

# **Scottish Hydro Electric Transmission Limited**

## **Regulatory Accounts for the year ended 31 March 2008**

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## **Scottish Hydro Electric Transmission Limited**

### **Corporate Report for the year ended 31 March 2008**

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## **Scottish Hydro Electric Transmission Limited**

### **Corporate Report: Review of the Year to 31 March 2008**

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 in December 2006 and this financial year has been the first year of this price control. As at 31 March 2008, the Company estimates that based on Ofgem's methodology for valuing the assets of the Company's transmission business (the Regulated Asset Value or 'RAV') was approximately £330m.

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.

The year to 31 March 2008 resulted in a decrease in operating profit of £5.3M (14.2%) to £31.9M. The level of revenue decreased by 11.8% during the year, primarily due to the collection in 2006/07 of an under-recovery of regulated revenue in 2005/06 and the impact of the reduction in regulated revenue following the introduction of the new price control. There have also been costs incurred during the year associated with the Beaulieu Denny Public Inquiry and other Beaulieu Denny pre construction costs which have not yet been recovered via regulated revenue. Discussions are ongoing with Ofgem to obtain permission to recover these costs under the Transmission Licence condition covering this project.

The number of transmission system incidents that resulted in a loss of supplies to customers increased to 18, compared with 17 in the previous year. However, the level of system availability increased from 95.7% in 2006/07 to 97.7% in 2007/08.

#### **Electricity Network Investment**

The level of investment in the Transmission network increased significantly to £44.2M, an increase of more than 75% from 2006/07 levels. As a result of the new price control the level of capital investment in the Transmission network was forecast to increase significantly and this has happened during 2007/08. This level of investment was within the allowable level of capital expenditure agreed with Ofgem at the price control.

#### **Electricity Transmission Priorities in 2008/09**

During 2008/09, 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 the implementation of a review of internal processes and customer-facing operations that took place during 2007/08.

During 2008/09, important questions will be asked about the reliability of the UK's electricity networks and their fitness for purpose in the context of the need to accommodate output from renewable energy schemes. Key priorities for the Company during the year will include the efficient delivery of the next phase of the major programme of investment in the network. This will be targeted at upgrading the network so as to benefit the greatest number of customers. It will also undertake work in advance of what is hoped to be a successful outcome from the Public Inquiry into the Beaulieu-Denny transmission line proposal.

## **Scottish Hydro Electric Transmission Limited**

### **Corporate Report: Review of the Year to 31 March 2008**

#### **1 Operational Review**

##### **1.1 Factors affecting the Business**

The Company is responsible for managing an electricity transmission network, serving more than 720,000 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 consequences of the growth in 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, the Company is required to ensure there is sufficient network capacity for those seeking to generate electricity from renewable sources. In January 2008, the Scottish Government designated electricity network reinforcement to support renewable energy development as one of nine proposed 'National Developments' in the draft second National Planning Framework. Designation as National Developments in the Framework establishes these projects as being in the national interest.

The Company believes the project to replace the electricity transmission line connecting Beauly in the Highlands with Denny in the Central Belt of Scotland is in line with its responsibilities as a licensed transmission company and is also in the national interest. A year-long Public Inquiry into the project was completed in February 2008. The Scottish Minister for Enterprise, Energy and Tourism stated in the Scottish Parliament in September 2007 that Ministers do not expect to receive the report of the Inquiry until late 2008 and that a determination is unlikely before early 2009. It is now likely that the construction of the Company's share of the replacement line will require investment in excess of £300m.

As the UK Business Council for Sustainable Energy said in its paper on implementing the EU renewable energy target in the UK, the consenting and completion of the Beauly-Denny rebuild is essential to releasing the upgrade potential of the existing Scottish transmission system. By rebuilding the weakest part of a north of Scotland transmission ring, it will allow the other elements to that ring to be re-conducted and re-insulated (avoiding any need for new overhead line routes) to increase the capability for renewable energy capacity in the north of Scotland to over 6GW, compared with around 2.2GW currently connected.

The Company has undertaken a public consultation exercise on its draft proposals for the possible development of a new high voltage electricity transmission cable capable of accommodating power from wind farms on Shetland and connecting it to the existing mainland transmission network at Blackhillock in Moray.

The Scottish Government is exploring subsea electricity network options through two offshore transmission studies: the Irish Scottish Links on Energy Study and the North Sea Energy Grid. The Company is well-placed to contribute to the development of new grid options and will continue to work on them with Scottish Ministers and officials and other stakeholders.

In September 2007, the European Commission published its third package of proposals to further liberalise the EU's energy market. The package includes options for electricity and gas transmission networks: the full ownership unbundling of transmission from production and supply in both electricity and gas; or the designation of an independent system operator (ISO) that would operate, maintain and develop the networks, which would make it possible for existing vertically-integrated companies to retain network ownership. The Group believes that the ISO model in Great Britain has worked well and could be successfully replicated elsewhere in the EU. Discussions on this issue are continuing, with a view to EU governments reaching agreement on a way forward later this year.

## Scottish Hydro Electric Transmission Limited

### Corporate Report: Review of the Year to 31 March 2008

#### 1 Operational Review (continued)

##### 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 £44.2m 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.

The most significant electricity transmission project on which work is actually getting under way is the Inveraman substation. Planning consent for this project was obtained in December 2007 and work has now commenced. This project will provide 200MW additional export capacity for electricity generated from renewable sources in Argyll. This is a joint project with Scottish Power Transmission. The Company's investment is around £12m.

##### 1.3 Employees

Employees are encouraged to participate in the businesses of the Group in a variety of ways. In support of the Board's commitment to providing opportunities for employees to become shareholders, the Group offers a Share Incentive Plan and a Sharesave Scheme which is open to all eligible employees. Employee participation in these schemes, over the Group, is around 38% and 37% respectively. The company recognises that its continuing success is closely linked to the performance, skills and individual commitment of its employees. As part of a 2007 employee award, all eligible employees were awarded 20 free shares. The company places a strong emphasis on employee communication and involvement. An employee newspaper is published and distributed to employees. Participation and engagement is encouraged through team meetings, briefings and the intranet where employees are informed of the latest company news from recent media coverage and about developments within the business.

The Group Chief Executive regularly communicates with employees through his blog and receives feedback, in addition to live on-screen question and answer style 'webchats'. During the year, the senior management held a series of roadshows around the Group to present and discuss the Group's vision, values and strategy. The company has in place an extensive range of policies to safeguard the interests of its employees and potential employees. In particular, its equal opportunities policy aims to ensure that all employees and job applicants are no less fairly treated due to age, gender, sexual orientation, race, disability or other reasons not justified in law or relevant to performing their job. The company also aims to ensure that employees have the right skills to deliver the high standards of performance that are necessary to achieve its objectives. Detailed information about the Group's approach to these and related matters is set out in its Corporate Responsibility Report 2008.

##### 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 Health, Safety and Environmental Advisory Committee, together with the Audit Committee and management, ensures that health, safety and environmental policy statements are being adhered to; sets health, safety and environmental targets for the Group; and monitors the performance of the Group against these targets. The Director with lead responsibility for Health and Safety is Colin Hood, who chairs the Safety and Health leadership team.

As a result of this commitment to safety, Scottish and Southern Energy plc continues to be at the forefront of Britain's electricity industry in relation to safety.

## Scottish Hydro Electric Transmission Limited

### Corporate Report: Review of the Year to 31 March 2008

#### 1 Operational Review (continued)

##### 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 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.

In March 2008, Ofgem announced plans to review the 20-year old regime governing the regulation of electricity and gas networks. The review will examine whether the 'current approach will continue to deliver customers reliable, well-run networks with good service at reasonable prices amid growing investment challenges faced by the energy networks in the future'. Ofgem has stated that the range of possible recommendations emerging from the review runs from no change to substantial change, and that where change is recommended, there will be full consultation. Because the review will not report until 2010, and because any proposed changes will be subject to consultation the impact of this review will not impact on the Company until the next Transmission Price Control review in 2012.

#### 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 2008, had a surplus included in the Group accounts, net of deferred tax, of £61.8M (2007 - £89.7M).

##### 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 2008, 65.7% of the Group's borrowings were at fixed or inflation-linked interest 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 31.4% compared with 32.1% in the previous year, after prior year adjustments. The headline effective tax rate is 20.2% compared with 29.9% 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 Transmission Limited**

### **Corporate Report: Review of the Year to 31 March 2008**

#### **2. Financial Review (continued)**

##### **2.5 Borrowings and Facilities**

The Company has loans of £158.1m (2007 – £158.1m) of which £133.1m (2007 - £133.1m) is due to other group companies and £25.0m (2007 - £25.0m) is in the form of loans from the European investment Bank. Of the total, interest is paid at fixed or inflation-linked interest rates on £158.1m (2007 - £158.1m).

As at 31 March 2008, the weighted average interest rate payable was 5.94% (2007 – 5.94%) and the weighted average remaining term was 11.66 years (2007 – 12.66 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 2008 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 is accountable to the Group's shareholders for the good conduct of the Group's affairs. Throughout the year the Group monitors developments in corporate governance best practice. Due regard is also given to the policy guidelines of organisations representing major institutional investors. In addition, internal procedures are regularly reviewed and updated by the Board and the various Board committees.

The Board continues to be committed to ensuring that the highest standards of corporate governance are maintained. The Group's core purpose is to provide the energy people need in a reliable and sustainable way while abiding by its core values: safety; service; efficiency; sustainability; excellence; and teamwork.

The Board continues to be committed to ensuring that the highest standards of corporate governance are maintained and the Board confirms that throughout the year, the Group complied with all provisions set out in Section 1 of the Code.

The Board consists of a non-Executive Chairman, four Executive Directors and five independent non-Executive Directors. This gives the Board an appropriate balance of independence and experience, ensuring that no one individual or group of individuals has undue influence over the Board's decision-making. The composition of the Board and its committees is regularly reviewed to ensure that this balance and mix of skills and experience is maintained.

#### **Scottish Hydro Electric Transmission Limited ("The Company")**

##### **Board of Directors**

The Board consists of four 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.

**213460**

**Scottish Hydro Electric Transmission Limited**

**Accounts for the year ended 31 March 2008**

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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 2008.

#### **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**

##### **Review of Business**

The Company is part of the Scottish and Southern Energy Group (the 'Group') and 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. Transmission of electricity, and the level of capital investment within the company's licensed area, is a monopoly activity and is closely regulated by the Office of Gas and Electricity Markets (Ofgem) within a framework known as the Transmission Price Control. This is set for a period of 5 years and the current price control commenced on 1<sup>st</sup> April 2007.

The year to 31 March 2008 was year 1 of the price control period and resulted in a decrease in operating profit of £5.3M (14.2%) to £31.9M. The level of revenue decreased by 11.8% during the year, primarily due to the collection in 2006/07 of an under-recovery of regulated revenue in 2005/06 and the impact of the reduction in regulated revenue following the introduction of the new price control. There has also been costs incurred associated with the Beaully Denny Public Inquiry and other Beaully Denny pre-construction costs which have not yet been recovered via regulated revenue. Discussions are ongoing with Ofgem to obtain permission to recover these costs under the Transmission Licence condition covering this project.

The level of investment in the Transmission network increased significantly to £44.2M, an increase of more than 75% from 2006/07 levels. As a result of the new price control the level of capital investment in the Transmission network was forecast to increase significantly and this has happened during 2007/08. This level of investment was within the allowable level of capital expenditure agreed with Ofgem at the price control.

As the licensed transmission company for the north of Scotland, the Company is required to ensure there is sufficient network capacity for those seeking to generate electricity from renewable sources. The Company believes the project to replace the electricity transmission line connecting Beaully in the Highlands with Denny in the Central Belt of Scotland is in line with its responsibilities as a licensed transmission company and is also in the national interest. A year-long Public Inquiry into the project was completed in February 2008. The Scottish Minister for Enterprise, Energy and Tourism stated in the Scottish Parliament in September 2007 that Ministers do not expect to receive the report of the Inquiry until late 2008 and that a determination is unlikely before early 2009. It is now likely that the construction of the Company's share of the replacement line will require investment in excess of £300m.

#### **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 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.

## Scottish Hydro Electric Transmission Limited

### Report of the Directors (continued)

#### 2. Business Review (continued)

##### Principal Risks and Uncertainties (continued)

In March 2008, Ofgem announced plans to review the 20-year old regime governing the regulation of electricity and gas networks. The review will examine whether the 'current approach will continue to deliver customers reliable, well-run networks with good service at reasonable prices amid growing investment challenges faced by the energy networks in the future'. Ofgem has stated that the range of possible recommendations emerging from the review runs from no change to substantial change, and that where change is recommended, there will be full consultation. Because the review will not report until 2010, and because any proposed changes will be subject to consultation the impact of this review will not impact on the Company until the next Transmission Price Control review in 2012.

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

###### a) Operating Profit (£M)

Year to March 2007	£37.2M
Year to March 2008	£31.9M
Reduction (%)	14.2%

###### b) Capital Expenditure (£M)

Year to March 2007	£24.9M
Year to March 2008	£44.2M
Increase (%)	77.5%

###### c) Number of Transmission System Incidents (Number)

Year to March 2007	17
Year to March 2008	18
Increase (%)	5.9%

###### d) System Availability (%)

Year to March 2007	95.7%
Year to March 2008	97.7%
Increase (%)	2.1%

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

## Scottish Hydro Electric Transmission Limited

### Report of the Directors (continued)

#### 3. Results and Dividends

The profit for the financial year amounted to £20.6m (2007 - £21.6m). The Directors do not recommend the payment of a dividend and no dividends were paid in the year (2007 – £nil).

#### 4. Directors

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

Gregor Alexander  
Colin Hood  
Steven Kennedy  
Mark Mathieson (appointed 21/11/2007)

#### 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.

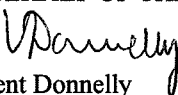
#### 7. Supplier Payment Policy

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 42 days at 31 March 2008.

#### 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  
22 July 2008

## **Scottish Hydro Electric Transmission Limited**

### **Statement of directors' responsibilities in respect of the Directors' Report and the Accounts**

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.

The licensee is also 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.

**Scottish Hydro Electric Transmission Limited**

**Profit and Loss Account  
for the year ended 31 March 2008**

	Note	2008 £M	2007 £M
<b>Turnover</b>		<b>54.5</b>	61.8
Cost of sales		(2.6)	(7.3)
<b>Gross profit</b>		<b>51.9</b>	54.5
Distribution costs		(16.5)	(13.2)
Administrative costs		(3.5)	(4.1)
<b>Operating profit</b>	2	<b>31.9</b>	37.2
Net interest payable	5	(6.1)	(6.4)
<b>Profit on ordinary activities before taxation</b>		<b>25.8</b>	30.8
Tax on profit on ordinary activities	6	(5.2)	(9.2)
<b>Profit for the financial year</b>	14	<b>20.6</b>	21.6

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 2008**

	Note	2008 £M	2007 £M
<b>Fixed Assets</b>			
Tangible assets	7	<u>251.2</u>	215.7
<b>Current assets</b>			
Debtors	8	75.8	82.4
<b>Creditors:</b>			
Amounts falling due within one year	9	(63.4)	(51.8)
<b>Net current assets</b>		<u>12.4</u>	30.6
<b>Total assets less current liabilities</b>		<u>263.6</u>	246.3
<b>Creditors:</b>			
Amounts falling due after more than one year	10	(162.5)	(162.9)
<b>Provisions for liabilities and charges</b>			
Deferred taxation	12	(34.4)	(37.3)
<b>Net assets</b>		<u>66.5</u>	46.1
<b>Capital and reserves</b>			
Called up share capital	13	4.3	4.3
Profit and loss account	14	62.4	41.8
<b>Shareholders' funds</b>		<u>66.7</u>	46.1

These Accounts were approved by the Directors on 22 July 2008 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 2008**

	2008 £M	2007 £M
Profit for the financial year	20.6	21.6
<b>Total recognised gains and losses relating to the financial year</b>	<b>20.6</b>	<b>21.6</b>

**Reconciliation of Movement in Shareholders' Funds  
as at 31 March 2008**

	2008 £M	2007 £M
Profit for the financial year	20.6	21.6
Credit in respect of employee share awards	-	0.1
<b>Net addition to shareholders' funds</b>	<b>20.6</b>	<b>21.7</b>
Opening shareholders' funds	46.1	24.4
<b>Closing shareholders' funds</b>	<b>66.7</b>	<b>46.1</b>

## Scottish Hydro Electric Transmission Limited

### Notes on the Accounts for the year ended 31 March 2008

#### 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).

It has also taken advantage of the exemption contained in FRS29 and has therefore not prepared the disclosures relating to financial instruments and capital as full disclosure is provided in the Group accounts.

##### **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 2008

#### 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

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 not been charged with the cash cost of acquiring shares on behalf of its employees, this cost is borne by the Ultimate Parent Company. 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 2008**

**2. Operating profit**

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

	<b>2008</b>	2007
	<b>£M</b>	£M
Depreciation of tangible fixed assets	8.7	8.0
Release of deferred income in relation to customer contributions and capital grants	<b>(0.5)</b>	(0.5)
Research and development	0.4	-
Net management fee in respect of services provided by parent company	<b>3.5</b>	4.1

The Company incurred an audit fee of £0.01m (2007 - £0.01m) in the year.

**3. Staff costs and numbers**

	<b>2008</b>	2007
	<b>£M</b>	£M
Staff costs:		
Wages and salaries	3.0	2.2
Social security costs	0.3	0.2
Other pension costs	<b>0.6</b>	0.5
	<b>3.9</b>	2.9
Less capitalised as tangible fixed assets	<b>(2.8)</b>	(1.2)
	<b>1.1</b>	1.7

Included within the above costs is a charge recognised under FRS 20 of £48,291 (2007 - £33,399).

**Employee numbers**

	<b>2008</b>	2007
	<b>Number</b>	Number
Numbers employed at 31 March	<b>73</b>	54

	<b>2008</b>	2007
	<b>Number</b>	Number
The monthly average number of people employed by the Company during the year	<b>73</b>	54

**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 2008**

**5. Net interest payable**

	2008 £M	2007 £M
Interest receivable:		
Other interest receivable	3.9	3.5
Interest payable and similar charges:		
Bank loans and overdrafts	(1.6)	(1.6)
Other financing charges	(8.4)	(8.3)
	<u>(10.0)</u>	<u>(9.9)</u>
Net interest payable	<u>(6.1)</u>	<u>(6.4)</u>

**6. Taxation**

	2008 £M	2007 £M
Current tax:		
UK corporation tax	8.1	9.9
Deferred tax:		
Current year	(0.3)	(0.7)
Effect of change in UK corporation tax	(2.5)	-
Adjustment in respect of prior years	(0.1)	-
Total Deferred Tax	<u>(2.9)</u>	<u>(0.7)</u>
<b>Total tax on profit on ordinary activities</b>	<u>5.2</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:

	2008 £M	2007 £M
Profit before tax	25.8	30.8
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2007 - 30%)	7.8	9.2
Effects of:		
Capital allowances in excess of depreciation	0.3	0.7
<b>Current tax charge for year</b>	<u>8.1</u>	<u>9.9</u>

**Scottish Hydro Electric Transmission Limited**

**Notes on the Accounts  
for the year ended 31 March 2008**

**7. Tangible fixed assets**

	Transmission assets £M	Other land and buildings £M	Vehicles and miscellaneous equipment £M	Total £M
<b>Cost:</b>				
At 1 April 2007	337.9	3.2	0.3	341.4
Additions	44.2	-	-	44.2
<b>At 31 March 2008</b>	<b>382.1</b>	<b>3.2</b>	<b>0.3</b>	<b>385.6</b>
<b>Depreciation:</b>				
At 1 April 2007	125.4	-	0.3	125.7
Charge for the year	8.7	-	-	8.7
<b>At 31 March 2008</b>	<b>134.1</b>	<b>-</b>	<b>0.3</b>	<b>134.4</b>
<b>Net book value:</b>				
<b>At 31 March 2008</b>	<b>248.0</b>	<b>3.2</b>	<b>-</b>	<b>251.2</b>
At 31 March 2007	212.5	3.2	-	215.7

	2008 £M	2007 £M
Tangible fixed assets include:		
Assets in the course of construction	16.4	26.1

**8. Debtors**

	2008 £M	2007 £M
Amounts falling due within one year:		
Trade debtors	-	0.5
Amounts owed by group undertakings	75.8	81.9
	<b>75.8</b>	<b>82.4</b>

Scottish Hydro Electric Transmission Limited

Notes on the Accounts  
for the year ended 31 March 2008

9. Creditors: amounts falling due within one year

	2008 £M	2007 £M
Trade creditors	3.2	1.7
Amounts owed to group undertakings	36.0	34.4
Corporation tax	6.2	8.0
Accruals and other deferred income	17.1	6.9
Other creditors	0.9	0.8
	<u>63.4</u>	<u>51.8</u>

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

	2008 £M	2007 £M
Loans (note 12)	25.0	25.0
Loans due to ultimate parent (note 12)	133.1	133.1
Accruals and other deferred income	4.4	4.8
	<u>162.5</u>	<u>162.9</u>

11. Analysis of borrowings

	Weighted Average Interest rate 2008 %	Weighted Average Interest rate 2007 %	2008 £M	2007 £M
Between two and five years				
6.29% European Investment Bank repayable 24 September 2012	6.29	-	25.0	
Over five years				
6.29% European Investment Bank repayable 24 September 2012	-	6.29	-	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>

12. Deferred taxation

Deferred taxation is provided as follows:

	2008 £M	2007 £M
Accelerated capital allowances	34.6	37.5
Other timing differences	(0.2)	(0.2)
Provision for deferred tax	<u>34.4</u>	<u>37.3</u>

	31 March 2008 £M
Provision at 31 March 2007	37.3
Transferred (to) profit and loss account	(2.9)
Provision at 31 March 2008	<u>34.4</u>

**Scottish Hydro Electric Transmission Limited**

**Notes on the Accounts  
for the year ended 31 March 2008**

**13. Share capital**

	2008 £M	2007 £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

**14. Reserves**

	Profit and loss account £M
At 31 March 2007	41.8
Profit for the year	20.6
At 31 March 2008	62.4

**15. 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 £0.6M (2007 - £0.5M).



## Scottish Hydro Electric Transmission Limited

### Notes on the Accounts for the year ended 31 March 2008

#### 16. 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 and 31 March 2007 the Company made a special award of 50 and 20 free shares respectively. These awards were made to all employees in employment at both 31 March and 20 August 2005 for the 2005 award, and 31 March and 30 May 2007 for the 2007 award, in recognition of their contribution to the success of the Company. 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 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		10 July 2007	
		2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
Outstanding at start of year	Shares	19,921	22,878	12,500	12,500	12,643	12,643	8,050	-	-	-
	Option price	562	562	622	622	886	-	999	-	-	-
Granted	Shares	-	-	-	-	-	-	-	8,050	9,283	-
	Option price	-	-	-	-	-	-	-	999	1,306	-
Exercised	Shares	-	(2,957)	(785)	-	-	-	-	-	(22)	-
	Weighted average price at date of exercise	-	1,331	1,474	-	-	-	-	-	1,456	-
Forfeited	Shares	(1,133)	-	-	-	(746)	-	(187)	-	-	-
	Option price	562	-	-	-	886	-	999	-	-	-
Outstanding at end of year	Shares	18,788	19,921	11,715	12,500	11,897	12,643	7,863	8,050	9,261	-
	Option price	562	562	622	622	886	886	999	999	1,306	-

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

## Scottish Hydro Electric Transmission Limited

### Notes on the Accounts for the year ended 31 March 2008

#### 16. Employee share-based payments (continued)

The fair value of these shares at vesting, calculated using the Black-Scholes model, and the assumptions made in that model are as follows:

	July 2003		July 2004		July 2005		July 2006		July 2007	
	3 Year	5 Year	3 Year	5 Year	3 Year	5 Year	3 Year	5 Year	3 Year	5 Year
Fair value	659p	667p	730p	739p	1,012p	1,023p	1,216p	1,226p	1,593p	1,619p
Expected volatility	17%	17%	17%	17%	15%	15%	19%	19%	25%	25%
Risk free rate	4.7%	4.8%	4.7%	4.8%	4.1%	4.2%	4.7%	4.7%	5.8%	5.7%
Expected dividends	4.6%	4.6%	4.6%	4.6%	4.2%	4.2%	4.8%	4.8%	5.3%	5.2%
Term of the option	3 yrs	5 yrs	3 yrs	5 yrs	3 yrs	5 yrs	3 yrs	5 yrs	3 yrs	5 yrs
Underlying price at grant date	630p	630p	699p	699p	967p	967p	1,180p	1,180p	1,460p	1,460p
Strike price	562p	562p	622p	622p	886p	886p	999p	999p	1,306p	1,306p

Expected price volatility was obtained by calculating the historical volatility of the Group's share price over the previous 12 months.

#### (ii) Share Incentive Plan

	2008		2007	
	Shares	Weighted average price (pence)	Shares	Weighted average price (pence)
Outstanding at start of year	8,503	976	6,113	837
Granted	2,541	1,506	2,390	1,330
Forfeited	(349)	1,173	-	-
Exercised	(60)	1,523	-	-
Outstanding at end of year	10,635	1,108	8,503	976
Exercisable at end of year	3,233	734	2,134	632

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 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.

Shares purchased under this scheme prior to 7 November 2002 have not been included as permitted by the transitional rules under FRS 20.

#### Free shares

	2008		2007	
	Shares	Weighted average price (pence)	Shares	Weighted average price (pence)
Outstanding at start of year	2,500	965	2,500	965
Granted	1,040	1,484	-	-
Forfeited	(50)	965	-	-
Outstanding at end of year	3,490	1,120	2,500	965

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

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 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.

## Scottish Hydro Electric Transmission Limited

### Notes on the Accounts for the year ended 31 March 2008

#### 17. Commitments and contingencies

##### (i) Capital commitments

##### Capital expenditure:

	2008 £M	2007 £M
Contracted for but not provided	56.8	51.9

##### (ii) Guarantees

The Company has provided a guarantee in relation to £300m Eurobonds held by Scottish and Southern Energy plc. This guarantee has been provided jointly with Scottish Hydro Electric Power Distribution plc.

#### 18. Ultimate parent company

The Company is a subsidiary of Scottish and Southern Energy plc, a company registered in Scotland, whose consolidated accounts (which include those of the Company) are available from Corporate Communications, Inveralmond House, 200 Dunkeld Road, Perth PH1 3AQ.

**Scottish Hydro Electric Transmission Limited**

**Additional Disclosures: Regulatory Accounts**

The attached schedules represent additional information required by Standard Condition B1 of the Company's Electricity Transmission Licence.

This includes a Cash Flow Statement and additional guidance on the accounting policies adopted.

Scottish Hydro Electric Transmission Limited

Cash Flow Statement  
for the year ended 31 March 2008

	Note	2008 £M	2007 £M
Net cash inflow from operating activities	(i)	49.9	42.8
Returns on investments and servicing of finance	(ii)	(6.1)	(6.4)
Taxation		(9.8)	(8.7)
<b>Free cash flow</b>		<b>34.0</b>	<b>27.7</b>
Capital expenditure and financial investment	(iii)	(34.0)	(27.7)
<b>Net cash (outflow)/inflow before management of liquid resources and financing</b>		<b>-</b>	<b>-</b>
Financing	(iv)	-	-
<b>Increase in cash* in the year</b>		<b>-</b>	<b>-</b>

Notes to the Cash Flow Statement  
for the year ended 31 March 2008

Reconciliation of net cash flow to movement in net debt

	2008 £M	2007 £M
Cash inflow from increase in cash*	-	-
Cash (inflow)/outflow from decrease in debt and lease financing	-	-
<b>Movement in net debt in the year</b>	<b>-</b>	<b>-</b>
Net debt at 1 April	(158.1)	(158.1)
<b>Net debt at 31 March</b>	<b>(158.1)</b>	<b>(158.1)</b>

Analysis of net debt

	As at 1 April 2007 £M	Increase in cash* £M	(Increase)/ decrease in debt £M	As at 31 March 2008 £M
Cash at bank and in hand	-	-	-	-
Other debt due within one year	-	-	-	-
Net borrowings due within one year	-	-	-	-
Net borrowings due after more than one year	(158.1)	-	-	(158.1)
<b>Net debt</b>	<b>(158.1)</b>	<b>-</b>	<b>-</b>	<b>(158.1)</b>

\* The Company does not hold cash balances at any time. Cash generated or required by the Company is remitted to or obtained from Scottish and Southern Energy plc or SSE Services plc. As a result the movement in increase of the indebtedness from the Group can be said to represent the cash generated in the year.

Scottish Hydro Electric Transmission Limited

Notes to the Cash Flow Statement (continued)  
for the year ended 31 March 2008

	2008 £M	2007 £M
<b>Reconciliation of operating profit to operating cash flows</b>		
Operating profit	31.9	37.2
Depreciation	8.7	8.0
Customer contributions and capital grants released	(0.5)	(0.5)
Decrease in debtors	0.5	4.2
Increase/(decrease) in creditors	9.3	(6.1)
Employee share award share purchase	-	-
<b>(i) Net cash inflow from operating activities</b>	<u>49.9</u>	<u>42.8</u>
<b>Returns on investments and servicing of finance</b>		
Interest received	3.9	3.5
Interest paid	(10.0)	(9.9)
<b>(ii) Net cash (outflow) from returns on investments and servicing of finance</b>	<u>(6.1)</u>	<u>(6.4)</u>
<b>Capital expenditure and financial investment</b>		
Purchase of tangible fixed assets	(34.0)	(27.7)
<b>(iii) Net cash (outflow) from capital expenditure and financial investment</b>	<u>(34.0)</u>	<u>(27.7)</u>
<b>Financing</b>		
New borrowings	-	-
Repayment of borrowings	-	-
<b>(iv) Net cash inflow/(outflow) from financing</b>	<u>-</u>	<u>-</u>

## **Scottish Hydro Electric Transmission Limited**

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

#### **1. Principal accounting policies**

##### **Basis of accounting**

The Regulatory Accounts have been prepared under the historical cost convention and in accordance with UK generally accepted accounting standards (UK GAAP) and as required by Standard Condition B1, Regulatory Accounts, of the Electricity Transmission Licence. The principal accounting policies are summarised in the Notes to the Accounts and have been applied consistently.

##### **Limitation of application of CA85 exemption disclosure**

Standard Condition B1 requires the Regulatory Accounts to be prepared inclusive of all mandatory disclosures which otherwise may have been excluded from the Statutory Accounts as a result of the application of a CA85 exemption allowance.

However, as the Company is a wholly owned subsidiary of Scottish and Southern Energy plc ("the Group"), the Directors believe certain accounting policies required of listed Companies cannot practicably be applied to the Company. These include, but are not limited to:

- Pensions. The Group operates two Defined Benefit Schemes, one of which, the Scottish Hydro-Electric Pension Scheme, is the main Pension Scheme for the Company. The contributions made to this scheme are treated as contributions to a Defined Contribution scheme. The Defined Benefit Schemes disclosure is published in the accounts of the Group. The Pensions accounting policy is commented upon in the notes to the accounts.
- Director's Remuneration. The remuneration of the Directors of the Company who are also Executive Directors of the Ultimate Parent is published in the accounts of the Group

Furthermore, while it has been mandatory to prepare Accounts of listed entities in accordance with EU-adopted International Financial Reporting Standards (adopted IFRS) for reporting periods beginning on or after 1 January 2005, the statutory accounts of all the Group's subsidiary entities continue to be prepared under UK GAAP. As a result, the Directors of the Company, and those of the Group, do not believe it would be reasonably practicable to prepare the Regulatory accounts of the Company under adopted IFRS.

**Independent auditors' report to Scottish Hydro Electric Transmission Limited and to the Gas and Electricity Markets Authority ("The Regulator")**

We have audited the Regulatory Accounts of Scottish Hydro Electric Transmission Limited ("the Company") set out in section 2 on pages 5 to 21 which comprise: the Profit and Loss Account, Balance Sheet, Statement of Recognised Gains and Losses, Reconciliation of Movements in Shareholders' Funds, Cash Flow statement and the related notes to the Regulatory Accounts. These Regulatory Accounts have been prepared under the accounting policies set out therein.

This report is made, on terms that have been agreed, solely to the Company and the Regulator in order to meet the requirements of Standard Condition B1 of the Company's Regulatory Licence. Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Company's Regulatory Licence to procure such a report and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Regulator, for our audit work, for this report, or for the opinions we have formed.

**Basis of preparation**

The Regulatory Accounts have been prepared under the historical cost convention and in accordance with Standard Condition B1 of the Regulatory Licence and the accounting policies set out in the statement of accounting policies.

The Regulatory Accounts are separate from the statutory Accounts of the Company. There are differences between United Kingdom Generally Accepted Accounting Principals (UK GAAP) and the basis of preparation of information provided in the regulatory accounts because the Standard Condition B1 of the Regulatory Licence specify alternative treatment or disclosure in certain respects. Where Standard Condition B1 of the Regulatory Licence does not specifically address an accounting issue, then it requires UK GAAP to be followed. Financial information other than that prepared wholly on the basis of UK GAAP may not necessarily represent a true and fair view of the financial performance or financial position of the Company as shown in Accounts prepared in accordance with the Companies Act 1985.

**Respective responsibilities of the regulator, the directors and auditors**

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

As described in the Statement of Directors' Responsibilities in section 2 on page 4, the Company's directors are responsible for the preparation of the Regulatory Accounts in accordance with Standard Condition B1 of the Regulatory Licence.

Our responsibility is to audit the Regulatory Accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland), except as stated in the "Basis of audit opinion", below and having regard to the guidance contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report to you our opinion as to whether the regulatory accounts present fairly in accordance with Standard Condition B1 of the Regulatory Licence and the accounting policies set out in section 2 on pages 8 to 9 and 21, the results, cash flows and financial position of the Company and whether they have been properly prepared in accordance with those conditions. We also report to you if, in our opinion, the Company has not kept proper accounting records or if, in our opinion, we have not received all the information and explanations we require for our audit.

We read the other information contained in the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Regulatory Accounts. The other information comprises the Corporate Report, review of the year and Corporate Governance Statement. Our responsibilities do not extend to the other information.

**Basis of audit opinion**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.



**Independent auditors' report to Scottish Hydro Electric Transmission Limited and to the Gas and Electricity Markets Authority ("The Regulator") (continued)**

**Basis of audit opinion (continued)**

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Regulatory Accounts are free from material misstatement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under those auditing standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the company on which we report, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the company (our "statutory" audit) was made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our statutory audit work was undertaken so that we might state to the company those matters which we are required to state to them in a statutory auditors' report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the company's members, as a body, for our statutory audit work, for our statutory audit report, or for the opinions we have formed in respect of that statutory audit.

**Opinion**

In our opinion the Regulatory Accounts of the Company for the year ended 31 March 2008 fairly present, in accordance with Standard Condition B1 of the Regulatory Licence and the accounting policies set out in section 2 on pages 8 to 9 and 21, the state of the Company's affairs at 31 March 2008 and of its profit and cash flows for the year then ended and have been properly prepared in accordance with those conditions.



KPMG Audit Plc  
Chartered Accountants  
Edinburgh  
22 July 2008

