Scottish Hydro Electric Power Distribution plc

Regulatory Accounts for the year ended 31 March 2007

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Scottish Hydro Electric Power Distribution plc

Corporate Report for the year ended 31 March 2007

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Scottish Hydro Electric Power Distribution plc

Corporate Report: Review of the Year to 31 March 2007

Scottish Hydro Electric Power Distribution plc (the Company) is a wholly owned subsidiary of Scottish and Southern Energy plc (the Group). The Company's first responsibility is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions. In line with this it is encouraging that our performance across a range of measures continues to be good. This performance has been achieved while maintaining close control over the operating cost base and confirms that the electricity networks managed by the Group are among the most efficient in the world.

The Company is the subject of incentive-based regulation by the Office of Gas and Electricity Markets (Ofgem), which sets for periods of five years the prices that can be charged for the use of the electricity network, the capital expenditure and the allowed operating expenditure. In broad terms, Ofgem seeks to strike the right balance between attracting investment in electricity, encouraging companies to operate the networks as efficiently as possible and ensuring that prices for customers are no higher than they need to be. As at 31 March 2007, the Company estimates that based on Ofgem's methodology for valuing the assets of the Company's distribution business, the Regulated Asset Value ('RAV') was approximately £795m.

Operating profit for the Company increased by 2.6% to £105.8m. In the Scottish Hydro Electric area, 8.5TWh of electricity were distributed during the year, compared with 8.9TWh distributed in the previous year. This reduction in the number of units distributed was, however, offset by changes in their price.

The average number of minutes that customers were without supply was 77, compared with 65 in the previous year (which was the best performance in the area since records began) and 82 in 2004/05. This followed an increase of almost 25% in the number of weather-related faults experienced on the 33kV network during January and February of 2007. The number of supply interruptions per 100 customers was 79, one more than in the previous year. Performance in respect of both minutes lost and interruptions was, however, ahead of Ofgem's QSIS targets. This, together with income earned in 2006/07 under other incentive arrangements, is expected to lead to the Company receiving additional revenue of just under £4m during the next two financial years.

Electricity Network Investment

The key responsibility of the Company's businesses is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions. The Distribution Price Control Review for 2005-10 resulted in substantially increased allowances for capital expenditure to maintain and improve the networks' performance. This will enable the Company to increase its revenue from its networks, and delivery of this enhanced investment programme was one of the Company's priorities for 2006/07. It is now well under way, with capital expenditure of £54.1m during the year, which was 26.1% higher than in 2005/06. In the course of the year, the Company added just over 300km to the length of its networks, taking the total, to nearly 46,000km.

Investment at similar levels to 2006/07 will continue during the remainder of the current price control period.

Electricity Distribution Priorities in 2007/08

During 2007/08, the Company's first objective in will be to maintain safe and reliable supplies of power and to restore supplies as quickly as possible in the event of interruptions, so performance in terms of customer minutes lost and customer interruptions will continue to be critical. This will be supported by delivery of continuous improvement initiatives, following a fundamental review of internal processes and customer-facing operations that is now under way. Other key priorities will be the efficient delivery of the next phase of the major programme of investment in the networks, targeted at upgrading them so as to benefit the greatest number of customers.

Scottish Hydro Electric Power Distribution plc

Corporate Report: Review of the Year to 31 March 2007

1 Operational Review

1.1 Factors affecting the Business

The Company is responsible for managing an electricity distribution network, serving more than 700,000 customers. Distribution of electricity within specified areas is a monopoly activity and the income earned by charging electricity customers for the use of the wires is closely regulated by Ofgem, as is the level of investment which is made in electricity networks. The Company has completed the second year of the price controls set for the period up to 31 March 2010.

Against this background, the Company's objective is to manage the demand for electricity and ensure the network has the minimum number of faults and the maximum robustness in the face of severe weather and other supply interruption risks. It is also important to automate networks so that when supply is interrupted, it can be restored as soon as possible. The programme of investment is designed with these goals in mind.

1.2 Use of Resources and Status of Significant Projects

In line with the policies in place to achieve the objectives highlighted at 1.1, a total of £54.1m was invested in the electricity network. Investment of this kind upgrades the electricity network and reinforces the value of the RAV which, in turn, supports the ongoing value of the business.

In the Scottish Hydro Electric Power Distribution area, the programme to upgrade and refurbish the network continued during 2006/07, with 1,784km of high voltage overhead lines and 350km of low voltage lines refurbished.

The programme of network automation continued, with another 81 new radio-controlled automated switching units in rural areas, allowing for faster restoration of supply to customers.

During 2006/07 work took place to refurbish major substations at Ballindalloch, Burghmuir, St Cyrus and at a number of locations in Shetland. Replacement of transformers, switchgear and ancillary equipment has brought these sites to an 'as new' condition. In addition, a major 33kV Distribution overhead line between Torr Achilty and Garve was refurbished and partially rebuilt. Work on replacing a specific type of circuit breaker that is known to be prone to early failure has continued to attract significant expenditure.

2007/08 will be marked by the replacement of no fewer than four subsea cables, reinforcing the electricity supply to islands off the north and west coasts.

The Company continues to implement a number of initiatives to improve further the resilience of the electricity network for the future. For example, falling trees or clashing branches are a major source of supply interruptions during windy weather conditions. To improve performance in this area, for the past number of years the Group has employed directly most of the people involved in tree cutting. This is also in line with the Group's general approach that operations and services are best managed and delivered by people who are directly employed by the company.

Scottish Hydro Electric Power Distribution plc

Corporate Report: Review of the Year to 31 March 2007

1 Operational Review (continued)

1.3 Employees

Enabling employees to derive the maximum possible benefit from their employment with the Group is one of the principles which has been adopted. The Board believes that this can be achieved through active encouragement of share ownership, participation in the Group's affairs, and the maintenance of effective policies on issues such as equal opportunities.

Participation in the Group's affairs is encouraged through team meetings, briefing documents and an internal magazine. During the year, employees were invited to attend business development and financial results briefings. Policies on such matters as Equal Opportunities and Health and Safety are regularly communicated to staff.

It is Group policy, where possible, to provide employment opportunities for disabled people. Staff who become disabled are supported in continuing employment through identification of suitable jobs and the provision of any necessary re-training.

1.4 Safety

The Group believes that all work can be done in such a way that no-one, whether an employee, contractor, customer or member of the community, suffers from its operations. It believes that all injuries are preventable and it aims to provide staff with training, work methods and equipment to achieve that goal.

'Being safe' is a core value in the business. In line with this, the Group's Health, Safety and Environment Manual, which has the status of a work instruction, emphasises that safety will not be compromised for business interest or operational pressures and all injuries, plant damage and near misses will be reported and investigated. The Director with lead responsibility for Health and Safety is Colin Hood.

The net result of this commitment to safety is that Scottish and Southern Energy plc continues to lead Britain's electricity industry in safety.

1.5 Principal risks and uncertainties

As noted, the Company is responsible for managing a regulated electricity distribution network, based in the North of Scotland. One of the major risks arises from the quinquennial price review when the future income that the Company may collect from the users of the electricity network is set. The current price control period runs from 1 April 2005 to 31 March 2010 and discussions on the next price control will formally start in 2008. The year to 31 March 2007 is the second year of the current price review period. In arriving at the allowed income Ofgem assess the revenue and capital expenditure plans of the business and determine an efficient level of that expenditure. In addition they assess the quality of service requirements for the network and determine a cost of capital sufficient to encourage the required investment in the network. Given the importance of the outcome of the price control review process, the establishment of allowable income for the following five years, the Company invests considerable management time to ensure that the correct price control is set.

The key responsibility of the Company is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions. In the long term this is done by ensuring the correct level of investment in the network. In the short term the electricity network can be subject to damage, and potentially major disruption, by the weather. Storms caused by winter weather fronts, winter snow fall and lightning storms at any time of year can damage the electricity distribution network and result in customers' supply of electricity being interrupted. To mitigate the effects of these events weather forecasts are closely monitored and staff deployed in advance of foreseeable major weather events. Arrangements are in place to use resources from contractors and other electricity distribution network operators in the event of major interruptions and contracts are in place with suppliers of materials and services which can be brought into action at short notice in the event of severe weather.

Scottish Hydro Electric Power Distribution plc

Corporate Report: Review of the Year to 31 March 2007

2. Financial Review

2.1 Balance Sheet

The Group and Company both continue to maintain one of the strongest balance sheets in the global utility sector. This gives the Company significant competitive advantage in terms of cost of funding and supporting new developments.

The majority of employees of the Company are members of the Scottish Hydro-Electric Pension Scheme, which, at 31 March 2007, had a surplus included in the Group accounts, net of deferred tax, of £89.7M (2006 - £63.1M).

2.2 Financial Risk Management

The Company's financial risk is managed as part of the wider group risk management policy.

The Company's operations are financed by a combination of retained profits, bank borrowings, long term debt issuance and inter company loan stocks.

The main financial risks affecting the Group include exposures to fluctuations or changes in interest rates, foreign exchange rates, liquidity, commodity prices and volumes and counterparty creditworthiness. The Group's Risk Committee, which reports to the Board, reviews and agrees policies for addressing each of these risks. At 31 March 2007, 82.6% of the Group's borrowings were at fixed rates, after taking account of interest rate swaps. The Company's main risk area is in relation to interest rates and, as noted, this is managed as part of the Group's risk policies.

2.3 Taxation

The Company's effective current tax rate was 31.3% compared with 35.2% in the previous year, after prior year adjustments. The headline effective tax rate is 26.0% compared with 34.4% in the previous year.

2.4 Dividend

The Company's dividend policy was to distribute up to 50% of surplus cash flow as a dividend for both years.

Scottish Hydro Electric Power Distribution plc

Corporate Report: Review of the Year to 31 March 2007

2. Financial Review (continued)

2.5 Borrowings and Facilities

The Company has loans of £475.0m (2006 – £375.0m) of which £300m (2006 - £300m) is due to other group companies and £175.0m (2006 - £75.0m) is in the form of loans from the European investment Bank and a new index-linked bond. Of the total, interest is paid at fixed rates on £450.0m (2006 - £350.0m).

As at 31 March 2007, the weighted average interest rate payable was 5.70% (2006 – 5.86%) and the weighted average remaining term was 20.88 years (2006 – 14.22 years).

2.6 International Financial Reporting Standards

The application of International Financial Reporting Standards (IFRS) is required for listed companies for accounting periods commencing on or after 1 January 2005. As a result, the Group's financial statements for the year to 31 March 2007 have been prepared in accordance with EU adopted IFRS.

The accounts of Scottish Hydro Electric Power Distribution plc have been prepared in accordance with applicable UK Generally Accepted Accounting Principles (UK GAAP). A number of the Company's accounting policies were changed in the accounts to 31 March 2007 following the Company re-registering as a Public company and the adoption of a number of new accounting standards issued by the Accounting Standards Board (ASB) as part of the project to converge UK GAAP with adopted IFRS. A fuller explanation of the changes in the Company's accounting policies is included in Notes 1 and 2 to the Accounts.

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement

Scottish and Southern Energy plc Group ("The Group")

The Board continues to commit to the highest standards of corporate governance, and has due regard to the continuing developments in this field. The Group seeks to run its entire business and maximise profits in a way which is responsible, safe, customer focused and commercially aware. These are the four core values which underlie everything the Group does. Moreover, the Group aims to conduct its business in an ethical manner that maintains an appropriate balance between social, economic and environmental issues.

In keeping with this, the Group has continued its commitment to high standards of corporate governance.

Throughout the year, the company has complied with all the provisions set out in Section 1 of the Combined Code and the Board therefore considers that the company has satisfied its obligations under the Combined Code.

The Board comprises a non-Executive Chairman, four Executive Directors and six independent non-Executive Directors, which complies with the Combined Code provisions in this regard.

The Board acknowledges its responsibility for ensuring that an adequate system of internal control exists which accords with the requirements of the Turnbull Committee guidance.

Scottish Hydro Electric Power Distribution plc ("The Company")

Board of Directors

The Board consists of three Directors, two of whom are Directors of the Group. None of the Directors are Directors of Group Companies involved in Supply or Generation activities. The Group has an Audit Committee, a Remuneration Committee, an Executive Committee, a Risk Committee, a Health, Safety and Environmental Advisory Committee and a Nomination Committee and details of the appointees are included in the published Corporate Governance Statement of the Group. The Company, as a subsidiary entity, has no such Committees.

Internal Control

The Directors acknowledge that they have responsibility for the Company's systems of internal control and risk management and for monitoring their effectiveness. The purpose of these systems are to manage, rather than eliminate, the risk of failure to achieve business objectives, and provide reasonable assurance as to the quality of management information and to maintain proper control over the income, expenditure, assets and liabilities of the Company.

No system of control can, however, provide absolute assurance against material misstatement or loss. Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the Company's business, to the materiality of the risks inherent in the business, and to the relative costs and benefits of implementing specific controls. This process is regularly reviewed by the Board and has been in place for the whole year.

Control is maintained through an organisation structure with clearly defined responsibilities, authority levels and lines of reporting; the appointment of suitably qualified staff in specialised business areas; and continuing investment in high quality information systems. These methods of control are subject to periodic review as to their implementation and continued suitability.

There are established procedures in place for regular budgeting and reporting of financial information. The Company's performance is reviewed by the Board and the Executive Committee. Reports include variance analysis and projected forecasts of the year compared to approved budgets and non-financial performance indicators.

There are policies in place covering a wide range of issues and risks such as financial authorisations, IT procedures, health, safety and environmental risks, crisis management, and a policy on ethical principles. The business risks associated with the Company's operations are regularly assessed by the Directors

The effectiveness of the systems of internal control is monitored by the internal audit department. Their reports, which include where appropriate relevant action plans, are distributed to senior managers and Directors.

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement

Scottish Hydro Electric Power Distribution plc ("The Company") (continued)

Environment

The Group manages a wide range of environmental issues. Operating the power systems network is recognised as a priority area and formal environmental management systems have been developed across the Group. The systems have five main elements, based on the established management cycle of (1) setting policy, (2) planning, (3) implementing and operating, (4) checking and correcting and (5) reviewing.

The system exists to enable managers to deliver the Group's environmental policies through procedures and work instructions. It reflects an integrated, Group-wide health and safety and environmental management system.

Going Concern

The Directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future. The accounts are therefore prepared on a going concern basis.

REGISTERED NO.

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Scottish Hydro Electric Power Distribution plc

Regulatory Accounts for the year ended 31 March 2007

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Scottish Hydro Electric Power Distribution plc

Report of the Directors

The Directors present their report together with the audited Accounts for the year ended 31 March 2007.

1. Principal Activities

The Company's principal activity during the year was the regulated distribution of electricity.

2. Business Review

On 25 August 2006, the Company converted from a limited company to a public limited company becoming Scottish Hydro-Electric Power Distribution plc as a result of this conversion. Subsequently, on 2 February 2007, the Company changed its name from Scottish Hydro-Electric Power Distribution plc to Scottish Hydro Electric Power Distribution plc.

The Company is responsible for managing an electricity distribution network, serving more than 700,000 customers in the North of Scotland. Distribution of electricity and the level of capital investment within the network area is a monopoly activity and is closely regulated by the Office of Gas and Electricity Markets (Ofgem) within a framework known as the Price Control. This is set for a period of 5 years and the current price control runs until April 2010.

Review of development and performance of the Company

The year to 31 March 2007 was the second year of the current distribution price control period and the operating profit increased by 2.6% to £105.8M despite a reduction in the number of units distributed in the year.

During the year, the Company distributed 8.5TWh of electricity, compared with 8.9TWh in the previous year, despite a growth in the number of customers to whom electricity is distributed. This reduction in the number of units distributed caused primarily by the higher than normal temperatures in the year but was, however, partially offset by changes in their price.

At the same time the level of investment in the network has also increased in the year in order that the network can be maintained and improved. In 2006/07 the capital expenditure was £54.1M an increase of 26% on 2005/06. This level of investment is expected to remain at approximately this level in the remaining years of the current price control period. In 2006/07 a further 300km in length was added to the network and 2,547km were refurbished.

The operational performance of the Company was good with the number of supply interruptions per 100 customers increasing slightly to 79 from 78 the previous year. There was, however, an increase in the number of customer minutes lost from 65 in 2005/06 to 77 in 2006/07. The 2005/06 performance was the best performance in the area since records began and the increase in 2006/07 followed a 25% increase in the number of weather related faults experienced on the 33kV network in January and February of 2007. Despite these increases the performance was ahead of targets set by Ofgem and is expected to contribute, along with other incentives established in the price control agreement, towards additional income of just under £4M in the next 2 financial years.

Scottish Hydro Electric Power Distribution plc

Report of the Directors (continued)

2. Business Review (continued)

Principal Risks and Uncertainties

As noted, the Company is responsible for managing a regulated electricity distribution network, based in the North of Scotland. One of the major risks arises from the quinquennial price review when the future income that the Company may collect from the users of the electricity network is set. The current price control period runs from 1 April 2005 to 31 March 2010 and discussions on the next price control will formally start in 2008. The year to 31 March 2007 is the second year of the current price review period. In arriving at the allowed income Ofgem assess the revenue and capital expenditure plans of the business and determine an efficient level of that expenditure. In addition they assess the quality of service requirements for the network and determine a cost of capital sufficient to encourage the required investment in the network. Given the importance of the outcome of the price control review process, the establishment of allowable income for the following five years, the Company invests considerable management time to ensure that the correct price control is set.

The key responsibility of the Company is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions. In the long term this is done by ensuring the correct level of investment in the network. In the short term the electricity network can be subject to damage, and potentially major disruption, by the weather. Storms caused by winter weather fronts, winter snow fall and lightning storms at any time of year can damage the electricity distribution network and result in customers' supply of electricity being interrupted. To mitigate the effects of these events weather forecasts are closely monitored and staff deployed in advance of foreseeable major weather events. Arrangements are in place to use resources from contractors and other electricity distribution network operators in the event of major interruptions and contracts are in place with suppliers of materials and services which can be brought into action at short notice in the event of severe weather.

The Directors acknowledge that they have responsibility for the Company's systems of internal control and risk management and for monitoring their effectiveness. The purposes of these systems are to manage, rather than eliminate, the risk of failure to achieve business objectives, to provide reasonable assurance as to the quality of management information and to maintain proper control over the income, expenditure, assets and liabilities of the Company.

No system of control can, however, provide absolute assurance against material misstatement or loss. Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the Company's business and to the relative costs and benefits of implementing specific controls.

Key Performance Indicators

The following financial and operational key performance indicators are used by the Company in measuring performance:

Financial

a) Operating Profit (£M)

Year to March 2006	£103.1M
Year to March 2007	£105.8M
Increase (%)	2.6%

b) Capital Expenditure (£M)

Year to March 2006	£42.9M
Year to March 2007	£54.1M
Increase (%)	26.1%

Operational

c) Electricity Distributed (TWh)

Year to March 2006	8.9 TWh
Year to March 2007	8.5TWh
Decrease (%)	-4.5%

Scottish Hydro Electric Power Distribution plc

Report of the Directors (continued)

2. Business Review (continued)

Key Performance Indicators (continued)

d) Customer Minutes Lost

Year to March 2006	65
Year to March 2007	77
Increase (%)	18.5%

e) Customer Interruptions – number per 100 customers

Year to March 2006	78
Year to March 2007	79
Increase (%)	1.3%

3. Results and Dividends

The profit for the financial year amounted to £66.2m (2006 - £55.4m). The directors do not recommend the payment of a dividend (2006 - £21.0m).

4. Directors

The Directors who served during the year were as follows: -

Gregor Alexander
Colin Hood
Steven Kennedy

5. Political and Charitable Donations

During the year, no charitable or political donations were made.

6. Employment Policies

Staff are actively encouraged to be involved in Company affairs in a wide variety of ways. These include monthly team meetings, briefing documents and internal videos. Policies on such matters as Equal Opportunities and Health and Safety are regularly communicated to staff and involvement is supported through local committees. New staff joining the Company receive induction training.

It is Company policy, where possible, to provide employment opportunities for disabled people. Staff who become disabled are supported in continuing employment through identification of suitable jobs and the provision of necessary retraining.

7. Supplier Payment Policy

The Company complies with the CBI Prompt Payment Code. The main features of the Code are that payment terms are agreed at the outset of a transaction and are adhered to; that there is a clear and consistent policy that bills are paid in accordance with the contract; and that there are no alterations to payment terms without prior agreement. Copies of the Code are available on application to the Company Secretary. The number of suppliers' days represented by trade creditors was 36 days at 31 March 2007.

Scottish Hydro Electric Power Distribution plc

Report of the Directors (continued)

8. Auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware; and each director has taken all the steps that ought to have been taken as a director to be aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

ON BEHALF OF THE BOARD

Vincent Donnelly
Company Secretary
25 July 2007

Scottish Hydro Electric Power Distribution plc

Statement of directors' responsibilities in respect of the Directors' Report and the Regulatory accounts and Compliance with Standard Licence Condition 42

The licensee is required by standard condition 42 of the Electricity Distribution Licence to deliver to the Authority regulatory accounts prepared for each financial year ending on 31 March.

The directors are responsible for preparing the Directors' Report and the Accounts in accordance with applicable law and regulations.

Company law requires the directors to prepare Accounts for each financial year. Under that law they have elected to prepare the Accounts in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The Accounts are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing these Accounts, 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 applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the Accounts; and
- prepare the Accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that its Accounts comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Scottish Hydro Electric Power Distribution plc

Profit and Loss Account
for the year ended 31 March 2007

	Note	2007 £M	2006 £M
Turnover		**216.7**	208.9
Cost of sales		**(26.0)**	(23.4)
Gross profit		**190.7**	185.5
Distribution costs		**(78.8)**	(74.5)
Administrative costs		**(6.1)**	(7.9)
Operating profit	3	**105.8**	103.1
Gains on disposal of fixed assets		**0.4**	0.1
Net interest payable	6	**(16.7)**	(18.8)
Profit on ordinary activities before taxation		**89.5**	84.4
Tax on profit on ordinary activities	7	**(23.3)**	(29.0)
Profit for the financial year	17	**66.2**	55.4

The above results are derived from continuing activities.

The accompanying notes are an integral part of these Accounts.

Scottish Hydro Electric Power Distribution plc

Balance Sheet
as at 31 March 2007

	Note	2007 £M	2006 restated £M
Fixed Assets			
Tangible assets	9	**728.8**	706.8
Current assets			
Stocks	10	**1.3**	1.2
Debtors:			
Amounts falling due within one year	11	**236.4**	225.2
Amounts falling due after more than one year	11	**28.0**	28.0
		265.7	254.4
Creditors			
Amounts falling due within one year	12	**(72.2)**	(192.2)
Net current assets		**193.5**	62.2
Total assets less current liabilities		**922.3**	769.0
Creditors:			
Amounts falling due after more than one year	13	**(546.2)**	(455.0)
Derivative financial liabilities	20	**(2.2)**	(3.7)
Provisions for liabilities and charges			
Deferred taxation	15	**(140.2)**	(145.2)
Net assets		**233.7**	165.1
Capital and reserves			
Called up share capital	16	**62.0**	62.0
Profit and loss account	17	**173.2**	105.7
Hedge reserve	17	**(1.5)**	(2.6)
Shareholders' funds		**233.7**	165.1

These Accounts were approved by the Directors on 25 July 2007 and signed on their behalf by

Gregor Alexander, Director

Scottish Hydro Electric Power Distribution plc

Statement of Total Recognised Gains and Losses for the year ended 31 March 2007

	2007 £M	2006 £M
Profit for the financial year	**66.2**	55.4
Losses on effective portion of cash flow hedges (net of tax)	**(1.1)**	-
Total recognised gains and losses relating to the financial year	**65.1**	55.4

Reconciliation of Movements in Shareholders' Funds as at 31 March 2007

	2007 £M	2006 £M
Profit for the financial year	**66.2**	55.4
Dividends	**-**	(45.0)
Credit in respect of employee share schemes	**1.7**	0.3
Purchase of shares to satisfy employee share awards	**(0.4)**	(0.7)
Losses on effective portion of cash flow hedges (net of tax)	**1.1**	-
Net addition to shareholders' funds	**68.6**	10.0
Opening shareholders' funds	**165.1**	155.1
Closing shareholders' funds	**233.7**	165.1

The opening shareholders' funds at 1 April 2005 were originally £157.7m, before prior year adjustments of £2.6m (note 2).

Scottish Hydro Electric Power Distribution plc

Notes on the Accounts
for the year ended 31 March 2007

1. Significant accounting policies

Basis of preparation
The Accounts have been prepared in accordance with all applicable United Kingdom accounting standards. The principal accounting policies are summarised below and have been applied consistently.

Under Financial Reporting Standard 1 (FRS 1), the Company is exempt from the requirement to prepare a cash flow statement on the grounds that the ultimate parent undertaking includes the Company in its own published consolidated Accounts.

As the Company is a wholly owned subsidiary of Scottish and Southern Energy plc (SSE plc), it has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the Scottish and Southern Energy Group (the Group).

Turnover
Turnover comprises the value of electricity distribution services and facilities provided during the year. Turnover includes an estimate of the value of the distribution of electricity on behalf of customers between the date of the last meter reading and the year-end.

Research and development
Expenditure on research and development is charged to the profit and loss account as incurred.

Taxation
The charge for taxation is based on the profit for the year and takes into account deferred taxation.

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted, or substantively enacted, by the balance sheet date.

Deferred taxation arises in respect of all items where there are timing differences between their treatment for accounting and taxation purposes. This is recognised where an obligation to pay more tax in the future has originated but not reversed at the balance sheet date. A deferred tax asset is recognised only when it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Scottish Hydro Electric Power Distribution plc

Notes on the Accounts
for the year ended 31 March 2007

1. Significant accounting policies (continued)

Tangible fixed assets
(i) Depreciation
Heritable and freehold land is not depreciated.

Depreciation is provided on tangible fixed assets to write off cost, less residual values, on a straight-line basis over their estimated operational lives. The estimated operational lives are as follows:

		Years
Distribution assets		10 to 40
Non-operational assets:		
Buildings	- freehold	Up to 60
	- leasehold	Lower of lease period and 60
Fixtures, equipment, plant and machinery, vehicles and mobile plant		4 to 10

(ii) Subsequent expenditure
Expenditure incurred to replace a component of a tangible fixed asset that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits of the tangible fixed asset to which it relates.

Stocks and work in progress
Stocks are valued at the lower of cost and net realisable value. The valuation of work in progress is based on the cost of labour, plus appropriate overheads and the cost of materials. Progress invoices are deducted in arriving at the amounts stated

Scottish Hydro Electric Power Distribution plc

Notes on the Accounts
for the year ended 31 March 2007

1. Significant accounting policies (continued)

Employee benefit obligations
Pensions
The Scottish and Southern Energy Group operates a number of pension schemes on behalf of employees. The amounts charged represent the contributions payable to the schemes in the year and are charged directly to the profit and loss account as incurred.

Equity and equity-related compensation benefits
Scottish and Southern Energy plc, the ultimate parent of the Company, operates a number of All Employee Share Schemes as described in the Remuneration Report of the Group. These schemes enable Group employees to acquire shares of the ultimate parent company. The employees of the Company are entitled, where applicable, to participate in these schemes. The Company has been charged with the cash cost of acquiring shares on behalf of its employees with a corresponding increase in the equity of Scottish and Southern Energy plc. Where the fair value of the options granted has been measured, the Company has recognised the expense as if the share based payments related to the Company's own shares.

Applying the transitional provisions of FRS 20, its requirements have been applied to all grants of equity instruments after 7 November 2002 that had not vested as at 1 January 2005.

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 at each balance sheet date with any adjustment in respect of the current and prior years being recognised in the profit and loss accounts.

The costs associated with the other main employee schemes, the share incentive plan and the deferred bonus scheme, are recognised over the period to which they relate.

Dividends on shares presented within shareholders' funds

Dividends unpaid at the balance sheet date are only recognised as a liability at that date to the extent that they are appropriately authorised and are no longer at the discretion of the Company. Unpaid dividends that do not meet these criteria are disclosed in the notes to these accounts.

Scottish Hydro Electric Power Distribution plc

Notes on the Accounts
for the year ended 31 March 2007

1. Significant accounting policies (continued)

Financial instruments:
The Company adopted FRS 25 and FRS 26 with effect from 1 April 2005. FRS 26 requires that financial instruments are initially recognised and subsequently measured at fair value. Financial assets and liabilities are recognised when the Company becomes a party to the provisions of the instrument.

Accounting policies under FRS 25 and 26
i) Interest Rate Derivatives
Financial derivative instruments are used by the Company to hedge interest rate exposures. All such derivatives are recognised at fair value and are re-measured 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 contract 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 re-measurement 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 attributable to the risk being hedged recorded through the profit and loss account.

A derivative classified as a 'fair value' hedge recognises gains and losses from re-measurement immediately in the profit and loss account. 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 profit and loss account.

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 profit and loss account. The gains or losses that are recognised directly in equity are transferred to the profit and loss account in the same period in which the forecast transaction actually occurs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecast transaction occurs. If the transaction is no longer expected to occur, the cumulative gain or loss recognised in equity is recognised in the profit and loss account.

ii) 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 Company's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

iii) Debtors
Debtors do not carry any interest and are measured at cost (less an appropriate allowance for irrecoverable balances).

iv) 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.

v) Share Capital
Ordinary shares are accounted for as equity. Costs associated with the issue of new shares are deducted from the proceeds of issue.

Scottish Hydro Electric Power Distribution plc

Notes on the Accounts
for the year ended 31 March 2007

2. Prior year adjustments

As a result of the mandatory adoption of FRS 26 *Financial instruments: Measurement* and FRS 25 *Financial Instruments: Disclosure and Presentation*, following the issue of the £100m listed index linked bond, a prior year adjustment has been made in respect of the fair valuation of derivative financial instruments.

Summary

Net assets

	2006 £M
Impact of FRS 26	
Increase in financial liabilities	(3.7)
Deferred tax thereon	1.1
(Reduction) in net assets	(2.6)
As previously reported	167.7
As restated	**165.1**

3. Operating profit

Operating profit is arrived at after charging / (crediting):

	2007 £M	2006 £M
Depreciation of tangible fixed assets	**32.1**	31.6
Operating lease rentals	**0.4**	0.5
Release of deferred income in relation to customer contributions and capital grants	**(3.6)**	(3.6)
Gain on disposal of tangible fixed assets	**(0.4)**	(0.1)
Research and development	**0.3**	0.3
Net management fee in respect of services provided by group companies	**6.1**	7.9

The Company incurred an audit fee of £0.05m in the year (2006 - £0.05m).