award granted in 2010) over the relevant performance period. Pro rata vesting will take place between the median and 75th percentile, with no vesting if the minimum target is not met.
- (ii) Under the EPS performance condition, pro rata vesting between the lower and upper level above RPI, with no vesting if the minimum EPS growth target is not achieved.
- (iii) Under the Dividend per share growth performance condition, pro rata vesting between 2% and 6% above RPI, with no vesting if the minimum dividend per share growth target is not achieved.

As allowed by IFRS 2, only options granted since 7 November 2002, which were unvested at 1 January 2005, have been included.

A charge of £9.9m (2010 – £17.9m) was recognised in the Income Statement in relation to these schemes, £3.1m (2010 – £3.7m) of this was in relation to the Directors of the Company.

Details used in the calculation of the costs of these schemes are as follows:

### (i) Savings-related share option scheme

The movement in savings related share option schemes in the year were as follows:

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 30. EMPLOYEE SHARE-BASED PAYMENTS (continued)

##### Consolidated

As at 31 March 2011

| Award date   | Option price (pence) | Outstanding at start of year | Granted   | Exercised   | Lapsed      | Outstanding at end of year | Date from which exercisable | Expiry date (i) |
|--------------|----------------------|------------------------------|-----------|-------------|-------------|----------------------------|-----------------------------|-----------------|
| 16 July 2004 | 622                  | 1,890                        | –         | (315)       | (1,575)     | –                          | 1 October 2009              | 31 March 2010   |
| 14 July 2005 | 886                  | 1,066,454                    | –         | (1,031,131) | (8,769)     | <b>26,554</b>              | 1 October 2010              | 31 March 2011   |
| 11 July 2006 | 999                  | 16,155                       | –         | (1,066)     | (15,089)    | –                          | 1 October 2009              | 31 March 2010   |
| 11 July 2006 | 999                  | 563,277                      | –         | (3,247)     | (42,193)    | <b>517,837</b>             | 1 October 2011              | 31 March 2012   |
| 10 July 2007 | 1,306                | 214,493                      | –         | (476)       | (23,265)    | <b>190,752</b>             | 1 October 2010              | 31 March 2011   |
| 10 July 2007 | 1,306                | 400,684                      | –         | –           | (136,005)   | <b>264,679</b>             | 1 October 2012              | 31 March 2013   |
| 17 July 2008 | 1,274                | 252,498                      | –         | –           | (73,817)    | <b>178,681</b>             | 1 October 2011              | 31 March 2012   |
| 17 July 2008 | 1,274                | 439,226                      | –         | –           | (168,629)   | <b>270,597</b>             | 1 October 2013              | 31 March 2014   |
| 30 June 2009 | 1,042                | 539,099                      | –         | (2,102)     | (228,646)   | <b>308,351</b>             | 1 October 2012              | 31 March 2013   |
| 30 June 2009 | 1,042                | 1,109,927                    | –         | (494)       | (546,526)   | <b>562,907</b>             | 1 October 2014              | 31 March 2015   |
| 30 June 2010 | 871                  | –                            | 823,143   | –           | (51,224)    | <b>771,919</b>             | 1 October 2013              | 31 March 2014   |
| 30 June 2010 | 871                  | –                            | 3,073,329 | –           | (127,079)   | <b>2,946,250</b>           | 1 October 2015              | 31 March 2016   |
|              |                      | 4,603,703                    | 3,896,472 | (1,038,831) | (1,422,817) | <b>6,038,527</b>           |                             |                 |

As at 31 March 2010

| Award date   | Option price (pence) | Outstanding at start of year | Granted   | Exercised | Lapsed    | Outstanding at end of year | Date from which exercisable | Expiry date (i) |
|--------------|----------------------|------------------------------|-----------|-----------|-----------|----------------------------|-----------------------------|-----------------|
| 25 July 2003 | 562                  | 6,736                        | –         | (2,492)   | (4,244)   | –                          | 1 October 2008              | 31 March 2009   |
| 16 July 2004 | 622                  | 536,374                      | –         | (533,644) | (840)     | 1,890                      | 1 October 2009              | 31 March 2010   |
| 14 July 2005 | 886                  | 4,002                        | –         | (209)     | (3,793)   | –                          | 1 October 2008              | 31 March 2009   |
| 14 July 2005 | 886                  | 1,094,271                    | –         | (8,057)   | (19,760)  | 1,066,454                  | 1 October 2010              | 31 March 2011   |
| 11 July 2006 | 999                  | 363,445                      | –         | (342,055) | (5,235)   | 16,155                     | 1 October 2009              | 31 March 2010   |
| 11 July 2006 | 999                  | 592,440                      | –         | (256)     | (28,907)  | 563,277                    | 1 October 2011              | 31 March 2012   |
| 10 July 2007 | 1,306                | 275,240                      | –         | –         | (60,747)  | 214,493                    | 1 October 2010              | 31 March 2011   |
| 10 July 2007 | 1,306                | 536,896                      | –         | –         | (136,212) | 400,684                    | 1 October 2012              | 31 March 2013   |
| 17 July 2008 | 1,274                | 332,998                      | –         | –         | (80,500)  | 252,498                    | 1 October 2011              | 31 March 2012   |
| 17 July 2008 | 1,274                | 644,748                      | –         | –         | (205,522) | 439,226                    | 1 October 2013              | 31 March 2014   |
| 30 June 2009 | 1,042                | –                            | 576,864   | –         | (37,765)  | 539,099                    | 1 October 2012              | 31 March 2013   |
| 30 June 2009 | 1,042                | –                            | 1,156,570 | –         | (46,643)  | 1,109,927                  | 1 October 2014              | 31 March 2015   |
|              |                      | 4,387,150                    | 1,733,434 | (886,713) | (630,168) | 4,603,703                  |                             |                 |

As share options are exercised continuously throughout the period from 1 October to 31 March, the weighted average share price during this period of 1,177p (2010 – 1,126p) is considered representative of the weighted average share price at the date of exercise. The weighted average share price of forfeitures is simply the option price to which the forfeit relates.

##### Company

As at 31 March 2011

| Award date   | Option price (pence) | Outstanding at start of year | Granted | Exercised | Outstanding at end of year | Date from which exercisable | Expiry date (i) |
|--------------|----------------------|------------------------------|---------|-----------|----------------------------|-----------------------------|-----------------|
| 14 July 2005 | 886                  | 3,655                        | –       | (3,655)   | –                          | 1 October 2010              | 31 March 2011   |
| 10 July 2007 | 1,306                | 144                          | –       | –         | <b>144</b>                 | 1 October 2010              | 31 March 2011   |
| 17 July 2008 | 1,274                | 442                          | –       | –         | <b>442</b>                 | 1 October 2011              | 31 March 2012   |
| 30 June 2009 | 1,042                | 1,253                        | –       | –         | <b>1,253</b>               | 1 October 2014              | 31 March 2015   |
| 30 June 2010 | 871                  | –                            | 413     | –         | <b>413</b>                 | 1 October 2013              | 31 March 2014   |
| 30 June 2010 | 871                  | –                            | 283     | –         | <b>283</b>                 | 1 October 2015              | 31 March 2016   |
|              |                      | 5,494                        | 696     | (3,655)   | <b>2,535</b>               |                             |                 |

As at 31 March 2010

| Award date   | Option price (pence) | Outstanding at start of year | Granted | Exercised | Outstanding at end of year | Date from which exercisable | Expiry date (i) |
|--------------|----------------------|------------------------------|---------|-----------|----------------------------|-----------------------------|-----------------|
| 16 July 2004 | 622                  | 1,681                        | –       | (1,681)   | –                          | 1 October 2009              | 31 March 2010   |
| 14 July 2005 | 886                  | 3,655                        | –       | –         | 3,655                      | 1 October 2010              | 31 March 2011   |
| 10 July 2007 | 1,306                | 144                          | –       | –         | 144                        | 1 October 2010              | 31 March 2011   |
| 17 July 2008 | 1,274                | 442                          | –       | –         | 442                        | 1 October 2011              | 31 March 2012   |
| 30 June 2009 | 1,042                | –                            | 1,253   | –         | 1,253                      | 1 October 2014              | 31 March 2015   |
|              |                      | 5,922                        | 1,253   | (1,681)   | 5,494                      |                             |                 |

No options were forfeited in the year.

(i) Options may remain exercisable beyond the published expiry date due to individuals taking advantage of the right to a payment holiday during the term of the scheme.

The fair value of these share options at the measurement date, calculated using the Black-Scholes model, and the assumptions made in that model are as follows:

|                                | July 2004 |        | July 2005 |        | July 2006 |        | July 2007 |        | July 2008 |        | July 2009 |        | July 2010 |        |
|--------------------------------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|
|                                | 3 Year    | 5 Year | 3 Year    | 5 Year | 3 Year    | 5 Year | 3 Year    | 5 Year | 3 Year    | 5 Year | 3 Year    | 5 year | 3 year    | 5 Year |
| Fair value of option           | 108p      | 117p   | 126p      | 137p   | 217p      | 227p   | 287p      | 313p   | 304p      | 339p   | 244p      | 269p   | 231p      | 246p   |
| Expected volatility            | 17%       | 17%    | 15%       | 15%    | 19%       | 19%    | 25%       | 25%    | 28%       | 28%    | 35%       | 35%    | 19%       | 19%    |
| Risk free rate                 | 4.7%      | 4.8%   | 4.1%      | 4.2%   | 4.7%      | 4.7%   | 5.8%      | 5.7%   | 4.9%      | 5.0%   | 2.7%      | 2.9%   | 1.4%      | 2.2%   |
| Expected dividends             | 4.6%      | 4.6%   | 4.2%      | 4.2%   | 4.8%      | 4.8%   | 5.3%      | 5.2%   | 4.1%      | 4.2%   | 4.1%      | 4.2%   | 1.7%      | 2.2%   |
| Term of the option             | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  |
| Underlying price at grant date | 699p      | 699p   | 967p      | 967p   | 1,180p    | 1,180p | 1,460p    | 1,460p | 1,397p    | 1,397p | 1,139p    | 1,139p | 1,089p    | 1,089p |
| Strike price                   | 622p      | 622p   | 886p      | 886p   | 999p      | 999p   | 1,306p    | 1,306p | 1,274p    | 1,274p | 1,042p    | 1,042p | 871p      | 871p   |

Expected price volatility was determined by calculating the historical volatility of the Group's share price over the previous 12 months.

## (ii) Share Incentive Plan

### Matching Shares

|                              | Consolidated |                                |           |                                | Company |                                |        |                                |
|------------------------------|--------------|--------------------------------|-----------|--------------------------------|---------|--------------------------------|--------|--------------------------------|
|                              | 2011         |                                | 2010      |                                | 2011    |                                | 2010   |                                |
|                              | Shares       | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares  | Weighted average price (pence) | Shares | Weighted average price (pence) |
| Outstanding at start of year | 1,745,224    | 1,215                          | 1,260,376 | 1,248                          | 1,588   | 1,130                          | 1,300  | 1,129                          |
| Granted during the year      | 571,166      | 1,161                          | 594,251   | 1,137                          | 288     | 1,161                          | 288    | 1,137                          |
| Forfeited during the year    | (68,670)     | 1,215                          | (41,145)  | 1,248                          | –       | –                              | –      | –                              |
| Exercised during the year    | (138,696)    | 1,149                          | (68,258)  | 1,125                          | –       | –                              | –      | –                              |
| Outstanding at end of year   | 2,109,024    | 1,205                          | 1,745,224 | 1,215                          | 1,876   | 1,135                          | 1,588  | 1,130                          |
| Exercisable at end of year   | 781,271      | 1,396                          | 655,440   | 1,289                          | 1,040   | 1,096                          | 800    | 968                            |

As shares are exercised continuously throughout the year, the weighted average share price during the period of 1,149p (2010 – 1,125p) is considered representative of the weighted average share price at the date of exercise.

The fair value of shares in the share incentive plan is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price and is based on the price paid for the shares at the grant date as shares are acquired out of the market as at that date to satisfy awards made under the scheme.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 30. EMPLOYEE SHARE-BASED PAYMENTS (continued)

##### Free Shares

|                              | Consolidated |                                |          |                                | Company |                                |        |                                |
|------------------------------|--------------|--------------------------------|----------|--------------------------------|---------|--------------------------------|--------|--------------------------------|
|                              | 2011         |                                | 2010     |                                | 2011    |                                | 2010   |                                |
|                              | Shares       | Weighted average price (pence) | Shares   | Weighted average price (pence) | Shares  | Weighted average price (pence) | Shares | Weighted average price (pence) |
| Outstanding at start of year | 673,999      | 1,210                          | 725,729  | 1,205                          | 320     | 1,151                          | 320    | 1,151                          |
| Granted during the year      | –            | –                              | –        | –                              | –       | –                              | –      | –                              |
| Forfeited during the year    | (7,080)      | 1,210                          | (9,778)  | 1,205                          | –       | –                              | –      | –                              |
| Exercised during the year    | (126,298)    | 1,149                          | (41,952) | 1,125                          | –       | –                              | –      | –                              |
| Outstanding at end of year   | 540,621      | 1,224                          | 673,999  | 1,210                          | 320     | 1,151                          | 320    | 1,151                          |
| Exercisable at end of year   | 414,691      | 1,076                          | 326,058  | 965                            | 280     | 1,113                          | 200    | 965                            |

As shares are exercised continuously throughout the year, the weighted average share price during the period of 1,149p (2010 – 1,125p) is considered representative of the weighted average share price at the date of exercise.

The fair value of these shares is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price and is based on the price paid for the shares at the grant date as shares are acquired out of the market as at that date to satisfy awards made under the scheme.

##### (iii) Deferred bonus scheme

|                              | Consolidated |                                |           |                                | Company |                                |           |                                |
|------------------------------|--------------|--------------------------------|-----------|--------------------------------|---------|--------------------------------|-----------|--------------------------------|
|                              | 2011         |                                | 2010      |                                | 2011    |                                | 2010      |                                |
|                              | Shares       | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares  | Weighted average price (pence) | Shares    | Weighted average price (pence) |
| Outstanding at start of year | 322,905      | 1,367                          | 612,475   | 1,324                          | 58,867  | 1,349                          | 291,608   | 961                            |
| Granted during the year      | 166,426      | 1,079                          | 153,353   | 1,174                          | 33,298  | 1,079                          | 31,115    | 1,174                          |
| Forfeited during the year    | (22,722)     | 1,367                          | –         | –                              | –       | –                              | –         | –                              |
| Exercised during the year    | (2,754)      | 1,054                          | (442,923) | 1,121                          | –       | –                              | (263,856) | 1,120                          |
| Outstanding at end of year   | 463,855      | 1,270                          | 322,905   | 1,367                          | 92,165  | 1,251                          | 58,867    | 1,349                          |
| Exercisable at end of year   | 868          | 1,072                          | 1,750     | 1,265                          | –       | –                              | –         | –                              |

The fair value of the deferred bonus shares is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price and is based on the price paid for the shares at the grant date as shares are acquired out of the market as at that date to satisfy awards made under the scheme.

##### (iv) Performance Share Plan

|                              | Consolidated |                                |           |                                | Company   |                                |           |                                |
|------------------------------|--------------|--------------------------------|-----------|--------------------------------|-----------|--------------------------------|-----------|--------------------------------|
|                              | 2011         |                                | 2010      |                                | 2011      |                                | 2010      |                                |
|                              | Shares       | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares    | Weighted average price (pence) |
| Outstanding at start of year | 1,592,479    | 1,353                          | 1,135,023 | 1,435                          | 752,945   | 1,360                          | 593,122   | 1,421                          |
| Granted during the year      | 840,095      | 1,079                          | 714,010   | 1,174                          | 338,645   | 1,079                          | 311,174   | 1,174                          |
| Forfeited during the year    | (379,500)    | 1,353                          | –         | –                              | (181,449) | 1,360                          | –         | –                              |
| Exercised during the year    | (60,590)     | 1,076                          | (256,554) | 1,174                          | (35,077)  | 1,076                          | (151,351) | 1,174                          |
| Outstanding at end of year   | 1,992,484    | 1,226                          | 1,592,479 | 1,353                          | 875,064   | 1,233                          | 752,945   | 1,360                          |

Of the outstanding options at the end of the year, none were exercisable.

The fair value of the performance share plan shares is not subject to valuation using the Black-Scholes model. The fair value of shares granted in the year is equal to closing market price on the date of grant.

### 31. FINANCIAL INSTRUMENTS AND RISK

This note presents information about the fair value of the Group's financial instruments, the Group's exposure to the risks associated with those instruments, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further qualitative disclosures are included throughout these consolidated financial statements.

The Group has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Commodity risk
- Currency risk
- Interest rate risk

The Board has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board established the Risk and Trading Committee, a standing committee of the Management Board comprising three Executive Directors and senior managers from the Generation and Supply and Finance functions, to oversee the control of these activities. This committee is discussed further in the Directors Report.

The Group's policies for risk management are established to identify the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. These policies, and the systems used to monitor activities, are reviewed regularly by the Risk and Trading Committee.

Exposure to the commodity, currency and interest rate risks noted arise in the normal course of the Group's business and derivative financial instruments are entered into to hedge exposure to these risks. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained below.

The Company is required to disclose information on its financial instruments and has adopted policies identical to that of the Group, where applicable. Separate disclosure is provided where necessary.

Before detailing the relevant qualitative and quantitative disclosures in relation to the potential risks faced by the Group, details on the different categories of financial instrument and the carrying and fair values of each of those categories is provided below.

# Notes on the financial statements (continued)

## for the year ended 31 March

### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

#### A. CATEGORIES OF FINANCIAL INSTRUMENTS AND FAIR VALUES OF THOSE ASSETS AND LIABILITIES

The fair values of the primary financial assets and liabilities of the Group together with their carrying values are as follows:

|                                                        | 2011<br>Amortised cost<br>or other (i)<br>£m | 2011<br>Classified as<br>trading (ii)<br>£m | 2011<br>Total carrying<br>value<br>£m | 2011<br>Fair value<br>£m | 2010<br>Amortised cost<br>or other (i)<br>Restated<br>£m | 2010<br>Classified as<br>trading (ii)<br>£m | 2010<br>Total carrying<br>value<br>Restated<br>£m | 2010<br>Fair value<br>Restated<br>£m |
|--------------------------------------------------------|----------------------------------------------|---------------------------------------------|---------------------------------------|--------------------------|----------------------------------------------------------|---------------------------------------------|---------------------------------------------------|--------------------------------------|
| <b>Financial assets</b>                                |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| <b>Current</b>                                         |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Trade receivables                                      | 3,331.7                                      | –                                           | 3,331.7                               | 3,331.7                  | 2,506.2                                                  | –                                           | 2,506.2                                           | 2,506.2                              |
| Other receivables                                      | 93.4                                         | –                                           | 93.4                                  | 93.4                     | 72.1                                                     | –                                           | 72.1                                              | 72.1                                 |
| Cash collateral                                        | –                                            | –                                           | –                                     | –                        | 71.2                                                     | –                                           | 71.2                                              | 71.2                                 |
| Cash and cash equivalents                              | 476.9                                        | –                                           | 476.9                                 | 476.9                    | 261.7                                                    | –                                           | 261.7                                             | 261.7                                |
| Derivative financial assets                            | –                                            | 2,525.5                                     | 2,525.5                               | 2,525.5                  | –                                                        | 1,468.3                                     | 1,468.3                                           | 1,468.3                              |
|                                                        | <b>3,902.0</b>                               | <b>2,525.5</b>                              | <b>6,427.5</b>                        | <b>6,427.5</b>           | <b>2,911.2</b>                                           | <b>1,468.3</b>                              | <b>4,379.5</b>                                    | <b>4,379.5</b>                       |
| <b>Non-current</b>                                     |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Loans to associates and jointly<br>controlled entities | 1,124.6                                      | –                                           | 1,124.6                               | 1,124.6                  | 970.5                                                    | –                                           | 970.5                                             | 970.5                                |
| Derivative financial assets                            | –                                            | 990.1                                       | 990.1                                 | 990.1                    | –                                                        | 466.3                                       | 466.3                                             | 466.3                                |
|                                                        | <b>1,124.6</b>                               | <b>990.1</b>                                | <b>2,114.7</b>                        | <b>2,114.7</b>           | <b>970.5</b>                                             | <b>466.3</b>                                | <b>1,436.8</b>                                    | <b>1,436.8</b>                       |
|                                                        | <b>5,026.2</b>                               | <b>3,515.6</b>                              | <b>8,542.2</b>                        | <b>8,542.2</b>           | <b>3,881.7</b>                                           | <b>1,934.6</b>                              | <b>5,816.3</b>                                    | <b>5,816.3</b>                       |
| <b>Financial liabilities</b>                           |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| <b>Current</b>                                         |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Trade payables                                         | (3,197.2)                                    | –                                           | (3,197.2)                             | (3,197.2)                | (2,161.6)                                                | –                                           | (2,161.6)                                         | (2,161.6)                            |
| Bank loans and overdrafts                              | (433.7)                                      | –                                           | (433.7)                               | (434.7)                  | (891.5)                                                  | –                                           | (891.5)                                           | (896.3)                              |
| Finance lease liabilities                              | (12.8)                                       | –                                           | (12.8)                                | (12.8)                   | (12.2)                                                   | –                                           | (12.2)                                            | (12.2)                               |
| Derivative financial liabilities                       | –                                            | (2,307.5)                                   | (2,307.5)                             | (2,307.5)                | –                                                        | (2,020.7)                                   | (2,020.7)                                         | (2,020.7)                            |
|                                                        | <b>(3,643.7)</b>                             | <b>(2,307.5)</b>                            | <b>(5,951.2)</b>                      | <b>(5,952.2)</b>         | <b>(3,065.3)</b>                                         | <b>(2,020.7)</b>                            | <b>(5,086.0)</b>                                  | <b>(5,090.8)</b>                     |
| <b>Non-current</b>                                     |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Loans and borrowings (iii)                             | (4,829.1)                                    | 28.6                                        | (4,800.5)                             | (5,153.7)                | (4,799.8)                                                | 28.7                                        | (4,771.1)                                         | (5,205.1)                            |
| Finance lease liabilities                              | (359.4)                                      | –                                           | (359.4)                               | (359.4)                  | (372.2)                                                  | –                                           | (372.2)                                           | (372.2)                              |
| Derivative financial liabilities                       | –                                            | (769.3)                                     | (769.3)                               | (769.3)                  | –                                                        | (899.0)                                     | (899.0)                                           | (899.0)                              |
|                                                        | <b>(5,188.5)</b>                             | <b>(740.7)</b>                              | <b>(5,929.2)</b>                      | <b>(6,282.4)</b>         | <b>(5,172.0)</b>                                         | <b>(870.3)</b>                              | <b>(6,042.3)</b>                                  | <b>(6,476.3)</b>                     |
|                                                        | <b>(8,832.2)</b>                             | <b>(3,048.2)</b>                            | <b>(11,880.4)</b>                     | <b>(12,234.6)</b>        | <b>(8,237.3)</b>                                         | <b>(2,891.0)</b>                            | <b>(11,128.3)</b>                                 | <b>(11,567.1)</b>                    |
| <b>Net financial liabilities/asset</b>                 | <b>(3,806.0)</b>                             | <b>467.4</b>                                | <b>(3,338.6)</b>                      | <b>(3,692.4)</b>         | <b>(4,355.6)</b>                                         | <b>(956.4)</b>                              | <b>(5,312.0)</b>                                  | <b>(5,750.8)</b>                     |

(i) Recorded at amortised cost or loans and receivables.

(ii) IAS 39 financial instruments.

(iii) Includes non-recourse borrowings.

The fair values of the primary financial assets and liabilities of the Company together with their carrying values are as follows:

|                                                     | 2011<br>Amortised cost<br>or other (i)<br>£m | 2011<br>Classified as<br>trading (ii)<br>£m | 2011<br>Total carrying<br>value<br>£m | 2011<br>Fair value<br>£m | 2010<br>Amortised cost<br>or other (i)<br>Restated<br>£m | 2010<br>Classified as<br>trading (ii)<br>£m | 2010<br>Total carrying<br>value<br>Restated<br>£m | 2010<br>Fair value<br>Restated<br>£m |
|-----------------------------------------------------|----------------------------------------------|---------------------------------------------|---------------------------------------|--------------------------|----------------------------------------------------------|---------------------------------------------|---------------------------------------------------|--------------------------------------|
| <b>Financial assets</b>                             |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| <b>Current</b>                                      |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Cash and cash equivalents                           | 319.1                                        | –                                           | 319.1                                 | 319.1                    | 99.7                                                     | –                                           | 99.7                                              | 99.7                                 |
| Amounts owed by subsidiary undertakings             | 2,220.9                                      | –                                           | 2,220.9                               | 2,220.9                  | 1,804.6                                                  | –                                           | 1,804.6                                           | 1,804.6                              |
| Derivative financial assets                         | –                                            | 30.0                                        | 30.0                                  | 30.0                     | –                                                        | 56.6                                        | 56.6                                              | 56.6                                 |
|                                                     | 2,540.0                                      | 30.0                                        | 2,570.0                               | 2,570.0                  | 1,904.3                                                  | 56.6                                        | 1,960.9                                           | 1,960.9                              |
| <b>Non-current</b>                                  |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Amounts owed by subsidiary undertakings             | 3,661.2                                      | –                                           | 3,661.2                               | 3,661.2                  | 3,456.1                                                  | –                                           | 3,456.1                                           | 3,456.1                              |
| Loans to associates and jointly controlled entities | 1,029.5                                      | –                                           | 1,029.5                               | 1,029.5                  | 835.5                                                    | –                                           | 835.5                                             | 835.5                                |
| Derivative financial assets                         | –                                            | 48.0                                        | 48.0                                  | 48.0                     | –                                                        | 47.5                                        | 47.5                                              | 47.5                                 |
|                                                     | 4,690.7                                      | 48.0                                        | 4,738.7                               | 4,738.7                  | 4,291.6                                                  | 47.5                                        | 4,339.1                                           | 4,338.9                              |
|                                                     | 7,230.7                                      | 78.0                                        | 7,308.7                               | 7,308.7                  | 6,195.9                                                  | 104.1                                       | 6,300.0                                           | 6,299.8                              |
| <b>Financial liabilities</b>                        |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| <b>Current</b>                                      |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Bank loans and overdrafts                           | (106.8)                                      | –                                           | (106.8)                               | (106.9)                  | (815.6)                                                  | –                                           | (815.6)                                           | (817.3)                              |
| Convertible bond                                    | –                                            | –                                           | –                                     | –                        | –                                                        | –                                           | –                                                 | –                                    |
| Amounts owed to subsidiary undertakings             | (2,757.0)                                    | –                                           | (2,757.0)                             | (2,757.0)                | (2,569.0)                                                | –                                           | (2,569.0)                                         | (2,569.0)                            |
| Derivative financial liabilities                    | –                                            | (15.5)                                      | (15.5)                                | (15.5)                   | –                                                        | (45.2)                                      | (45.2)                                            | (45.2)                               |
|                                                     | (2,863.8)                                    | (15.5)                                      | (2,879.3)                             | (2,879.4)                | (3,384.6)                                                | (45.2)                                      | (3,429.8)                                         | (3,431.5)                            |
| <b>Non-current</b>                                  |                                              |                                             |                                       |                          |                                                          |                                             |                                                   |                                      |
| Eurobonds                                           | (2,857.1)                                    | –                                           | (2,857.1)                             | (3,167.2)                | (2,858.6)                                                | –                                           | (2,858.6)                                         | (3,203.1)                            |
| Bank loans                                          | (671.0)                                      | 28.6                                        | (642.4)                               | (676.9)                  | (271.3)                                                  | 28.7                                        | (242.6)                                           | (270.2)                              |
| Amounts owed to subsidiary undertakings             | (257.4)                                      | –                                           | (257.4)                               | (257.4)                  | (240.2)                                                  | –                                           | (240.2)                                           | (240.2)                              |
| Derivative financial liabilities                    | –                                            | (136.7)                                     | (136.7)                               | (136.7)                  | –                                                        | (82.8)                                      | (82.8)                                            | (82.8)                               |
|                                                     | (3,785.5)                                    | (108.1)                                     | (3,893.6)                             | (4,238.2)                | (3,370.1)                                                | (54.1)                                      | (3,424.2)                                         | (3,796.3)                            |
|                                                     | (6,649.3)                                    | (123.6)                                     | (6,772.9)                             | (7,117.6)                | (6,754.7)                                                | (99.3)                                      | (6,854.0)                                         | (7,227.8)                            |
| <b>Net financial (liabilities)/asset</b>            | <b>(581.4)</b>                               | <b>(45.6)</b>                               | <b>(535.8)</b>                        | <b>191.1</b>             | <b>(558.8)</b>                                           | <b>4.8</b>                                  | <b>(554.0)</b>                                    | <b>(928.0)</b>                       |

(i) Recorded at amortised cost, available for sale, or loans and receivables.

(ii) IAS 39 financial instruments.

#### Basis of determining fair value

Certain assets and liabilities designated and carried at amortised cost are loans and receivables. For certain current assets and liabilities their carrying value is equivalent to fair value due to short term maturity.

Assets and liabilities designated at fair value and the fair value of other financial assets and liabilities have been determined by reference to closing rate market values. This basis has been used in valuing interest rate instruments, foreign currency hedge contracts and denominated long-term fixed rate debt. Commodity contracts fair values are based on published price quotations.

The fair values are stated at a specific date and may be different from the amounts which will actually be paid or received on settlement of the instruments. The fair value of items such as property, plant and equipment, internally generated brands or the Group's customer base are not included as these are not financial instruments.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS

###### (i) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations.

Credit risk arising from the Group's normal commercial operations is controlled by individual business units operating in accordance with Group policies and procedures. Generally, for significant contracts, individual business units enter into contracts or agreements with counterparties having investment grade credit ratings only, or where suitable collateral or other security has been provided. Counterparty credit validation is undertaken prior to contractual commitment.

Credit risk management for the Group's regulated businesses is performed in accordance with industry standards as set out by the Regulator and is controlled by the individual business units. The Group's greatest credit risks lie with the non-regulated operations of the Generation and Supply business and the activities carried out by the Group's Treasury function, for which specific credit risk controls that match the risk profile of those activities are applied.

Exposure to credit risk in the supply of electricity and gas arises from the potential of a customer defaulting on their invoiced payables. The financial strength and credit-worthiness of business customers is assessed prior to commencing, and for the duration of, their contract of supply. Domestic customers' credit-worthiness is reviewed from a variety of internal and external information.

Exposure to credit risk in the procurement of wholesale energy and fuel is managed by reference to agreed transaction credit limits which are determined by whether the counterparty:

- (i) holds an investment grade credit rating; or
- (ii) can be assessed as adequately credit-worthy in accordance with internal credit rules using information from other external credit agencies; or
- (iii) can provide a guarantee from an investment grade rated entity or post suitable collateral or provide other acceptable assurances in accordance with Group procedures where they have failed to meet the above conditions; or
- (iv) can be allocated a non-standard credit limit approved by the Risk and Trading Committee within its authorised limits as delegated by the Management Board.

Credit support clauses or side agreements are typically included or entered into to protect the Group against counterparty failure or non-delivery. Within the Generation and Supply business, increasing volumes of commodity derivative products are now traded through cleared exchanges to further mitigate credit risk. Such exchanges are subject to strict regulation by the UK Financial Services Authority (FSA) and participants in these exchanges are obliged to meet rigorous capital adequacy requirements.

Individual counterparty credit exposures are monitored by category of credit risk and are subject to approved limits. At 31 March 2011, the Group's Generation and Supply business had pledged £201.1m (2010 – £169.9m) of cash collateral and letters of credit and had received £38.7m (2010 – £28.6m) of cash collateral and letters of credit principally to reduce exposures on credit risk.

Bank credit exposures, which are monitored and reported on daily, are calculated on a mark-to-market basis and adjusted for future volatility and probability of default. Any issues relating to these credit exposures are presented for discussion and review by the Risk and Trading Committee.

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to cash. These are subject to insignificant risk of change in value or credit risk. Derivative financial instruments are entered into to cover the Group's market risks – commodity risk, interest rate risk, currency risk – and are consequently covered elsewhere in this note.

Trade receivables represent the most significant exposure to credit risk and are stated net of collateral held and other credit enhancements. The trade receivables total includes an allowance for impairment.

### Concentrations of risk

Trade receivables recorded by reported segment held at the 31 March were:

|                       | 2011<br>£m | 2010<br>£m |
|-----------------------|------------|------------|
| Power Systems         |            |            |
| Scotland              | 34.9       | 21.2       |
| England               | 28.6       | 21.7       |
|                       | 63.5       | 42.9       |
| Generation and Supply |            |            |
| Retail customers      | 563.7      | 596.3      |
| Wholesale receivables | 2,226.9    | 1,381.6    |
| Other                 | 366.3      | 355.6      |
| Other businesses      | 111.3      | 129.8      |
|                       | 3,331.7    | 2,506.2    |

The Generation and Supply segment accounts for 94.8% (2010 – 93.2%) of the Group's trade receivables. Trade receivables associated with the Group's energy related customers are recorded in this segment. The Group also has significant receivables associated with its wholesale activities which are generally settled within 2 to 4 weeks from invoicing. The Group's exposure to credit risk is therefore subject to diversification with no exposure to individual customers totalling >10% of trade receivables. The biggest customer balance, due from a wholesale customer (also a wholesale supplier), is less than 10% (2010 – less than 9%) of the total trade receivables.

The ageing of trade receivables at the reporting date was:

|                                         | 2011<br>£m | 2010<br>£m |
|-----------------------------------------|------------|------------|
| Not past due                            | 3,053.7    | 2,258.5    |
| Past due but not individually impaired: |            |            |
| 0 – 30 days                             | 181.7      | 153.6      |
| 31 – 90 days                            | 69.0       | 57.9       |
| Over 90 days                            | 171.5      | 185.1      |
|                                         | 3,475.9    | 2,655.1    |
| Less: allowance for impairment          | (144.2)    | (148.9)    |
| Net Trade receivables                   | 3,331.7    | 2,506.2    |

The Group has past due debt which has not had an impairment allowance set aside to cover potential credit losses. The Group has certain procedures to pursue customers in significant arrears and believes its impairment policy in relation to such balances is appropriate. Those debts which are neither past due nor impaired are considered to be good and are expected to be recoverable.

The Group has other receivables which are financial assets totalling £93.4m (2010 – £72.1m). The Company does not have trade receivables.

The movement in the allowance for trade receivables was:

|                                                   | 2011<br>£m | 2010<br>£m |
|---------------------------------------------------|------------|------------|
| Balance at 1 April                                | 148.9      | 126.7      |
| Increase in allowance for impairment              | 50.7       | 81.7       |
| Impairment losses recognised                      | (61.7)     | (70.2)     |
| Recovery of impairment loss previously recognised | 6.3        | 9.5        |
| Acquired allowance                                | –          | 1.2        |
| Balance at 31 March                               | 144.2      | 148.9      |

At the end of each reporting period a review of the provision for bad and doubtful debts is performed. It is an assessment of the potential amount of trade receivables which will not be paid by customers after the balance sheet date. This amount is calculated by reference to the age, status and risk of each receivable.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

###### (iii) Liquidity risk and Going Concern

Liquidity risk, the risk that the Group will have insufficient funds to meet its liabilities, is managed by the Group's Treasury function. The Group can have significant movements in its liquidity position due to movement in commodity price, working capital requirements, the seasonal nature of the business and phasing of its capital reduction programme.

Treasury is responsible for managing the banking and liquidity requirements of the Group, risk management relating to interest rate and foreign exchange exposures, and for managing the credit risk relating to the banking counterparties with which it transacts. Short term liquidity is reviewed daily by Treasury, while the longer term liquidity position is reviewed on a regular basis by the Management Board. The department's operations are governed by policies determined by the Management Board and any breaches of these policies are reported to the Risk and Trading Committee and the Audit Committee.

In relation to the Group's liquidity risk, the Group's policy is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

The Group's approach to managing liquidity is to seek to ensure that the Group has available committed borrowings and facilities equal to at least 105% of forecast borrowings over a rolling 12 month period.

The Group uses a cash flow forecast to monitor its ongoing borrowing requirements. Typically, the Group will fund any short term borrowing positions by issuing commercial paper or borrowing from uncommitted bank lines and will invest in money market funds when it has a cash surplus. In addition to the borrowing facilities listed at note 23, the Group has £70m of uncommitted bank lines and a £20m overdraft facility.

During the year, the Group has extended its existing £900m revolving credit facility and its £100m bilateral facility on reduced terms which will now mature in August 2015. In the year, the Group borrowed £100m at a fixed price of 3.725% for a period of 10 years and £300m at a floating rate of GBP 6 month LIBOR plus 50.2 basis points also for a period of 10 years from its £400m loan facility with the European Investment Bank. In addition to these, the Group issued Hybrid Capital of £1,161.4m in the year. Details are included at note 28.

Under the going concern principle, the Group does not expect to issue medium to long term debt during the year ended 31 March 2012 although it may choose to do so at its discretion. Taking this and the current liquidity in the commercial paper market and the availability of undrawn committed bank facilities into account, the Directors have concluded that the Group has sufficient headroom to continue as a going concern. In coming to this conclusion the Directors have taken into account the successful issuance of £4.1bn of medium to long term debt including Hybrid Capital since July 2008, the Group's credit rating, the successful renewal and increase of committed bank facilities and current market conditions. The statement of going concern is included in the Corporate Governance report on page 75.

Treasury also manage the Group's interaction with its relationship banks (defined as those banks that support the Company's financing activities through their ongoing participation in the committed lending facilities that are maintained by the Group). These are each allocated financial limits, subject to the maintenance of a minimum credit rating of 'A' or equivalent allocated by a recognised major ratings group. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria.

As at 31 March 2011, the value of outstanding cash collateral in respect of mark-to-market related margin calls on exchange traded positions was £nil (2010 – £71.2m).

The contractual cash flows shown in the following tables are the contractual undiscounted cash flows under the relevant financial instruments. Where the contractual cash flows are variable based on a price, foreign exchange rate or index in the future, the contractual cash flows in the following tables have been determined with reference to the relevant price, foreign exchange rate, interest rate or index as at the balance sheet date. In determining the interest element of contractual cash flows in cases where the Group has a choice as to the length of interest calculation periods and the interest rate that applies varies with the period selected, the contractual cash flows have been calculated assuming the Group selects the shortest available interest calculation periods. Where the holder of an instrument has a choice of when to redeem, the amounts in the following tables are on the assumption the holder redeems at the earliest opportunity.

The numbers in the following tables have been included in the Group's cash flow forecasts for the purposes of considering liquidity risk as noted above.

The following are the undiscounted contractual maturities of financial liabilities, including interest and excluding the impact of netting agreements:

### Liability risk

|                                                     | 2011<br>Carrying<br>value<br>£m | 2011<br>Contractual<br>cash flows<br>£m | 2011<br>0-12<br>months<br>£m | 2011<br>1-2<br>years<br>£m | 2011<br>2-5<br>years<br>£m | 2011<br>> 5<br>years<br>£m | 2010<br>Carrying<br>value<br>£m | 2010<br>Contractual<br>cash flows<br>£m | 2010<br>0-12<br>months<br>£m | 2010<br>1-2<br>years<br>£m | 2010<br>2-5<br>years<br>£m | 2010<br>> 5<br>years<br>£m |
|-----------------------------------------------------|---------------------------------|-----------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|---------------------------------|-----------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|
| <b>Financial liabilities</b>                        |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| <b>Loans and borrowings</b>                         |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Bank overdrafts                                     | 5.3                             | (5.3)                                   | (5.3)                        | –                          | –                          | –                          | 9.2                             | (9.2)                                   | (9.2)                        | –                          | –                          | –                          |
| Commercial paper and cash advances                  | 106.7                           | (106.8)                                 | (106.8)                      | –                          | –                          | –                          | 745.6                           | (745.6)                                 | (745.6)                      | –                          | –                          | –                          |
| Bank loans – floating                               | 511.5                           | (564.5)                                 | (107.3)                      | (31.5)                     | (103.7)                    | (322.0)                    | 281.6                           | (296.0)                                 | (72.4)                       | (2.8)                      | (220.8)                    | –                          |
| Bank loans – fixed                                  | 778.9                           | (1,189.5)                               | (239.9)                      | (106.8)                    | (322.9)                    | (519.9)                    | 530.9                           | (851.5)                                 | (62.0)                       | (60.2)                     | (407.7)                    | (321.6)                    |
| Unsecured bonds – fixed                             | 3,643.5                         | (6,833.0)                               | (215.3)                      | (215.3)                    | (1,803.4)                  | (4,599.0)                  | 3,639.9                         | (6,956.7)                               | (215.2)                      | (215.2)                    | (1,807.4)                  | (4,718.9)                  |
| Non-recourse funding                                | 216.9                           | (217.6)                                 | (12.5)                       | (11.9)                     | (43.3)                     | (149.9)                    | 484.1                           | (648.9)                                 | (53.6)                       | (51.0)                     | (145.7)                    | (398.6)                    |
| Fair value adjustment                               | (28.6)                          | –                                       | –                            | –                          | –                          | –                          | (28.7)                          | –                                       | –                            | –                          | –                          | –                          |
|                                                     | 5,234.2                         | (8,916.7)                               | (687.1)                      | (365.5)                    | (2,273.3)                  | (5,590.8)                  | 5,662.6                         | (9,507.9)                               | (1,158.0)                    | (329.2)                    | (2,581.6)                  | (5,439.1)                  |
| Finance lease obligations                           | 372.2                           | (743.0)                                 | (52.1)                       | (50.2)                     | (152.4)                    | (488.4)                    | 384.4                           | (796.2)                                 | (52.8)                       | (52.0)                     | (153.7)                    | (537.7)                    |
|                                                     | 5,606.4                         | (9,659.7)                               | (739.2)                      | (415.7)                    | (2,425.7)                  | (6,079.2)                  | 6,047.0                         | (10,304.1)                              | (1,210.8)                    | (381.2)                    | (2,735.3)                  | (5,976.8)                  |
| <b>Derivative financial liabilities</b>             |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Operating derivatives designated at fair value      | 2,911.8                         | 12,623.3                                | 9,363.5                      | 2,413.4                    | 846.4                      | –                          | 2,738.1                         | (11,514.2)                              | (8,421.2)                    | (1,870.1)                  | (1,174.8)                  | (48.1)                     |
| Interest rate swaps used for hedging                | 33.3                            | (33.2)                                  | (8.5)                        | (7.6)                      | (8.8)                      | (8.3)                      | 74.2                            | (74.3)                                  | (15.9)                       | (14.8)                     | (26.2)                     | (17.4)                     |
| Interest rate swaps designated at fair value        | 115.7                           | (115.6)                                 | (7.1)                        | (5.3)                      | (15.9)                     | (87.3)                     | 101.6                           | (101.6)                                 | (8.0)                        | (6.1)                      | (11.9)                     | (75.6)                     |
| Forward exchange contracts held for hedging         | 0.6                             | (10.2)                                  | (5.5)                        | (4.7)                      | –                          | –                          | 1.1                             | (3.3)                                   | (2.0)                        | (1.2)                      | (0.1)                      | –                          |
| Forward exchange contracts designated at fair value | 15.4                            | (960.5)                                 | (488.3)                      | (363.3)                    | (108.9)                    | –                          | 4.7                             | (198.0)                                 | (179.4)                      | (58.2)                     | (39.6)                     | –                          |
|                                                     | 3,076.8                         | 11,503.8                                | 8,854.1                      | 2,032.5                    | 712.8                      | (95.6)                     | 2,919.7                         | (11,891.4)                              | (8,626.5)                    | (1,950.4)                  | (1,173.4)                  | (141.1)                    |
| <b>Other financial liabilities</b>                  |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Trade payables                                      | 3,197.2                         | (3,197.2)                               | (3,197.2)                    | –                          | –                          | –                          | 2,161.6                         | (2,161.6)                               | (2,161.6)                    | –                          | –                          | –                          |
|                                                     | 3,197.2                         | (3,197.2)                               | (3,197.2)                    | –                          | –                          | –                          | 2,161.6                         | (2,161.6)                               | (2,161.6)                    | –                          | –                          | –                          |
| <b>Total</b>                                        | <b>11,880.4</b>                 | <b>(1,353.1)</b>                        | <b>4,917.7</b>               | <b>1,616.8</b>             | <b>(1,712.9)</b>           | <b>(6,174.8)</b>           | <b>11,128.3</b>                 | <b>(24,357.1)</b>                       | <b>(11,998.9)</b>            | <b>(2,331.6)</b>           | <b>(3,908.7)</b>           | <b>(6,117.9)</b>           |
| <b>Derivative financial assets</b>                  |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Financing derivatives                               | (81.9)                          | (777.2)                                 | (860.1)                      | 113.9                      | (10.7)                     | (20.3)                     | (106.8)                         | (1,466.4)                               | (1,149.8)                    | (280.6)                    | (18.5)                     | (17.5)                     |
| Operating derivatives designated at fair value      | (3,433.7)                       | (15,189.2)                              | (10,945.1)                   | (2,832.5)                  | (1,359.2)                  | (52.4)                     | (1,827.8)                       | 8,200.6                                 | 6,930.1                      | 1,175.5                    | 119.2                      | (24.2)                     |
|                                                     | (3,515.6)                       | (15,966.4)                              | (11,805.2)                   | (2,718.6)                  | (1,369.9)                  | (72.7)                     | (1,934.6)                       | 6,734.2                                 | 5,780.3                      | 894.9                      | 100.7                      | (41.7)                     |
| <b>Net total (i)</b>                                | <b>8,364.8</b>                  | <b>(17,319.5)</b>                       | <b>(6,887.5)</b>             | <b>(1,101.8)</b>           | <b>(3,082.8)</b>           | <b>(6,247.5)</b>           | <b>9,193.7</b>                  | <b>(17,622.9)</b>                       | <b>(6,218.6)</b>             | <b>(1,436.7)</b>           | <b>(3,808.0)</b>           | <b>(6,159.6)</b>           |

(i) The Group believes the liquidity risk associated with out-of-the-money operating derivative contracts needs to be considered in conjunction with the profile of payments or receipts arising from derivative financial assets. It should be noted that cash flows associated with future energy sales and commodity contracts which are not IAS 39 financial instruments are not included in this analysis, which is prepared in accordance with IFRS 7.

# Notes on the financial statements (continued)

## for the year ended 31 March

### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

#### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

The Company has the following liquidity maturity profile:

#### Liquidity risk

|                                                     | 2011<br>Carrying<br>value<br>£m | 2011<br>Contractual<br>cash flows<br>£m | 2011<br>0-12<br>months<br>£m | 2011<br>1-2<br>years<br>£m | 2011<br>2-5<br>years<br>£m | 2011<br>> 5<br>years<br>£m | 2010<br>Carrying<br>value<br>£m | 2010<br>Contractual<br>cash flows<br>£m | 2010<br>0-12<br>months<br>£m | 2010<br>1-2<br>years<br>£m | 2010<br>2-5<br>years<br>£m | 2010<br>> 5<br>years<br>£m |
|-----------------------------------------------------|---------------------------------|-----------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|---------------------------------|-----------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|
| <b>Financial liabilities</b>                        |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| <b>Loans and borrowings</b>                         |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Commercial paper and cash advances                  | 106.8                           | (106.8)                                 | (106.8)                      | -                          | -                          | -                          | 745.6                           | (745.6)                                 | (745.6)                      | -                          | -                          | -                          |
| Bank loans – floating                               | 361.5                           | (412.3)                                 | (6.0)                        | (6.0)                      | (78.4)                     | (321.9)                    | 131.5                           | (142.5)                                 | (71.2)                       | (1.7)                      | (69.6)                     | -                          |
| Bank loans – fixed                                  | 309.5                           | (375.3)                                 | (16.2)                       | (16.2)                     | (226.1)                    | (116.8)                    | 209.8                           | (252.4)                                 | (12.5)                       | (12.5)                     | (227.4)                    | -                          |
| Unsecured bonds – fixed                             | 2,857.1                         | (4,949.8)                               | (179.4)                      | (179.4)                    | (1,695.1)                  | (2,895.9)                  | 2,858.6                         | (5,060.6)                               | (179.4)                      | (179.4)                    | (1,699.5)                  | (3,002.3)                  |
| Fair value adjustment                               | (28.6)                          | -                                       | -                            | -                          | -                          | -                          | (28.7)                          | -                                       | -                            | -                          | -                          | -                          |
|                                                     | <b>3,606.3</b>                  | <b>(5,844.2)</b>                        | <b>(308.4)</b>               | <b>(201.6)</b>             | <b>(1,999.6)</b>           | <b>(3,334.6)</b>           | <b>3,916.8</b>                  | <b>(6,201.1)</b>                        | <b>(1,008.7)</b>             | <b>(193.6)</b>             | <b>(1,996.5)</b>           | <b>(3,002.3)</b>           |
| <b>Derivative financial liabilities</b>             |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Interest rate swaps used for hedging                | 29.1                            | (29.1)                                  | (6.3)                        | (6.3)                      | (8.2)                      | (8.3)                      | 32.3                            | (32.3)                                  | (9.2)                        | (9.2)                      | (13.9)                     | -                          |
| Interest rate swaps designated at fair value        | 106.8                           | (106.8)                                 | (5.8)                        | (4.8)                      | (15.4)                     | (80.8)                     | 89.9                            | (89.9)                                  | (6.5)                        | (4.6)                      | (10.7)                     | (68.1)                     |
| Forward exchange contracts held for hedging         | 0.6                             | (10.2)                                  | (5.5)                        | (4.7)                      | -                          | -                          | 1.1                             | (3.3)                                   | (2.0)                        | (1.2)                      | (0.1)                      | -                          |
| Forward exchange contracts designated at fair value | 15.7                            | (960.5)                                 | (488.3)                      | (363.3)                    | (108.9)                    | -                          | 4.7                             | (198.0)                                 | (179.4)                      | (58.2)                     | 39.6                       | -                          |
|                                                     | <b>152.2</b>                    | <b>(1,106.6)</b>                        | <b>(505.9)</b>               | <b>(379.1)</b>             | <b>(132.5)</b>             | <b>(89.1)</b>              | <b>128.0</b>                    | <b>(323.5)</b>                          | <b>(197.1)</b>               | <b>(73.2)</b>              | <b>14.9</b>                | <b>(68.1)</b>              |
| <b>Other financial liabilities</b>                  |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Amounts due to subsidiary undertakings              | 2,757.0                         | (2,757.0)                               | (2,757.0)                    | -                          | -                          | -                          | 2,569.0                         | (2,569.0)                               | (2,569.0)                    | -                          | -                          | -                          |
|                                                     | <b>2,757.0</b>                  | <b>(2,757.0)</b>                        | <b>(2,757.0)</b>             | <b>-</b>                   | <b>-</b>                   | <b>-</b>                   | <b>2,569.0</b>                  | <b>(2,569.0)</b>                        | <b>(2,569.0)</b>             | <b>-</b>                   | <b>-</b>                   | <b>-</b>                   |
| <b>Total</b>                                        | <b>6,515.5</b>                  | <b>(9,707.8)</b>                        | <b>(3,571.3)</b>             | <b>(580.7)</b>             | <b>(2,132.1)</b>           | <b>(3,423.7)</b>           | <b>6,613.8</b>                  | <b>(9,093.6)</b>                        | <b>(3,774.8)</b>             | <b>(266.8)</b>             | <b>(1,981.6)</b>           | <b>(3,070.4)</b>           |
| <b>Derivative financial assets</b>                  |                                 |                                         |                              |                            |                            |                            |                                 |                                         |                              |                            |                            |                            |
| Financing derivatives                               | (78.0)                          | (777.3)                                 | (860.3)                      | 113.7                      | (10.4)                     | (20.3)                     | (104.1)                         | (1,466.5)                               | (1,149.8)                    | (280.6)                    | (18.5)                     | (17.6)                     |
| Net total                                           | <b>6,437.5</b>                  | <b>(10,485.1)</b>                       | <b>(4,431.6)</b>             | <b>(467.0)</b>             | <b>(2,142.5)</b>           | <b>(3,444.0)</b>           | <b>6,509.7</b>                  | <b>(10,560.1)</b>                       | <b>(4,924.6)</b>             | <b>(547.4)</b>             | <b>(2,000.1)</b>           | <b>(3,088.0)</b>           |

#### (iii) Commodity risk

The Group's Generation and Supply business faces exposure to energy commodity price movements and also to physical commodity volume requirements as part of its normal course of business. This arises from the Group's requirement to source gas or electricity to supply customers, or to procure fuel to produce electricity from its generation assets.

The Group's strategy is to manage all exposures to commodity risk through volumetric limits and to measure the exposure by use of a Value at Risk (VaR) model. The exposure is subject to financial limits established by the Management Board and managed by the Risk and Trading Committee. The exposure is reported to the Committee on a monthly basis and to the Board when certain trigger levels are exceeded. Within this approach, only certain of the Group's energy commodity contracts are deemed to constitute financial instruments under IAS 39. As a result, while the Group manages the commodity price risk associated with both financial and non-financial commodity contracts, it is only the fair value of IAS 39 financial instruments which represents the exposure of the Group's commodity price risk under IFRS 7. This is a consequence of the accounting policy which requires that commodity contracts which are designated as financial instruments under IAS 39 should be accounted for on a fair value basis with changes in fair value reflected in profit or equity. Conversely, commodity contracts that are not financial instruments under IAS 39 are accounted for as 'own use' contracts. As fair value changes in own use contracts are not reflected through profit or equity, these do not represent the IFRS 7 commodity price risk. Therefore, as the overall Group VaR associated

with the Generation and Supply business is monitored for internal risk management purposes and is outside the scope of IAS 39, these measures are not required to comply with IFRS 7.

Operationally, the economic risks associated with this exposure are managed through a selection of longer and shorter term contracts for commodities such as gas, electricity, coal and oil, the acquired exploration and production business and also the flexibility of the Group's fleet of generation assets.

Short-term exposures arise from the requirement to match volumes of procured gas, electricity and power station fuel with demand for gas and electricity by its customers, which can vary from expectations and result in a requirement to close the resulting positions at unfavourable prices. This aspect of commodity risk is managed through the ability to increase or decrease energy production either in the form of flexible purchase contracts or assets such as pumped storage generating plant, flexible hydro generating plant, standby oil plant and gas storage.

Longer-term exposures are managed through the Group's generation plant and longer term contracts (including forwards, futures contracts and other financial instruments). These, in turn, are used to reduce short-term market exposures.

Certain commodity contracts are entered into primarily for own use purposes to supply to existing customers or to fuel existing power stations. However, as noted, a number of these contracts do not qualify for own use treatment under IAS 39 and are subject to fair value measurement through the income statement. In addition to this, the Group enters into certain contracts to manage commodity price and volume risk. These are also subject to fair value measurement through the income statement. Finally, certain other physical contracts are treated as the hedging instrument in documented cash flow hedging relationships where the hedged item is the forecast future purchase requirement to meet production or customer demand. The accounting policies associated with such items are explained in note 1.

The consequential commodity risk which derives from these activities is quantified by the use of a Value at Risk (VaR) model which considers exposures in all commodities and provides an estimate of the potential change to the Groups forecast profits over a given period and to a given confidence level. The calculated financial risk is controlled through the imposition of a number of risk limits approved by the Board and monitored and managed by the Risk and Trading Committee. The Group's exposure to commodity risk is reported to and monitored by the Risk and Trading Committee and to the Board by exception.

The Group's exposure to commodity price risk according to IFRS 7 is measured by reference to the Group's IAS 39 commodity contracts. IFRS 7 requires disclosure of sensitivity analysis for market risks that is intended to illustrate the sensitivity of the Group's financial position and performance to changes in market variables impacting upon the fair value or cash flows associated with the Group's financial instruments.

Therefore, the sensitivity analysis provided discloses the effect on profit or loss and equity at the balance sheet date assuming that a reasonably possible change in the relevant commodity price had occurred, and been applied to the risk exposures in existence at that date. The reasonably possible changes in commodity prices used in the sensitivity analysis were determined based on calculated or implied volatilities where available, or historical data.

The sensitivity analysis has been calculated on the basis that the proportion of commodity contracts that are IAS 39 financial instruments remains consistent with those at that point. Excluded from this analysis are all commodity contracts that are not financial instruments under IAS 39.

|                         | 2011           |                                                   | 2010           |                                                   |
|-------------------------|----------------|---------------------------------------------------|----------------|---------------------------------------------------|
|                         | Base price (i) | Reasonably possible increase/decrease in variable | Base price (i) | Reasonably possible increase/decrease in variable |
| <b>Commodity prices</b> |                |                                                   |                |                                                   |
| UK gas (p/therm)        | 72             | +/- 10                                            | 44             | +/- 6                                             |
| UK power (£/MWh)        | 63             | +/- 9                                             | 43             | +/- 6                                             |
| UK coal (US\$/tonne)    | 132            | +/- 13                                            | 97             | +/- 11                                            |
| UK emissions (£/tonne)  | 19             | +/- 3                                             | 14             | +/- 2                                             |
| UK oil (US\$/bbl)       | 109            | +/- 12                                            | 86             | +/- 10                                            |

(i) The base price represents the average forward market price over the duration of the active market curve used to calculate the sensitivity analysis.

# Notes on the financial statements (continued)

## for the year ended 31 March

### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

#### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

The impacts of reasonably possible changes in commodity prices on profit after taxation based on the rationale described are as follows:

|                                      | 2011                   |                        | 2010                   |                        |
|--------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                      | Impact on profit<br>£m | Impact on equity<br>£m | Impact on profit<br>£m | Impact on equity<br>£m |
| <b>Incremental profit/(loss)</b>     |                        |                        |                        |                        |
| Commodity prices combined – increase | <b>257.3</b>           | –                      | 196.0                  | –                      |
| Commodity prices combined – decrease | <b>(257.3)</b>         | –                      | (196.0)                | –                      |

The sensitivity analysis provided is hypothetical and is based on the Group's commodity contracts under IAS 39. This analysis should be used with caution as the impacts disclosed are not necessarily indicative of the actual impacts that would be experienced. It should also be noted that these sensitivities are based on calculations which do not consider all interrelationships, consequences and effects of such a change in those prices.

#### (iv) Currency risk

The Group publishes its consolidated financial statements in sterling but also conducts business in foreign currencies. As a result, it is subject to foreign currency exchange risk arising from exchange rate movements which will be reflected in the Group's transaction costs or in the underlying foreign currency assets of its foreign operations.

The Group's policy is to use forward contracts, swaps and options to manage its exposures to foreign exchange risk. All such exposures are transactional in nature, and relate primarily to procurement contracts, commodity purchasing and related freight requirements, commodity hedging, long term plant servicing and maintenance agreements, and the purchase and sale of carbon emission certificates. The Group's policy is to seek to hedge 100% of its currency requirements arising under all committed contracts excepting commodity hedge transactions, the requirements for which are significantly less predictable. The policy for these latter transactions is to assess the Group's requirements on a rolling basis and to enter into cover contracts as appropriate.

The Group has foreign subsidiary operations with significant euro-denominated net assets. The Group's policy is to hedge its net investment in its foreign operations by ensuring the net assets whose functional currency cash flows are denominated in euros are matched by borrowings in euros. For the acquired net assets whose functional cash flows are in sterling, the Group will ensure sterling denominated borrowings are in place to minimise currency risk.

Significant exposures are reported to, and discussed by, the Risk and Trading Committee on an ongoing basis and additionally form part of the bi-annual Treasury report to the Audit Committee.

At the balance sheet date, the total nominal value of outstanding forward foreign exchange contracts that the Group has committed to is:

|                                    | 2011<br>£m     | 2010<br>£m |
|------------------------------------|----------------|------------|
| Forward foreign exchange contracts | <b>2,074.4</b> | 1,864.8    |

The Group's exposure to foreign currency risk was as follows:

|                                             | 2011            |                  |                |                |                  | 2010     |                  |         |         |                  |
|---------------------------------------------|-----------------|------------------|----------------|----------------|------------------|----------|------------------|---------|---------|------------------|
|                                             | ¥m              | DKK<br>(million) | €m             | \$m            | CHF<br>(million) | ¥m       | DKK<br>(million) | €m      | \$m     | CHF<br>(million) |
| Loans and borrowings                        | <b>28,000.0</b> | –                | <b>664.8</b>   | <b>150.0</b>   | <b>20.0</b>      | 28,000.0 | –                | 1,370.0 | 210.0   | –                |
| Purchase and commodity contract commitments | –               | <b>1,036.8</b>   | <b>415.0</b>   | <b>1,859.7</b> | –                | 253.4    | 843.1            | 627.5   | 2,818.4 | –                |
| Gross exposure                              | <b>28,000.0</b> | <b>1,036.8</b>   | <b>1,079.8</b> | <b>2,009.7</b> | <b>20.0</b>      | 28,253.4 | 843.1            | 1,997.5 | 3,028.4 | –                |
| Forward exchange/ swap contracts            | <b>28,000.0</b> | <b>1,036.8</b>   | <b>770.0</b>   | <b>1,682.3</b> | <b>20.0</b>      | 28,253.4 | 843.1            | 843.2   | 1,538.9 | –                |
| Net exposure (in currency)                  | –               | –                | <b>309.8</b>   | <b>327.4</b>   | –                | –        | –                | 1,154.3 | 1,489.5 | –                |
| Net exposure (in £m)                        | –               | –                | <b>273.7</b>   | <b>203.8</b>   | –                | –        | –                | 1,028.1 | 980.5   | –                |

This represents the net exposure to foreign currencies, reported in pounds sterling, and arising from all Group activities. All sensitivity analysis has been prepared on the basis of the relative proportions of instruments in foreign currencies being consistent as at the balance sheet date. This includes only monetary assets and liabilities denominated in a currency other than sterling and excludes the translation of the net assets of foreign operations but not the corresponding impact of the net investment hedge.

The sensitivity analysis is indicative only and it should be noted that the Group's exposure to such market rate changes is continually changing. The calculations are based on linear extrapolations of rate changes which may not reflect the actual result which would impact upon the Group.

A 10% increase in foreign currency exchange rates would have had the following impact on profit after taxation, based on the assumptions presented above:

|            | Equity                 |                        | Income Statement       |                        |
|------------|------------------------|------------------------|------------------------|------------------------|
|            | At 31 March 2011<br>£m | At 31 March 2010<br>£m | At 31 March 2011<br>£m | At 31 March 2010<br>£m |
| US Dollars | -                      | -                      | 16.5                   | 78.4                   |
| Euro       | 68.8                   | 58.4                   | (46.6)                 | 23.9                   |
| DKK        | -                      | -                      | -                      | -                      |
| ¥          | -                      | -                      | -                      | -                      |
| CHF        | -                      | -                      | -                      | -                      |
|            | 68.8                   | 58.4                   | (30.1)                 | 102.3                  |

The impact of a 10% decrease in rates would be an equal and opposite change in the annual charge.

#### (v) Interest rate risk

Interest rate risk derives from the Group's exposure to changes in the value of an asset or liability or future cash flows through changes in interest rates.

The Group's policy is to manage this risk by stipulating that a minimum of 50% of Group borrowings be subject to fixed rates of interest, either directly through the debt instruments themselves or through the use of derivative financial instruments. Such instruments include interest rate swaps and options, forward rate agreements and, in the case of debt raised in currencies other than sterling, cross currency swaps. These practices serve to reduce the volatility of the Group's financial performance.

Although interest rate derivatives are primarily used to hedge risk relating to current borrowings, under certain circumstances they may also be used to hedge future borrowings. Any such pre-hedging is unwound at the time of pricing the underlying debt, either through cash settlement on a net present value basis or by transacting offsetting trades. The floating rate borrowings mainly comprise commercial paper issued at interest rates of LIBOR plus a variable margin and cash advances from the European Investment Bank (EIB).

The impact of a change in interest rates is dependent on the specific details of the financial asset or liability in question. Changes in fixed rate financial assets and liabilities, which account for the majority of cash, loans and borrowings, are not measured at fair value through the income statement. In addition to this, changes to fixed-to-floating hedging instruments which are recorded under cash flow hedge accounting also do not impact the income statement. Changes in variable rate instruments and hedging instruments and hedged items recorded under fair value hedge accounting are recorded through the income statement. The exposure measured is therefore based on variable rate debt and instruments.

The net exposure to interest rates at the balance sheet date can be summarised thus:

|                                                  | 2011<br>Carrying<br>amount<br>£m | 2010<br>Carrying<br>amount<br>£m |
|--------------------------------------------------|----------------------------------|----------------------------------|
| Interest bearing/earning assets and liabilities: |                                  |                                  |
| – Fixed                                          | (4,258.4)                        | (4,833.6)                        |
| – Floating                                       | (1,016.2)                        | (1,090.7)                        |
|                                                  | (5,274.6)                        | (5,924.3)                        |
| Represented by:                                  |                                  |                                  |
| Cash and cash equivalents                        | 476.9                            | 261.7                            |
| Derivative financial liabilities                 | (116.5)                          | (110.5)                          |
| Loans and borrowings                             | (5,262.8)                        | (5,691.1)                        |
| Finance lease obligations                        | (372.2)                          | (384.4)                          |
|                                                  | (5,274.6)                        | (5,924.3)                        |

# Notes on the financial statements (continued)

## for the year ended 31 March

### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

#### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

Following from this, the table below represents the expected impact of a change in 100 basis points in short term interest rates at the reporting date in relation to equity and income statement. The analysis assumes that all other variables, in particular foreign currency rates, remain constant. An increase in exchange rates would be a change to either the income statement or equity. The assessment is based on a revision of the fair value assumptions included in the calculated exposures in the previous table.

All sensitivity analysis has been prepared on the basis of the proportion of fixed to floating instruments being consistent as at the balance sheet date and is stated after the effect of taxation.

The sensitivity analysis is indicative only and it should be noted that the Group's exposure to such market rate changes is continually changing. The calculations are based on linear extrapolations of rate changes which may not reflect the actual result which would impact upon the Group.

|                  | 2011<br>£m | 2010<br>£m |
|------------------|------------|------------|
| Income statement | 10.4       | 9.9        |
|                  | 10.4       | 9.9        |

The impact of a decrease in rates would be an identical reduction in the annual charge. There is no impact on equity as the analysis relates to the Group's net exposure at the balance sheet date. Contracts qualifying for hedge accounting are, by definition, part of the Group's covered position.

#### (vi) Primary statement disclosures

For financial reporting purposes, the Group has classified derivative financial instruments into two categories, operating derivatives and financing derivatives. Operating derivatives include all qualifying commodity contracts including those for electricity, gas, oil, coal and carbon. Financing derivatives include all fair value and cash flow interest rate hedges, non-hedge accounted (mark-to-market) interest rate derivatives, cash flow foreign exchange hedges and non-hedge accounted foreign exchange contracts. Non-hedge accounted contracts are treated as held for trading.

The net movement reflected in the Income Statement can be summarised thus:

|                                                 | 2011<br>£m     | 2010<br>£m   |
|-------------------------------------------------|----------------|--------------|
| <b>Operating derivatives</b>                    |                |              |
| Total result on operating derivatives (i)       | 887.9          | (3,449.6)    |
| Less: Amounts settled (ii)                      | 573.9          | 3,881.8      |
| Movement in unrealised derivatives              | 1,461.8        | 432.2        |
| <b>Financing derivatives (and hedged items)</b> |                |              |
| Total result on financing derivatives (i)       | (935.9)        | (640.6)      |
| Less: Amounts settled (ii)                      | 891.5          | 604.1        |
| Movement in unrealised derivatives              | (44.4)         | (36.5)       |
| <b>Net income statement impact</b>              | <b>1,417.4</b> | <b>395.7</b> |

(i) Total result on derivatives in the income statement represents the total amounts (charged) or credited to the income statement in respect of operating and financial derivatives.

(ii) Amounts settled in the year represent the result on derivatives transacted which have matured or been delivered and have been included within the total result on derivatives.

The net derivative financial assets and (liabilities) are represented as follows:

|                                    | 2011<br>£m       | 2010<br>£m |
|------------------------------------|------------------|------------|
| <b>Derivative financial assets</b> |                  |            |
| Non-current                        | 990.1            | 466.3      |
| Current                            | 2,525.5          | 1,468.3    |
|                                    | <b>3,515.6</b>   | 1,934.6    |
| <b>Derivative liabilities</b>      |                  |            |
| Non-current                        | (769.3)          | (899.0)    |
| Current                            | (2,307.5)        | (2,020.7)  |
| Total derivative liabilities       | <b>(3,076.8)</b> | (2,919.7)  |
| <b>Net asset/(liability)</b>       | <b>438.8</b>     | (985.1)    |

#### Fair Value Hierarchy

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from unadjusted quoted market prices for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data.

|                              | Level 1 | Level 2   | Level 3 | Total            |
|------------------------------|---------|-----------|---------|------------------|
| <b>Financial assets</b>      |         |           |         |                  |
| Energy derivatives           | 212.3   | 3,225.4   | –       | <b>3,437.7</b>   |
| Interest rate derivatives    | –       | 32.2      | –       | <b>32.2</b>      |
| Foreign exchange derivatives | –       | 45.7      | –       | <b>45.7</b>      |
|                              | 212.3   | 3,303.3   | –       | <b>3,515.6</b>   |
| <b>Financial liabilities</b> |         |           |         |                  |
| Energy derivatives           | (132.4) | (2,779.4) | –       | <b>(2,911.8)</b> |
| Interest rate derivatives    | –       | (149.0)   | –       | <b>(149.0)</b>   |
| Foreign exchange derivatives | –       | (16.0)    | –       | <b>(16.0)</b>    |
| Loans and borrowings         | –       | 28.6      | –       | <b>28.6</b>      |
|                              | (132.4) | (2,915.8) | –       | <b>(3,048.2)</b> |

There were no significant transfers out of level 1 into level 2 and out of level 2 into level 1 during the year ended 31 March 2011.

#### (vii) Cash flow hedges

The Group designates contracts which qualify as hedges for accounting purposes either as cash flow hedges or fair value hedges. Cash flow hedges are contracts entered into to hedge a forecast transaction or cash flow risk generally arising from a change in interest rates or foreign currency exchange rates and which meet the effectiveness criteria prescribed by IAS 39. The Group's accounting policy on cash flow hedges is explained in note 1.

The following table indicates the contractual maturities of the expected transactions and the qualifying cash flow hedges associated:

#### Cash flow hedges

|                                    | 2011<br>Carrying<br>amount<br>£m | 2011<br>Expected<br>cash flows<br>£m | 2011<br>0-12<br>months<br>£m | 2011<br>1-2<br>years<br>£m | 2011<br>2-5<br>years<br>£m | 2011<br>> 5<br>years<br>£m | 2010<br>Carrying<br>amount<br>£m | 2010<br>Expected<br>cash flows<br>£m | 2010<br>0-12<br>months<br>£m | 2010<br>1-2<br>years<br>£m | 2010<br>2-5<br>years<br>£m | 2010<br>> 5<br>years<br>£m |
|------------------------------------|----------------------------------|--------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|----------------------------------|--------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|
| <b>Interest rate swaps:</b>        |                                  |                                      |                              |                            |                            |                            |                                  |                                      |                              |                            |                            |                            |
| Liabilities                        | (4.0)                            | (4.0)                                | (2.2)                        | (1.3)                      | (0.5)                      | –                          | (7.1)                            | (7.1)                                | (3.2)                        | (2.1)                      | (1.8)                      | –                          |
| <b>Forward exchange contracts:</b> |                                  |                                      |                              |                            |                            |                            |                                  |                                      |                              |                            |                            |                            |
| Assets                             | 18.5                             | (237.8)                              | (186.2)                      | (11.8)                     | (19.5)                     | (20.3)                     | 22.0                             | (543.5)                              | (485.5)                      | (11.8)                     | (19.4)                     | (26.8)                     |
| Liabilities                        | (0.6)                            | (10.2)                               | (5.5)                        | (4.7)                      | –                          | –                          | (1.1)                            | (3.3)                                | (2.0)                        | (1.2)                      | (0.1)                      | –                          |
|                                    | <b>17.9</b>                      | <b>(248.0)</b>                       | <b>(191.7)</b>               | <b>(16.5)</b>              | <b>(19.5)</b>              | <b>(20.3)</b>              | <b>20.9</b>                      | <b>(546.8)</b>                       | <b>(487.5)</b>               | <b>(13.0)</b>              | <b>(19.5)</b>              | <b>(26.8)</b>              |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

###### Net investment hedge

The Group's net investment hedge consists of debt issued in the same currency (€) as the net investment in foreign subsidiaries with € denominated functional currencies being the Airtricity Supply business and the Ireland and European wind farm portfolios. The hedge compares the element of these net assets whose functional cash flows are denominated in € to the matching portion of the € borrowings held by the Group. This therefore provides protection against movements in foreign exchange rates.

Gains and losses in the hedge are recognised in equity and will be transferred to the income statement on disposal of the foreign operation (2011 – £4.3m gain, 2010 – £47.2m loss). Gains and losses on the ineffective portion of the hedge are recognised immediately in the income statement (2011 – £nil, 2010 – £nil).

###### (viii) Capital management

The Board's policy is to maintain a strong balance sheet and credit rating so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Group's credit ratings are also important in maintaining an efficient cost of capital and in limiting collateral requirements throughout the Group. As at 31 March 2011, the Group's long term credit rating was A3 stable outlook for Moody's and A- stable outlook for Standard & Poors. These remained unchanged in the year to 31 March 2011. Further detail of the capital management objectives, policies and procedures are included in the 'Financial management and balance sheet' section of the Financial Overview at pages 20 to 22 of this report.

The maintenance of a medium-term corporate model is a key control in monitoring the development of the Group's capital structure, and allows for detailed scenarios and sensitivity testing. Key ratios drawn from this analysis underpin regular updates to the Board and include the ratios used by the rating agencies in assessing the Group's credit ratings.

From time-to-time the Group purchases its own shares on the market; the timing of these purchases depends on market prices and economic conditions. The use of share buy-backs is the Group's benchmark for investment decisions and can be utilised at times when management believe the Group's shares are undervalued. No share buy-back was made during the year.

The Group's debt requirements are principally met through issuing bonds denominated in sterling and euros as well as medium term bank loans predominately with the European Investment Bank. The Group also maintains £1bn of committed bank facilities that act as a backstop to the Group's commercial paper programme and these remain undrawn for the majority of the time.

In October 2010 the Group issued its debut Hybrid bond, a financial instrument which brings together features of both debt and equity and is perpetual and subordinate to all senior creditors. The dual tranche issue comprised £750m and €500m (£461m) and has an all-in funding cost of around 5.6% per annum. There is no fixed redemption date but SSE may, at its sole discretion, redeem all, but not part of, these bonds at their principal amount on 1 October 2015 or 1 October 2020 or any subsequent annual coupon payment date. The issue of the Hybrid bond and the equity placing back in January 2009 reflects the Group's prudent approach to financing investment and has also enhanced the Group's future options by providing additional sources of funding.

In summary, the Group's intent is to balance returns to shareholders between current returns through dividends and long-term capital investment for growth. In doing so, the Group will maintain its capital discipline and will continue to operate within the correct economic environment prudently. There were no changes to the Group's capital management approach during the year.

## 32. RELATED PARTY TRANSACTIONS

The immediate parent and ultimate controlling party of the Group is Scottish and Southern Energy plc (incorporated in Scotland).

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below.

### (i) Trading transactions

The following transactions took place during the year between the Group and entities which are related to the Group but which are not members of the Group. Related parties are defined as those in which the Group has control, joint control or significant influence over.

|                                     | Sale of goods<br>and services<br>2011<br>£m | Purchase of<br>goods and<br>services<br>2011<br>£m | Other<br>transactions<br>2011<br>£m | Sale of goods<br>and services<br>2010<br>£m | Purchase of<br>goods and<br>services<br>2010<br>£m | Other<br>transactions<br>2010<br>£m |
|-------------------------------------|---------------------------------------------|----------------------------------------------------|-------------------------------------|---------------------------------------------|----------------------------------------------------|-------------------------------------|
| <b>Jointly controlled entities:</b> |                                             |                                                    |                                     |                                             |                                                    |                                     |
| Seabank Power Limited               | 7.9                                         | (121.3)                                            | 22.5                                | 3.0                                         | (107.1)                                            | 7.1                                 |
| PriDE (SERP) Limited                | 39.7                                        | –                                                  | –                                   | 40.5                                        | –                                                  | –                                   |
| Scotia Gas Networks Limited         | 61.8                                        | (131.2)                                            | –                                   | 54.9                                        | (145.0)                                            | –                                   |
| Marchwood Power Limited             | –                                           | (82.7)                                             | 14.6                                | 31.5                                        | (65.7)                                             | –                                   |
| Greater Gabbard Offshore Winds Ltd  | 6.3                                         | (0.2)                                              | –                                   | 3.9                                         | –                                                  | –                                   |
| <b>Associates:</b>                  |                                             |                                                    |                                     |                                             |                                                    |                                     |
| Barking Power Limited               | 0.9                                         | (45.3)                                             | 6.1                                 | 2.5                                         | (135.5)                                            | 15.2                                |
| Derwent Cogeneration Limited        | 38.8                                        | (53.2)                                             | –                                   | 30.6                                        | (96.6)                                             | –                                   |
| Logan Energy Ltd                    | –                                           | (0.1)                                              | –                                   | 0.8                                         | –                                                  | –                                   |
| Onzo Limited                        | –                                           | (4.3)                                              | –                                   | –                                           | (0.1)                                              | (4.9)                               |
| Geothermal International Limited    | –                                           | (0.8)                                              | –                                   | –                                           | –                                                  | –                                   |
| Aquamarine Power Limited            | –                                           | –                                                  | 0.1                                 | –                                           | –                                                  | –                                   |
| Green Highland Renewables Limited   | –                                           | –                                                  | –                                   | 0.3                                         | –                                                  | –                                   |
| Vital Holdings Limited              | 0.2                                         | (0.6)                                              | –                                   | 1.1                                         | (0.6)                                              | –                                   |

The transactions with Seabank Power Limited, Barking Power Limited and Derwent Cogeneration Limited relate to the contracts for the provision of energy or the tolling of energy under power purchase arrangements. Other transactions with Seabank Power Limited and Barking Power Limited relate to dividends received by the Group. PriDE (SERP) Limited operates a long-term contract with Defence Estates for management of MoD facilities in the South East of England. All operational activities are sub-contracted to the ventures partners including Southern Electric Contracting Limited. Scotia Gas Networks Limited has operated the gas distribution networks in Scotland and the South of England from 1 June 2005. The Group's gas supply activity incurs gas distribution charges while the Group also provides services to Scotia Gas Networks in the form of a management service agreement for corporate services, stock procurement services and the provision of the capital expenditure on the development of front office management information systems.

The balances outstanding with related parties at 31 March were as follows:

### Consolidated

|                                     | Amounts owed by<br>related parties |            | Amounts owed to<br>related parties |            |
|-------------------------------------|------------------------------------|------------|------------------------------------|------------|
|                                     | 2011<br>£m                         | 2010<br>£m | 2011<br>£m                         | 2010<br>£m |
| <b>Jointly controlled entities:</b> |                                    |            |                                    |            |
| Seabank Power Limited               | 0.3                                | 0.3        | 25.9                               | 26.0       |
| PriDE (SERP) Limited                | 0.3                                | 7.0        | 0.6                                | –          |
| Scotia Gas Networks Limited         | 15.7                               | 16.4       | 12.1                               | 1.3        |
| Marchwood Power Limited             | 0.1                                | –          | 7.3                                | 7.0        |
| <b>Associates:</b>                  |                                    |            |                                    |            |
| Barking Power Limited               | –                                  | 16.4       | 1.0                                | 9.3        |
| Derwent Cogeneration Limited        | 3.1                                | 2.0        | 1.8                                | 9.4        |
| Onzo Limited                        | 5.2                                | –          | 0.9                                | 1.2        |
| Logan Energy Ltd                    | –                                  | –          | –                                  | 0.1        |

The amounts outstanding are trading balances, 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 the amounts owed by related parties. Aggregate capital loans to jointly controlled entities and associates are shown in note 14.

# Notes on the financial statements (continued)

## for the year ended 31 March

### 32. RELATED PARTY TRANSACTIONS (continued)

#### Remuneration of key management personnel

The remuneration of the key management personnel of the Group, is set out below in aggregate.

|                                                      | 2011<br>£m | 2010<br>£m |
|------------------------------------------------------|------------|------------|
| <b>Short-term employment benefits</b>                |            |            |
| Executive Directors                                  | 3.7        | 3.6        |
| Other Management Board members (from 1 January 2011) | 0.3        | –          |
|                                                      | <b>4.0</b> | <b>3.6</b> |

Key management personnel are responsible for planning, directing and controlling the operations of the Group. From 1 January 2011 these were identified as the Management Board, which is made up of the Executive Directors and six senior managers.

In addition, the key management personnel receive share based remuneration, details of which are found at note 30. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report. The Executive Directors are employed by the Company.

Information regarding transactions with post-retirement benefit plans is included in note 29.

### 33. COMMITMENTS AND CONTINGENCIES

#### (i) Capital commitments

|                                 | 2011<br>£m | 2010<br>£m |
|---------------------------------|------------|------------|
| Capital expenditure:            |            |            |
| Contracted for but not provided | 1,146.9    | 994.5      |

Contracted for but not provided capital commitments includes the fixed contracted costs of the Group's major capital projects. In practice contractual variations may arise on the final settlement of these contractual costs.

#### (ii) Operating lease commitments

##### (a) Leases as lessee:

|                                                                                           | 2011<br>£m   | 2010<br>£m   |
|-------------------------------------------------------------------------------------------|--------------|--------------|
| Amount included in the income statement relating to the current year leasing arrangements |              |              |
| Minimum lease payments – power purchase agreement                                         | 182.0        | 229.6        |
| Other lease payments                                                                      | 37.7         | 41.6         |
|                                                                                           | <b>219.7</b> | <b>271.2</b> |

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

|                                    | 2011<br>£m   | 2010<br>£m   |
|------------------------------------|--------------|--------------|
| <b>Power purchase agreements</b>   |              |              |
| Within one year                    | 120.8        | 178.1        |
| In second to fifth years inclusive | 358.0        | 374.9        |
| After five years                   | 156.5        | 217.7        |
|                                    | <b>635.3</b> | <b>770.7</b> |
| <b>Other leases</b>                |              |              |
| Within one year                    | 51.6         | 41.0         |
| In second to fifth years inclusive | 93.3         | 63.0         |
| After five years                   | 139.4        | 94.3         |
|                                    | <b>284.3</b> | <b>198.3</b> |
| <b>Total</b>                       |              |              |
| Within one year                    | 172.4        | 219.1        |
| In second to fifth years inclusive | 451.3        | 437.9        |
| After five years                   | 295.9        | 312.0        |
|                                    | <b>919.6</b> | <b>969.0</b> |

The average power purchase agreement lease term is 5 years.

The obligations under power purchase agreements with various power generating companies are not deemed to qualify as finance leases under IAS 17.

The Company has no operating lease commitments as a lessee.

**(b) Leases as lessor:**

The Group and Company have no operating lease commitments as a lessor.

**(iii) Guarantees and indemnities**

Scottish and Southern Energy plc has provided guarantees on behalf of subsidiary, joint venture and associated undertakings as follows:

|                          | 2011<br>£m | 2010<br>£m |
|--------------------------|------------|------------|
| Bank borrowing           | 400.0      | –          |
| Performance of contracts | 1,851.9    | 2,042.1    |
| Purchase of gas          | 50.5       | 60.5       |

The Company has entered into guarantees in respect of 50% of the major contracts for the Greater Gabbard Offshore Winds joint venture project which is reflected in the above guarantees.

In addition, unlimited guarantees have been provided on behalf of subsidiary undertakings in relation to six contracts in respect of performance of work and any liabilities arising. Southern Electric Power Distribution plc and the Company have provided guarantees to the Southern Group of the ESPS in respect of the funding required by the scheme. Scottish Hydro Electric Power Distribution plc and the Company have provided guarantees to the Scottish Hydro Electric Pension Scheme in respect of funding required by the scheme. SSE E&P UK Limited, a wholly owned subsidiary of the Company, has provided a guarantee to Hess Limited in respect of decommissioning liabilities.

The Group has drawn down £400m from its European Investment Bank facility in the year. SSE Renewables Holdings Limited and SSE Generation Limited, both wholly owned subsidiaries of the Company, have entered into guarantee and indemnity agreements with the European Investment Bank for the amounts drawn down.

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its Group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

**34. POST BALANCE SHEET EVENTS**

On 14 April 2011 the Group disposed of three wind farms to Infinis for a final cash consideration of £178.4m. The wind farms were included in assets held for sale in note 16. No profit or loss was recognised on this transaction.

# Shareholder information

Overview  
Strategy  
Group performance  
Segmental performance  
Corporate governance  
Financial statements  
**Shareholder information**

## Shareholder enquiries

Share Registrar:  
Capita Registrars, The Registry,  
34 Beckenham Road, Beckenham,  
Kent BR3 4TU

Telephone: 0845 143 4005  
Email: [sse@capitaregistrars.com](mailto:sse@capitaregistrars.com)

## Financial calendar

Annual General Meeting  
21 July 2011

Ex dividend date  
27 July 2011

Record date  
29 July 2011

Final date for receipt of Scrip Elections  
(in respect of the 2010/11 final dividend)  
25 August 2011

Final dividend payable  
23 September 2011

Half year results announcement\*  
9 November 2011

## Website – [www.sse.com](http://www.sse.com)

The Company's website contains a wide range of information including a dedicated Investors section where you can find further information about shareholder services including:

- share price information;
- dividend history and trading graphs;
- the Scrip Dividend Scheme;
- telephone and internet share dealing; and
- downloadable shareholder forms.

## Mobile users

If you use a mobile phone with a barcode scanning application, you can scan the barcode below to access a copy of our website from your mobile device. If you don't have a mobile phone with a barcode scanning application you can still visit [www.sse.com/mobile](http://www.sse.com/mobile) for a mobile-friendly version of the Company's website.



\* Provisional date.

## eCommunications programme

To sign up to our eCommunications Programme visit [www.sse.com/investors/ecommsprogramme](http://www.sse.com/investors/ecommsprogramme). As a thank you we will donate £2 on your behalf to the World Wildlife Fund's (WWF) International Forest Programme. In 2010, SSE made a donation of over £22,000 to this fund on behalf of shareholders.

## Keep us informed

Keep us informed of changes to your email address by visiting [www.sse.com/investors/ecommsprogramme](http://www.sse.com/investors/ecommsprogramme) and follow the instructions under 'update your email address'.

## Copy reports

Copies of the Annual Report and Accounts 2011 can be obtained, free of charge, from the Company Secretary, Scottish and Southern Energy plc, Inveralmond House, 200 Dunkeld Road, Perth PH1 3AQ or by accessing the Company's website at [www.sse.com](http://www.sse.com).



For further information  
about SSE, please contact:

**Scottish and Southern Energy plc**

Corporate Affairs  
Inveralmond House  
200 Dunkeld Road  
Perth PH1 3AQ  
UK

T: +44 (0)1738 456000

E: [info@sse.com](mailto:info@sse.com)

[www.sse.com](http://www.sse.com)

Follow the latest news  
from SSE on Twitter at:

[www.twitter.com/sse](https://www.twitter.com/sse)

Registered in Scotland No. 117119

STOCK CODE 008235

In producing this report we have chosen production methods which aim to minimise the impact on our environment. The papers used – Revive 50:50 Silk and Kaskad – are manufactured from sustainable sources. Revive 50:50 Silk also contains 50% recovered waste. Both the paper mills and printer involved in this production are environmentally accredited with ISO 14001. The printer is also registered as a Carbon Neutral company.

