

Scottish Hydro Electric Transmission Limited

Regulatory Accounts for the year ended 31 March 2007

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Scottish Hydro Electric Transmission Limited

Corporate Report for the year ended 31 March 2007

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Scottish Hydro Electric Transmission Limited

Corporate Report: Review of the Year to 31 March 2007

Scottish Hydro Electric Transmission Limited (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 the electricity network, encouraging companies to operate the networks as efficiently as possible and ensuring that prices for customers are no higher than they need to be. A new five-year Transmission Price Control was agreed during 2006/07 and came into effect on 1 April 2007. As at 31 March 2007, the Company estimates that based on Ofgem's methodology for valuing the assets of the Company's transmission business, the Regulated Asset Value ('RAV') was approximately £300m.

Since the introduction of British Electricity Trading and Transmission Arrangements (BETTA) in April 2005, National Grid has been Great Britain System Operator, responsible for balancing the supply and demand of electricity across Great Britain. Scottish Hydro Electric Transmission Limited remains responsible for operating, maintaining and investing in the transmission network in its area, which serves around 70% of the landmass of Scotland. These arrangements are working well.

Operating profit increased by 3.9% to £37.2M. The level of revenue increased by 16% during the year, primarily due to an under recovery of regulated revenue in 2005/06 that was collected in 2006/07. The reason for the under recovery was primarily associated with the pre-construction costs associated with the proposed upgrade of the Beaully to Denny Transmission line. These costs were allowed to be recovered via regulated revenue and in 2006/07 there was £5.4M of revenue and costs accounted for associated with this.

The number of transmission system incidents increased to 17, compared with 10 in the previous year. This rise was wholly due to a change in reporting definitions to bring the three UK Transmission Owners onto a consistent reporting basis. On a like for like basis, the figure for 06/07 was down one, to 9 incidents. The level of system availability increased from 96.9% in 2005/06 to 97.9% in 2006/07.

One of the Company's priorities for 2006/07 was to secure a satisfactory outcome from the Transmission Price Control Review for 2007-12, and in December 2006 it decided, on balance, to accept Ofgem's final proposals. While the allowed cost of capital was, and remains, disappointing, the Company concluded, ultimately, that there was within Ofgem's detailed proposals for areas such as capital and operational expenditure sufficient scope and incentive to secure an acceptable level of revenue from its transmission business.

Electricity Network Investment

The level of investment in the transmission network increased to £24.9M, an increase of 30% from 2005/06 levels. This level of investment was within the allowable level of capex agreed with Ofgem in the two year price control period from April 2005 to March 2007.

Electricity Transmission Priorities in 2007/08

During 2007/08, the Company's first objective 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 transmission system incidents and availability 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 and the successful completion of the Public Inquiry into the Beaully-Denny transmission line proposal.

Scottish Hydro Electric Transmission Limited

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 transmission network, serving more than 700,000 customers. Transmission of electricity within specified areas is a monopoly activity and the income earned by charging electricity customers for the use of the system is closely regulated by Ofgem, as is the level of investment which is made.

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.

As the licensed transmission company for the north of Scotland, Scottish Hydro Electric Transmission Limited is required to ensure there is sufficient network capacity for those seeking to generate electricity from renewable sources. The project to replace the electricity transmission line connecting Beaulay in the Highlands with Denny in the Central Belt of Scotland is in line with that responsibility. It is likely that the construction of its part of the replacement line will require the Company to invest over £250m, and making progress with this project was another priority during 2006/07. A Public Inquiry into the project began in February 2007, and was still on schedule at the end of July 2007. It is expected that the report of the Inquiry will be submitted to Scottish Ministers for a decision during 2008. The workload and time commitment from the Company to participate in this Inquiry is significant.

In December 2006, SSE published a consultation document on the possible development of a new high voltage transmission line capable of accommodating power from possible renewable energy developments on the Western Isles and connecting this to the existing mainland transmission network at Beaulay. The consultation document set out a preferred option for the new connection which would involve the construction of a subsea High Voltage Direct Current (HVDC) cable circuit and an underground HVDC cable. The development on this basis would require investment by the Company broadly estimated at around £375m.

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 £24.9m was invested in the transmission 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.

One example of the major investments undertaken in the year was the replacement of a number of 275kV air blast circuit breakers. Refurbishment of Grid Substations at Kintore, Fraserburgh, Inverary and Charleston, Dundee was also undertaken. Transmission tower lines were reconducted and refurbished on the Sloy-Killin circuit whilst a new 132kV wood pole line was built between Sloy and Inverary.

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.

Scottish Hydro Electric Transmission Limited

Corporate Report: Review of the Year to 31 March 2007

1 Operational Review (continued)

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 transmission 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. A new five-year Transmission Price Control was agreed during 2006/07 and came into effect on 1 April 2007. 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.

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).

Scottish Hydro Electric Transmission Limited

Corporate Report: Review of the Year to 31 March 2007

2. Financial Review (continued)

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 32.1% compared with 32.5% in the previous year, after prior year adjustments. The headline effective tax rate is 29.9% compared with 31.8% 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.

2.5 Borrowings and Facilities

The Company has loans of £158.1m (2006 – £158.1m) of which £133.1m (2006 - £133.1m) is due to other group companies and £25.0m (2006 - £25.0m) is in the form of loans from the European investment Bank. Of the total, interest is paid at fixed rates on £158.1m (2006 - £158.1m).

As at 31 March 2007, the weighted average interest rate payable was 5.94% (2006 – 5.94%) and the weighted average remaining term was 12.66 years (2006 – 13.66 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 Transmission Limited have been prepared in accordance with applicable UK Generally Accepted Accounting Principles (UK GAAP).

Scottish Hydro Electric Transmission Limited

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 Transmission Limited (“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 Transmission Limited

Corporate Governance Statement

Scottish Hydro Electric Transmission Limited ("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 Transmission Limited

Regulatory Accounts for the year ended 31 March 2007

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Scottish Hydro Electric Transmission Limited

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 transmission of electricity in the north of Scotland.

2. Business Review

On 2 February 2007, the Company changed its name from Scottish Hydro-Electric Transmission Limited to Scottish Hydro Electric Transmission Limited.

Review of Business and Principal Risks and Uncertainties

The key responsibility of the Group's Power Systems businesses, including the Company, is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions.

Since the introduction of British Electricity Trading and Transmission Arrangements (BETTA) in April 2005, National Grid has been Great Britain System Operator, responsible for balancing the supply and demand of electricity across Great Britain. Scottish Hydro Electric Transmission Limited remains responsible for operating, maintaining and investing in the transmission network in its area, which serves around 70% of the landmass of Scotland. These arrangements are working well.

The year to 31 March 2007 resulted in an increase in operating profit of £1.4M (3.9%) to £37.2M. The level of revenue increased by 16% during the year, primarily due to an under recovery of regulated revenue in 2005/06 that was collected in 2006/07. The reason for the under recovery was primarily associated with the pre-construction costs associated with the proposed upgrade to the Beaulieu to Denny Transmission line. These costs were allowed to be recovered via regulated revenue and in 2006/07 there was £5.4M of revenue and costs accounted for in relation to this.

The level of investment in the Transmission network increased by £24.9M, an increase of more than 30% from 2005/06 levels. This level of investment was within the allowable level of capex agreed with Ofgem in the two year price control period from April 2005 to March 2007.

One of the company's priorities for 2006/07 was to secure a satisfactory outcome from the Transmission Price Control Review for 2007-12, and in December 2006 it decided, on balance, to accept Ofgem's final proposals. While the allowed cost of capital was, and remains, disappointing, the Company concluded, ultimately, that there was within Ofgem's detailed proposals for areas such as capital and operational expenditure sufficient scope and incentive to secure an acceptable level of revenue from its transmission business. The new price control period came into effect on 1 April 2007.

As the licensed transmission company for the north of Scotland, the Company has to ensure there is sufficient network capacity for those seeking to generate electricity from renewable sources, in response to the Renewables Obligation. The project to replace the electricity transmission line connecting Beaulieu in the Highlands with Denny in the Central Belt of Scotland is in line with that responsibility. It is likely that the construction of its part of the replacement line will require an investment by the Company of over £250m. A Public Inquiry into the project began in February 2007, and is due to be completed by the end of the 2007. It is expected that the report of the Inquiry will be submitted to Scottish Ministers for a decision during 2008.

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.

Scottish Hydro Electric Transmission Limited

Report of the Directors (continued)

2. Business Review (continued)

Key Performance Indicators

The following are the key performance indicators used by the Company for measuring performance:

a) Operating Profit (£M)

Year to March 2006	£35.8M
Year to March 2007	£37.2M
Increase (%)	3.9%

b) Capital Expenditure (£M)

Year to March 2006	£19.1M
Year to March 2007	£24.9M
Increase (%)	30.4%

c) Number of Transmission System Incidents (Number)

Year to March 2006	10
Year to March 2007	17
Increase (%)	70%

d) System Availability (%)

Year to March 2006	96.9%
Year to March 2007	97.9%
Increase (%)	1.0%

The Directors intend the Company to pursue its principal activity of the transmission of electricity in the north of Scotland.

3. Results and Dividends

The profit for the financial year amounted to £21.6m (2006 - £19.7m). The Directors do not recommend the payment of a dividend and no dividends were paid in the year (2006 - dividends of £26.7m were paid).

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.

Scottish Hydro Electric Transmission Limited

Report of the Directors (continued)

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.

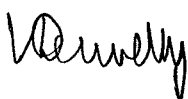
7. Supplier Payment Policy

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.

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 Transmission Limited

Statement of directors' responsibilities in respect of the Directors' Report and the Regulatory accounts and Compliance with Standard Licence Condition B1

The licensee is required by standard condition B1 of the Company's Electricity Transmission 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 Transmission Limited

**Profit and Loss Account
for the year ended 31 March 2007**

	Note	2007 £M	2006 £M
Turnover		61.8	53.2
Cost of sales		(7.3)	-
Gross profit		54.5	53.2
Distribution costs		(13.2)	(13.3)
Administrative costs		(4.1)	(4.1)
Operating profit	2	37.2	35.8
Net interest payable	5	(6.4)	(6.9)
Profit on ordinary activities before taxation		30.8	28.9
Tax on profit on ordinary activities	6	(9.2)	(9.2)
Profit for the financial year	15	21.6	19.7

The above results are derived from continuing activities.

The accompanying notes are an integral part of these Accounts.

Scottish Hydro Electric Transmission Limited

**Balance Sheet
as at 31 March 2007**

	Note	2007 £M	2006 £M
Fixed Assets			
Tangible assets	8	<u>215.7</u>	198.8
Current assets			
Debtors	9	82.4	80.6
Creditors:			
Amounts falling due within one year	10	(51.8)	(53.6)
Net current assets		<u>30.6</u>	27.0
Total assets less current liabilities		<u>246.3</u>	225.8
Creditors:			
Amounts falling due after more than one year	11	(162.9)	(163.4)
Provisions for liabilities and charges			
Deferred taxation	13	(37.3)	(38.0)
Net assets		<u>46.1</u>	24.4
Capital and reserves			
Called up share capital	14	4.3	4.3
Profit and loss account	15	41.8	20.1
Shareholders' funds		<u>46.1</u>	24.4

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



Gregor Alexander, Director

Scottish Hydro Electric Transmission Limited

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

	2007	2006
	£M	£M
Profit for the financial year	21.6	19.7
Total recognised gains and losses relating to the financial year	<u>21.6</u>	<u>19.7</u>

**Reconciliation of Movement in Shareholders' Funds
as at 31 March 2007**

	2007	2006
	£M	£M
Profit for the financial year	21.6	19.7
Dividends	-	(26.7)
Credit in respect of employee share awards	0.1	-
Purchase of shares to satisfy employee share awards	-	(0.1)
Net addition to / (reduction in) shareholders' funds	<u>21.7</u>	<u>(7.1)</u>
Opening shareholders' funds	24.4	31.5
Closing shareholders' funds	<u>46.1</u>	<u>24.4</u>

Scottish Hydro Electric Transmission Limited

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

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 substantially enacted, by the balance sheet date.

Deferred taxation arises in respect of 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 Transmission Limited

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 charged to the profit and loss account 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
Transmission assets	10 to 80
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.

Employee benefit obligations

Pensions

Contributions to pension schemes on behalf of the employees of the Company are charged to the profit and loss account in accordance with the contributions incurred in the year.

Equity and equity-related compensation benefits

SSE 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 SSE plc. 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 SSE 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 Transmission Limited

**Notes on the Accounts
for the year ended 31 March 2007**

2. Operating profit

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

	2007 £M	2006 £M
Depreciation of tangible fixed assets	8.0	7.5
Release of deferred income in relation to customer contributions and capital grants	(0.5)	(0.4)
Net management fee in respect of services provided by parent company	4.1	4.1
	<hr/>	<hr/>

The Company incurred an audit fee of £0.01m (2006 - £0.01m) in the year.

3. Staff costs and numbers

	2007 £M	2006 £M
Staff costs:		
Wages and salaries	2.2	2.0
Social security costs	0.2	0.2
Other pension costs	0.5	0.3
	<hr/>	<hr/>
	2.9	2.5
Less capitalised as tangible fixed assets	(1.2)	(1.5)
	<hr/>	<hr/>
	1.7	1.0

Included within the above costs is a charge recognised under FRS 20 of £33,399 (2006 - £23,071).

Employee numbers

	2007 Number	2006 Number
Numbers employed at 31 March	54	54
	<hr/>	<hr/>

	2007 Number	2006 Number
The monthly average number of people employed by the Company during the year	54	52
	<hr/>	<hr/>

4. Directors' remuneration

No Director received remuneration in respect of their service to the Company.

Scottish Hydro Electric Transmission Limited

**Notes on the Accounts
for the year ended 31 March 2007**

5. Net interest payable

	2007 £M	2006 £M
Interest receivable:		
Other interest receivable	3.5	2.8
Interest payable and similar charges:		
Bank loans and overdrafts	(1.6)	(1.6)
Other financing charges	(8.3)	(8.1)
	<u>(9.9)</u>	<u>(9.7)</u>
Net interest payable	<u>(6.4)</u>	<u>(6.9)</u>

6. Taxation

	2007 £M	2006 £M
Current tax:		
UK corporation tax	9.9	9.4
Deferred tax:		
Current year	(0.7)	(0.7)
Adjustment in respect of prior years	-	0.5
Total Deferred Tax	<u>(0.7)</u>	<u>(0.2)</u>
Total tax on profit on ordinary activities	<u>9.2</u>	<u>9.2</u>

The difference between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2007 £M	2006 £M
Profit before tax	30.8	28.9
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2006 - 30%)	9.2	8.7
Effects of:		
Capital allowances in excess of depreciation	0.7	0.7
Current tax charge for year	<u>9.9</u>	<u>9.4</u>

Scottish Hydro Electric Transmission Limited

**Notes on the Accounts
for the year ended 31 March 2007**

7. Dividends

	2007 £M	2006 £M
Amounts recognised as distributions from equity:		
Final dividend for the previous year of nil (2006 - £3.88) per share	-	16.7
Final dividend for the current year of nil (2006 - £2.33) per share	-	10.0
	<u>-</u>	<u>26.7</u>
 Proposed final dividend for the current year of nil (2005 - nil) per share	 -	 -

8. Tangible fixed assets

	Transmission assets £M	Other land and buildings £M	Vehicles and miscellaneous equipment £M	Total £M
Cost:				
At 1 April 2006	313.0	3.2	0.3	316.5
Additions	24.9	-	-	24.9
At 31 March 2007	<u>337.9</u>	<u>3.2</u>	<u>0.3</u>	<u>341.4</u>
Depreciation:				
At 1 April 2006	117.4	-	0.3	117.7
Charge for the year	8.0	-	-	8.0
At 31 March 2007	<u>125.4</u>	<u>-</u>	<u>0.3</u>	<u>125.7</u>
Net book value:				
At 31 March 2007	<u>212.5</u>	<u>3.2</u>	<u>-</u>	<u>215.7</u>
At 31 March 2006	195.6	3.2	-	198.8

	2007 £M	2006 £M
Tangible fixed assets include:		
Assets in the course of construction	<u>26.1</u>	<u>10.6</u>

9. Debtors

	2007 £M	2006 £M
Amounts falling due within one year:		
Trade debtors	0.5	4.7
Amounts owed by group undertakings	81.9	75.9
	<u>82.4</u>	<u>80.6</u>

Scottish Hydro Electric Transmission Limited

**Notes on the Accounts
for the year ended 31 March 2007**

10. Creditors: amounts falling due within one year

	2007 £M	2006 £M
Trade creditors	1.7	1.7
Amounts owed to group undertakings	34.4	41.2
Corporation tax	8.0	6.5
Accruals and other deferred income	6.9	4.2
Other creditors	0.8	-
	<u>51.8</u>	<u>53.6</u>

11. Creditors: amounts falling due after more than one year

	2007 £M	2006 £M
Loans (note 12)	25.0	25.0
Loans due to ultimate parent (note 12)	133.1	133.1
Accruals and other deferred income	4.8	5.3
	<u>162.9</u>	<u>163.4</u>

12. Analysis of borrowings

	Weighted Average Interest rate 2007 %	Weighted Average Interest rate 2006 %	2007 £M	2006 £M
Over five years				
6.29% European Investment Bank repayable 24 September 2012	6.29	6.29	25.0	25.0
6.00% Loan Stock repayable to Scottish and Southern Energy plc on 31 March 2021	6.00	6.00	100.0	100.0
5.50% Loan Stock repayable to Scottish and Southern Energy plc on 31 March 2021	5.50	5.50	33.1	33.1
			<u>158.1</u>	<u>158.1</u>

13. Deferred taxation

Deferred taxation is provided as follows:

	2007 £M	2006 £M
Accelerated capital allowances	37.5	38.2
Other timing differences	(0.2)	(0.2)
Provision for deferred tax	<u>37.3</u>	<u>38.0</u>

	31 March 2007 £M
Provision at 31 March 2006	38.0
Transferred (to) profit and loss account	(0.7)
Provision at 31 March 2007	<u>37.3</u>

Scottish Hydro Electric Transmission Limited

**Notes on the Accounts
for the year ended 31 March 2007**

14. Share capital

	2007 £M	2006 £M
Equity:		
Authorised:		
4,301,000 ordinary shares of £1 each	4.3	4.3
Allotted, called up and fully paid:		
4,300,000 ordinary shares of £1 each	4.3	4.3

15. Reserves

	Profit and loss account £M
At 31 March 2006	20.1
Profit for the year	21.6
Credit in respect of employee share awards	0.1
At 31 March 2007	41.8

16. Pensions

The majority of the Company's employees are members of the Scottish Hydro-Electric Pension Scheme which provides defined benefits based on final pensionable pay. The Company's contributions to this scheme are set in relation to the current service period only (i.e. these are not affected by any surplus or deficit in the scheme relating to past service of its own employees and any other members of the scheme) and as such are treated as contributions to a defined contribution scheme.

New employees can opt to join a personal pension scheme which is a money purchase scheme with the Company matching the members' contributions up to a maximum of 6% of salary. The scheme is managed by Friends Provident.

The Company's share of the total contribution payable to the pension schemes during the year was £0.5M (2006 - £0.3M).

Scottish Hydro Electric Transmission Limited

Notes on the Accounts for the year ended 31 March 2007

17. Employee share-based payments

The Group operates a number of share schemes for the benefit of all employees. Details of these schemes are as follows:

(i) Savings-related share option schemes ("Sharesave")

This scheme gives employees the option to purchase shares in the parent Company at a discounted market price, subject to them remaining in employment with the Group for the term of the agreement. Employees may opt to save between £5 and £250 per month for a period of 3 or 5 years and at the end of this period, employees have six months to exercise their options by using the cash saved (including a 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 parent Company on a monthly basis. Employees may nominate an amount between £10 and £125 to be deducted from their gross salary, and this is then used to purchase shares ('partnership shares') in the market on the final business day of each month. These shares are then held in trust for a period of 5 years, at which point they are transferred at no further cost to the employee. These shares may be withdrawn at any point during the 5 years, but tax and national insurance would then be payable on any amounts withdrawn.

In addition to the shares purchased on behalf of the employee, the Group will match the purchase up to a maximum of 5 shares ('matching shares') per month. Again these shares are held in trust for the five years until they are transferred to the employee. 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, at 31 March 2005 the Group made a special award of 50 free shares to all employees in employment at both 31 March and 20 August 2005 in recognition of their contribution to the success of the Group. Under the arrangements for the award, the shares will be held in trust for five years, at which point they will be transferred to the employees at no cost to the employee. These shares may be withdrawn by the employee at any point during years four and five, but tax and national insurance would then be payable on any amounts withdrawn.

Details used in the calculation of these costs are as follows:

(i) Savings-related share option scheme

	Date of grant	25 July 2003		16 July 2004		14 July 2005		11 July 2006	
		2007	2006	2007	2006	2007	2006	2007	2006
Outstanding at start of year	Shares	22,878	22,878	12,500	12,500	12,643	-	-	-
	Price	562	562	622	622	886	-	-	-
Granted	Shares	-	-	-	-	-	-	8,050	-
	Price	-	-	-	-	-	-	999	-
Exercised	Shares	(2,957)	-	-	-	-	-	-	-
	Price	1,331	-	-	-	-	-	-	-
Outstanding at end of year	Shares	19,921	22,878	12,500	12,500	12,643	-	8,050	-
	Price	562	562	622	622	886	-	999	-

Of the outstanding options at the end of the year, none were exercisable.

