



**Making energy better**  
Annual Report 2012





## Inside this report...

### Overview

- 01 Chairman's statement
- 02 The energy sector
- 02 Global context
- 04 Great Britain
- 06 Ireland
- 07 Weather
- 09 Questions and answers with the SSE Executive Team
- 12 SSE – a balanced range of energy businesses

### Strategy

- 14 Why invest in SSE?

### Group performance

- 17 Key performance indicators
- 18 Financial overview

### Segmental performance

- 24 Networks
- 24 Economically-regulated businesses
- 30 Market-based businesses
- 31 Retail
- 31 Market-based businesses
- 39 Wholesale
- 39 Market-based businesses

### Corporate governance

- 54 Key performance indicators – SSE's core values
- 55 Chairman's introduction to SSE corporate governance
- 56 Board of Directors
- 58 The SSE team
- 61 How the Board works
- 65 Risk management
- 71 Nomination Committee
- 72 Audit Committee
- 74 Safety, Health and Environment Advisory Committee
- 75 Remuneration Report
- 75 Introduction
- 77 Remuneration in 2011/12
- 80 Remuneration for 2012/13 and beyond
- 84 Remuneration in detail
- 87 Other statutory information

### Financial statements

- 90 Independent auditor's report
- 91 Consolidated income statement
- 92 Statement of comprehensive income
- 93 Balance sheets
- 94 Statement of changes in equity
- 96 Cash flow statements
- 98 Notes on the financial statements
- 98 1. Significant accounting policies
- 108 2. Change of reportable segments
- 111 3. Segmental information
- 114 4. Other operating income and expense
- 115 5. Exceptional items and certain remeasurements
- 117 6. Directors and employees
- 118 7. Finance income and costs
- 119 8. Taxation
- 121 9. Dividends
- 121 10. Earnings per share
- 122 11. Intangible assets
- 126 12. Property, plant and equipment
- 127 13. Biological assets
- 128 14. Investments
- 131 15. Subsidiary undertakings
- 133 16. Acquisitions, disposals and held for sale assets
- 134 17. Inventories
- 135 18. Trade and other receivables
- 135 19. Cash and cash equivalents
- 135 20. Trade and other payables
- 136 21. Current tax liabilities
- 136 22. Construction contracts
- 136 23. Loans and other borrowings
- 139 24. Deferred taxation
- 140 25. Provisions
- 141 26. Share capital
- 141 27. Reserves
- 142 28. Hybrid capital
- 142 29. Retirement benefit obligations
- 146 30. Employee share-based payments
- 151 31. Financial instruments and risk
- 165 32. Related party transactions
- 166 33. Commitments and contingencies
- 167 34. Post balance sheet events

### Shareholder information

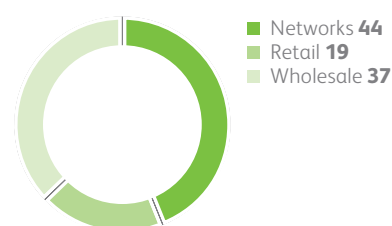
- 168 Shareholder information

### Dividend per share – pence

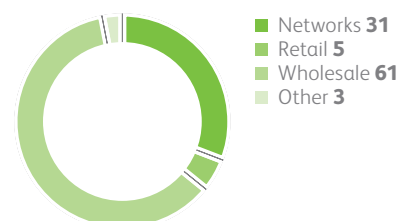
# 80.1

2011: 75.0

### Operating profit by business 2011/12 – %



### Capital expenditure and investment 2011/12 – %



### Total recordable injury rate 2011/12

# 0.11

per 100,000 hours worked

The Directors' Report is set out on pages 1 to 88.

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

## Chairman's statement

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



This report summarises SSE's performance in 2011/12 and its plans for 2012/13 and beyond.

There are three issues over which SSE has no control but which in one way or another touched every part of its business in 2011/12 – upheaval in global energy markets, widespread economic uncertainty and the weather. Higher wholesale gas prices, falling demand for energy and a succession of winter storms presented major challenges for the wholesale, retail and networks parts of SSE.

The fact that, despite all of this, SSE again delivered increases in the full-year dividend and in adjusted profit before tax\* demonstrates the resilience inherent in its balanced model of market-based and economically-regulated energy businesses, and the robustness of its strategy of focusing on operations and investment in each of those businesses. It also demonstrates the outstanding commitment and professionalism of the people who work for SSE throughout the UK and Ireland, where the Company's operations and investments are focused.

In very challenging circumstances, the 2% increase achieved by SSE in adjusted profit before tax\* in 2011/12 was a solid result and it is particularly encouraging to see such a good performance in Networks, which for so long have been SSE's backbone. Also encouraging was the increase in capacity for, and output of, renewable energy. In both of these areas there has been significant investment in recent years, the benefits of which are now coming through.

For some people, 'profit' and 'dividend' are contentious words when it comes to energy, which is not a discretionary purchase but essential to the functioning of modern life. The reality is, however, that profit and dividend allow SSE to employ people, pay tax, make investments that keep the lights on and provide an income return that shareholders need. In doing this, SSE aims to provide social value as well as economic value.

As a result of this, SSE recognises that it must continually earn the right to make a profit and pay dividends and that it must do so in an environment in which trust in business and other institutions has eroded significantly and in which there will be other significant challenges. This means that 2012/13 and beyond will be about SSE continuing the work to earn the trust of customers in retail and business markets, delivering reliable supplies of energy to network customers and investing in assets to support secure and lower-carbon supplies of energy in the future.

The more some things change in the future, however, the more others should stay the same. That means SSE must adhere to its core values of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork. These are the values of an organisation that is committed to the long-term provision of services, investment in assets and payment of dividends and they are the values on which SSE expects to be judged.

With such a strong commitment to values, there can be every confidence that SSE will extend further its record of annual above-inflation dividend growth. SSE paid its first full-year dividend in 1999. Since then, there have been 13 successive above-inflation increases. The target for 2012/13 is to deliver a 14th increase in the full-year dividend of at least 2% more than inflation.

At heart, SSE remains a consistent and straightforward company – providing vital services to customers, investing in essential energy assets and paying dividends to shareholders every year. It is a company with which I believe customers, shareholders, employees and the Board should be pleased to be associated now and in the future.

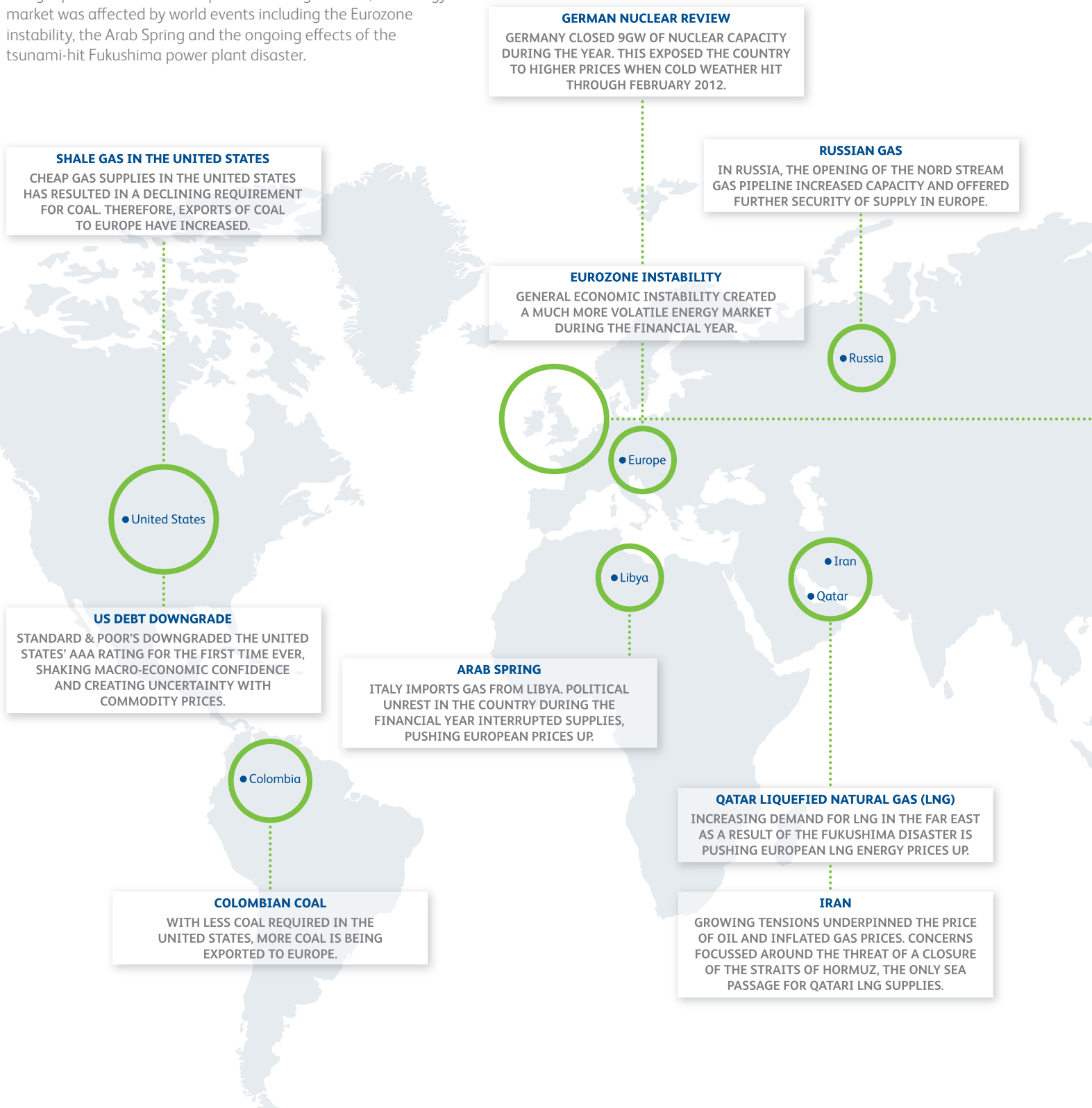
**Lord Smith of Kelvin**  
Chairman

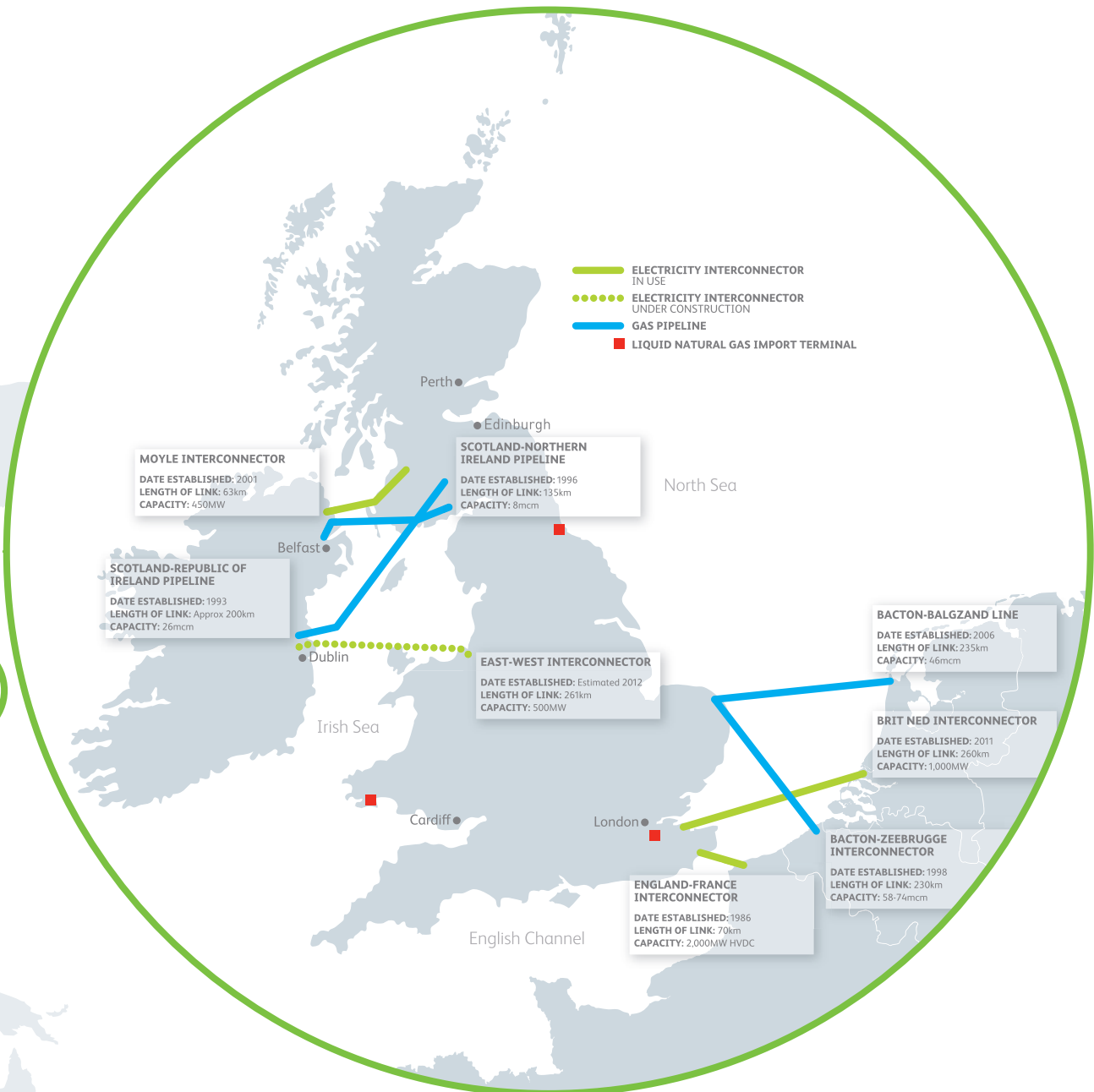
## The energy sector

### Global context

The production of electricity and gas for customers in the UK and Ireland is a market-based activity in which producers, retailers, large users and other energy traders buy and sell electricity and gas like any other commodity.

As the decline of oil and gas production from the UK Continental Shelf continues, there is a continuing integration of UK energy prices in the wider global market, which means macro economic and geopolitical factors are important. During 2011/12, the energy market was affected by world events including the Eurozone instability, the Arab Spring and the ongoing effects of the tsunami-hit Fukushima power plant disaster.





● Fukushima

**FUKUSHIMA**  
 FOLLOWING THE FUKUSHIMA DISASTER, JAPAN HAS HAD TO RELY ON GREATER USE OF OTHER SUBSTITUTE FUELS, PARTICULARLY LIQUIFIED NATURAL GAS (LNG).

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

## The energy sector (continued)

### Great Britain

#### SSE in electricity

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



1

##### ELECTRICITY GENERATION

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



2

##### ELECTRICITY TRANSMISSION

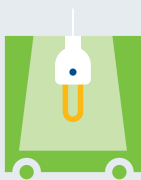
USING HIGHER VOLTAGE LINES AND CABLES TO TRANSMIT ELECTRICITY FROM GENERATING PLANT TO THE DISTRIBUTION NETWORK.



3

##### ELECTRICITY DISTRIBUTION

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



4

##### ELECTRICITY SUPPLY

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

**The majority of SSE's operations are in England, Scotland and Wales, where most parts of the energy sector have been privatised for over 20 years.**

Reflecting its island status, Great Britain's energy (ie electricity and gas) sector is largely free-standing with the exception of some electricity interconnection with Ireland and mainland Europe and some gas pipelines from mainland Europe and to Ireland (see the map on page 3).

Around 30 million homes, offices and businesses are connected to the electricity network in Great Britain and around 23 million to the gas network. Total electricity consumption in Great Britain in 2011 (the latest for which information is available) was 371TWh and total gas consumption was 906TWh.

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

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

#### Economic regulation of networks

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

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

Distribution networks are each owned and operated by the same company. Transmission networks have a single, GB-wide system operator – National Grid operates the GB electricity and gas systems.

# 40%

**Over 40% of gas used in the UK was imported. This is likely to increase to around 80% in 2020.**

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

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

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

The RAV is indexed to the Retail Price Index.

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

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

The current Price Controls are due to run until:

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

For future Price Controls, Ofgem is using its new RIIO (Revenue = Incentives + Innovation

+ Outputs) model, which is designed to secure greater stakeholder engagement in, and deliver an outputs-led approach to, energy network regulation.

## Electricity and gas markets

In line with its island status, around 98% of the electricity consumed by UK customers is generated in the UK. At 30 May 2011 (the latest date for which data is available), there were 26 electricity generators with more than 50MW of capacity operating in Great Britain. In total there was around 85GW of installed capacity.

In the year 2010/11, over 40% of the gas used in the UK by customers and by electricity generators was imported via pipelines from European gas fields, the England-Belgium pipeline or liquefied natural gas terminals. This is set to increase significantly in the years ahead, as production of gas from the North Sea declines.

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

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

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

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

## Gas storage

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

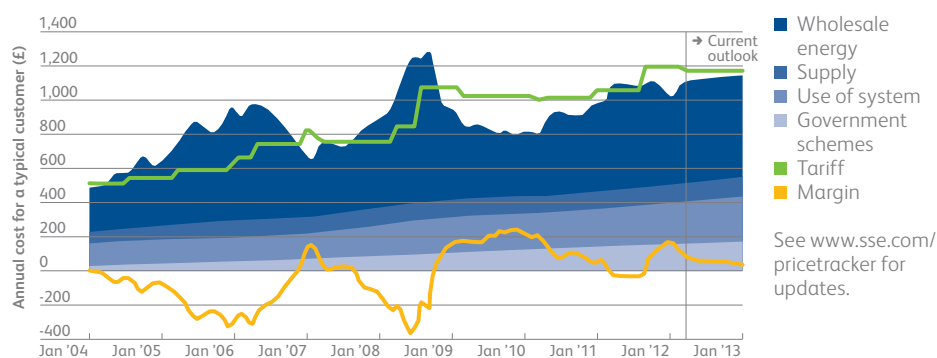
## Electricity and gas retailing

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

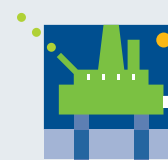
At 31 March 2012, there were six electricity and gas suppliers in Great Britain with a market share each of more than 5%. Across Europe, only the markets in Poland, Slovenia and Romania have a larger number of suppliers with a market share of more than 5%.

Ofgem is responsible for licensing the supply of electricity and gas and also scrutinises retail prices for electricity and gas and the overall effectiveness of the retail energy market. Its Retail Market Review represents Ofgem's attempt to enhance competition in the retail energy market and make it work more effectively so that the benefits can be realised for more consumers. •

## SSE price tracker showing components of a typical dual fuel bill



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



1

### GAS PRODUCTION

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



2

### GAS STORAGE

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



3

### GAS DISTRIBUTION

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



4

### GAS SUPPLY

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



## The energy sector (continued)

### Ireland

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

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

As in GB, Ireland has limited interconnection consisting of:

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

An additional 500MW interconnector is under construction between Dublin and Wales, which is scheduled to come online by November 2012.

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

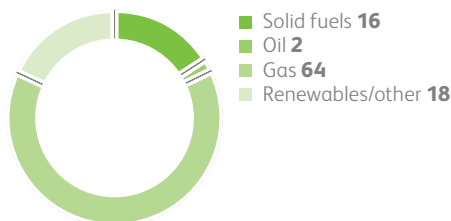
Both governments have set a target of 40% renewable electricity to be delivered by 2020, which will require approximately 5,000MW of renewable capacity to be installed across the island. Renewables, mainly hydro and wind, currently supply 15% of electricity demand. The electricity Transmission System Operator (TSO), EirGrid announced that Ireland had reached 2GW of installed wind capacity as of March 2012. With largely untapped offshore resources Ireland has a significant opportunity to be an exporter of renewable energy. The British Irish Council is currently looking at removing barriers to cross-border renewables trading.

#### Economic regulation of networks

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

The state-owned (ROI) Electricity Supply Board (ESB) owns and operates the distribution and transmission networks in ROI and NI. Similarly to GB, these assets are regulated through Price Controls set by CER and NIAUR for five-year periods.

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



The current price controls in ROI will run until 2015 and 2012 in NI.

The TSO in ROI is EirGrid plc with SONI Ltd, a wholly-owned subsidiary of EirGrid plc, operating the system in NI.

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

In NI the gas market is in the early stage of development. Two companies Firmus Energy, a subsidiary of Bord Gáis, and Phoenix Natural Gas own and operate separate distribution networks, regulated by NIAUR. Phoenix's price control ended in 2011 and is currently being reviewed by the Competition Commission, while Firmus' runs to 2013.

#### Electricity and gas markets

Across ROI and NI there is a common wholesale electricity market; the Single Electricity Market (SEM). This market operates with dual currencies (Euro and Sterling) and dual support mechanisms for renewable energy. In 2011 the SEM controlled over 6,000MW of fully dispatchable generation and supplied over 33TWh, costing around €2bn. The retail market continues to operate as two separate markets with around 2 million customers in the Republic of Ireland and 0.8 million in Northern Ireland.

The island consumes approximately 73TWh of gas annually of which around two thirds is used in power generation. As in electricity the gas retail market operates as two separate markets with some 650,000 consumers in ROI and 150,000 in NI. The majority of gas consumed is imported. The governments and regulatory authorities are currently developing an all-island gas market. Gas prices in Ireland tend to be set by the UK wholesale price.

#### Electricity and gas retailing

At 31 March 2012 there were four main electricity and gas suppliers operating in ROI and NI.

Despite competitive business markets in ROI and NI for a number of years, domestic switching in electricity and gas has been a recent phenomenon. SSE's retail brand in Ireland, Airtricity, has been a significant contributor to the development of domestic competition across the island with over 525,000 customers joining in the last two years.

This has allowed full deregulation of ROI electricity retail market, since April 2011. While deregulation in ROI gas and NI electricity and gas will follow, significantly lower switching rates are slowing its delivery. As deregulation progresses the regulatory authorities will transition from tariff regulation to market monitoring.

#### Market structure

The ROI government in early 2012 announced a programme for the disposal of State assets through the National Treasury Management Agency (NTMA). The sale of Bord Gáis Energy (BGE), which contains retail, trading and generation assets will comprise the main element of the disposal, with some non-strategic power generation capacity owned by ESB included. Gas and electricity transmission and distribution systems will remain in state control. •

# 80%

Over 80% of electricity generated in Ireland comes from fossil fuels, of which over 90% is imported.



## The energy sector (continued)

### Weather

#### Weather and climate change

Often, when discussing prevailing conditions, the terms weather and climate are used interchangeably. This is particularly evident when unseasonably warm or cold days are contrasted with wider discussions on climate change.

For clarity, weather is the temperature, precipitation and wind, which sees hourly and daily fluctuations. Climate is the average weather we expect over a long period of time, typically 30 years or more.

For the UK and Ireland long-term weather forecasting is difficult given their geographic location sitting between the Atlantic Ocean on one side and continental Europe on the other. This means even subtle changes in the wind direction can bring marked changes in the weather.

The UK and Ireland also lie at a particularly volatile latitude where warm air from the tropics and cold air from the Arctic collide to create numerous weather systems. This creates unpredictable conditions where weather can change very quickly.

#### 2011 weather patterns relative to the 30 year average

In the UK 2011/12 will be remembered for a warm spring and autumn, contrasting with an 'indifferent' summer, isolated storm events, and a pronounced north-west to south-east gradient in rainfall.

The months with notable anomalies were:

- April 2011 – the warmest and sunniest on record in the UK with temperatures some 3.7°C above the average for the month.
- September 2011 – a post tropical storm that had formerly been hurricane Katia tracked across the Atlantic bringing very strong winds. This was the most powerful ex-hurricane to reach the UK and Ireland since 1996.
- October 2011 – new records were set during a heat wave when temperatures widely exceeded 25°C. By contrast, such warmth was rare during the summer, the coolest since 1993.
- January 2012 – stormy conditions brought ground level wind speeds in excess of 90mph.

The UK annual rainfall total was close to average, but this masked striking variations across the country. While some places in the west Highlands of Scotland accumulated almost 4,000mm, parts of the east midlands and East Anglia recorded less than 400mm. Much of central, eastern and southern England was very dry, causing concerns for water resources, agriculture and the environment. Provisionally, several Midland counties had their driest year on record while in East Anglia and Lincolnshire only 1921 was drier. In contrast, Scotland experienced several very wet months, notably May and December across the west and August in eastern areas. Overall, Scotland had its wettest year since 1910.

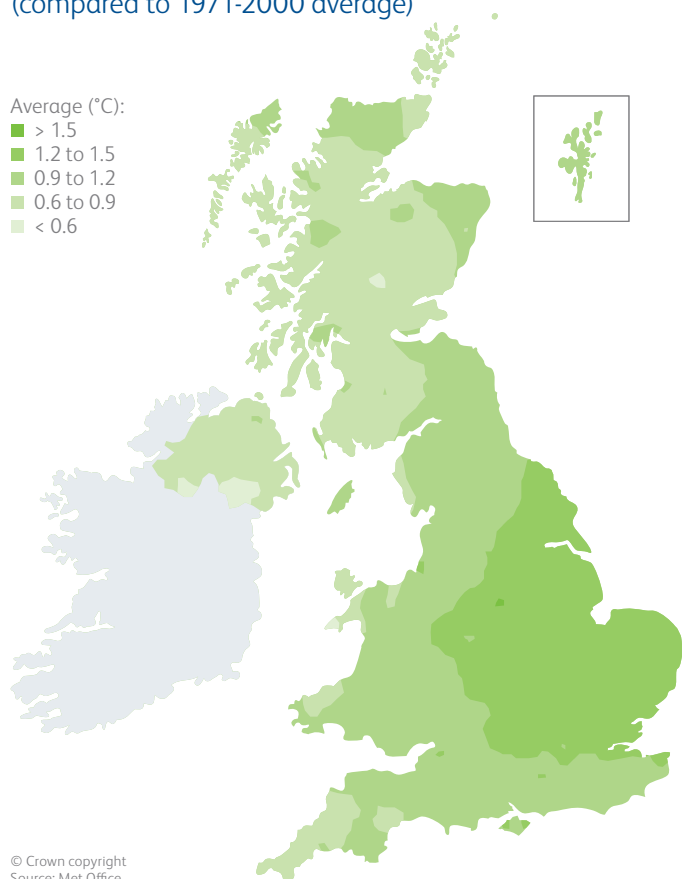
In summary, for the calendar year 2011 it was the:

- second warmest year for the UK on record (records began in 1910);
- second warmest year for central England on record (records began in 1659);
- wettest year for Scotland on record (records began in 1910); and
- wind speeds for the UK were close to the 11-year average.

#### Annual 2011 mean temperature (compared to 1971-2000 average)

Average (°C):

- > 1.5
- 1.2 to 1.5
- 0.9 to 1.2
- 0.6 to 0.9
- < 0.6

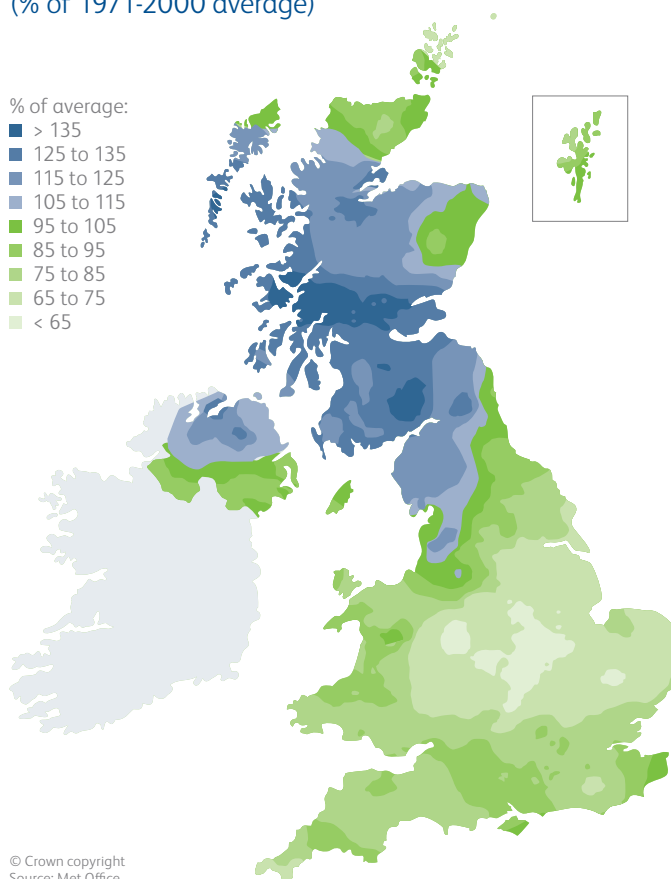


© Crown copyright  
Source: Met Office

#### Annual 2011 rainfall amount (% of 1971-2000 average)

% of average:

- > 135
- 125 to 135
- 115 to 125
- 105 to 115
- 95 to 105
- 85 to 95
- 75 to 85
- 65 to 75
- < 65



© Crown copyright  
Source: Met Office

## The energy sector (continued)

### Weather

#### How weather impacts demand

With its prevailing cool-temperate climate, demand response to above or below average temperatures in GB and Ireland tends to be pronounced. Cold spells result in an upsurge in heat demand, while in warm weather, demand can fall dramatically. This contrasts sharply with other jurisdictions where higher penetrations of air conditioning in buildings will also see electricity demand increase at times of higher temperature.

The residential and commercial building sectors which combined account for almost two thirds of non-transport energy consumed each year, experience the greatest weather related fluctuations in energy use. With almost 60% of residential energy used for heating and cooling a 1°C increase in average temperature decreases space heating needs by 6-10%. For commercial consumers, where 40% of energy is for heating and cooling, it decreases by 7-9%.

The weather effect for industrial users is less correlated, however, it can indirectly impact the sector as some industries are incentivised to reduce energy consumption during periods of peak power demand. Furthermore, many industries require large quantities of water for boilers and cooling systems, the temperature of which can be influenced by weather. For example, it takes less energy to bring 75°C water to a boil than 70°C water. It also requires more 75°C water to cool a system than 70°C water.

#### 2011 weather and energy demand

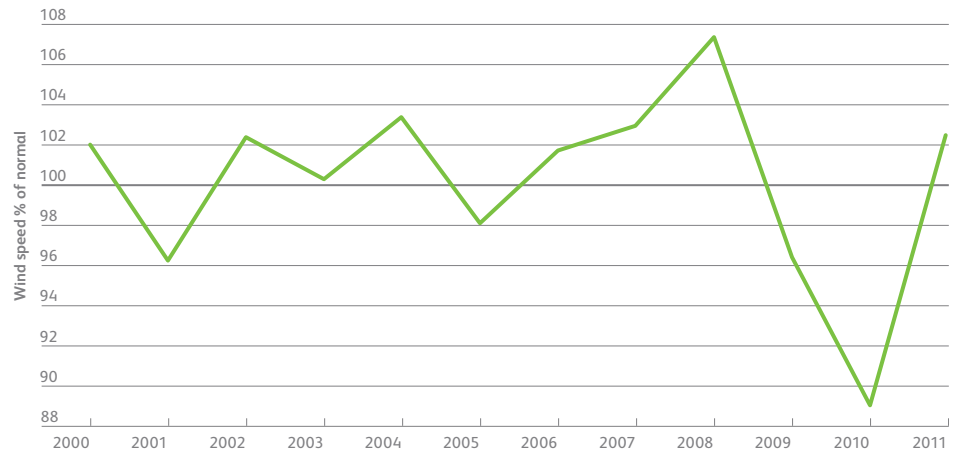
As the second warmest year on record and with unseasonably warm weather in spring and autumn, UK energy consumption in 2011 was down significantly. Department of Energy and Climate Change (DECC) data shows year-on-year primary energy usage fell by 7.3% last year; with electricity falling by 3.6% and gas by 17%. As a result, gas demand was the lowest in the UK since 1995.

#### SSE and the weather

With its variances across both space and time, weather is an important influence on how SSE manages its business. Accurate forecasting, coupled with analysis of generation plant availability (in SSE's own portfolio and elsewhere in the market), customer demand and its contractual position means SSE can assess, and therefore manage, exposure to weather fluctuations and wider market prices.

With unseasonably mild weather throughout the financial year 2011/12, SSE saw a 19.9% drop in average household gas consumption

#### Average GB wind speed (2000-2011)



and a 6.9% fall in average household electricity demand. It is through SSE's focus on diversity and maintaining a balanced portfolio of customers, generation technologies and energy contracts of varying lengths for purchasing gas and power purchase agreements, that it annually ensures its customers and shareholders are appropriately hedged against weather risk, while maintaining its commitment to dividend growth.

Given there are uncertainties around the volume of energy that will be required at any particular point, arising from unexpected weather and other global factors, SSE is unlikely to be fully hedged until close to the delivery of the energy itself. This approach is designed to hedge SSE's requirements in a way that minimises its costs while ensuring its exposure to market prices is not excessive.

SSE's core operational priority for Generation, ensuring that power stations maintain a high level of availability to generate electricity in response to customers' needs and market conditions, supports this focus. During the financial year 2011/12 availability was also complemented by very favourable wet (see map on page 7) and windy weather across the UK and Ireland. This was SSE's best year for renewables output – hydro generation delivered a new record electricity output of 4,262GWh up from 2,558GWh in 2010/11, while SSE's wind generation had 97% availability with an output of 3,199GWh up from 1,653GWh in 2010/11. Excluding new wind turbines delivered in 2011/12, wind energy output was up one third on 2010 levels.

#### Weather and SSE Networks

While 2011/12 was generally mild it also experienced an unusually high number of storms, bringing very high wind speeds

at ground level. Both 3 and 4 January were exceptional with winds of 90 miles per hour resulting in the loss of power to 40,000 households. With its highly experienced team of Network engineers SSE identified and repaired over 1,000 points of damage on the electricity network over the course of four days, the equivalent of three months' work. Also during this period SSE's Emergency Service Centre supported 126,000 inbound calls and proactively contacted over one thousand vulnerable customers.

#### Future trends

Weather is unpredictable. However, by optimising its diverse portfolio of assets and contracts and swiftly and professionally managing Network outages SSE ensures that its customers are protected from the volatility that arises from unexpected weather events while ensuring adequate returns to support the business's commitment to sustained dividend growth. •

## Questions and answers with the SSE Executive Team

**SSE has three Executive Directors: Chief Executive, Ian Marchant; Finance Director, Gregor Alexander; and Generation and Supply Director, Alistair Phillips-Davies. Together they have over 30 years' experience of serving on the Board of SSE. Here they answer questions about SSE's performance and plans for the future.**

### How would you describe 2011/12?

**Ian →** Difficult. At 2%, we reported one of the smallest increases in adjusted profit before tax\* ever delivered by SSE – but also one of the hardest to achieve. The combination of higher wholesale gas prices, poor levels of income for gas-fired power stations and falling demand for gas and electricity made it a tough environment for us, but the whole of the SSE team responded really well to the challenge.

**Gregor →** There were some bright spots. Our investment in renewable energy paid off, with record output. That again showed the value of our large capital projects like wind farms – although it was also thanks, in part, to the weather! Our electricity and gas networks also achieved good results and the gas production assets we bought at the start of 2011 performed well. All of that showed the benefit of maintaining a balance between market-based and economically-regulated businesses.

### Was there a particular low point in what you've said was a difficult year?

**Alistair →** Absolutely – SSE being found guilty at Guildford Crown Court on two counts out of seven relating to the use of doorstep sales aids, and being fined £1.25m. We should never have found ourselves in that position and I'm very sorry that we did.

**Ian →** I agree. We've all thought long and hard about the lessons that the Guildford case holds for us. I'm confident that they have been well and truly learned throughout the SSE management team and that the need to maintain the highest standards in everything we do is clearly understood.

### Do you think you have made it particularly hard to build people's trust in energy suppliers?

**Ian →** Clearly, the doorstep selling case didn't help, but I'm proud of the progress that has been made by SSE in the past year in terms of more transparent pricing, simplified tariffs, improved service standards and the



**Gregor Alexander** Finance Director  
**Ian Marchant** Chief Executive  
**Alistair Phillips-Davies** Generation and Supply Director

Gregor, Ian and Alistair pictured in the Scottish Hydro Centre for Renewable Excellence in Glasgow.



## Questions and answers with the SSE Executive Team (continued)

We understand that energy is one of the most essential household costs and also one of the biggest and that the standards that people expect are – rightly – increasing all the time.

implementation of our sales guarantee. I'm also determined that we will maintain the momentum in the new financial year and the new commitments we announced in April in areas like estimated billing were part of that.

**Alistair →** We understand that energy is one of the most essential household costs and also one of the biggest and that the standards that people expect are – rightly – increasing all the time. We're doing better – but we realise we have to do much better still and that's what we're working to achieve.

**The nature of electricity and gas makes energy subject to a lot of political and regulatory intervention. Does that worry you?**

**Ian →** It goes with the territory. Elected politicians have every right to intervene in the sector if they want to and every right to give powers to regulators to do so. Our job is to work with them to make sure that changes are coherent, practical to implement and actually in the short-, medium- and long-term interests of customers.

**Gregor →** We have a very simple approach to this. If we're making any financial decision we assess the risks, and legislative and regulatory change are amongst those risks. If the risks can't be managed or are too great, then we won't invest. At the same time, we work with governments and regulators to help them understand what is needed to stimulate the investment they want.

**It's one thing making the investment decision – it's another thing making sure it's well-executed. Is SSE doing well enough in this area?**

**Gregor →** Our large capital project programme took a big step up five years ago and in the time since we've gained significant experience and expertise that is now standing us in good stead. I'm particularly pleased with our progress in onshore wind farm construction. Development and construction

of big projects is a complex area, however, in which continuous improvement – not complacency – is the order of the day.

**Ian →** Maintaining excellence in project selection and execution is a key priority for SSE. That means picking the right projects, assigning the right resources and delivering them well, with managed risks and no surprises. While the principles of project selection and execution have to remain the same, each project presents its own challenges. This will always be a demanding and critical area for a company like SSE, and it will always be treated as such.

**As well as politics, regulation and large capital projects, SSE lists energy portfolio management as one of its key risks. Is this getting to be a more difficult area?**

**Ian →** UK gross imports of natural gas now exceed gross production for the first time since the 1960s. This big change means that there is an ongoing integration of UK prices into the wider global energy market, so we're affected by macro economic or geopolitical issues. This is an issue we can manage through things like diversifying our energy procurement in areas like location, counterparty and timing. We're also producing more energy ourselves, with our gas production assets and with our major investment in renewables.

**Alistair →** As well as acquiring gas production assets, we've also been building up our portfolio of long-term fuel supply contracts with companies like Shell and Statoil to help us meet demand for gas over the rest of this decade and beyond.

**What does this mean for household energy bills?**

**Alistair →** We've said we won't increase energy prices before October 2012 at the earliest. Unfortunately, the long-term trend for unit prices for energy is upwards as worldwide demand for commodities increases. Equally, the last few years have shown that prices are

not the same as bills and investment in energy efficiency really does cut consumption and help keep bills down.

**Ian →** If the long-term trend for unit prices is upwards, we have to redouble our efforts to show that any profits we make in supplying energy are fair and reasonable. We've taken a number of steps to improve the transparency of our Energy Supply business, and we expect our average profit margin in this area to be around 5% over the medium term. That's what fair and reasonable means in practice.

**Why have you started reporting operating profit for Energy Supply, and why have you changed your reportable segments to Networks, Retail and Wholesale?**

**Gregor →** It's the transparency word again. We already produced what's called a Consolidated Segmental Statement for Ofgem and we've decided that we should take the natural next step and adjust the segments in our financial statements. The three segments themselves reflect the way we manage, review and report our businesses internally.

**Alistair →** Some things haven't changed. We still think that being involved in the Wholesale activities of energy production and portfolio management and the Retail activity of energy supply gives us a balanced business model that's in the interests of customers and shareholders. Balance will always be a key part of the SSE proposition.

**It's said that the cost of renewable energy is pushing up household bills. Are you concerned about the hostility to wind farms and what that might mean for the future?**

**Alistair →** Some people simply don't like wind farms, and they are entitled to have that view. In terms of cost, we have a responsibility to get the cost of renewable energy as low as possible, and we're doing a lot of work with our supply chain to try to do that. At the same time, demand for commodities like oil and gas is likely to increase – and it's also getting more and more difficult to extract them, even if they are available. The cost of wind energy has to be assessed in that context and on the basis that wind farms should last for 25 years or more.

**Ian →** Wind as a source of energy is indigenous, renewable and free at the point of delivery. I think those features are going to become more and more important over the next decade and beyond.

### Can SSE continue to finance the investment in energy infrastructure like wind farms and transmission upgrades that will be needed over the next few years?

**Gregor** → Yes. We have plans to invest between £1.5bn and £1.7bn a year in the period up to 2015, and these plans are consistent with our long-held financial principles, including balance sheet strength. We've been successful in moving quickly to secure the right financing options, like reopening the corporate bond market last September and completing a private placement with US investors earlier this year.

**Ian** → There are some eye-watering numbers in terms of what the UK and Ireland will need to invest in energy over the next couple of decades – but investment decisions in things like power stations and wind farms are up to us. As I've said before, investment opportunities are not the same as investment obligations, and we will only invest in a way that is disciplined and consistent with earning returns that support dividend growth.

### If the business environment is difficult, can SSE sustain its commitment to above-inflation increases in the dividend?

**Ian** → Yes. We're committed to an increase of at least 2% more than RPI inflation for 2012/13 and then annual above-inflation increases after that. These are realistic targets which our balanced range of businesses and our investment programme in large capital projects are designed to help us achieve.

**Gregor** → I agree. Our dividend payments are comfortably covered by our adjusted earnings per share\* and we expect dividend cover to be in a range around 1.5 over the medium term. We have many new assets coming into operation now which should put us in a good position to deliver real dividend growth in the years ahead.

**Alistair** → Dividend growth isn't just a financial commitment. It's a management commitment to being disciplined, consistent and long term. That's entirely appropriate in a sector like energy and I think goes to the heart of the type of company SSE is.

### Is SSE's focus on the dividend compatible with wider corporate and social responsibilities?

**Ian** → Yes. SSE can only pay out dividends if it is a successful company. It can only be

a successful company in the short and long term if it meets the needs of customers and communities, in a responsible and sustainable way. That includes providing a fulfilling working environment. Successful companies buy services from other companies, employ people and pay taxes that governments can use to meet society's requirements. I think successful companies with a long-term outlook make a positive contribution to society and I strongly believe SSE makes a positive contribution in England, Scotland, Wales, Northern Ireland and the Republic of Ireland.

### SSE is now one of just five long-serving FTSE 100 companies to have delivered above-inflation dividend growth every year since the year it was formed, 1998. It's had the same business model and financial principles throughout that period. Do you ever worry that the longevity of this approach could make it difficult for SSE to handle change in its sector or in society more widely?

**Ian** → It's the job of every management team to anticipate change, influence change and respond to change. I actually think it's easier to do that if the organisation is designed for the long term and has clear values and principles. All around me I see work being done that will be of benefit to SSE in three, five and 10 years' time and beyond.

**Gregor** → SSE is actually different from what it was five or 10 years ago, and it will be different again in five years' time. You just have to look at the asset base for a start. But everything we do does come back to the business model and financial principles. They've stood us in good stead in a volatile world since 1998, and I think they provide the basis for continued success in the future.

**Alistair** → I think SSE is actually very innovative and progressive, and we can clearly point to many parts of the business having a sector-leading position, from commitment

to renewable energy to building trust in energy supply. There is also what you might call restlessness in the organisation, with people constantly looking for new opportunities to be better at what we do.

### So what's the financial outlook for 2012/13 and beyond?

**Gregor** → It's partly the job of the Finance Director to say each year that big challenges lie ahead – but they certainly do in 2012/13. Everything from wholesale energy prices to the weather can affect our financial performance – but we have a balanced business model to make sure that the risk arising from any single business activity is contained. The key question for SSE will always be can the dividend targets be met and the answer is that I am very confident they can. That means we expect to recommend an increase of at least 2% more than inflation in the full-year dividend in the Annual Report 2013.

### What is your personal priority for SSE in 2012/13?

**Alistair** → I have two that stand out particularly. Last year we adopted a simple goal on safety – work without anyone getting injured. I want to see real progress on that. I also want to keep up the momentum on building trust in energy supply, with SSE showing real leadership and taking real action that makes a difference.

**Gregor** → I'd echo what Alistair said on safety. My other priority is value for money. For both current operational and capital expenditure, I want to make sure that every penny in SSE counts and that we demonstrate efficiency in everything we do.

**Ian** → I think we're all agreed on safety. After that, I'd like to see more progress on taking the carbon out of electricity, either through producing more energy from renewable sources or putting in place the networks to deliver it. That will reinforce the sustainability of SSE in every sense. •

SSE can only pay out dividends if it is a successful company. It can only be a successful company in the short and long term if it meets the needs of customers and communities, in a responsible and sustainable way.

## SSE – a balanced range of energy businesses

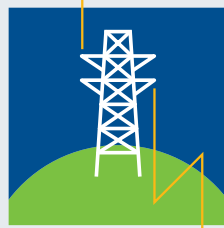
# SSE

## ECONOMICALLY-REGULATED

## MARKET-BASED

### NETWORKS

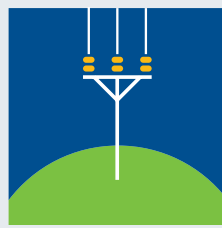
SSE has an ownership interest in economically-regulated network businesses in electricity transmission and electricity and gas distribution and has other networks businesses in market-based areas such as lighting services, utility solutions and telecoms. In operating and investing in these businesses, SSE's Networks priorities are efficiency, responsiveness and innovation.



Electricity Transmission

**£770m**

Regulated asset value



Electricity Distribution

**£2,840m**

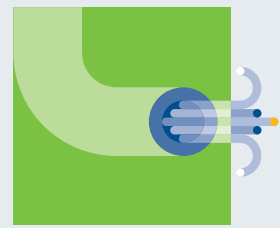
Regulated asset value



Gas Distribution

**£2,270m**

Regulated asset value (SSE share)



Other Networks

**£48m**

Capital expenditure in 2011/12



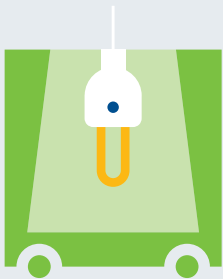
**Business model**

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

This balance means SSE has a strong and diverse group of energy assets and businesses from which to secure the revenue to support future dividend growth.

**RETAIL**

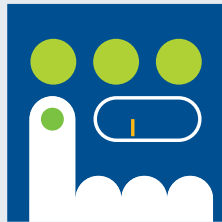
Through brands such as SSE, Southern Electric, Swalec, Scottish Hydro, Atlantic and Airtricity, SSE supplies electricity and gas in markets in Great Britain and Ireland and also provides other energy-related services such as mechanical and electrical contracting. Its Retail priorities are fair prices, simple products and excellent service.



Energy Supply

**9.55m**

Total energy customer accounts



Energy-related Services

**£78m**

SSE Contracting order book as at 31 March 2012

**WHOLESALE**

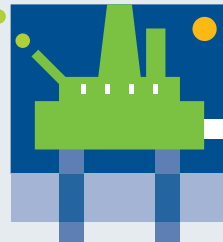
To secure energy for its customers, SSE is involved in energy portfolio management, electricity generation, gas production and gas storage. Amongst other things, it is the leading generator of electricity from renewable sources across the UK and Ireland. Its Wholesale businesses priorities are competitiveness, sustainability and flexibility.



Energy Portfolio Management and Electricity Generation

**£982m**

Capital expenditure in 2011/12



Gas Production

**177m**

Therms produced in 2011/12



Gas Storage

**490mcm**

Storage net capacity

## Why invest in SSE?

SSE's principal financial objective is to deliver annual above-inflation increases in the **dividend**. To do this, it operates and invests in a balanced range of energy networks, retail and wholesale businesses.

These businesses, and the people employed in them, are guided by the SSE SET of core **values**: Safety, Service, Efficiency, Sustainability, Excellence and Teamwork.

### Continuing strategy for dividend growth

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

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

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

The objective of delivering annual above-inflation increases in the dividend paid to shareholders means SSE has a clear, measurable and practical goal which sets the long-term financial context for its operational and investment decisions.

### Sticking to financial principles to underpin dividend growth

The requirement on SSE to maintain a disciplined, consistent and long-term approach to the management of business

activities is underpinned by a series of long-standing financial principles:

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

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

### Delivering dividend growth for a thirteenth successive year

For 2011/12, the Board is recommending a final dividend of 56.1p per share, making a full-year dividend of 80.1p, an increase of 6.8% on the previous year. The full-year dividend is:

- covered 1.41 times by SSE's adjusted earnings per share\*;
- more than three times the first full-year dividend paid by SSE, in 1999; and
- more than twice the full-year dividend paid eight years ago, in 2004.

The recommended full-year dividend increase of 6.8% represents the thirteenth successive above-inflation dividend increase since SSE paid its first full-year dividend in 1999. SSE is now one of just five continuing FTSE 100 companies to have delivered better-than-inflation dividend

### Key development

**2012**  
GREEN DEAL

**2013**  
PHASE 3 OF EU EMISSIONS TRADING SCHEME

NEW ELECTRICITY TRANSMISSION PRICE CONTROL (RIIO-T1)

NEW GAS DISTRIBUTION PRICE CONTROL (RIIO-G1)

**2014**  
NEW LOW CARBON SUPPORT MECHANISM INTRODUCED

SMART METER ROLL-OUT BEGINS

## 2012



### Main impact

Forecast implementation of new energy efficiency framework for GB, with the 'Green Deal' finance mechanism and new Energy Company Obligation (ECO).

In Phase 3 of EU ETS, all carbon dioxide emissions allowances for electricity generators will be auctioned. Carbon price support introduced in UK.

RIIO-T1 will set for an eight-year period the allowed revenues electricity transmission companies in GB can collect.

RIIO-G1 will set for an eight-year period the allowed revenues gas distribution companies in GB can collect.

Under Electricity Market Reform (EMR), the first projects are to be given the option to use a new low carbon support mechanism, the Contract for Difference (CFD).

The government driven, supplier led roll-out is due to begin, delivering 55 million smart electricity and gas meters.

growth every year during this period and ranks third amongst that group in terms of compound annual growth rate.

Of the 48 companies which have been FTSE 100 constituents since 1998, when SSE joined the Index, SSE is ranked 10th for Total Shareholder Return.

**Targeting sustained dividend growth over the long-term**

As Capita Registrars Dividend Monitor, published in February 2012, stated, a ‘company’s value depends, most fundamentally, on the ability of the firm to make money and return it to shareholders. Ultimately, dividends are the principal way in which corporate profits are distributed’. It is in recognition of this that SSE’s key financial objective is the delivery of annual above-inflation increases in the dividend paid to shareholders, and its targets are to deliver:

- a full-year dividend increase of at least 2% more than RPI inflation for 2012/13; and
- annual above-RPI inflation dividend increases from 2013/14 onwards.

In this context, inflation is defined as the average annual rate across each of the 12 months to March.

SSE’s policy is that dividend targets should be:

- set in a way which is consistent with SSE’s financial principles (see previous page);
- realistic and attainable, so there can be the fullest possible confidence in their achievability; and
- consistent with maintaining dividend cover over the medium term within a range of around 1.5 times, which is close to the average dividend cover which SSE has achieved in the most recent four years.

**Maintaining a balanced range of energy businesses through which to achieve dividend growth**

SSE has adopted new reportable segments covering Networks, Retail and Wholesale businesses and is the only company listed on the London Stock Exchange which owns, operates and invests in a balanced group of economically-regulated energy businesses, such as electricity networks, and market-based energy businesses, such as energy supply and electricity generation. The balance between these activities means that:

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

This balance, diversity, growing asset base and range of investment options means that SSE has a broad platform from which to deliver the levels of profitability and the long-term value required to support sustained real dividend growth. In addition, the risks to the achievement of that growth are contained by that balance and by the diversity of SSE’s businesses, assets and investment options.

Moreover, the fact those businesses, assets and investment options are almost entirely in Great Britain, Northern Ireland and the Republic of Ireland means that SSE is able to combine diversity with a depth of experience, knowledge and understanding of the markets in which it operates.

**Sustaining dividend growth through a period of change**

Energy markets in Great Britain and Ireland are increasingly shaped by the EU Climate

Change and Renewable Energy Package, which aims to achieve by 2020:

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

In addition, the EU has a non-binding target to achieve a 20% reduction in energy consumption by 2020 through improvements in energy efficiency and in June 2011 the European Commission proposed an Energy Efficiency Directive. The proposed Directive is broad in scope and would replace a number of existing Directives.

The EU Package provides the context for four major developments which are under way in public policy and regulation and which will affect SSE’s operations and investments for years to come:

- Ofgem’s new ‘RIIO’ model for the economic regulation of energy networks in Great Britain is now going through the key tests of actual Price Control Reviews;
- the Retail Market Review in Great Britain, being undertaken by Ofgem, is designed to deliver improvements in the operation of the retail markets for electricity and gas;
- the UK government’s White Paper, *Planning our Electric Future*, sets out a series of proposed reforms to the market arrangements for electricity generation in Great Britain; and
- energy markets on the island of Ireland are undergoing a process of harmonisation to support further the development of competition, for the benefit of customers.

At the heart of these developments is the energy ‘trilemma’ – the need for supplies

**2015**  
NEW ELECTRICITY DISTRIBUTION PRICE CONTROL

LARGE COMBUSTION PLANT DIRECTIVE (LCPD) DEADLINE

**2017**  
RENEWABLES OBLIGATION (RO) CLOSURE

**2020**  
DEADLINE FOR EU RENEWABLE ENERGY TARGETS

DEADLINE FOR EU EMISSIONS REDUCTION TARGETS

**2023**  
INDUSTRIAL EMISSIONS DIRECTIVE DEADLINE



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

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

Under Electricity Market Reform (EMR), the RO is due to be replaced by a new low carbon support mechanism, the Contract for Difference (CFD).

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

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

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



## Why invest in SSE? (continued)

of energy that are secure, sustainable and affordable. There are three other significant factors with which energy companies such as SSE have to deal:

- as the decline of oil and gas production from the UK Continental Shelf continues, there is a continuing integration of UK energy prices into the wider global market, which means macro-economic and geopolitical factors are important;
- demand for energy in the UK and Ireland is, rightly, on a downward trend through the effects of investment in, and greater awareness of, energy efficiency measures, more efficient appliances and price sensitivity on the part of customers; and
- the expectation that the decarbonisation of the economies in the UK and Ireland will present opportunities for flexible and skilled employment that is sustainable in every sense.

As well as dealing with geopolitical, macro-economic and energy-specific issues, SSE acknowledged, in a submission to the UK and Scottish governments in February 2012, that it would have to decide whether the additional risk of regulatory and legislative change with regard to Scotland, raised by the forthcoming referendum on its future, means it should apply a risk premium to any investment proposal in Scotland and assess the impact of such a premium on whether or not to proceed with the proposed investment.

### Setting the right long-term priorities to achieve dividend growth

SSE has identified five long-term priorities across its balanced range of businesses which reflect and are consistent with the changes under way at global, EU, UK and Irish levels and with addressing the energy 'trilemma'. The long-term priorities are:

- efficiency, responsiveness and innovation in energy networks;
- gaining and retaining the trust of a growing number of household energy customers;
- breadth and depth in the provision of energy-related services to businesses and other organisations;
- competitive and sustainable energy procurement; and
- flexible and 'greener' electricity production.

In focusing on these priorities, SSE will maintain a strong emphasis on its six core values, the 'SSE SET' of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork. It believes these values are especially significant because energy is

something which people *need* rather than *want* and so the highest possible standards in its operations and investments are essential.

This means that safety must come first. SSE believes that the effective management of safety issues is a barometer of effective management of all operational and investment-related activities. In 2011/12, its Total Recordable Injury Rate per 100,000 hours worked was 0.11, compared with 0.12 in 2010/11 and 0.14 in 2009/10. The total number of working days lost in SSE as a result of injuries occurring during the year was 53, compared with 171 in the previous year. The Total Recordable Injury Rate and total number of working days lost as a result of injuries occurring during 2011/12 was the lowest that SSE has had.

In addition, and in keeping with its commitment to sustainability, SSE's target for every year is zero environmental incidents which result in it being served with an enforcement notice or prosecution by a government-sponsored environment protection agency. There were no such incidents during 2011/12, the second successive year in which this was achieved.

### The prospects for dividend growth in 2012/13 and beyond

The economic outlook for the UK and Ireland in 2012/13 continues to be uncertain, and the global nature of energy markets means that SSE, like every other company in the sector, has to be prepared to manage the energy consequences of exceptional and unpredictable macro-economic, geopolitical or other events of potentially global significance.

Against this uncertain background, and with its strategic focus on efficiency in operations and investment, SSE's core operational priorities during 2012/13 are to:

- carry out all work in a safe and responsible manner, with a lower Total Recordable Injury Rate;
- maintain strong cost control throughout all business activities;
- distribute electricity and (through Scotia Gas Networks) gas with the minimum possible interruptions to supplies;
- demonstrate responsiveness and innovation in the management of electricity and gas networks;
- develop and sustain long-term partnerships and contracts with business customers and other large organisations;
- improve the standards of service delivered to energy supply customers and continue the drive to build trust in it as an energy supplier;

- work with the UK government and Ofgem to secure a stable and competitive framework for electricity generation and energy supply in Great Britain;
- optimise the management of its portfolio of energy assets and contracts and of its energy procurement; and
- ensure power stations maintain a high level of flexibility and fuel efficiency to generate electricity in response to customers' needs and market conditions.

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

- making significant progress in its programme of capital investment in electricity and (through Scotia Gas Networks) gas networks, including electricity transmission;
- commissioning assets in renewable energy, including completion of the wind farm development at Clyde;
- meeting development and construction goals in its investment programme, including identifying opportunities for possible new fuel-efficient gas-fired power stations; and
- improving the flexibility and efficiency of its existing fleet of thermal power stations and maintaining options for future development.

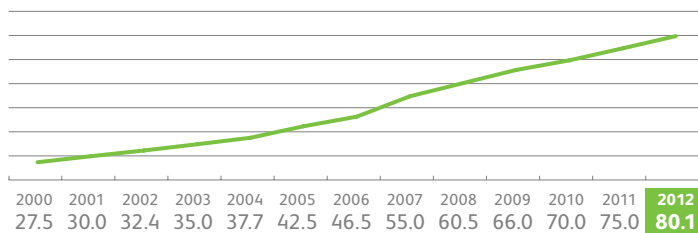
The delivery of a strong operational performance and the achievement of its investment priorities should enable SSE to discharge its first financial responsibility to shareholders in 2012/13: an increase of at least 2% more than RPI inflation in the full-year dividend. It should also put SSE in a good position to deliver dividend increases that are greater than RPI inflation from 2013/14 onwards. •

## Key performance indicators

The key performance indicators set out below demonstrate SSE's performance in respect of its first financial responsibility to shareholders – sustained real dividend growth – and include other important financial metrics. They also demonstrate SSE's balanced range of energy businesses.

SSE's performance in key non-financial areas and in respect of its core values is set out on page 54.

### Dividend per share – pence



### Dividend cover – times

|      |      |
|------|------|
| 2012 | 1.41 |
| 2011 | 1.50 |
| 2010 | 1.57 |
| 2009 | 1.57 |
| 2008 | 1.73 |

### Adjusted profit before tax\* – £m

|      |         |
|------|---------|
| 2012 | 1,335.7 |
| 2011 | 1,310.1 |
| 2010 | 1,290.1 |
| 2009 | 1,253.7 |
| 2008 | 1,229.2 |

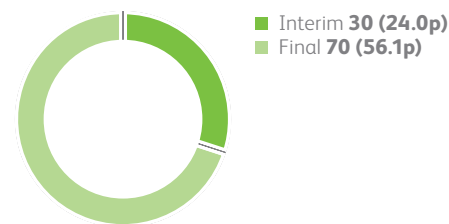
### Capital expenditure and investment – £m

|      |         |
|------|---------|
| 2012 | 1,706.9 |
| 2011 | 1,443.7 |
| 2010 | 1,315.2 |
| 2009 | 1,279.8 |
| 2008 | 810.3   |

### Energy customer numbers – millions

|      |      |
|------|------|
| 2012 | 9.55 |
| 2011 | 9.65 |
| 2010 | 9.35 |
| 2009 | 9.10 |
| 2008 | 8.49 |

### Dividend 2011/12 composition – %



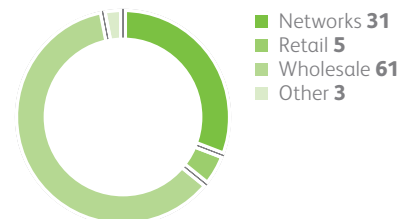
### Adjusted earnings per share\* – pence

|      |       |
|------|-------|
| 2012 | 112.7 |
| 2011 | 112.3 |
| 2010 | 110.2 |
| 2009 | 108.0 |
| 2008 | 105.6 |

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

|           | 2011  | 2012  |
|-----------|-------|-------|
| Networks  | 690.5 | 737.1 |
| Retail    | 400.5 | 321.6 |
| Wholesale | 571.5 | 607.9 |

### Capital expenditure and investment 2011/12 – %



### Networks Regulated Asset Value – £bn

|      |      |
|------|------|
| 2012 | 5.88 |
| 2011 | 5.40 |
| 2010 | 4.94 |
| 2009 | 4.71 |
| 2008 | 4.45 |

## Financial overview

### Changing reportable segments

In its Annual Report 2011, SSE said that its reporting requirements may evolve and during 2011/12 it completed a review of the reportable segments contained within its financial statements. The review was undertaken following the creation of SSE's Management Board in January 2011 and resulting changes in the way that SSE manages, reviews and reports internally its businesses.

The previous segments – Energy Networks, Generation and Supply and Other Energy and Utility Services – have been replaced with the following:

- **Networks** – the economically-regulated transmission and distribution of electricity and gas, and other related networks;
- **Retail** – the supply of electricity, gas and other services to household and business customers; and
- **Wholesale** – the production, storage and generation of energy, and energy portfolio management.

These are consistent with the principle that components of a business qualify as separate reporting segments if they are capable of earning revenue and incurring expenses in their own right.

SSE believes that the adoption of these segments will add further transparency to its business and to the financial performance of each part of it. In particular, the new segments are consistent with SSE's continuing work to build customers' trust in energy supply, where there will now be separate reporting of profit.

### Increasing adjusted profit before tax\*

These financial results for the year to 31 March 2012 are reported under International Financial Reporting Standards, as adopted by the EU. SSE's focus has consistently been, and remains, on profit before tax before exceptional items, remeasurements arising from IAS 39, and after the removal of taxation on profits from jointly controlled entities and associates.

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

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

The tables that follow reconcile SSE's adjusted profit before tax\* to its reported profit before tax and set out the position after tax and in respect of adjusted earnings per share\*. The volatility that arises from IAS 39 is also demonstrated.

### Factors affecting adjusted profit before tax\* in 2011/12

Adjusted profit before tax\* rose by 2.0%, from £1,310.1m to £1,335.7m in the year to 31 March 2012. The level of adjusted profit before tax\* was constrained by four main factors (comparisons with the year to 31 March 2011 unless otherwise stated):

- the wholesale cost of gas, which was typically around 20% higher;
- 'spark' spreads (the difference between the cost of gas and the price of the electricity produced from it), which were around 75% lower;
- the decision to shield household customers from rising wholesale energy prices for as long as practical before eventually implementing a price increase in September; and
- the actual reduction in average consumption of both electricity (6.9%) and gas (19.9%) by household customers in the GB market.

In addition, there was a 5.3% reduction in operating profit\* in Electricity Distribution due to the timing of revenue recovery.

Despite these factors, growth in adjusted profit before tax\* was still achieved, for four main reasons:

- a significant rise (73%) in the output of renewable energy (hydro and wind), reflecting more favourable weather conditions and an increase in the amount of on- and offshore wind farm capacity which SSE has in operation;

- operating profit\* of £42.6m from gas production assets acquired by SSE towards the end of 2010/11;
- an increase of 54.5% in the operating profit\* of Electricity Transmission, reflecting the increase in its asset base resulting from capital invested; and
- greater allowed revenue in Scotia Gas Networks, supporting an increase of 43.5% in that business' contribution to adjusted profit before tax\*.

All of this illustrates that SSE continues to benefit from maintaining a balance between economically-regulated and market-based businesses because it is able to continue to deliver increases in adjusted profit before tax\* even when, as in 2011/12, there are significant issues to be managed within individual businesses. It also illustrates that major benefits from SSE's programme of investment in new assets are now emerging and making a positive contribution to sustaining growth in adjusted profit before tax\*.

### Impact of the movement on derivatives (IAS 39)

At 31 March 2012, there was a net derivative financial liability in SSE's balance sheet arising from IAS 39 of £17.6m, before tax, compared with a net asset of £438.8m, before tax, at 31 March 2011. This consists of:

- a liability following the valuation of financial instruments used by SSE to hedge its exposure to financial risks such as interest rates; and
- an asset relating to the forward commodity purchase contracts for gas, coal, oil, carbon and wholesale electricity that SSE, like all major energy suppliers, has to enter into to ensure that the future requirements of its customers are met.

| Profit before tax                                      | March 12<br>£m | March 11<br>£m | March 10<br>£m |
|--|----------------|----------------|----------------|
| <b>Adjusted profit before tax*</b>                     | <b>1,335.7</b> | 1,310.1        | 1,290.1        |
| Movement on derivatives (IAS 39)                       | <b>(509.0)</b> | 1,423.3        | 399.8          |
| Exceptional items                                      | <b>(551.6)</b> | (625.0)        | –              |
| Tax on JCEs and Associates                             | <b>(6.6)</b>   | 3.3            | (51.3)         |
| <b>Reported profit before tax*</b>                     | <b>268.5</b>   | 2,111.7        | 1,638.6        |
| Adjusted profit before tax*                            | <b>1,335.7</b> | 1,310.1        | 1,290.1        |
| Adjusted current tax charge                            | <b>(213.4)</b> | (268.2)        | (274.1)        |
| <b>Adjusted profit after tax*</b>                      | <b>1,122.3</b> | 1,041.9        | 1,016.0        |
| <b>Reported profit after tax<sup>1</sup></b>           | <b>197.8</b>   | 1,504.5        | 1,235.5        |
| Number of shares for basic and adjusted EPS* (million) | <b>937.8</b>   | 927.6          | 921.9          |
| <b>Adjusted EPS*<sup>1</sup></b>                       | <b>112.7p</b>  | 112.3p         | 110.2p         |
| <b>Basic EPS</b>                                       | <b>21.1p</b>   | 162.2p         | 134.0p         |

1 Includes a deduction for hybrid debt coupon payment of £65.5m in the year to March 2012.

IAS 39 requires SSE to record these contracts at their 'fair value' at each balance sheet date. This involves comparing the contractual price for commodities against the prevailing forward market price at 31 March. On that date this year, the average contractual price was lower than the market price (in other words, the contracts were 'in the money'). The actual value of the contracts will be determined as the relevant commodity is delivered to meet customers' energy needs. For around 70% of the total energy volume, this will be over the next 12 months. As a result, SSE believes the movement in 'fair value' of the contracts is not relevant to the underlying performance in 2011/12.

The movement on derivatives under IAS 39 of £509m shown in the table on page 18 and on the face of the income statement is primarily due to the change in the commodity contract position between the 'in the money' positions on 31 March 2011 and 31 March 2012, when the average contractual price continued to be lower than the prevailing forward market price, but not as much as previously. SSE sets out these movements in 'fair value' separately, as remeasurements, as the extent of the actual profit or loss arising over the life of the contracts giving rise to this liability will not be determined until they unwind.

### Exceptional items

The pre-tax exceptional items totalling £551.6m relate to the Wholesale (£491.6m) and Retail (£60.0m) segments and are mainly non-cash.

In the Wholesale segment, changing market conditions have resulted in impairment and other charges being made against the value of some electricity generation plant, CO<sub>2</sub> emissions allowances, goodwill relating to gas storage assets and gas and oil production prospects. In particular, following a sustained period of low 'spark' spreads, SSE decided to undertake a comprehensive programme of maintenance and upgrade work to support more flexible operations at Keadby and Medway power stations from 2013 onwards. This means the way in which the stations will operate and be remunerated in the future will change. Other issues include a small write-down at Ferrybridge power station, due to the early use of allowed running hours under the Industrial Emissions Directive, and a write-down in the value of on- and offshore wind assets in continental Europe.

In the Retail segment, restructuring and related costs arising from SSE's decision to stop all of its doorstep sales operations in Great Britain have been recognised as exceptional. The value of some metering

## SSE's first financial responsibility to its shareholders is to remunerate their investment through the delivery of sustained, above-inflation increases in the dividend.

assets has also been impaired in anticipation of the expected introduction of smart meters.

### Delivering adjusted profit before tax\* in 2012/13

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

At the same time, SSE has delivered 13 successive increases in adjusted profit before tax\* since it first reported full-year results in 1999. As in any other year, SSE's adjusted profit before tax\* for 2012/13 as a whole will be determined by issues such as:

- the management of the overall energy portfolio, in the context of geopolitical and macro-economic issues;
- the interaction between wholesale prices for energy and fuel and the prices for the electricity and gas charged to customers;
- the availability of its operating thermal power stations to generate electricity;
- the output of renewable energy from its hydro-electric stations and wind farms; and
- the actual and underlying level of customers' energy consumption.

In terms of 2012/13, SSE continues to believe that its balanced range of market-based and economically-regulated energy businesses, and the diversity of opportunities within those businesses, should enable it to deliver a level of adjusted profit before tax\* capable of supporting the achievement of its principal financial objective, a full-year dividend increase of at least 2% more than RPI inflation, while maintaining dividend cover in a range around 1.5 times.

SSE will provide an update on its financial, operational and investment progress during 2012/13 when it presents its results for the six

months to 30 September 2012. Its expectation at the start of each financial year is that it will not provide an outlook for adjusted profit before tax\* before the publication of its fourth quarter Interim Management Statement, not least because its principal financial objective is dividend growth, and that remains the case for 2012/13.

### Monitoring adjusted earnings per share\*

To monitor financial performance over the medium-term, SSE continues to focus on adjusted earnings per share\* because it has the straightforward benefit of defining the amount of profit after tax that has been earned for each Ordinary Share and so reflects a clear view of underlying financial performance.

In 2011/12, SSE's adjusted earnings per share\* were 112.7p, based on 937.8 million shares, compared with 112.3p, based on 927.6 million shares, in the previous year. As stated in SSE's Annual Report 2011, the charge for the hybrid debt coupon is presented within dividends and reflected within adjusted earnings per share\*.

## Dividend

### Increasing the dividend for 2011/12

SSE's first financial responsibility to its shareholders is to remunerate their investment through the delivery of sustained, above-inflation increases in the dividend. The Board is recommending a final dividend of 56.1p, compared with 52.6p in the previous year, an increase of 6.7%. This will make a full-year dividend of 80.1p, which is:

- an increase of 6.8% compared with 2010/11;
- a real-terms increase of 2.0%, based on the average annual rate of RPI inflation in the UK between April 2011 and March 2012, which meets the target set for the year;
- the thirteenth successive above-inflation dividend increase since the first full-year dividend paid by SSE, for 1998/99;
- more than three times the first full-year dividend paid by SSE, for 1998/99; and



## Financial overview (continued)

| Investment and capital expenditure summary      | March 12<br>£m | March 11<br>£m |
|---|----------------|----------------|
| Electricity Transmission                        | 228.7          | 117.4          |
| Electricity Distribution                        | 260.3          | 211.9          |
| Other Networks                                  | 48.0           | 55.0           |
| <b>Total Networks</b>                           | <b>537.0</b>   | <b>384.3</b>   |
| <b>Total Retail</b>                             | <b>78.5</b>    | <b>27.9</b>    |
| Thermal Generation                              | 129.7          | 129.8          |
| Renewable Generation                            | 852.3          | 813.8          |
| Gas Storage and Gas Production                  | 57.1           | 52.6           |
| <b>Total Wholesale</b>                          | <b>1,039.1</b> | <b>996.2</b>   |
| <b>Other</b>                                    | <b>52.3</b>    | <b>35.3</b>    |
| <b>Total investment and capital expenditure</b> | <b>1,706.9</b> | <b>1,443.7</b> |
| 50% of SGN capital/replacement expenditure      | 202.2          | 199.7          |

→ covered 1.41 times by SSE's adjusted earnings per share\*.

SSE is now one of just five companies to have delivered better-than-inflation dividend growth every year since 1999, while remaining part of the FTSE 100 for at least 50% of that time, and ranks third amongst that group in terms of compound annual growth rate over that period.

### Targeting further dividend increases in 2012/13 and beyond

SSE's key financial objective will remain the delivery of increases in the dividend paid to shareholders, and its targets are to deliver:

- a full-year dividend increase of at least 2% more than RPI inflation for 2012/13; and
- annual dividend increases from 2013/14 onwards which are greater than RPI inflation.

### Scrip Dividend Scheme option for shareholders

In 2010, SSE's shareholders approved for five years the provision of a Scrip Dividend Scheme, to give them the option to receive new fully paid Ordinary Shares in the Company in place of their cash dividend payments. Scrip dividend take-up was as follows:

- **September 2011:** a total of 30,397 shareholders elected to receive the final dividend of 52.6p per Ordinary Share in respect of 22.6 million Ordinary Shares in the form of Scrip dividend. This resulted in the issue of 0.9 million new Ordinary Shares, fully paid, an increase of 0.1% on the issued share capital at the dividend record date of 29 July 2011; and

- **March 2012:** a total of 30,504 shareholders elected to receive the interim dividend of 24.0p per Ordinary Share in respect of 318 million Ordinary Shares in the form of Scrip dividend. This resulted in the issue of 6.27 million new Ordinary Shares, fully paid, an increase of 0.67% on the issued share capital at the dividend record date of 27 January 2012.

This had the effect of reducing by £88.2m the amount of dividends paid in cash during 2011/12. The total number of shares in issue at 31 March 2012 was 944.7 million.

## Investment and capital expenditure

### Investing for sustained dividend growth

In November 2010, SSE said that it expected its investment and capital expenditure would be in the range of £1.5bn to £1.7bn in each of the five years to March 2015. In 2011/12, its capital and investment expenditure totalled £1,706.9m, compared with £1,443.7m in the previous year. During the year there was investment of:

- £228.7m in **electricity transmission**, of which £126.3m was spent on the work to replace SSE's section of the Beaulieu-Denny line;
- £260.3m in **electricity distribution**, the majority of which was spent on system upgrades;
- £129.7m in **thermal generation**, the majority of which was for maintenance and early development of future projects;
- £852.3m in **renewable generation**, the larger part of which was invested in the Clyde, Griffin and Gordonbush onshore wind farms; and

- £57.1m in **gas storage and gas production**, including investment in the new facility at Aldbrough, which is nearing completion.

Including investment of £134.2m in 2011/12, SSE's cumulative investment in the Greater Gabbard offshore wind farm is now £672.2m, excluding costs associated with the construction of the offshore transmission line.

### Delivering an expanded asset base

In the five years to March 2012, SSE's investment and capital expenditure totalled just over £6.5bn. This has resulted in a significantly expanded asset base for SSE, including:

- completion of the 840MW Marchwood Power Station (SSE share – 50%);
- an increase of around 1,500MW in its capacity for generating electricity from wind farms (which produced around 3.2TWh of electricity in 2011/12);
- near-completion of the Aldbrough gas storage facility (SSE share – two thirds); and
- an increase of over £1bn in the RAV of its electricity networks.

The 100MW Glendoe hydro-electric scheme was also commissioned during this period, in early 2009. It operated for less than a year before a tunnel blockage resulted in electricity generation being stopped. The progress of repair work means electricity generation is expected to resume this summer.

SSE remains committed to constructing robust assets, from which revenue can be generated on a reliable, long-term basis and which deliver profit to support future dividend growth. This entails rigorous scrutiny and control of the costs of large capital projects and a clear focus on the return which completed projects should generate.

In line with this, SSE keeps the economic evaluation of its investment programme under close scrutiny to ensure that it continues to make the right investment decisions. It continues to be confident that an enhanced asset base and significant value are being created from its capital and investment expenditure programme as a whole, based on actual delivery of the projects within it and on the most up-to-date costs and schedules for projects.

### Investing in gas distribution through Scotia Gas Networks (SGN)

In addition to its own capital and investment expenditure programme, SSE effectively has

a 50% interest in SGN's capital and replacement expenditure, through its 50% equity share in that business. SGN is self-financing and all debt relating to it is separate from SSE's balance sheet. Nevertheless, it is a very substantial business which gives SSE, through its 50% stake, a major interest in gas distribution. In 2011/12, a 50% share of SGN's capital and replacement expenditure was £202.2m, compared with £199.7m in the previous year.

### Delivering investment efficiently

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

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

The premium is applied to reflect any risk associated with asset construction, market dynamics, new technologies or regulatory or legislative change.

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

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

Decisions on whether to proceed with individual projects are made:

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

- in the light of developments in public policy and regulation; and
- on the basis of the experience and skills available to SSE.

SSE believes that its pipeline of development opportunities means that it will be able to focus uncommitted spend on projects with the strongest potential to achieve returns well in excess of its cost of capital, enhance earnings and contribute to dividend growth.

In particular, a disciplined programme with the principles, shape and scale described above is designed to allow SSE to maintain the development of a balanced and diverse range of assets to support sustained, above-inflation dividend growth while remaining consistent with the criteria for a 'single A' credit rating without the need to issue new shares. It will deliver:

- further significant enhancements to the asset base in key businesses, including economically-regulated electricity networks;
- a continuing increase in fuel for electricity in the form of renewable sources of energy, supporting a reduction in the CO<sub>2</sub> intensity of electricity generated; and

- additional cash flows and profits to support continuing dividend growth.

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

## Financial management and balance sheet

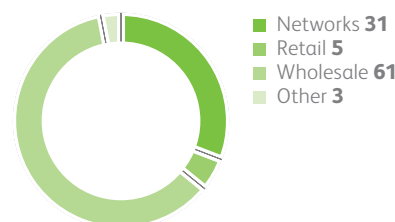
### Maintaining a prudent treasury policy

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

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

As a matter of policy, a minimum of 50% of SSE's debt is subject to fixed, or inflation-linked, rates of interest. Within this policy framework, SSE borrows as required on different interest bases, with derivatives and forward rate agreements being used to achieve the desired out-turn interest rate profile. At 31 March 2012, after taking account of interest rate swaps, 77.4% of SSE's borrowings were at fixed rates.

## Capital expenditure and investment 2011/12 – %



## Renewable energy capital expenditure – £m

|      |       |
|------|-------|
| 2012 | 852.3 |
| 2011 | 813.8 |
| 2010 | 666.6 |
| 2009 | 525.6 |
| 2008 | 132.8 |

## Electricity networks capital expenditure – £m

|      |       |
|------|-------|
| 2012 | 489.0 |
| 2011 | 329.3 |
| 2010 | 334.5 |
| 2009 | 314.6 |
| 2008 | 264.4 |

## Financial overview (continued)

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

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

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

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

### Managing net debt and maintaining cash flow

SSE's adjusted net debt and hybrid capital was £6.76bn at 31 March 2012, compared with £5.89bn at 31 March 2011. Fundamentally, this increase reflects:

- the quantum and phasing of capital and investment projects to support sustained real dividend growth; and
- the decision to delay the increase in household energy prices until September 2011 meant some additional revenue would not be collected until the new financial year.

In addition, significant coal stocks have been acquired in anticipation of the fuel requirements at SSE's coal-fired power stations during 2012/13.

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

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

SSE's objective is to maintain a balance between continuity of funding and flexibility, with debt maturities set across a broad range of dates. Its average debt maturity as at 31 March 2012 was 9.3 years, compared with 10.6 years at 31 March 2011. The completion of the private placement (see 'Ensuring SSE is well-financed' below) means that SSE's average debt maturity was 9.6 years at 30 April 2012.

SSE's debt structure remains strong, with around £5.1bn of medium- to long-term borrowings in the form of issued bonds, European Investment Bank debt and long-term project finance and other loans. The table below also includes the issue by SSE, in September 2010, of hybrid capital of £1.16bn. The balance of SSE's adjusted net debt is financed with short-term commercial paper and bank debt. SSE's adjusted net debt includes cash and cash equivalents totalling £189.2m.

Around £100m of medium-to-long-term borrowings will mature during 2012/13.

### Ensuring SSE is well-financed

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

- 'A-', with a 'stable' outlook (Standard & Poors); and
- 'A3' with a 'stable' outlook (Moody's).

SSE is committed to maintaining financial diversity and will move quickly to take the right financing options, including issuing new bonds and loans. In line with that it:

- successfully re-opened the European corporate bond market in September 2011 with the issuance of a £300m bond with a 4.25% coupon and a 10-year maturity. As Lloyds Bank Corporate Markets stated, the strength of the order book was testament to SSE's attractions to investors;
- secured in October 2011 a JP¥15bn (equivalent to around £125m) seven-year loan with an effective interest rate of 3.52%; and
- undertook in February 2012 a private placement of senior notes with 22 US-based investors for a total consideration of US\$700m (equivalent to around £450m). The senior notes consist of four tranches with a weighted average maturity of 10.3 years and an all-in funding cost of around 4.25% once swapped to Sterling.

Following the issue of hybrid capital in 2010/11, the private placement was a further example of SSE diversifying its funding sources and putting in place funding at attractive rates. The placement was formally completed in April 2012. The net proceeds will be used to refinance short-term debt and to support SSE's programme of large capital projects.

With regard to shorter-term funding, SSE's core revolving credit facilities of £900m are, and are expected to remain, undrawn. The facilities are the subject of an agreement with banks which runs to 2015. In addition to these facilities, SSE has a committed bilateral facility of £100m with one other bank.

SSE believes that it has sufficient financial flexibility to pursue the best opportunities to provide the means with which to increase dividends. At the same time, it also believes that history – including shocks and uncertainties seen in the financial markets in recent years – demonstrates how companies with a commitment to the long-term must be disciplined when managing their balance sheets and cautious in financing their activities.

### Net finance costs

The table on page 23 reconciles reported net finance costs to adjusted net finance costs, which SSE believes is a more meaningful measure. In line with this, SSE's adjusted net finance costs during 2011/12 were £322.1m, compared with £342.8m in the previous year.

### Adjusted net debt and hybrid capital

|   | March 12<br>£m   | March 11<br>£m |
|---|------------------|----------------|
| <b>Adjusted net debt and hybrid capital</b> | <b>(6,755.8)</b> | (5,890.6)      |
| Less: hybrid capital                        | 1,161.4          | 1,161.4        |
| <b>Adjusted net debt</b>                    | <b>(5,594.4)</b> | (4,729.2)      |
| Add: outstanding liquid funds               | (119.9)          | (28.1)         |
| Add: finance leases                         | (342.1)          | (372.2)        |
| <b>Unadjusted net debt</b>                  | <b>(6,056.4)</b> | (5,129.5)      |

The charge for hybrid debt is presented within dividends and reflected within adjusted earnings per share\*.

The average interest rate for SSE, excluding JCE/ Associate interest, during 2011/12 was 5.06%, compared with 5.43% for the previous year. Based on adjusted interest costs, SSE's adjusted interest cover (including the hybrid coupon) was (previous year's comparison in brackets):

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

Excluding shareholder loans, SGN's net debt at 31 March 2012 was £3.27bn, and within the adjusted net finance costs of £322.1m, the element relating to SGN's net finance costs was £96.5m (compared with £90.4m in the previous year), after netting loan stock interest payable to SSE. Its contribution to SSE's adjusted profit before tax\* was £138.3m, compared with £96.4m in 2010/11.

### Contributing to employees' pension schemes

In line with the IAS 19 treatment of pension scheme assets, liabilities and costs, pension

scheme liabilities of £731.9m are recognised in the balance sheet at 31 March 2012, before deferred tax. This compares to a liability of £668.6m at 31 March 2011.

During the year to March 2012, employer cash contributions amounted to:

- £47.9m for the Scottish Hydro-Electric scheme, including deficit repair contributions of £29.5m; and
- £90.1m for the Southern Electric scheme, including deficit repair contributions of £67.2m.

As part of the electricity Distribution Price Control for 2010-15, it was agreed that allowances equivalent to economically-regulated businesses' share of deficit repair contributions in respect of the Southern Electric and Scottish Hydro-Electric schemes would be included in price controlled revenue, with an incentive around ongoing pension costs.

## Tax

### Being a responsible tax payer

Central to SSE's approach to tax is that it should be regarded as a responsible tax payer. As a consequence, SSE maintains a good

relationship with HM Revenue & Customs, based on trust and co-operation.

SSE strives to manage efficiently its total tax liability, and this is achieved through operating within the framework of legislative reliefs. SSE does not take an aggressive stance in its interpretation of tax legislation, or use so-called 'tax havens' as a means of reducing its tax liability. SSE's tax policy is to operate within both the letter and spirit of the law at all times.

SSE's tax paid to the government in the UK, including Corporation Tax, Employers' National Insurance Contributions and Business Rates, totalled £396.4m during the year to 31 March 2012, compared with £343.8m in the previous year. SSE also pays taxes in the Republic of Ireland, in relation to its operations there, and indirectly contributed £59.5m to UK government tax revenues through its significant investment in joint ventures and associates (as compared with £69.9m in the previous year).

As a member of the Hundred Group of Finance Directors, SSE contributes to its annual Total Tax Contribution survey. SSE ranked 23rd in the 2011 survey, both in terms of tax paid and total tax contribution.

### Setting out SSE's tax position

To assist the understanding of SSE's tax position, the adjusted current tax charge is presented in the table opposite.

The effective adjusted current tax rate, based on adjusted profit before tax\*, was 16%, compared with 20.5% in 2010/11, on the same basis. The impact of SSE's higher capital expenditure programme and the changes introduced in Budget 2007, and subsequently, have had, and will continue to have, a positive impact on the effective current tax rate.

The Budgets in June 2010, March 2011 and March 2012 have announced a series of annual reductions in the UK Corporation Tax rate for future years. The deferred tax balance has been remeasured to reflect the latest of these enacted rate reductions (from 26% to 24%) and the effect of this has been disclosed as an exceptional item. The deferred tax balances for future years will continue to be remeasured as each subsequent rate reduction is enacted.

The reported tax charge for 2011/12 is £5.2m, compared with a tax charge of £607.2m in the previous year. This reflects a large exceptional credit in 2011/12 compared to a large exceptional charge in 2010/11. •

| Net finance costs   | March 12<br>£m | March 11<br>£m |
|---|----------------|----------------|
| <b>Adjusted net finance costs</b>                             | <b>322.1</b>   | 342.8          |
| add/(less):   |                |                |
| Movement on derivatives                                       | 89.5           | 44.4           |
| Exceptional charges   | -              | 8.8            |
| Share of JCE <sup>1</sup> /Associate interest                 | (146.5)        | (139.9)        |
| Reported net finance costs                                    | 265.1          | 256.1          |
| Adjusted net finance costs                                    | 322.1          | 342.8          |
| Return on pension scheme assets                               | 147.4          | 141.9          |
| Interest on pension scheme liabilities                        | (149.8)        | (150.2)        |
| Finance lease interest  | (38.4)         | (39.7)         |
| Notional interest arising on discounted provisions            | (7.8)          | (4.3)          |
| Hybrid coupon payment   | 65.5           | -              |
| <b>Adjusted interest costs for interest cover calculation</b> | <b>339.0</b>   | 290.5          |

1 Jointly Controlled Entities

| Tax charge                                      | March 12<br>£m | March 11<br>£m |
|---|----------------|----------------|
| <b>Adjusted current tax charge</b>              | <b>213.4</b>   | 268.2          |
| add/(less):                                     |                |                |
| Share of JCE/Associate tax                      | (6.6)          | 3.3            |
| Deferred tax                                    | 118.0          | 83.3           |
| Tax on exceptional items/certain remeasurements | (319.6)        | 252.4          |
| Reported tax charge                             | 5.2            | 607.2          |



## Networks

Economically-regulated businesses

# NETWORKS

Keeping the lights on and supporting growth.

### Networks operating profit – £m

# 737.1

2011: 690.5

Change: +6.7%

SSE is involved in: electricity transmission; electricity distribution; gas distribution (through Scotia Gas Networks); and other networks-related businesses in lighting services, utility solutions and telecoms.

### Electricity networks capital expenditure – £m

# 489

2011: 329

Change: +48.5%

SSE owns, operates and invests in three electricity networks companies: Scottish Hydro Electric Transmission; Scottish Hydro Electric Power Distribution; and Southern Electric Power Distribution.

### Utility Solutions electricity networks

# 118

2011: 74

Change: +59.5%

SSE's Utility Solutions business designs, builds, owns and operates networks for electricity, gas, water and heat. The electricity networks are outside SSE's two distribution areas.

### Networks Regulated Asset Value (net) – £bn

# 5.88

2011: 5.40

Change: +8.9%

The RAV is the price paid for economically-regulated energy networks when they were privatised plus allowed capital expenditure less depreciation. It is indexed to the Retail Price Index.

### Customer minutes lost (South)

# 60

2011: 64

Change: -6.2%

Customer minutes lost is the average number of minutes that customers are without electricity supply in a year. SSE's Southern network distributes electricity to almost three million properties.

### Lighting Services PFI contracts

# 11

2011: 10

Change: +10.0%

SSE's Lighting Services business is the UK's and Ireland's largest streetlighting contractor, involved in the maintenance and replacement of public lighting units.

### Owning, operating and investing in Networks

In previous years, SSE reported the performance of its electricity networks on a geographical basis (ie the north of Scotland and central southern England). In terms of regulation, process, customers and service, it is now more relevant to report performance of electricity networks by activity (ie transmission and distribution) rather than geography and so from 2011/12 onwards SSE is adopting this approach.

The performance of the economically-regulated business SGN will continue to be reported within Networks. In addition, market-based activities of Lighting Services, Utility Solutions and Telecoms are also network-based and have, therefore, been included within SSE's Networks segment as Other Networks.

### Economically-regulated network companies with a growing Regulated Asset Value

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

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

SSE's electricity networks transmit and distribute electricity to around 3.7 million businesses, offices and homes via around 130,000km of overhead lines and under ground cables; and SGN's gas networks distribute gas to around 5.7 million homes, offices and businesses via 75,000km of gas pipes.

SSE estimates that the total Regulated Asset Value (RAV) of its economically-regulated 'natural monopoly' businesses is now £5.88bn, up from £4.2bn five years ago, comprising:

- £770m for electricity transmission;
- £2.84bn for electricity distribution; and
- £2.27bn for gas distribution (ie 50% of the businesses' total RAV of £4.54bn).

SSE is the only energy company in the UK to be involved in electricity transmission, electricity distribution and gas distribution. Through Price Controls, Ofgem sets the index-linked revenue the network companies can earn through charges levied on their users to cover their costs and earn a return on their regulated assets. These lower-risk economically-regulated natural monopoly businesses provide a financial backbone and operational focus for SSE and balance its activities in the competitive Wholesale and Retail markets. They are core to SSE, to its strategy in the short-, medium- and long-term and to its ability to deliver sustained real dividend growth.

### Developing market-based networks businesses

In addition to its economically-regulated network companies, SSE owns and operates three other networks businesses, which are market-based:

- Lighting Services: maintaining and replacing street and highway lighting;
- Utility Solutions: designing, building, owning and operating networks for electricity, gas, water and heat; and
- Telecoms: providing network capacity, bandwidth and data centre services.

As with economically-regulated networks, they have made significant progress in the past five years, in terms of assets, contracts and operating profit\*.

### Financial performance in Networks

Operating profit\* in Networks increased by 6.7%, from £690.5m to £737.1m, contributing 44.5% of SSE's total operating profit\*. This comprised (comparisons with the previous year in brackets):

- £73.7m in electricity transmission (£47.7m);
- £396.5m in electricity distribution (£418.9m);
- £234.8m representing SSE's share of the operating profit\* for SGN (£186.8m); and
- £32.1m in other network businesses (£37.1m).

## Electricity Transmission

### Performance in Scottish Hydro Electric Transmission Ltd (SHTL)

In SHTL, operating profit\* increased by 54.5% from £47.7m to £73.7m. This reflected the increase in its asset base following on from the ongoing increase in capital invested. During 2011/12, a total of £228.7m was invested by SHTL in its networks, up from £117.4m in the previous year, taking its total Regulated Asset Value from £560m to £770m.

### Upgrading Scotland's electricity transmission network

SHTL is responsible for maintaining and investing in the transmission network in its area, which comprises almost 5,300km of high voltage overhead lines and under ground cables and which serves around 70% of the land mass of Scotland. As the licensed transmission company for the area, SHTL has to ensure there is sufficient network capacity for those within it seeking to generate electricity from renewable and other sources.

A series of major developments is under way which is transforming the scale and scope of SHTL:

- **Knocknagael Substation:** Ofgem authorised £43.8m of investment in this project (at 2009/10 prices) and all major construction works relating to the substation and related overhead lines and under ground cables have been completed. The successful completion of the project has increased by 125MW the amount of electricity that can be exported from the north of Scotland;
- **Beaulay-Blackhillock-Kintore:** Work on replacing the conductors of the 275kV transmission lines between Beaulay and Blackhillock and Blackhillock and Kintore, to allow an increase in the capacity of the network to transmit electricity, is well under way and is expected to be finished in 2015. Ofgem has authorised investment of £81m (at 2009/10 prices) for this development;
- **Dounreay-Beaulay:** Work on upgrading and reinforcing the transmission network between Dounreay and Beaulay is continuing, including the installation of a second set of conductors to create a double circuit line and development of new and upgraded substations. Ofgem has authorised investment of £73.5m (at 2009/10 prices) for this programme, which should be completed in 2013; and
- **Beaulay-Denny:** Following consultation, Ofgem approved, in September 2011, an asset value adjusting event submitted

by SHTL to recover additional forecast construction costs arising from the replacement of its part of the line, from Beaulay to Wharry Burn, taking the total to £539m (at 2009/10 prices). Full construction work on the replacement line is now under way, including the erection of the first of the new pylons. The replacement line should be completed in 2014.

A total of £173m was invested in these four projects during 2011/12 and their completion is expected to take SHTL's RAV from £770m as at 31 March 2012 to over £1bn by March 2013 and around £1.6bn in March 2015. In 2012/13, SHTL expects to incur capital expenditure of over £350m.

In addition, in January 2012, SHTL submitted to Scottish Ministers an application to construct a replacement 132kV transmission line between Beaulay and Mossford to accommodate a higher capacity. Work on a new substation is getting under way. Based on current estimates, the two parts of the project are likely to require total investment of around £45m.

### Achieving a 'fast track' to Price Control agreement

In January 2012 Ofgem announced that it was recommending that SHTL be 'fast tracked' under the RIIO T1 (Revenue = Incentives + Innovation + Outputs) process for the eight-year transmission Price Control period from April 2013. This was on the basis of the business plan submitted by SHTL, *Keeping the lights on and supporting growth*, which set three key objectives for the next decade:

- keep the lights on for customers;
- invest for a greener future; and
- minimise as far as possible the impact on the environment.

Ofgem said the business plan provided good evidence of how significant benefits will be delivered to consumers through 'greater efficiency, enhanced consumer engagement and investment'.

Ofgem adopted the new RIIO framework during 2011, and it is designed to incentivise companies to deliver investment while providing value for money for customers. RIIO T1 is the first Price Control to be conducted under the new process. As Ofgem stated, fast-tracked companies, such as SHTL, can 'benefit from the swiftness of the process and concentrate on delivering efficient network improvements for consumers'.

## Networks (continued)

### Economically-regulated businesses

Following consultation, Ofgem published Final Proposals for RIIO T1 in April 2012, featuring:

- an allowed cost of equity of 7.0%;
- a new index for determining companies' debt costs;
- depreciation based on 20 years for existing assets; and
- depreciation for new assets (except Beaully-Denny) moving to 45 years over the course of two Price Control periods.

SHETL is now developing a full implementation plan for the new Price Control period, which will be shared with stakeholders later this year, much earlier in the process than would have been possible had it not been fast tracked. This should be of benefit to SHETL and its stakeholders.

#### Keeping the lights on and supporting growth in the long-term

The central case of SHETL's business plan is a £1.1bn capital investment programme, with flexibility to increase this by up to a further £4bn if required, to upgrade the transmission network during 2013-21. Projects currently being developed and which could be constructed during the period include:

- **Western Isles:** In October 2010, SHETL concluded that the lack of financial underwriting from electricity generators (attributed to the level of transmission charges) relating to the proposed link from the Western Isles to the mainland meant it would not be able to conclude a contract for the supply of the necessary electricity cable. As a result, it withdrew its request to Ofgem for authorisation to make the investment. Developers of wind farms on the Western Isles are now conveying greater confidence about the deliverability of their projects, which means that the case for the Western Isles link has been renewed and submitted to Ofgem. Detailed work is being undertaken to ensure that the final scheme design for the link meets the needs of the developers and, over the coming months, work will resume on placing the relevant contracts and undertaking environmental and other studies;
- **Caithness to Moray:** SHETL is now planning to develop a subsea electricity cable between Caithness, where consent has been secured for a new substation at Spittal, and Moray, where it is proposed to upgrade the existing substation at Blackhillock, to transmit the large volume of existing and planned electricity from renewable sources in the north of Scotland. The cable will be capable of transmitting around 1,200MW

of electricity. This proposal to develop a subsea cable retains the flexibility to accommodate generation developments in the north of Scotland as and when the need to do so arises. An investment case will be submitted to Ofgem shortly; and

- **Shetland:** SHETL has now secured consent for converter stations associated with the proposed subsea/onshore under ground high voltage direct current (HVDC) transmission link between the Shetland Islands and the Scottish mainland to accommodate renewable energy developments in Shetland. The link would also connect properties in Shetland to the mainland electricity network for the first time and could be installed in the second half of this decade.

Based on current estimates (although these will inevitably be revised) these developments could require investment of around £1.4bn and would form part of the £4bn investment programme that is additional to the £1.1bn central case of SHETL's business plan.

In May 2012, Ofgem set out plans to change the charging arrangements for electricity transmission networks, with greater account being taken of the type of electricity generator seeking to use the networks. This will require the Investment Cost Related Pricing (ICRP) methodology to be improved. Once this is completed, Ofgem will consider the final form of the ICRP and make a final decision on its modification. The impact of the planned changes will have a bearing on the amount of electricity from renewable sources that is developed in Scotland and, therefore, on the way in which the transmission network is upgraded.

#### Electricity Transmission priorities for 2012/13 and beyond

SHETL is SSE's fastest-growing and fastest-changing business, where the core activity for much of the next decade will be construction. Against this background, its priorities for 2012/13 and beyond are to:

- complete successfully the remaining stages of the RIIO T1 price control process;
- meet key milestones in projects under construction, in a way that is consistent with all safety and environmental requirements;
- make progress with projects in development; and
- ensure it has the people, skills, resources, supply chain and stakeholder relationships that will be necessary to support growth on a significant scale.

## Electricity Distribution

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

The performance of SSE's two electricity distribution companies during 2011/12 was as follows (comparisons with previous years in brackets):

- operating profit\* decreased by 5.3% to £396.5m;
- electricity distributed fell by 1.4TWh to 40.7TWh;
- the average number of minutes of lost supply per customer was 73 in the north (78) and 60 in the south (64);
- the number of supply interruptions per 100 customers was 71 in the north (74) and 70 in the south (64); and
- performance-based additional incentive income and allowances (excluding losses) of £11.4m is expected to be earned (£8.5m).

The decrease in operating profit\* principally reflects the timing of recovery of allowed income.

Performance in respect of both minutes lost and interruptions was ahead of the targets set by Ofgem under its Interruptions Incentive Scheme (IIS), which gives financial benefits to distribution network operators that deliver good performance for customers. The number of minutes lost in the south was the lowest ever. Performance-based income covers a number of issues, including the quality of service provided to customers, and innovation.

### Volume of electricity distributed

The total volume of electricity distributed by the two distribution companies during 2011/12 was 40.7TWh, compared with 42.1TWh in the previous year. Under the electricity Distribution Price Control for 2010-15, the volume of electricity distributed no longer affects companies' overall allowed revenue (although it does have an impact on the timing of revenue). This has further reduced the level of risk associated with energy networks businesses.

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

As a result of their operational performance during 2011/12 SSE's two electricity distribution companies expect to earn additional incentive income and allowances of £11.4m (2010/11 – £8.5m) including additional incentive income of £4.5m (2010/11 – £3.4m). This reflects effective investment in the automation of the networks and effective operational responses to electricity supply interruptions.

### Responding to the effects of severe weather

In the winter of 2011/12, SSE's electricity networks were subjected to the effects of severe weather on an unusually large number of occasions, including the 3 January storm affecting the north of Scotland. This weather event alone, featuring exceptional low altitude wind speeds of over 90 miles per hour, resulted in 600 separate faults and over 1,000 points of damage on the network and the loss of power to around 40,000 households. The equivalent of three months of fault repair work was carried out in four days (with very high winds also occurring on 4 January) and was marked by the commitment of SSE employees and the patience on the part of affected communities. The efforts of SSE and other service providers were praised by the Scottish government. The 3 January storm and a number of other weather events were treated as exceptional by Ofgem, meaning that they are excluded from the calculation of performance measures such as customer minutes lost.

### Operating electricity networks efficiently

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

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

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

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

2011/12 was the second year of the electricity Distribution Price Control for 2010-15. The Price Control changed the framework for operating and capital expenditure to remove the perceived bias in favour of the latter and to ensure the delivery of not only the investment itself but of agreed outputs from it. The most successful electricity distribution companies, therefore, will be those that apply efficiency and innovation to maximise outputs from agreed expenditure.

In response to this, SSE has identified a number of solutions and interventions for wider deployment in 2010-15 to ensure its success throughout the Price Control period. This means SSE has robust and cost efficient network investment processes that deliver real value for customers. It has also identified a number of important innovations and new technologies that are delivering cost savings and minimising disruption.

For example, in rural areas, use of the Ordnance Survey's Imagery database of aerial photography has provided a simple and effective way of surveying thousands of kilometres of overhead lines for potential risk of tree damage. In urban areas, SSE has used directional drill technology, which creates minimum disturbance to the highway and thereby reduces disruption to the public and the cost of reinstatement, to install – for example – new 66kW circuits in west London.

The deployment of innovations and technologies such as these, plus good performance in response to Ofgem's enhanced incentive mechanisms in areas such as customer service should enable SSE to continue to achieve the post-tax real return in excess of 5% which it is targeting in electricity distribution.

Against this background, capital expenditure in electricity distribution networks was £260.3m in 2011/12. The need for further significant investment in Great Britain's electricity distribution networks, to maintain and/or replace ageing assets or to provide additional capacity, is likely to mean SSE will

### Networks Regulated Asset Value – £bn

| Year | Value (£bn) |
|------|-------------|
| 2012 | 5.88        |
| 2011 | 5.40        |
| 2010 | 4.94        |
| 2009 | 4.71        |
| 2008 | 4.45        |

### Networks Regulated Asset Value 2011/12 – %



invest around £275m in 2012/13, taking the total for the first three years of the 2010-15 Price Control to around £750m. As a result, the RAV of SSE's two electricity distribution networks should increase to over £2.9bn over the course of the year.

Significant developments include a £30m project to install new 132kV plant at Bracknell and Camberley substations and new 132kV under ground cables between the substations. The project will help to meet demand for electricity in a key area between the M3 and M4 motorways. The cabling works should be finished in the autumn of this year and the final substation work should be completed in 2013.

In Scotland, plans have been made to invest in the resilience of the electricity network in Argyll and Bute, which was particularly affected by the storms of 2011/12, including provision of under ground cables in Dunoon and of large-scale mobile generation connection points for Bute.

### Making electricity networks smart

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

The next decade promises major technological change for electricity distribution networks as a result of things like micro-generation,



## Networks (continued)

### Economically-regulated businesses

the replacement of gas with electricity as a source of heating and electric vehicles. All of this will change the traditional flows of electricity, which means smarter, more dynamic networks will be required.

SSE, with Smarter Grid Solutions Ltd, an associate company, 'switched on' the UK's first commercial smart grid technology on its power distribution network on Orkney in 2009. This has since allowed 20MW of additional capacity for generating electricity to be connected to the network, at a small fraction of the cost that would have been required had traditional means been adopted.

Two other major smart projects, with total funding of £64m, are being led by SSE's electricity distribution businesses:

#### → Northern Isles New Energy Solutions (NINES) in Shetland:

NINES is a pilot project representing the first stage of the Integrated Plan for managing electricity supply and demand in Shetland, which Scottish Hydro Electric Power Distribution is required by Ofgem to present in 2013. It features the use of heat and electricity storage to manage intelligently the impact of movements in demand on electricity generation in Shetland, which could allow more renewable energy to be connected to the network. It also features new active network management solutions. In September 2011, Ofgem announced that NINES should be funded as part of the Integrated Plan, with 85% of its expenditure included in SHEPD's RAV and the remaining 15% included in SHEPD's allowed revenue. This confirmed that NINES is not just a smart programme but a comprehensive and sustainable solution to the energy challenges on Shetland which is designed to meet the needs and aspirations of the community; and

#### → New Thames Valley Vision (NTVV) in and around Bracknell:

NTVV aims to demonstrate that applying new technologies to Bracknell's network will provide a lower-cost alternative to redeveloping the substation to meet increasing electricity demand, with the potential to reduce significantly costs to customers. NTTV involves monitoring and predicting electricity demand and usage patterns and using a range of innovative technologies, including network automation, energy storage and automated demand response, to manage the network flows predicted by the modelling. In November 2011, Ofgem announced that NTTV should secure funding totalling £30m under its

Low Carbon Networks Fund and, as a result, NTTV will lead to the creation of one of the UK's first intelligent distribution networks.

#### Supporting deployment of electric vehicles

Electric vehicles (EVs) will be an essential part of the move towards a low-carbon transport infrastructure. Current predictions suggest that EVs could account for as many as 10% of new car sales by 2020. The challenge for electricity distribution companies is to prepare their networks for the likely upswing in demand arising from EVs and SSE was a full participant in two EV projects, both supported by the Technology Strategy Board – the MINI E and the Ford Transit Connect consortia.

These have helped to demonstrate that up to one in four homes will be able to have an EV without it having a significant impact on the electricity network. Nevertheless, other issues – such as the need to schedule re-charging effectively and to develop new control systems – require significant attention and SSE is carrying out further work to understand the requirements of so-called 'smart charging' to maximise use of the existing infrastructure.

In March 2012, SSE opened in Glasgow the UK's first dedicated free EV charging, hiring and parking facility. The facility features six charging car park spaces and electric car hire from Europcar and Peugeot as well as an electric car available for test drives.

#### Electricity Distribution priorities in 2012/13 and beyond

During 2012/13 and beyond SSE's priorities in Electricity Distribution are to:

- comply fully with all safety standards and environmental requirements;
- ensure that the networks are managed as efficiently as possible, delivering required outputs while maintaining tight controls over operational expenditure;
- put responsiveness at the heart of day-to-day operations, so that the number and duration of power cuts experienced by customers is kept to a minimum;
- ensure that there is adequate capacity to meet changing demands on the electricity system;
- deliver excellent service to customers, which responds effectively to their needs during supply interruptions and in 'business-as-usual' situations; and

- make progress on the deployment of innovative investment in smart grids.

With such significant changes required over the next few years, not least in adapting the networks to accommodate changes in production and consumption, the scope for additional incremental growth in electricity distribution networks is clear.

## Gas Distribution

### Performance in SGN

SSE receives 50% of the distributable earnings from Scotia Gas Networks (SGN), in line with its equity holding, and also provides it with corporate and management services. In SGN in 2011/12 (comparisons with the previous year in brackets):

- SSE's share of operating profit\* was £234.8m (£186.8m);
- gas transported fell by 22.8TWh to 143.4TWh; and
- 98.7% of uncontrolled gas escapes were attended within one hour of notification, compared with the standard of 97% (97.2%).

The increase in operating profit\* for SGN is primarily due to three things:

- the impact of the price changes agreed as part of the five-year gas Distribution Price Control to March 2013;
- underlying operational efficiencies achieved during the year; and
- income from 2010/11 not recovered during that financial year but subsequently received.

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

### Operating gas networks efficiently

When SGN acquired its networks in June 2005, National Grid was contracted to provide it with services with a total value of £30m per annum. In following years, services were brought within SGN, and SGN's remaining service contracts with National Grid totalled £7m per annum by the end of 2010/11.

These Managed Services Agreement contracts covered transmission services, control and IT services and emergency call handling, and the process of bringing them within SGN is continuing. In June 2011, SGN stopped using

National Grid's Gas Transportation Management System and replaced it with its new Distribution Network Control System and in September 2011 it replaced a National Grid system with a new application called Demand Management System. This means that SGN's remaining contracts with National Grid now total £4.5m per annum.

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

The five-year gas Distribution Price Control, which began in April 2008, provides the opportunity for SGN to increase significantly investment in its gas distribution networks, thereby reinforcing their safety and reliability and securing another significant increase in their RAV. By the end of 2012/13, SGN estimates that its total RAV will be around £4.8bn.

During 2011/12, SGN invested £404.3m in capital expenditure and mains and services replacement projects, compared with £399.3m in the previous year, including the £21m replacement of the under-sea gas main between the south coast of England and the Isle of Wight, completed during the year. The project involved connecting Lepe and Gurnard through the longest directional drill ever undertaken (2.9km). Tunnels were bored from each direction, meeting around 40 metres below the seabed, to take the two 12 inch diameter pipes.

The majority of the mains replacement expenditure was incurred under the 30:30 mains replacement programme which was started in 2002. This requires that all iron gas mains within 30 metres of homes and premises must be replaced over a 30-year period. During 2011/12, SGN replaced 1,202km of its metallic gas mains with modern polyethylene pipes.

SGN is also committed to making new gas connections to existing homes that are not on mains gas as affordable as possible, and is running a new Assisted Connections scheme, under which 19,456 properties were connected to its networks during 2011/12. A further 19,500 properties are expected to be connected in 2012/13.

Investment will continue to be a top priority for SGN and, in line with that, it expects to invest around £400m in capital expenditure and mains and service replacement projects during 2012/13.

### Earning financial rewards for corporate responsibility

In July 2011, SGN was awarded £1.3m under Ofgem's Discretionary Reward Scheme which rewards companies for developing and

adopting best practice in serving the interests of customers, society and the environment. This was the third successive year in which SGN secured the highest award under the scheme, and it recognised SGN's work on its environmental impact, fuel poverty and safety. The Scheme, which is judged by a panel of industry experts, was established as part of Ofgem's gas Distribution Price Control 2008-13.

### Making gas networks more sustainable

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

SGN has long recognised that renewable heat is an untapped resource. Working with a water company and a gas supplier, it began the delivery and supply of biomethane to 200 homes in Oxfordshire. Under the scheme, the first of its kind in Britain, sludge is subjected to the process of anaerobic digestion to create biogas which, after the removal of impurities, is fed into the gas distribution network. It has since begun participation in the first commercial biomass upgrading system in England, near Poundbury in the Duchy of Cornwall. Biogas produced from green waste and chicken manure will be upgraded to natural gas quality and fed into SGN's gas network to supply green gas to almost 4,000 homes.

It is estimated that biomethane could account for up to 15% of domestic gas needs in the UK in 2020.

SGN is now developing this technology so that larger volumes of biomethane at other sites can be commissioned into the network and is carrying out feasibility studies on a further six proposals for biomethane network entry points from anaerobic digestion and landfill gas projects in Scotland and southern England.

### Preparing for the new gas Distribution Price Control

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

In October 2011, SGN completed a public consultation on its proposed business plan for RIIO-GD1 and submitted it to Ofgem in November 2011. The plan set out four key themes and related measures of progress:

- acting safely, through reducing risk and protecting the public and employees;
- providing excellent service through maintaining gas supplies, giving timely information and listening to customers;
- being good neighbours by reducing environmental impact and removing assets that affect local communities; and
- being a business for the future by helping to mitigate and adapt to climate change and keeping costs down.

In February 2012, Ofgem set out its initial assessment of gas distribution networks' business plans. Overall, it decided not to retain SGN (or any other company) within the 'fast track' process because of the number of issues that would have to be resolved in a compressed timetable. SGN submitted a revised business plan in April 2012 which it is hoped Ofgem will adopt as the basis for its Initial Proposals document on the gas distribution Price Control in July 2012.

### Gas Distribution priorities in 2012/13 and beyond

During 2012/13, SGN's priorities are to:

- deliver a safe and secure gas supply to customers;
- deliver to time and budget the 2012/13 mains replacement and capital works programmes;
- continue to work with stakeholders to secure an acceptable outcome to the new gas Distribution Price Control; and
- support sustainable developments in gas distribution.



### Making energy better: → Restoring power

**In January, engineers tackled three months worth of damage repair work in just four days due to storms.**

## Networks (continued)

### Market-based businesses

#### Other Networks

##### Performance in Other Networks

SSE's 'Other Networks' businesses – Lighting Services, Utility Solutions and Telecoms – are relatively small when compared with its energy networks, and they operate in tough and competitive markets. As a result of difficult economic circumstances, their contribution to SSE's operating profit\* fell from £37.1m in 2010/11 to £32.1m in 2011/12.

##### Maintaining leadership in lighting services provision

SSE remains the UK and Ireland's leading streetlighting contractor. It has:

- 24 contracts with local authorities in England, Wales and Scotland to maintain over 630,000 lighting units;
- 28 contracts with local authorities in the Republic of Ireland to maintain over 240,000 lighting units, through Airtricity Utility Solutions; and
- 11 contracts with 12 local authorities, under the Private Finance Initiative, to replace and maintain over 610,000 lighting units.

The PFI contracts include the 25-year contract awarded by Knowsley Metropolitan Borough Council for the maintenance of over 24,000 lighting columns, traffic bollards and traffic signs and for the replacement of more than 70% of these during the initial four-year investment period which began in August 2011. It includes the deployment of SSE's Mayflower technology which offers customers variable light control, monitoring, fault detection and energy consumption measurement – all undertaken from a central location.

Lighting Services fits well within SSE's business model and, as in electricity distribution, future success will be based on effective and efficient customer service and successful deployment of new technology.

##### Providing comprehensive Utility Solutions

SSE provides a comprehensive range of 'utility solutions'. It designs, builds, owns, operates and maintains cable and pipe networks for delivering electricity, gas, water, heat and telecommunications to existing and new commercial and residential developments in England, Wales and Scotland. It is, therefore, able to provide a one-stop solution for multi-utility infrastructure requirements to customers in the development and construction sectors.

- **Electricity networks:** SSE now owns and operates 118 embedded energised

electricity networks outside the areas served by its economically-regulated subsidiaries Scottish Hydro Electric Power Distribution and Southern Electric Power Distribution. A further 43 are under construction and contracts have been signed for the development of an additional five, taking the total to 166 – up from 117 at the end of 2010/11. In total, SSE has 825MW of network capacity, including 476MW of existing demand and 349MW of connections to be completed.

- **Gas pipelines:** SSE is also a licensed gas transporter, installing, owning and operating gas mains and services on new housing and commercial developments throughout the UK. The total number of new premises connected to its gas networks has continued to grow, and during 2011/12 it connected a further 13,853 premises, taking the total number of connections to over 92,000. Contracts have been signed for a further 60,000 connections to be completed.
- **Water:** Through SSE Water (SSEW) SSE is able to install, own, operate and supply water and sewerage services alongside its existing electricity and gas services. An 'inset' appointment is the route by which one company replaces another as the appointed water and/or sewerage company for a specified area. SSEW now has 15 such appointments and provides, or has secured contracts to provide, water and sewerage services to over 21,000 properties in England and Wales.
- **Heat:** SSE uses a range of sustainable technical solutions, including Combined Heat and Power (CHP) generation, biomass boilers and ground- and air-source heat pumps and combines these with community heating schemes where appropriate. There are currently seven heat networks in operation and five further schemes where SSE is the preferred bidder.

Of the four areas that Utility Solutions operates in, Heat is the least developed and has the most potential yet to fulfil as a result of the planning requirements placed on developers and the introduction of the Renewable Heat Incentive. That, allied to continuing focus on safety, customer service and value across all activities and an ability to offer a true multi-utility solution to customers, means that Utility Solutions should continue to increase its already prominent market presence.

##### Operating a national telecoms network

SSE's Telecoms business operates in two different markets. It owns and operates the UK's fourth largest fibre and microwave

network offering carrier standard connectivity to external customers and providing SSE's internal managed voice and data services. The origins of this business lie in the installation, a decade ago, of fibre on SSE's electricity network, and the telecoms network now comprises:

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

To complement its core telecoms network business, SSE's Fareham-based data centre provides capacity for more than 1,200 racks for the co-location of IT services within the 80,000 square feet secure site and 10MW of power in a resilient and energy efficient environment.

Despite gaining some large, high-profile technology companies as clients, the year was characterised by a challenging environment for sales in respect of the network, which made tight control on operating costs especially important. To support the business in the future, there will be a focus on development of its network and products in what remains a very fast-developing sector.

##### Conclusion

Through efficiency, responsiveness and innovation, SSE aims to expand significantly its Networks businesses in the coming years and they will play a significant part in helping it to meet its financial objective of sustained and real dividend growth.

##### Other Networks priorities in 2012/13 and beyond

Lighting Services, Utility Solutions and Telecoms have specific priorities for 2012/13, but across all of them there is a continuing need for:

- efficiency and customer service;
- effective product development; and
- technological change and innovation.

# RETAIL

Earning the right to make a profit.

## Retail operating profit – £m

**321.6**

2011: 400.5

Change: -19.7%

SSE is involved in the supply of electricity and gas and in other energy-related services such as electrical contracting to business and household customers.

## Home services customer accounts – 000s

**412**

2011: 420

Change: -1.9%

Home services provided by SSE include gas boiler, central heating and wiring maintenance and installation and telephone line rental, calls and broadband services.

## Financial assistance for vulnerable customers – £m

**46**

2011: 28

Change: +64.3%

SSE provides assistance for customers who struggle to pay for their basic energy needs, including discounts on energy bills.

## Energy customer accounts – millions

**9.55**

2011: 9.65

Change: -1.0%

SSE supplies electricity and gas to household and business customers in the energy markets in Great Britain and Ireland. It is Britain's second largest energy supplier.

## Energy efficiency installations (GB) – 000s

**315**

2011: 193

Change: +63.2%

As an energy supplier, SSE has obligations under government-sponsored schemes to deliver energy efficiency measures in households throughout Great Britain that deliver savings in CO<sub>2</sub>.

## SSE Contracting Order Book – £m

**78**

2011: 67

Change: +16.4%

SSE Contracting is one of the largest mechanical and electrical contracting businesses in the UK, operating from regional offices throughout Great Britain.

## Improving transparency in competitive customer-facing businesses

In previous years, SSE reported performance relating to its Energy Supply activities as part of a Generation and Supply segment and SSE continues to believe that its involvement in the Retail activity of energy supply and the Wholesale activities of energy production and portfolio management means it has a well-balanced portfolio of customers, assets and contracts for purchasing gas and power purchase agreements.

In October 2009, Ofgem introduced the requirement to report details of SSE's Generation and Supply results in a Consolidated Segmental Statement (CSS). Ofgem commissioned an independent review of suppliers' segmental statements by BDO LLP and in January 2012 announced that while BDO had recommended several changes to the way suppliers prepare their statements to improve transparency and cross-company comparability the fact it 'found suppliers' financial information to be fair and appropriate and should also give consumers a degree of reassurance'.

Therefore, in relation to Generation and Supply, SSE was already publishing information to help to improve the transparency of its financial reporting. Following changes to SSE's management structure in 2011 and in the interests of further transparency, it has concluded that this should be extended to its financial statements.

## The second biggest energy supplier across the Great Britain and Ireland markets

SSE is the second biggest energy retailer across the competitive markets in Great Britain and Ireland. It supplies electricity and gas to more than 9.5 million household and business accounts under brands such as SSE, Scottish Hydro, Southern Electric, SWALEC and Atlantic in the Great Britain market and Airtricity in the markets on the island of Ireland.

The key responsibilities of the Energy Supply business are to:

- ensure it secures enough electricity and gas to meet customers' needs;



## Retail (continued)

### Market-based businesses

- arrange for electricity and gas to be distributed to customers' premises through the relevant networks;
- provide customers with necessary associated services such as metering and billing; and
- meet obligations in respect of energy efficiency and any related social or environmental schemes promoted by government.

It must do so while being mindful of the fact that its core products – electricity and gas – are something which people need to buy rather than choose to buy, which means there is legitimate and significant political and regulatory interest in energy supply markets. In Great Britain, for example, energy supply has been the subject of a Retail Market Review announced by Ofgem in November 2010, which is supposed to make energy retail markets work more effectively in the interests of customers.

#### A significant provider of energy-related services

SSE provides other energy-related goods and services to customers, covering three principal areas:

- retailing of 'home services' such as gas boiler, central heating and wiring maintenance and installation, telephone line rental, calls and broadband services and micro-generation;
- supplying, installing, maintaining and reading meters in the household, commercial, industrial and generation sectors in Great Britain; and
- domestic, commercial and industrial mechanical and electrical contracting and electrical and instrumentation engineering.

SSE's contracting business is the second largest mechanical and electrical contracting business in the UK. Its metering business became national in Great Britain in 2010 after it completed a programme of in-sourcing of activities. Home services were supplied to over 400,000 customer accounts as at 31 March 2012.

SSE's activities in home services, metering and electrical and mechanical contracting are all customer-facing and have, therefore, been included in the Retail segment.

#### Financial performance in Retail

Operating profit\* in Retail fell by 19.7%, from £400.5m to £321.6m, contributing 19% of SSE's total operating profit\*. This comprised (comparisons with the previous year in brackets):

- £271.7m in Energy Supply (£347.7m); and
- £49.9m in Energy-related Services (£52.8m).

## Energy Supply

### Performance in Energy Supply

SSE's Energy Supply business buys the electricity and gas it needs through SSE's Energy Portfolio Management and Generation divisions. The associated cost to the Energy Supply business comprises:

- the weighted average cost of electricity, made up of fuel used in generation plus associated costs of CO<sub>2</sub> emissions, power purchase agreements and direct bilateral electricity contracts; and
- the weighted average cost of gas, made up of gas purchase contracts and direct bilateral gas contracts and gas storage.

It therefore carries risks associated with energy procurement. In addition, the Energy Supply business has to meet costs associated with the transmission and distribution of energy, customer service and government-sponsored social and environmental obligations.

Operating profit\* in Energy Supply in 2011/12 fell by 21.9% to £271.7m, and comprised 16.4% of SSE's total operating profit\*.

Within this, SSE's operating profit\* from supplying energy to a household account in Great Britain in 2011/12 was an average of around £30. Operating profit\* in Energy Supply reflects the higher wholesale gas costs, and the delay to September 2011 in implementing an increase in household energy prices and falling energy consumption. There was, however:

- a reduction in overheads associated with the doorstep sales operation as a result of its closure in July 2011; and
- success in managing, with customers, the level of aged debt.

### Expected profitability in Energy Supply

Electricity and gas are things which people need to buy rather than choose to buy (unless they are used inefficiently), so SSE recognises that it would not be acceptable for it to achieve an excessive level of profitability in Energy Supply. At the same time, a reasonable and sustainable level of profitability is necessary to ensure that the risks associated with energy procurement can be remunerated in a way that will sustain investment and to ensure that investment can also be made in the services and systems that customers will need in the future.

SSE expects that its profit margin (ie adjusted operating profit\* as a percentage of revenue) in Energy Supply will average around 5% over

the medium-term (ie three to five years). In 2011/12, it was 3.5%. On this basis, SSE hopes to demonstrate that the prices it charges for, and any profit it makes in, supplying electricity and gas are fair. It also hopes to give further momentum to its efforts to build trust in energy supply.

### Building trust in energy supply

In October 2011, SSE published a document, *Building Trust: SSE's proposals to build customers' trust in energy supply* in Great Britain. It set out 10 measures to:

- restore simplicity, including reducing the number of tariffs from over 60 to four core products;
- enhance transparency, including improving wholesale electricity market liquidity;
- improve customer service, including retrospective introduction of a Sales Guarantee; and
- ensure fairness for all customers, including ensuring all customers have the opportunity to access all tariffs.

In line with the fairness principle, SSE has made a clear commitment never to engage in any form of unfair pricing. As the Institute for Public Policy Research stated in February 2012, 'customers are being overcharged to subsidise cheap offers for customers who switch suppliers in the more competitive end of the market'. An effect of this practice is to make entry in to the energy supply market in Great Britain more difficult for new suppliers, and that is another reason why the practice should be stamped out.

In April 2012, SSE confirmed that the 10 measures had been completed including two that had been successfully piloted and would go forward to full implementation. It also set out a number of other measures to maintain the momentum, including steps to simplify energy bills, tackle estimated bills and to enable prepayment meter customers to get on to the best tariff.

As part of its Retail Market Review, Ofgem has completed consultations on possible interventions in areas such as pricing structures, tariff comparability and customer communications. Ofgem has said it would prefer to implement reform wherever appropriate with the co-operation of energy supply companies but will consider a referral to the Competition Commission if necessary.

SSE accepts the challenge posed by Ofgem but believes it is moving faster, and further, to meet customers' needs in a way that a

regulator-determined approach would not be able to achieve. Indeed, the quick way in which SSE was able, in April 2012, to enter into an agreement with the UK government on measures to help improve the quality and relevance of the information available to customers demonstrates that speed of response and innovation are most likely to sustain and build customers' trust in energy supply.

Energy supply markets in Ireland are at a different stage of development; indeed, since 2009, Ireland has experienced the EU's highest levels of customers switching between suppliers. Nevertheless, after a period of rapid growth in customer numbers, SSE is committed to ensuring that the principles of *Building Trust* are also applied on the island of Ireland, and its Customer Charter for household customers in the Republic of Ireland reflects that commitment.

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

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

- offering consistently competitive prices over the medium-term;
- providing a straightforward range of products that are easy to assess; and
- delivering the highest possible quality of service.

In summary, its proposition to customers is based on fair pricing, simple products and excellent service. At the same time, SSE believes that, because the products it supplies are fundamental to the functioning of modern life and so are not discretionary, it has a responsibility to earn and retain the trust of customers.

#### Supplying energy to customers in GB and Ireland

During 2011/12, SSE's energy customer accounts in Great Britain and Ireland fell slightly to 9.55 million from 9.65 million in March 2011. Customer accounts at March 2012 comprised:

- 8.52 million household electricity and gas accounts in GB;
- 407,000 business electricity and gas sites in GB; and
- 621,000 electricity and gas customer accounts in Northern Ireland and the Republic of Ireland (91% household and 9% business).

The reduction in customer account numbers in GB was, therefore, offset somewhat by the

success in the Irish markets, where there was a net customer gain of 130,000. In contrast, there was a reduction of 230,000 in customer numbers in Great Britain, reflecting the highly competitive market conditions. Of this net reduction, most accounts were lost in the six months between July and December 2011. This was the period following SSE's decision to stop selling energy on the doorstep in Great Britain and the announcement of increases in household gas and electricity prices.

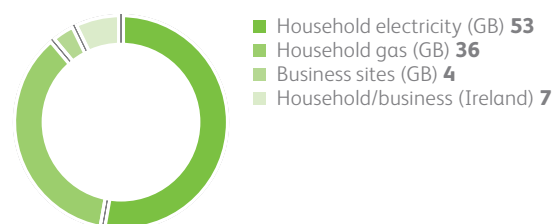
Customer account numbers do not tell the whole story, however. Within the overall total, 2.5 million customer accounts in Great Britain are for loyalty products such as:

- **energyplus Argos**, which rewards customers with money-off discount vouchers;
- **energyplus Pulse**, under which customers are able to support the British Heart Foundation (which received £133,000 from SSE in respect of energyplus Pulse customers during 2011/12, taking the total since the product was launched to £1.5m); and
- **M&S Energy**, available to customers through Marks and Spencer's stores and website.

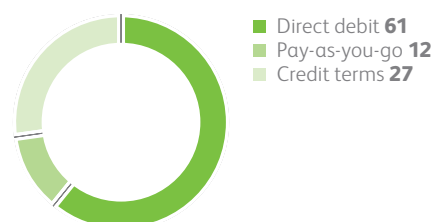
#### Energy customer numbers – millions

|      |      |
|------|------|
| 2012 | 9.55 |
| 2011 | 9.65 |
| 2010 | 9.35 |
| 2009 | 9.10 |
| 2008 | 8.49 |

#### Energy customer numbers 2011/12 composition – %



#### Domestic customers' payment methods 2011/12 – %



In May 2012 SSE announced its intention to acquire Phoenix Supply Limited, a regulated supplier of natural gas to 130,000 customers in Northern Ireland. The acquisition also includes a small number of customers in RoI's deregulated commercial supply market. The acquisition is subject to approval by the Irish Competition Authority and SSE expects to complete the purchase during the summer.

#### Selling energy in the right way

In July 2011, SSE became the first of the leading suppliers in the Great Britain market to stop commission-based doorstep selling of energy. The decision was taken because confidence in the way energy was being sold on the doorstep and in the way in which salespeople were being remunerated had become low.

This was followed in December 2011 by SSE's decision to implement its Sales Guarantee for household energy customers and to apply the guarantee to any household energy sales made by it since October 2009, when Ofgem placed new obligations on energy suppliers to make sure sales activities are conducted in a fair and professional manner.

## Retail (continued)

### Market-based businesses

Under the guarantee, devised as part of SSE's *Building Trust* initiative, any customer who shows that they switched their energy supply to SSE after being given inaccurate information or being misled will have any resulting financial loss made good. Since it was launched, SSE has contacted customers about the guarantee and so far settled over 3,000 claims. It expects that the retrospective implementation of the guarantee could cost up to £5m. The application of the guarantee is being independently assured and extended to all energy products.

In May 2012, SSE was fined £1.25m after being found guilty, at Guildford Crown Court, on two counts (out of seven) relating to the use of direct sales aids in February 2009. SSE recognises that a company of its standing and with its values should not have found itself in this position and various steps – of which the Sales Guarantee is one – have been taken to ensure that it does not do so again.

Meanwhile, SSE is continuing to co-operate with Ofgem's investigation into whether it complied with the new licence conditions to govern sales processes introduced in 2009.

SSE aims to gain customers through venue, telephone, online and direct mail sales and through customer advice activities; through extending its range of affinity partnerships, of which M&S Energy is one example; and through a series of commercially-focused sponsorships.

It is also planning to launch later this year pilot networks of appointment-only and salary-based 'smart energy advisers', starting



#### Making energy better: → Educating customers

We're helping our customers understand how they use energy by providing the real-time and historic information they need to become more energy efficient.

in Wales and Scotland and trained to an externally-accredited standard. The advisers will draw on SSE's experience in the Energy Demand Research Project carried out in North Leigh, Oxfordshire, between 2007 and 2010, during which a locally-based energy adviser employed by SSE engaged with local people to secure a 10% reduction in household energy consumption. According to the Independent Project Final Analysis, published in June 2011, the adviser was 'able to work very well within the community and was very well received by them'.

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

SSE household customers have continued to reduce their use of energy, and on an actual basis in 2011/12 SSE household customers used, on average:

- 451 therms of gas, compared with 563 therms in the previous year; and
- 4,104kWh of electricity, compared with 4,408kWh in the previous year.

On a weather-corrected basis, average household consumption of gas by SSE's customers has fallen by 21.5% in the five years since 2007 and consumption of electricity has fallen by 16.7%. The decline in energy consumption is expected to continue for the next few years.

Falling consumption presents short-term issues in relation to the revenue that companies are able to earn from supplying energy and in relation to the operation and development of plant for generating electricity. Nevertheless, as a result of the underlying fall in energy consumption, households are less exposed to the impact of high unit prices than they otherwise would be and the overall sustainability of supplies of gas and electricity is improved. These are very positive trends, which SSE welcomes.

#### Helping customers use less energy in the future

As an energy supplier, SSE has obligations under the Carbon Emissions Reduction Target (CERT) 2008-12 scheme to deliver energy efficiency measures to households throughout Great Britain that deliver savings in CO<sub>2</sub> emissions. In 2011/12, SSE funded the installation of cavity wall insulation in over 125,000 homes and loft insulation in over 190,000 homes (excluding DIY insulation), an increase of over 60% on last year.

In August 2011, Ofgem published its Annual Report on suppliers' progress towards CERT

targets for 2008-12. It reported that SSE had achieved 64% of its obligation by the end of the third year of CERT; this increases to 71% when the innovation features of CERT are taken into account. The delivery of CERT and, in particular, of the requirement to ensure that 15% of the CO<sub>2</sub> savings are achieved in a subset of low-income households considered to be at high risk of fuel poverty (the Super Priority Group) has proved to be very challenging, not least because of difficulties associated with identifying, and then collecting the information required to verify, a customer as being within the Super Priority Group.

Complementing CERT, the Community Energy Savings Programme (CESP) is an obligation placed on energy suppliers and electricity generators to make savings in customers' homes by helping to install energy efficiency measures. The programme is designed to ensure that suppliers work in the lower income areas and to incentivise a 'whole house' approach to energy savings. While delivering CESP is challenging, SSE now has 33 CESP agreements in place for locations throughout England, Scotland and Wales.

CERT and CESP will be superseded by the Green Deal and Energy Company Obligation (ECO) when they are introduced following the passage of the Energy Act 2011:

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

In April 2012, SSE was one of 22 organisations to sign an agreement with the UK government to work to become one of the first Green Deal providers, offering energy efficiency packages to consumers when the scheme launches later this year. The UK government has emphasised the importance of a 'good customer experience from day one' of the Green Deal, a point which SSE strongly endorses.

Energy efficiency is also a key issue in Ireland and 2013 will see the introduction there of an energy company-administered Pay As You Save programme.

### Helping vulnerable customers

In March 2012 Professor John Hills published the final report following his review of the fuel poverty definition and target commissioned by the Secretary of State for Energy and Climate Change. Under the existing definition, a household is classed as being in 'fuel poverty' if it would need to spend more than 10% of its income on fuel to keep its home warm enough.

Hills has proposed an alternative measurement framework focused directly on the overlap of high energy costs and low income. Hills believes that the new framework will show that interventions targeted at the core of the problem – especially energy efficiency policies focused on low income households – can make a substantial difference. Following Hills' final report, the UK government has committed to the adoption of a revised approach to measuring fuel poverty by the end of the year.

SSE agrees with Hills' assessment of the importance of energy efficiency, and the successful deployment of measures under schemes like CERT and CESP, is an important priority for it. In addition, SSE fulfils three other key responsibilities in order to help those of its customers who struggle to pay for their basic energy needs:

- giving financial assistance with energy bills, helping over 400,000 customers with a total of £46m in 2011/12;
- providing tailor-made payment arrangements, helping over 300,000 customers who may be experiencing hardship and having difficulty in paying their energy bills; and
- contacting more than 60,000 potentially vulnerable customers, helping them with practical advice and support.

As in Great Britain, greater energy efficiency is seen as the most sustainable solution to issues relating to energy affordability in Ireland.

### Retail energy bills in Great Britain

SSE increased its prices for household gas supply by 18% and household electricity supply by 11% (average) on 14 September 2011. That was the first increase in household electricity prices for three years. SSE was able to cut the unit price of gas for household customers by 4.5% on 26 March 2012.

There are three upward pressures on household energy bills:

- the cost of using energy networks to distribute electricity and gas to customers' homes;

## As a result of the underlying fall in energy consumption, households are less exposed to the impact of high unit prices than they otherwise would be and the overall sustainability of supplies of gas and electricity is improved.

- the cost of mandatory environmental and social schemes that energy suppliers are required to fund; and
- the wholesale cost of energy.

The decline in actual average consumption of electricity and gas by SSE's household customers in Great Britain in 2011/12, compared with 2010/11 means that – despite the price increase on 14 September – a typical household customer of SSE paid £1,118 for electricity and gas in the year to 31 March 2012 (excluding VAT), down from £1,137 in the previous year. This illustrates the distinction between the price of a unit of energy and the amount customers pay for heating and powering their homes.

According to the UK government's statement of Energy Trends in March 2012, for the period July to December 2011, prices (including tax) paid by medium domestic gas and electricity customers in the UK were the lowest and fourth lowest in the EU15 respectively.

A typical SSE dual fuel bill from 26 March 2012 is made up of:

- distribution costs – 23%;
- metering and customer service costs – 8%;
- mandatory social and environmental costs – 9%;
- VAT – 5%; and
- Energy costs – 50%.

This leaves SSE with a profit of around 5%. As recently as 2008, energy costs accounted for 55% of a typical dual fuel bill. The fall to 50% in 2012 shows the impact of distribution, environmental and social costs on household energy bills. The bills issued by SSE now contain this breakdown.

SSE will not implement an increase in the price of household electricity or gas before October 2012 at the earliest. Beyond that, energy prices for household customers will ultimately depend on what happens in wholesale electricity and gas markets, with public

policy and regulatory decisions on energy production, distribution and consumption also having a significant impact.

As part of its *Building Trust* initiative, SSE publishes an online 'tracker' showing the relationship between the different components of a typical dual fuel energy bill. The tracker shows the changing components of bills with the aim of explaining the rationale for pricing decisions (see page 5, and [www.sse.com/pricetracker](http://www.sse.com/pricetracker)).

### How people pay their energy bills

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

### Keeping customers' energy debt under control

As at 31 March 2012, the total aged debt (ie debt that is overdue by more than six months) of SSE's domestic and small business electricity and gas customers in Great Britain and Ireland was £88.3m, compared with £89.2m in March 2011. A bad debt-related charge to profits of £40.5m has been made. This compares with a charge of £47.4m in the previous year.

The general economic climate means there are significant debt management challenges, with the volume of work in this area for SSE's Customer Service division again increasing. SSE has office- and field-based employees who work with customers to resolve debt issues. They aim to help customers by identifying as early as is practical when their payments are in arrears and contacting them as soon as possible to discuss the options available to them. This makes the situation easier from both SSE's point of view and that of the customer and the benefit can be seen in the fact that debt which is less than three



## Retail (continued)

### Market-based businesses

months old was 16.5% lower on 31 March 2012 than the year before and debt overdue by four-to-six months was 6.3% lower.

#### Providing sector-leading service to customers

SSE continues to be independently and consistently recognised as the customer service benchmark for the leading energy suppliers in Great Britain. To provide customers with the best possible value for money, SSE believes that it needs to provide excellent service, simple products and fair prices.

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

- the UK Customer Satisfaction Index, published in July 2011, in which SSE achieved the top ranking in the utility sector for the fourth consecutive year;
- the uSwitch.com Energy Customer Satisfaction Awards, announced in November 2011, in which SSE won the Overall Customer Satisfaction category for the eighth time in a row. Altogether, SSE won eight of the 11 categories;
- the J.D. Power and Associates 2011 UK Electricity and Gas Supplier Customer Satisfaction Study, in which SSE brands topped both the electricity and gas supplier rankings; and
- the energy complaints league table, published by Consumer Focus in March 2012, in which SSE achieved a five star rating with the lowest number of customer complaints to Ombudsman Services: Energy, Consumer Direct and contacts with Consumer Focus' Extra Help Unit. SSE is the only company to achieve a five star rating and has topped the league table since it began in April 2010.

During 2011/12, there were 896 SSE-related complaints to the following third party organisations: the Ombudsman Services: Energy, Consumer Focus and Consumer Direct. This was a reduction from the 1,161

complaints in the previous year and the 1,231 complaints in 2009/10.

Although SSE maintained its best-in-sector position in customer service during 2011/12, it was a year in which the profile of the energy supply sector remained very high. In total, SSE's energy supply customers in Great Britain made almost 16 million calls (excluding calls handled by automated services) to its teams in Basingstoke, Cardiff, Cumbernauld, Havant and Perth during the year. These conversations allow SSE to assess, consider and respond to customers' concerns and, over time, adapt the services and products it provides accordingly.

The same applies in markets in Ireland and SSE is planning further investment in customer services and training to deliver sector leadership there also.

#### Making services available digitally

Web and email are now firmly established as the second most common means of communication with the Company used by SSE's customers. Around 26% of SSE's transactions with customers now take place using digital channels.

Moreover, SSE's customers in the Great Britain and Ireland markets now have 1.7 million digitally-billed accounts, up from 1.3 in the year before. Such customers can view their account and payment history, submit meter readings and receive an up-to-date balance on their account, make secure payments on their account and other such services.

The popularity of e-services such as paperless billing is likely to continue to increase rapidly over the next few years. Enabling customers to carry out more transactions using digital channels if they so choose, is now one of SSE's top customer service priorities and significant investment is being made in this and in services to customers generally. In this context, the development of mobile apps and social media channels such as Twitter and Facebook mean

the ways in which customers engage with SSE is undergoing further change and responding to this is a key priority for 2012/13 and beyond.

At the same time, the charges SSE makes for energy will always be cost-reflective. This means that any differences between prices available online and prices available through other channels will reflect only the different cost of the transactions. Among leading energy suppliers, SSE has had the lowest differential between its online and standard credit prices.

In line with its *Building Trust* commitments, SSE has gone one step further and in October 2011 removed all differentials between its tariffs online and offline. This means that a customer of SSE will have the same price for their energy, regardless of the sign-up method used. SSE will continue to offer a 1% discount to all customers who choose paperless billing, which reflects the lower cost of providing this option.

SSE believes that its approach helps make tariffs simpler and energy prices across all of its customers fairer. It continues to believe the much larger differentials maintained by other suppliers should be the subject of the most detailed investigation by Ofgem.

#### Developing new energy products and services

The competitive energy supply market in Great Britain spurred companies to develop and deploy an ever-increasing number of features and options around the core commodities of electricity and gas. This led critics to say that customers had become 'bamboozled' by the complexities that resulted from this.

As part of its *Building Trust* initiative, SSE has responded to this by introducing, in February 2012, a dramatically-simplified range of energy tariffs which will meet the needs of the vast majority of customers, featuring:

- four core products – two with a variable price and two with a fixed price;



#### Making energy better: → Zero-carbon living

**In Slough we've built ten highly efficient homes to better understand customers' needs in the future as the UK moves to reduce carbon emissions by 80% by 2050.**

## In response to SSE's tariff simplification, uSwitch.com said: 'Yet again, SSE is setting the pace for the rest of the industry, this time unveiling its plans to simplify its products and prices while Ofgem is still consulting on its own proposals.'

- five simple questions to enable customers to find the best deal;
- a new price comparison metric to enable customers to see the relative cost of each tariff; and
- the same availability online, face-to-face or over the telephone.

This fulfils two key principles:

- simplicity for the customer who is concerned only or mainly about price; and
- choice for the customer who is more concerned about features and products.

To achieve this simplification, SSE removed the 'no standing charge' option from all of its products, with all new customers being placed on a tariff consisting of:

- a standing charge which covers a proportion of the fixed costs in a customer's bill; and
- a single unit price for all units consumed.

In response to SSE's tariff simplification, uSwitch.com said: 'Yet again SSE is setting the pace for the rest of the industry, this time unveiling its plans to simplify its products and prices while Ofgem is still consulting on its own proposals.'

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

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

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

- the foundation stage to enable the energy industry to build and test all the systems needed to start the roll-out, ensure positive customer engagement and deliver energy savings and to enable the UK government to establish the Data Communications Company, on which a consultation was launched in February 2012, to manage smart meter communications; and
- the roll-out stage, between 2014 and 2019, during which the meters themselves will be installed in most households. This has to be a positive experience for customers, and there is evidence from elsewhere that customers can be hostile to smart meter installation programmes.

SSE sees its role in the smart meter roll-out as a service provider, operating within the framework set by the UK government for issues like technical standards, data access and security. In line with this, and its measured and realistic approach to the roll-out, SSE's priority is to make substantive progress on the necessary IT systems to support the wider roll-out, without making commitments that may prove to be mis-placed as the roll-out plan gets under way. This means that, under its own programme, it had installed just 2,500 smart meters in customers' homes by the end of March 2012, as opposed to the hundreds of thousands installed by one other supplier, many of which do not conform to the technical specification issued by the UK government in March 2012.

Fundamentally, SSE believes that the smart meter roll-out is something which should be started well and completed successfully, rather than started too quickly and burdened by problems before completion.

In Ireland, installation of smart meters will be the responsibility of network companies.

### Delivering zero-carbon homes

Smart meters are one example of change in the energy sector designed to help the way

in which electricity and gas are used to become more sustainable. The way in which people live is also changing and, in line with that, SSE completed a development of 10 zero-carbon homes on a brownfield site in Slough in 2010. They feature triple glazing, mechanical ventilation systems, solar PV tiles, solar thermal panels and an energy centre with a biomass boiler and a ground-source heat pump and conform to the highest specification for sustainable building, Code 6 in the Code for Sustainable Homes.

The homes have been occupied throughout the period since, allowing information to be gathered about how householders adapt and respond to zero-carbon living. The main findings so far are that:

- residents like zero-carbon homes which, despite the extensive renewable and energy efficiency measures, feel very normal;
- due to enhanced insulation and triple glazing, residents hear very little external noise;
- the homes have used less electricity and less hot water than expected but more space heating than expected but net energy costs were less than half that of a traditionally-built home; and
- the integration of four different renewable heating technologies into one energy centre has required time to commission and optimise.

Final conclusions from the zero-carbon homes will be prepared when the initial trial period is completed, which is expected to be in late 2012. Those conclusions will help inform future developments in the decarbonisation of the energy sector.

### Energy Supply priorities in 2012/13 and beyond

During 2012/13, and beyond, SSE's priorities in Energy Supply are to:

- deliver fair prices, simple products and excellent service to customers;
- continue to build customers' trust in energy supply;
- deliver energy efficiency programmes;
- make substantive preparations for the roll-out of smart meters and related developments; and
- maintain progress in providing additional services through digital channels.

## Retail (continued)

### Market-based businesses

#### Energy-related Services

##### Providing energy-related products and services

In addition to electricity and gas, SSE also provides energy-related products and services to customers, covering three principal areas:

- retailing of 'home services' such as gas boiler, central heating and wiring maintenance and installation, telephone line rental, calls and broadband services and micro-generation;
- supplying, installing, maintaining and reading meters in the household, commercial, industrial and generation sectors in Great Britain; and
- domestic, commercial and industrial mechanical and electrical contracting and electrical and instrumentation engineering.

##### Providing home services

SSE provides home services to 412,000 accounts. In addition, micro-renewables is a very small market, but it has grown quickly in response to Feed-in Tariffs with solar PV being the most popular product. At 31 March 2012, SSE had 38,000 registered FiT customers, equating to a market share of around 15%. At the same time, customer numbers are limited by the fact that SSE's home services products and services have only been available in some regions.

SSE believes that extending the availability of its home services, especially in the context of the forthcoming launch of the Green Deal, will be necessary to integrate these products and services more closely with its wider proposition for electricity and gas customers and it intends to do this over the next three years. It is also intended to extend SSE's home services offering in Ireland.

##### Maintaining a national Metering business

SSE's Metering business provides services to most electricity suppliers with customers in central southern England and the north of Scotland. It undertakes meter reading operations and meter operator work in all

other parts of Great Britain. It supplies, installs and maintains domestic meters and carries out metering work in the commercial, industrial and generation sectors. It also offers data collection services to the domestic and SME sectors. This national metering business was created following the completion of a programme of in-sourcing in 2010.

During 2011/12, SSE collected (previous year in brackets):

- 9.1 million electricity readings (8.4 million); and
- 5.9 million gas readings (5.4 million).

Longer term, SSE's Great Britain-wide metering team will be able to support the transition to smart meters which will take place in the coming decade and will help SSE deploy other energy-related services and products during that time (see 'Preparing for the roll-out of smart meters' on page 37).

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

SSE Contracting has two main areas of activity:

- industrial, commercial and domestic mechanical and electrical contracting; and
- electrical and instrumentation engineering.

It is one of the largest mechanical and electrical contracting businesses in the UK. It employs around 4,000 people and operates from regional offices throughout Great Britain.

SSE Contracting continued to make solid progress during 2011/12. Its order book ended the financial year at £78m, compared with £67m in 2010/11 (on the revised basis adopted on 1 April 2011). The order book features a number of important new contracts with customers as diverse as Tesco and National Air Traffic Services.

A key focus for SSE Contracting is on post-sales control, particularly in terms of costs, and maintaining strong customer relationships, with careful analysis of the markets and areas of work it should prioritise.

The structure of the business has also been kept under review and some rationalisation of depots has been undertaken.

##### Conclusion

Through focusing on fair prices, simple products and excellent service SSE believes that it can achieve long-term success in its Retail businesses which, in turn, will contribute to the achievement of its key financial goal of sustained real growth in the dividend.

#### Energy-related Services priorities in 2012/13 and beyond

Home Services, Metering and Contracting have specific priorities for 2012/13 and beyond, but across all of them there is a need to:

- maintain the right portfolio of products and services;
- deliver high standards of customer service; and
- anticipate the changing requirements of customers.

Through focusing on fair prices, simple products and excellent service, SSE believes that it can achieve long-term success in its Retail business.

# WHOLESALE

Securing the energy people and businesses need.

## Wholesale operating profit – £m

**607.9**

**2011: 571.5**

**Change: +6.4%**

The businesses in SSE's Wholesale segment source, produce and store energy through energy portfolio management, electricity generation, gas production and gas storage.

## Thermal generation output – TWh

**38.4**

**2011: 42.9**

**Change: -10.5%**

Thermal generation output covers the amount of electricity generated at gas- and coal-fired power stations at which SSE has an ownership or contractual interest.

## Renewable generation output – TWh

**7.6**

**2011: 4.4**

**Change: +72.7%**

Renewable generation output is output from SSE's conventional hydro-electric schemes, wind farms and dedicated biomass plant. Output is affected by the amount of plant in operation and by weather conditions.

## Thermal generation capacity – GW

**8.84**

**2011: 8.84**

**Change: 0.0%**

SSE has wholly-owned gas-fired power stations at Keadby, Medway and Peterhead and coal-fired power stations at Ferrybridge, Fiddler's Ferry and Uskmouth.

## Renewable generation capacity – GW

**3.02**

**2011: 2.45**

**Change: +23.3%**

Renewable generation capacity covers hydro-electric schemes (conventional and pumped storage), wind farms (onshore and offshore) and dedicated biomass plant.

## Gas Storage capacity (net) – mcm

**490**

**2011: 440**

**Change: +11.4%**

SSE has gas storage capacity at Hornsea and, in a joint venture with Statoil (UK) Ltd, is completing a new development at nearby Aldbrough.

## Sourcing and producing energy

In previous years, SSE reported performance in Energy Portfolio Management (EPM) and Electricity Generation as part of a Generation and Supply segment. Following changes in SSE's management structure in 2011 and in order to report the results of the Generation and Supply business in a more meaningful and consistent manner, these activities have been separated into different segments.

This means that the results from the Energy Supply business are being reported separately within the Retail segment and the combined results of SSE's wholesale energy procurement and optimisation activities and the electricity generation operations are being reported together as EPM and Electricity Generation.

The aggregation of these activities reflects the way they are managed and their relationship to the Energy Supply business, with EPM acting as the bridge that delivers energy to Retail customers from SSE's electricity generation, gas production and energy contracts portfolio.

EPM is responsible for the scheduling of Generation plant through capacity contracts with the asset owners, the procurement of fuel for the plants and the optimisation and trading of electricity, gas and other commodities. The Generation business is responsible for asset management, maintenance and making available plant for use by EPM. Neither activity is reported as a discrete profit centre or activity. In combination, these activities are carried out to provide the lowest cost input to the Energy Supply business for provision of energy to customers.

Under the new basis of reporting, performance in Gas Production and Gas Storage will be reported separately, within the Wholesale segment.

SSE continues to believe that its involvement in the Wholesale activities of Energy Generation and Energy Portfolio Management and the Retail activity of Energy Supply means it has a well-balanced portfolio of customers, assets,



## Wholesale (continued)

### Market-based businesses

contracts for purchasing gas and power purchase agreements.

In undertaking these activities, SSE publicly discloses planned or unplanned outages affecting its wholly-owned power plant for units of more than 100MW in capacity (or more than 100MW in aggregate for wind capacity), including the reason for the outage and its expected duration. This information is in line with the expected requirements of the EU Regulation on Energy Market Integrity and Transparency (REMIT) as it affects wholesale energy markets.

#### Financial performance in Wholesale

Operating profit\* in Wholesale increased by 6.4%, from £571.5m to £607.9m, contributing 37% of SSE's total operating profit\*. This comprised (comparisons with the previous year in brackets):

- £541.5m in EPM and Electricity Generation, (£543.4m);
- £42.6m in Gas Production (£4.6m); and
- £23.8m in Gas Storage (£23.5m).

#### Energy Portfolio Management and Electricity Generation

##### Financial performance in Energy Portfolio Management and Electricity Generation

SSE's EPM and Electricity Generation businesses have six main responsibilities for which they are remunerated:

- energy contract management;
- sourcing energy through participation in wholesale markets for electricity, gas, coal, oil, biomass and CO<sub>2</sub> emission permits;
- management of existing power generating assets and making available those assets for use;
- producing renewable energy;
- securing Renewable Obligation Certificates and Levy Exemption Certificates; and
- services to the electricity balancing market under the Balancing and Settlement Code.

Operating profit\* in EPM and Electricity Generation reduced by 0.3%, from £543.4m to £541.5m. It contributed 33% of SSE's total operating profit\* in 2011/12. The reasons behind this performance are set out under 'Factors affecting adjusted profit before tax\* in 2011/12' on page 18.

##### Working to reduce volatility for energy customers

SSE's activities in EPM and Electricity Generation are guided by two long-term priorities:

- competitive and sustainable energy procurement; and
- flexible and 'greener' electricity production.

In delivering on these priorities SSE is committed to the delivery of a diverse portfolio of robust assets, from which revenue can be generated on a reliable, long-term basis and which support future dividend growth.

The wholesale price of energy can fluctuate greatly, according to variables such as physical supply, customers' demand, the weather, the availability of delivery infrastructure and geopolitical issues. EPM and Generation act in unison maintaining a diverse and well-balanced portfolio of contracts and assets, both long- and short-term, to ensure that customers benefit from lower exposure to wholesale price volatility and therefore price stability. In doing so SSE provides:

- lower risk from wholesale energy price volatility through reduced exposure to any single commodity;
- greater ability to manage wholesale energy price volatility and to protect customers from it; and
- more scope to deliver the investment needed in Generation because the risks associated with large-scale and long-term investments are balanced by having electricity and gas customers.

##### Generating and buying electricity in Great Britain

As at 31 March 2012, SSE's generation capacity, including its share of joint ventures and associates, was around 11,860MW, comprising:

- 11,360MW in Great Britain;
- 80MW in Northern Ireland; and
- 420MW in the Republic of Ireland.

During 2011/12, in Great Britain, SSE (previous year's numbers in brackets):

- generated 38.4TWh, based on contracted output of electricity from all thermal power stations in which it has an ownership interest in GB (42.9TWh); and
- generated 6.4TWh based on contracted output from renewable sources of energy in which it has an ownership interest in GB, including pumped storage (3.7TWh).

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

- supplied 25.2TWh of electricity to its industrial and commercial customers; and

- supplied 26.7TWh to its small business and household customers.

This means that, during the year, SSE:

- generated the equivalent of 86% of the electricity needed to supply all of its customers; and
- generated the equivalent of 168% of the electricity needed to supply its household and small business customers.

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

##### Increasing wholesale market transparency

In response to customers' wishes for greater transparency and concerns regarding the lack of liquidity in the short-term wholesale market for electricity, SSE introduced a new approach in October 2011 under which it started to phase in the auction of all of its electricity supply and purchase all of its electricity demand in the day-ahead market. This move was broadly welcomed by stakeholders, with Ofgem saying it would 'create greater liquidity and more efficient price discovery on the day-ahead market'.

Moving to this approach effectively means that SSE is delivering a new level of transparency, significantly improving liquidity, increasing the depth and credibility of the market, and assisting in the creation of a robust and tangible pricing index.

By the end of 2011/12, SSE had consistently placed 100% of its flexible thermal electricity generation and about 60% of its power demand via Nasdaq OMX Group Inc. and Nord Pool Spot AS's N2EX daily auction. In the financial year 2011/12, SSE traded over 25TWh in the day-ahead auction market and, since starting the initiative, daily market volumes have increased by over 300%. While it is SSE's aim to trade 100% of its power in the day-ahead auction (subject to costs and market conditions), delays by other utilities in trading larger volumes has slowed the process.

Overall the move by SSE has been successful in transforming the market and has significantly improved liquidity, depth and credibility. It has contributed to the creation of a more robust and tangible pricing index for electricity contracts and with greater participation will make prices more transparent, robust and further increase liquidity.

In April 2012, in line with its *Building Trust* initiative, SSE announced a series of trading

commitments for smaller suppliers of electricity to help them secure contracts for wholesale electricity of the right size and shape to enable them to manage their risk profile.

### Key trends in EPM and Electricity Generation

Whether at global, European or GB and Irish levels, the energy sector is experiencing a period of profound change and challenge, with a number of external trends influencing SSE's decisions, including:

- slow economic growth implying lower electricity demand;
- UK climate change legislation requiring a 34% reduction in greenhouse gas emissions, particularly CO<sub>2</sub>, by 2020 (compared with 1990 levels);
- EU 2020 targets requiring 15% of the UK's energy requirements to come from renewable sources (for Ireland, it is 16%);
- projected global growth in coal (25%) and gas (65%) demand by 2035 (IEA), impacting fuel supply security;
- continuing integration of UK energy prices into the wider global market;
- tightening generation capacity in GB as older plant closes including coal, nuclear and gas plant;
- increasing system variability due to higher penetrations of variable energy sources;
- uncertainties surrounding electricity market reform and a regulatory framework trending towards increased central planning; and
- increasing market integration between GB and Ireland.

In assessing and responding to these various trends SSE is committed to the delivery of a diverse portfolio of robust assets, from which revenue can be generated on a reliable, long-term basis and which supports future dividend growth.

The main public policy driver is European and GB-led decarbonisation policy. In line with the energy 'trilemma', this must be carefully balanced by the need for supply security, both in terms of fuel security and capacity availability and the need for energy affordability and competitiveness. To achieve this tripartite objective, SSE recognises the need for a diverse, sustainable and complementary generation and fuel portfolio. It is, therefore, focused on maintaining a range of options that will meet policy goals while being consistent with its financial goal of sustained real dividend growth. Retaining options is important but must

also be balanced by a focus on selected areas of competitive advantage to SSE.

### Managing an energy portfolio

SSE typically needs around 10 million therms of gas per day to supply its customers and to fuel its power stations and around 150GWh of electricity per day to supply its customers. It is the role of EPM to acquire the necessary energy to meet this demand. In focusing on the competitive and sustainable procurement of energy, it seeks to meet the needs of Generation and of Retail customers' and to maintain a diverse portfolio of energy options to ensure the effective spread of risk.

Managing energy procurement risk is a key challenge as it is heavily influenced to varying degrees by a multitude of national and international factors including: demand growth/decline; the global economy; fuel supply disruptions; international affairs such as Libya; nuclear availability; CCGT demand; shale gas; and Liquefied Natural Gas.

In managing this risk Energy Portfolio Management has three primary routes for energy procurement:

- **assets:** upstream gas exploration and production, coal production, renewables, forests and agriculture;
- **contracts:** gas producer contracts, LNG capacity, power purchase agreements, solid fuel contracts; and
- **wholesale trading:** where energy contracts are transparently traded on international exchanges.

By optimising this diverse portfolio SSE ensures that its customers are protected from the considerable volatility that exists in global markets, while ensuring adequate returns to support its commitment to sustained real dividend growth.

### Meeting longer-term energy requirements

Fuel supply contracts play a key part in helping SSE to meet its customers' needs and contribute to the long-term stability of its energy portfolio. Long-term fuel supply contracts also support a stable and confident market which supports investment in new gas-fired generation. Over the past year SSE has secured two significant long-term fuel supply contracts including:

- a 10-year gas supply agreement of 790 million cubic metres (mcm) (292Mth) per annum with Shell Energy Europe, commencing in 2015. The gas will be supplied as a firm delivery of 800,000 th/day, at a price linked to prevailing prices in the

natural gas market; and

- a 10-year contract with Statoil for the annual supply of 500mcm (185Mth) of natural gas to be delivered to SSE's Peterhead power station via the St Fergus gas terminal. Delivery of gas is due to begin in the final quarter of 2012 with the price of the gas also linked to prevailing prices in the natural gas market. The contract also contains provisions to allow the supply of gas to be diverted to help meet SSE's other requirements if Peterhead is undergoing maintenance or repair work.

The structure of these agreements fits well with the gas purchasing profile SSE needs to support its business contracts and generation requirements. They provide an excellent opportunity to cover a portion of future gas needs with an attractive pricing structure and minimal risk.

SSE's contracts with Shell and Statoil add to a number of arrangements agreed in recent years including the 15-year tolling agreement with Marchwood Power Ltd which commenced in 2009, and the 2008 extension of the contract for electricity output from Seabank Power Ltd.

Furthermore, SSE's investment in renewable energy sources across the UK and Ireland provides long-term energy supply with no fuel purchasing requirement and a hedge against the volatility in fossil fuel markets. During 2011/12 the energy produced by SSE's renewables portfolio was equivalent to 260Mth of gas. Renewables, coupled with existing and future investments in exploration and production assets, are an increasingly important source of energy for SSE.

In recent years LNG has come more to the fore in the UK representing around one quarter of gas entering the National Transmission System in 2011. As a further diversification to its long-term energy contracts, SSE is proactively investigating options for booking LNG regasification capacity.

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

During 2011, SSE defined its long-term priorities in Generation as being: flexibility in operations; and a 'greening' in production. The establishment of these priorities clearly summarises SSE's ambitions and is underpinned by six core principles that direct the operation of, and investment in, its Generation portfolio:

- **compliance:** with all safety standards and environmental requirements;

## Wholesale (continued) Market-based businesses

- **capacity:** to meet the electricity needs of domestic and small business customers;
- **diversity:** to avoid over-dependency on particular fuels or technologies;
- **availability:** to respond to customer demand and market conditions;
- **flexibility:** to ensure that changes in demand for electricity can be addressed; and
- **sustainability:** to deliver an overall 50% cut in the CO<sub>2</sub> intensity of electricity produced.

Playing to its strengths is an important focus for SSE as it ensures capital and management resources are employed in areas and at stages where it best retains competitive advantage, maximises shareholder value and supports continued dividend growth.

### A decision to exit nuclear power development

In its Annual Report 2011, SSE said that: 'the cost, development issues and timetable and operational efficacy of nuclear power stations all require the greatest possible scrutiny before a commitment to invest in new nuclear power stations can be made'.

It was against this background that SSE announced in September 2011 its intention to dispose of its 25% stake in NuGeneration Ltd, the joint venture company established to develop proposals for a new nuclear power station in West Cumbria. In focusing on its strengths SSE concluded that, for the time being, its resources are better deployed on business activities and technologies where it has the greatest knowledge and experience.

In February 2012, the sale – to NNB Development Company S.A. – was concluded for an upfront cash consideration of £5.75m, with a further contingent payment of £1.25m dependent on progress with the development of the West Cumbria site.

While SSE may become involved in nuclear again at a future date, either as an investor or as a purchaser of nuclear-generated electricity, its Generation investment plans for now are focused on a diverse range of options including renewable energy, gas-fired generation, plant with carbon capture and storage and developments with solid fuel.

### Maintaining a diverse Generation portfolio

The way in which energy is converted to electricity is changing, primarily driven by policy drivers directing decarbonisation. There is no 'one size fits all' solution to the

achievement of this objective; rather it will require a broad portfolio of solutions including conventional and renewable generation and where feasible carbon abatement technologies. With its keen focus on diversity and sustainability, SSE continues to operate and develop a variety of options that play to its strengths and capabilities.

The practical application of its generation principles means SSE's portfolio comprised at 31 March 2012:

- 4,470MW of gas- and oil-fired capacity;
- 4,370MW of coal-fired capacity (with biomass co-firing capability); and
- 3,020MW of renewable (hydro, including pumped storage; wind; and dedicated biomass) capacity.

With this portfolio, SSE has the greatest diversity in fuels for generating electricity among UK generators, which enables it to:

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

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

SSE's 31 March 2012 portfolio of 11,860MW of capacity for generating electricity compares with 11,290MW the year before. During 2011/12, SSE:

- added 495MW of new onshore wind farm capacity as a result of its investment programme;
- commissioned over 180MW of new offshore wind farm capacity at Walney and Greater Gabbard (this excludes capacity in disputed turbines at Greater Gabbard); and
- sold 96.8MW of onshore wind farm capacity in April 2011 the majority of which had no SSE power purchase contracts, and took a small wind farm at Spurness offline for re-powering.

### Maximising the capability of SSE's Generation portfolio

In order to deliver the long-term value and reliability of its Generation portfolio and to better inform its decision-making process SSE has developed its purpose-built Engineering Centre of Excellence. Its objectives are to:

- support safe operation of power generating plant;
- help deliver increased availability and performance of key plant; and
- mitigate project risk with optimum design solutions and technology choice.

A primary output of the centre, through its Equipment Performance Centre (EPC) is the bespoke asset management model which analyses almost 500 million data points every hour, allowing for the early identification and resolution of potential plant safety and availability risks. The EPC has enabled a number of early interventions which previously may have led to significant forced outages. The first wind farms were connected to the EPC during 2011 and predictive monitoring trials are currently in progress, specifically looking at the operational performance of each SSE wind turbine.

With ever-increasing knowledge as to the performance and capability of its portfolio, SSE can ensure the right long-term decisions are made to deliver an efficient, flexible, low-carbon generation portfolio which plays to the Company's strengths and experience.

### Improving delivery of Large Capital Projects

It is through maintaining a breadth of opportunities that SSE can take forward the best investments and achieve the strongest possible returns to support dividend growth. SSE is focused on the safe, sustainable and timely execution of its major project portfolio, delivering business revenues and shareholder value.

To meet this objective SSE has developed a Large Capital Project Governance Framework, which ensures that all of its major investment projects are governed, developed, approved and executed in a consistent and effective manner. Through the rigorous implementation of this framework SSE is demonstrating industry-leading performance and delivering on its business goals as planned.

A further dimension of the Large Capital Project framework is designed to inform and optimise the stage at which SSE enters the project development cycle which can range from asset purchases, to new build, to long-term electricity contracts. This supports SSE in identifying the point of entry where it can best maximise value and competitive advantage.

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

SSE owns 4,470MW of gas- and oil-fired

electricity generation capacity, including its share of joint ventures.

During 2011/12, SSE's principal wholly-owned gas-fired power stations (Keadby, Medway and Peterhead) achieved 94% of their maximum availability to generate electricity, excluding planned outages, compared with 88% availability in the previous year. In addition to SSE's ongoing focus on high operational performance, availability was increased by the return to service of Keadby in early May 2011 following the successful repair of a generator fault.

In addition to its wholly-owned gas generation SSE has joint venture interests in:

- Marchwood, the 840MW CCGT, owned by Marchwood Power Ltd, a 50:50 joint venture between SSE and ESB International. During 2011/12 the plant, achieved 94% of its maximum availability to operate during the year compared with 93% the previous year; and
- Seabank, the 1,140MW CCGT, owned by Seabank Power Limited, a 50:50 joint venture between SSE and Cheung Kong Infrastructure Holdings Limited. During 2011/12 the plant, achieved 86% of its maximum availability to operate during the year, down from 96% the previous year.

All of the electricity output at both plants is sold under contract to SSE.

The amount of electricity generated by SSE at gas-fired power stations in which it has an ownership or contractual interest, including CHP, was 21.6TWh in the year to 31 March 2012 (including 12.5TWh from wholly-owned stations), compared with 29.3TWh in the previous year (including 13.3TWh from wholly-owned stations).

This reduction in output was driven by very high wholesale gas prices in the course of the year which had a significant negative impact on spark spreads, which averaged less than £1/MWh over the year. Spark spread is the difference between the cost of gas and the price of electricity produced from it. Because it was very low over the period, the stations were operated less frequently. This was consistent with the Department of Energy and Climate Change's *Energy Trends*, published in March 2012, which indicated a 17.4% reduction in gas used for electricity generation.

However, a record year for SSE's renewable generation, alongside increased output from its coal-fired power stations mitigated the

impact of spark spreads by displacing higher-cost CCGTs and highlighting the significant benefits to customers of SSE's diverse generation portfolio.

#### Developing flexibility in gas-fired generation

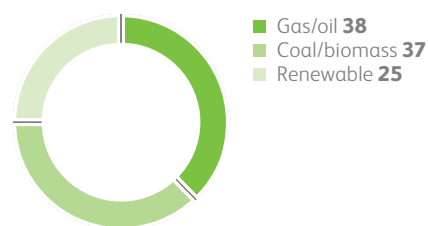
With more penetration of renewable generation in the GB system, the stations at Peterhead, Keadby and Medway have, increasingly, been required to operate on a more flexible 'two shift' basis. This requirement will grow in the medium term. To increase flexibility SSE is applying modifications to support more frequent 'two shifting'.

Against this background, and following the sustained period of low spark spreads, SSE has decided to undertake a comprehensive programme of upgrade work to support more flexible operations at its Keadby and Medway power stations from 2013 onwards. To allow this work to be carried out, it suspended electricity generation at the stations at the end of March 2012 (see also exceptional items in the Financial Overview). The work that will be carried out follows a similar and successful programme undertaken at Peterhead power station in 2011.

### Total generation capacity – MW

| 2012 | 11,860 |
|------|--------|
| 2011 | 11,290 |
| 2010 | 11,330 |
| 2009 | 10,740 |
| 2008 | 10,530 |

### Generation capacity 2011/12 composition – %



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

| 2012 | 531 |
|------|-----|
| 2011 | 504 |
| 2010 | 494 |
| 2009 | 491 |
| 2008 | 496 |

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

Irrespective of current market circumstances, gas will play an increasingly important role in electricity generation, providing vital flexibility to support the increasing amount of generation from on- and offshore wind farms required to deliver renewable energy and climate change targets.

As stated in the EU Energy Roadmap 2050 'gas will be critical for the transformation of the energy system' and, in particular the power sector. Many factors support this including its relatively low capital costs, flexibility, short construction time, high thermal efficiency and its status as the cleanest of the fossil fuel technologies.

Recognising this future role for gas in a diversified generation portfolio SSE continues to develop a range of CCGT options for both the medium and long term.

SSE's most advanced CCGT option, Abernedd in South Wales, secured its construction and operation consents in February 2011. SSE is pursuing a single CCGT unit of up to 470MW, which it considers the most economic option



## Wholesale (continued) Market-based businesses

# Gas will play an increasingly important role in electricity generation, providing vital flexibility to support the increasing amount of generation from wind farms.

in the context of the site and the medium-term outlook for gas-fired generation. While an invitation to tender was issued in late 2011 an investment decision will not be taken until the second half of 2012 at the earliest and will depend, amongst other things, on the emerging shape of the electricity market following the UK government's proposed electricity market reforms. This means that the power station, if built, will not be operational before 2015.

Furthermore, SSE has a number of high potential CCGT development options located at existing generation sites including Keadby, Ferrybridge and Fiddler's Ferry, plus Seabank, where SSE has recently acquired adjacent land for possible further development. These locations offer many attractive characteristics including established grid and gas connections, availability of cooling water and land area. These and other potential sites across GB and Ireland mean SSE has a wide range of CCGT development options for independent or co-development.

Additional factors when considering the development and operation of CCGTs include fuel procurement, technical requirements for plant flexibility and future carbon abatement. In assessing these options, SSE is continuing its policy of rigorous analysis to ensure the right investment decisions are made and then effectively delivered. It is against this backdrop that:

- Barking Power Ltd, in which SSE has a 30% interest, is mothballing capacity at its 1,000MW power station; and
- Derwent Cogeneration Limited, in which SSE has a 49.5% share, is planning to cease operation at its CHP plant during 2013. The plant provides heat to the nearby Celanese Acetate's Spondon factory in Derbyshire.

While SSE agrees with the important role of gas-fired generation in both the Company's and the overall UK portfolio it believes the right market signals must be apparent if the necessary investment decisions are to be taken, particularly the introduction of a well functioning capacity mechanism under Electricity Market Reform proposals.

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

During 2011/12, SSE's 4,370MW of coal-fired power stations, located at Fiddler's Ferry, Ferrybridge and Uskmouth generated 16.8TWh of electricity, compared with 13.6TWh in the previous year.

This increase in output took place against a backdrop of global and national energy market volatility and demonstrated the considerable value of SSE's coal-fired stations as part of a diverse portfolio through their operational flexibility, availability and reduced reliance on imported gas.

The stations achieved 89% of their maximum availability to generate electricity, excluding planned outages, compared with 84% in the previous year. Availability was primarily impacted by a number of emergent issues identified during scheduled outages at Ferrybridge and Fiddler's Ferry but all units were available during the 2011/12 winter period.

SSE Mineral Solutions owns and operates an ash separation plant at Fiddler's Ferry, where fresh and stored ash produced by the power station can be processed into marketable minerals and materials such as cement substitutes. While SSE fundamentally believes in the inherent value of the asset, overall market demand for its products is such that the business is trading at an ongoing loss. However, as coal-fired stations close, this situation may change as the value of ash as a cement substitute increases. Accordingly, SSE announced in April 2012, the mothballing of the plant until conditions improve sufficiently to support the business. This will have no impact on the continued operation of Fiddler's Ferry power station.

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

As exemplified in 2011/12 coal-fired power stations will continue to have a significant part to play in maintaining secure supplies of electricity and ensuring customers benefit from the most cost-effective portfolio of fuels. Additional value also accrues to SSE's

coal-fired power sites as they benefit from key infrastructure including access to water, transport links, and electricity network connections.

All of the capacity at Fiddler's Ferry and Uskmouth and half of the capacity at Ferrybridge (over 3,300MW in total) complies with the EU Industrial Emissions Directive and can operate for 17,500 hours between 2016 and 2023.

However, consistent with the UK's climate change abatement policies, as set out in the White Paper *Planning our Electric Future*, it is SSE's view that no new coal-fired power generation plant should be built in the UK without CO<sub>2</sub> abatement and that no coal-fired plant without such abatement should remain operational beyond 2030.

SSE's desire to deliver the full current and future value potential of these sites, while meeting carbon abatement targets, means operational and investment decisions in its coal-fired power plants will be influenced by four main factors:

- the need to maintain and improve the day-to-day performance of the stations while they are operational;
- the prospects for the development of other solid fuels;
- the UK government's final determination on proposed levels of banded support under the Renewables Obligation between 2013 and 2017; and
- the continuing UK government commitment to the development of Carbon Capture and Storage (CCS) technology.

### Generating electricity from 'multi-fuel'

The potential of the sites of SSE's coal-fired power stations was demonstrated in April 2012 when SSE and Wheelabrator Technologies Ltd entered into a 50:50 joint venture to develop a new £300m multi-fuel generation facility at Ferrybridge power station. The joint venture – Multifuel Energy Ltd (MFE) – expects to begin full construction of a 68MW multi-fuel facility later this year and to complete it in 2015. When operational, the electricity generated by the plant will be sold to SSE.

MFE has entered into a long-term fuel procurement contract with 3SE (SSE's joint venture with Shanks Plc), which will provide processed waste-derived fuels using waste taken from nearby Barnsley, Rotherham and Doncaster councils. To support this contract 3SE intends to develop a new Mechanical

Biological Treatment and Anaerobic Digestion facility. Subject to planning permission, this is expected to be operational by 2015.

Multi-fuel technology is a tried and tested way of generating clean, base-load power. This new multi-fuel plant will provide additional diversity to SSE's Generation portfolio and make a useful contribution to ensuring there are reliable energy supplies in the future. The transactions that make up this project represent a strong partnership between major players in the multi-fuel sector, who are committed to making a significant level of investment in this technology.

Between them the companies involved have extensive experience in sourcing and processing waste, constructing and commissioning multi-fuel technologies, and operating generation plant. This partnership creates a valuable platform to develop multi-fuel technology in the future.

#### Maintaining additional options for coal-fired power stations

In addition to multi-fuel, SSE's investment strategy for Fiddler's Ferry, Ferrybridge and Uxbridge power stations is as follows:

- following completion of a front-end engineering design (FEED) study, it is investing in NOx emissions reduction technology for one unit of 500MW at Fiddler's Ferry to establish the feasibility of the various options for operating the unit up to and beyond 2023;
- it is continuing to invest in the operation and maintenance of the three stations with a total of £60.1m invested in the stations during 2011/12;
- it is investigating the potential to increase co-firing with biomass at Fiddler's Ferry, subject to the RO banding review and the impact on future operation arising from the Industrial Emissions Directive; and
- it is operating Europe's largest post-

combustion CO<sub>2</sub> capture trial at Ferrybridge, in collaboration with Doosan Babcock and Vattenfall, following its completion during 2011/12 (see 'Making progress on Carbon Capture and Storage' below).

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

EU energy policy is primarily driven by the decarbonisation agenda and will broadly require a halving of carbon emissions by the electricity sector every decade between now and 2050. Ensuring that this transition is achieved while retaining supply security and affordability will require the continued involvement of carbon-based fuels including coal and gas.

In the near term, coal-fired power stations still have a crucial role to play in maintaining secure supplies of electricity as they provide capacity availability, flexibility and diversity. However, in the medium-term, the use of coal to generate electricity will depend on the extent to which CCS technology can be applied to abate CO<sub>2</sub> emissions.

In the longer-term CCS technology will need to be applied as widely as possible if targets for reducing CO<sub>2</sub> emissions are to be met and has become a key consideration when planning the development of gas-fired generation. Consequently, the development of viable carbon capture technology is central to the UK's climate change and energy security objectives and this is reflected in the UK government's welcome inclusion of gas-fired generation plant in its CCS demonstration programme.

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

- **Coal at Ferrybridge:** This project, Europe's largest post-combustion CO<sub>2</sub> capture trial, came into full operation

in early 2012. The project is a collaboration between SSE, Doosan Power Systems and Vattenfall and is the first of its size to be integrated into a working power plant in the UK. The plant bridges the gap between the pilot-scale trials and the commercial-scale demonstration projects envisaged by the UK government. It captures 100 tonnes of CO<sub>2</sub> per day from the equivalent of 5MW of coal-fired power generating capacity. The significance of the project lies in its scale and its ability to demonstrate the operational characteristics of capture plant on an actual power station; and

- **Gas at Peterhead:** In April 2012, the UK government announced a new competition for funding of commercial-scale CCS projects in the UK. SSE is working with Shell UK to develop a gas CCS project at SSE's gas-fired power station in Peterhead. The project aims to design and develop a full chain, post-combustion CCS facility which will be capable of capturing CO<sub>2</sub> from one 385MW CCGT unit. It is planned that the CO<sub>2</sub> will then be transported to the Shell-operated Goldeneye gas field in the North Sea using, as far as possible, existing infrastructure. With works already undertaken, the Peterhead project should be in a position to begin a full FEED study in the second half of 2012 positioning it as a leading contender for the new CCS competition. The correct funding package will be necessary for the project to go ahead, and it is also being considered by the European Commission to receive funding under the EU's NER (New Entrant Reserve) scheme to support CCS and renewable energy projects across the EU.

#### Generating electricity from alternative sources like biomass

In October 2011, the UK government released proposals for the level of banded support under the Renewables Obligation between 2013 and 2017. This included proposals for:



Making energy better:

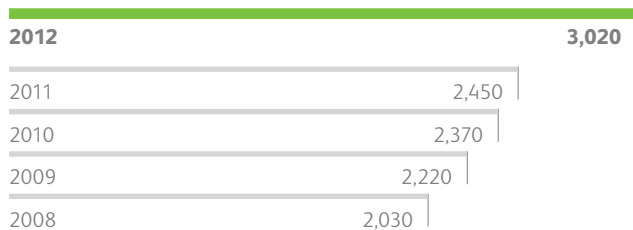
#### → Renewable generation

We now have 3,020MW of renewable energy capacity (onshore wind, offshore wind, hydro and dedicated biomass) in operation, in the UK and Ireland.

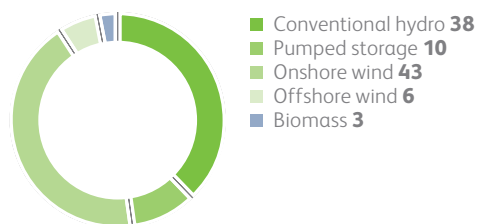
## Wholesale (continued)

### Market-based businesses

#### Renewable generation capacity – MW



#### Renewable energy capacity 2011/12 composition – %



- dedicated biomass (1.5 ROCs);
- biomass conversion (1.0 ROCs);
- co-firing biomass (0.5 ROCs); and
- enhanced co-firing, where biomass is used to generate at least 15% of gross output (1.0 ROCs).

The outcome of this consultation will have a significant influence on SSE's plans for developments in biomass, particularly enhanced co-firing, at its coal-fired power stations.

Under the proposals, qualifying output from dedicated regular biomass plants will continue to attract 1.5 ROCs per MWh. SSE's plant at Slough has a current generating capacity of 80MW and remains the UK's largest dedicated biomass energy facility. During 2011/12, it produced 156GWh of electricity from renewable sources, compared with 200GWh during the previous year.

#### Participating in the EU Emissions Trading Scheme

Phase II of the EU Emissions Trading Scheme (EU ETS) began on 1 January 2008. Across its electricity generation portfolio (taking account of contractual shares), SSE has an allocation of 18.9 million tonnes of CO<sub>2</sub> emissions allowances per calendar year. During 2011/12, the price of allowances ranged from around €6/tonne to around €17/tonne.

SSE's emissions allowances requirement for 2011/12, beyond those apportioned from the EU ETS allocation, was 5.3 million tonnes. This compares with 6.5 million tonnes in the previous year. With high gas prices and low spark spreads for gas generation, SSE used the

portfolio diversity provided by its coal plants to ensure least-cost power generation for its customers. However, increased CO<sub>2</sub> emissions from coal generation were offset by reduced emissions from gas-fired generation, and record volumes of renewable output.

Assuming current market conditions persist, SSE expects a similar output from its coal plant during 2012/13, after which point it anticipates a substantial reduction in coal-related emissions as gas plants such as Keadby and Medway return to service, additional renewables are commissioned and coal plants use up their allocated running hours under the EU's Industrial Emissions Directive. This means SSE remains on track to half its CO<sub>2</sub> emissions by 2020.

From 2013, all of the CO<sub>2</sub> emissions allowances for electricity producers will be auctioned. Moreover, the UK government's introduction of the carbon price floor provides a clear market signal for investment in low carbon and carbon sequestration investments. Proposals for the introduction of a 'floor' for the price of allowances in the electricity sector will result in an effective carbon price of £16/tonne in 2013, rising to around £30/tonne in 2020 (in 2009 prices). This further signals the importance of carbon capture and storage for coal and gas generation in ensuring the achievement of long-term carbon abatement targets.

#### Tackling emissions of CO<sub>2</sub> in thermal generation

SSE's priorities in Generation are to be a greener and more flexible non-nuclear electricity generator. Greener means

effectively halving its carbon footprint every decade between now and 2050. As a non-nuclear generator, this goal will be achieved through a stable, managed transition utilising a diverse range of solutions including:

- expanding biomass co-firing at coal-fired stations;
- demonstrating carbon capture technology for both coal and gas;
- increasing significantly the output of renewable electricity; and
- ensuring industry-leading operational efficiency of its generation portfolio.

In 2011/12, emissions of CO<sub>2</sub> from power stations in which SSE has an ownership or contractual interest totalled 24.9 million tonnes, compared with 25.3 million tonnes in the previous year. SSE's CO<sub>2</sub> emissions data is externally verified by a UK Accreditation Service (UKAS)-accredited organisation.

SSE's first target is to reduce the amount of CO<sub>2</sub> per kWh of electricity generated at plant in which it has an ownership or contractual interest by 50%, between 2006, the first full year after it acquired coal-fired power stations, when it was just over 600g/kWh, and 2020. On this basis, its CO<sub>2</sub> intensity in 2011/12 was 531g/kWh, compared with 504g/kWh in the previous year, primarily reflecting increased output from coal-fired power stations.

More broadly, SSE has formed a partnership with other European energy companies, calling for the EU to adopt a greenhouse gas emissions reduction target of 25% (up from 20% at present) as part of a long-term move away from fossil fuel-based electricity generation and full decarbonisation by 2050. As the 2020 deadline nears, SSE considers it critical that the institutions of Europe provide investors with certainty regarding targets and the policy framework beyond the current 2020 cliff edge.

#### Fulfilling the potential of renewable sources of energy

The way energy is transformed into electricity is evolving. While decarbonisation, supply security and affordability are of equal importance, the primary European and UK energy policy intervention is on decarbonisation. The targets that underpin this include the binding EU carbon abatement target of a 20% reduction in CO<sub>2</sub> emissions by 2020, compared with 1990 levels, coupled with more challenging targets over and above this that have been adopted by both the UK and Ireland. These targets accompany the UK and Ireland's 15% and 16% renewable energy targets respectively.

While achievement of the renewable energy targets is spread across electricity, heating and transport, it is the electricity sector that has proven itself most adept at responding to the policy. This has been evidenced most recently by DECC's *Energy Trends 2011* which saw Renewables' share of generation in the UK increase to a record 9.5%, coupled with a one third increase in capacity for renewable energy over the year.

In its *Renewable Energy Roadmap* the UK government made clear its commitment to increasing the deployment of renewable energy across the UK stating that 'renewables will make the UK more energy secure, will help protect consumers from fossil fuel price fluctuations, is driving investment in new jobs and businesses in the renewable energy sector, as well as keep us on track to meet our carbon reduction objectives for the coming decades'.

With this clear vision, public policy is strongly aligned with the renewable energy targets, providing financial support via the Renewables Obligation in the UK and the Renewable Energy Feed-in-Tariff in the Republic of Ireland. Furthermore, the UK government's current work on electricity market reform is explicitly intended to make sure that low carbon technologies such as energy from renewable sources become a more attractive choice for investors. The effect of appropriate policy supports should not be undervalued and the viability of the renewables industry remains dependent on their continued existence.

With the exception of hydro, SSE believes that the UK's revised ROC levels are appropriate to changing market conditions, once they are complemented by an effective carbon floor price and cost reductions in the supply chain for renewable energy. It is also of the view that, given hydro's flexibility, storage capacity and investment economics, a ROC of around 1.0/MWh is required to sustain investment in this important source of renewable energy.

With this continued strong political support for increased renewable penetration in the portfolio mix SSE does not perceive any weakening of public policy commitment to renewable energy in either the UK or Ireland. Nevertheless, it remains one of SSE's priorities to avoid dependency on a single generation technology or related financial support.

### Increasing energy from renewable sources

In January 2012, SSE announced that ongoing progress in the construction of its large capital projects meant that its onshore wind farm capacity had exceeded

its conventional hydro-electric capacity for the first time. It now has over 1,300MW of onshore wind farm capacity for the first time. That total compares with just 40MW of wind power just six years ago.

Good progress made on SSE's landmark projects including Clyde, Griffin and Gordonbush wind farms in Scotland and Slieve Kirk wind farm in Northern Ireland means that 495MW of onshore wind farm capacity became operational during 2011/12. Progress at Greater Gabbard and Walney has taken SSE's net offshore wind farm capacity to 187MW.

At 31 March 2012, SSE had 3,020MW of commissioned renewable energy capacity in the UK and Ireland, including its share of joint ventures, comprising:

- 1,150MW conventional hydro;
- 1,303MW onshore wind;
- 187MW offshore wind;
- 80MW dedicated biomass; and
- 300MW pumped storage.

Of this, output from over 1,500MW qualifies for ROCs, the key financial support scheme for renewable energy in the UK, with:

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

In advance of planned revisions to ROC banding, most of SSE's existing construction sites will be accredited before the April 2013 value revision and, as such, will be eligible for existing 20-year supports.

Following a very successful year of constructing renewable energy projects SSE remains on course to own around 3,500MW of renewable capacity that is in operation or under construction, in the UK and Ireland, by the end of 2012/13. This will mean SSE is making solid progress in line with its 'green' priority and is supporting the achievement of CO<sub>2</sub> abatement targets, maximising the potential of indigenous and free renewable resources and reducing consumer exposure to the price volatility of internationally-traded fossil fuels.

### Producing electricity from renewable sources

Total electricity output from all of SSE's renewable resources including conventional hydro-electric schemes, onshore wind

farms, offshore wind farms and dedicated biomass plant was 7,617GWh during 2011/12 compared with 4,411GWh in 2010/11. This 73% increase is a reflection of additional generation capacity coming into operation and the wet and windy weather conditions experienced during the period. In energy terms, it is equivalent to 260Mth of gas.

### Producing electricity from hydro-electric schemes

SSE owns and operates more than 50 hydro-electric power stations in the Highlands, Perth and Kinross, and Argyll and Bute, with just over 1,150MW of capacity. A further 300MW comes from its pumped storage facility at Foyers, on Loch Ness.

Over the last 30 years, electricity output from conventional hydro-electric schemes has ranged from a high of 3,896GWh to a low of 2,429GWh. However, 2011/12 was an exceptional year, delivering a new record hydro-electricity output of 4,262GWh. This success is a result of SSE's continued investment in refurbishment of its hydro schemes in the North of Scotland coupled with a particularly high amount of rainfall and snowmelt in each hydro catchment.

During 2011/12 (previous year's comparison in brackets):

- total output from all of SSE's conventional hydro-electric schemes was 4,262GWh (2,558GWh); and, within this,
- total output from SSE's hydro-electric capacity qualifying for ROCs – just over 500MW – was 1,954GWh (1,193GWh).

As at 31 March 2012, the total amount of water held in SSE's reservoirs which could be used to generate electricity was 60% of the maximum, compared with 61% in the previous year.

### Restoring generation at the Glendoe hydro-electric scheme

Work on the restoration of electricity generation at the 100MW Glendoe hydro-electric scheme is continuing to progress well, although it is a very substantial project which has required considerably more investment than originally expected. The restoration works arose due to a rock fall which blocked the tunnel carrying water from the reservoir to the power station, stopping operation. The process of re-filling the reservoir is expected to begin shortly, with electricity generation resuming in the middle of the calendar year.



## Wholesale (continued)

### Market-based businesses

Meanwhile, SSE is continuing to pursue its legal and insurance options following the loss of electricity generation in August 2009. The net cost to SSE of the restoration work will not be known until the works and the insurance and legal processes are complete. The actual and projected rate of return on the total net investment at Glendoe, including the original construction cost of £160m, will depend on this and on the prices achieved for the electricity produced. These prices should, in turn, reflect the strategic nature of the asset and its ability to respond rapidly to help meet changes in electricity demand.

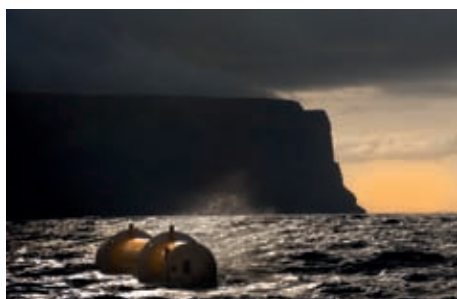
#### Developing new hydro-electric schemes

Through the combination of investment and ideal weather conditions hydro-sourced generation has demonstrated its continuing success as a valued source of renewable energy.

Investment in such schemes should continue to be attractive as they provide firm capacity and fast-response flexibility complementing variable output from the growing number of wind farms – characteristics that the market should value more in the future.

With its considerable operational experience in this technology SSE is advancing a number of development opportunities:

→ **Kildermorie:** SSE has consent to develop a new 7.5MW hydro-electric power station near Ardross in Ross-shire. It will consist of a new dam and storage reservoir, a buried pipeline and a semi-buried powerhouse with associated tailrace. Construction is



Making energy better:  
→ **Generating with waves**

**North of mainland Orkney we have been awarded exclusive rights to develop Costa Head, a 200MW wave energy site.**

scheduled to commence later in 2012, but is subject to the outcome of the current ROC banding review.

→ **Sloy:** SSE has consent to develop a 60MW pumped storage scheme as part of its 152MW Sloy power station, near Loch Lomond. This means that, in addition to electricity produced from water collected and held in the Loch Sloy reservoir, Sloy will be able to generate an additional 100GWh of electricity in a typical year using water pumped from Loch Lomond to the reservoir. A final decision on this circa £40m investment will be made following review of technical and engineering assessments, which are now nearing completion and following consideration of decisions relating to Electricity Market Reform.

→ **Coire Glas:** In February 2012 SSE submitted an application to the Scottish government for consent to construct a new pumped storage scheme of up to 600MW capacity to the north-west of Loch Lochy in the Great Glen. This scheme has the potential to produce 1,000GWh of electricity in a typical year and would be the largest hydro project to be built in Scotland and the first brand new pumped storage scheme to be developed in Great Britain in almost 40 years. The scheme would require the construction of a new dam and upper reservoir at Loch a' Choire Ghlais (the upper reservoir). A powerhouse complex would be constructed underground, together with a series of tunnels to provide access and convey water between the lower reservoir (Loch Lochy) and the upper reservoir. Once completed the scheme would have minimal visual impact in the Great Glen.

→ **Balmacaan:** SSE is also proposing to develop a 300MW-600MW pumped storage scheme at Loch Ness. While independent of Coire Glas the two projects are managed by a single development team. Balmacaan has recently completed its pre-planning consultation on its environmental impact assessment and is expected to be submitted for planning during 2012.

Construction of Coire Glas and/or Balmacaan would not begin before 2014 at the earliest and, subject to planning consent among other factors, SSE will have the option to build neither, one or both of the schemes.

Furthermore, progressing these schemes and other similar developments will be dependent upon a satisfactory public policy and regulatory framework, including the ROC banding review and the transmission

charging regime changes envisaged by Ofgem's Project TransmiT.

#### Adding to onshore wind farm capacity and production

At 31 March 2012, SSE owned 1,303MW of onshore wind farm capacity and output during 2011/12 was as follows (previous year's comparison in brackets):

- 1,418GWh in the UK, (739GWh); and
- 1,353GWh in the Republic of Ireland, (914GWh).

Total electricity output from onshore wind-based generation increased from 1,653GWh in 2010/11 to 2,771GWh in 2011/12. The key drivers of this increase was the completion of an additional 495MW of new generation and the significantly windier weather relative to 2010/11. Windier conditions also saw load factors rise above 30% compared with 24% in 2010/11.

On average, the turbines at SSE's onshore wind farms in the UK and Ireland achieved 97% of their maximum availability to generate electricity which has been consistent over the past three years.

#### Delivering new onshore wind farms

In meeting its commitment to high quality project delivery SSE has made significant progress in 2011/12 with the completion of its wind farms at Griffin (156MW) in Perthshire and Gordonbush (70MW) in Sutherland. Their total capital cost was £340m and they are expected to produce around 640GWh of electricity in a typical year.

At Clyde, 100 turbines with a total capacity of 230MW are producing electricity. The remaining 52 turbines, which will bring the project to its 350MW total, are expected to be completed around the end of summer 2012. The project is expected to cost around £500m and produce over 1,000GWh of electricity in a typical year.

Also during 2011/12, SSE constructed and commissioned the 27MW Slieve Kirk wind farm in Northern Ireland and the 12MW Rathcahill wind farm located in the Republic of Ireland.

#### Developing new onshore wind farms

At 31 March 2012, SSE's onshore wind farm portfolio comprised around (net):

- 1,303MW in operation;
- 380MW in construction or pre-construction; and
- over 550MW with consent for development.

As the current tranche of onshore wind farms reaches completion during 2012/13 SSE is focusing on the alignment of its development pipeline into strategic areas. These areas facilitate the continued efficient allocation of resources and economies of scale. The following fully consented projects in the UK and Ireland are components of these areas:

- **Strathy North** (75MW): Located near Strathy village, Sutherland, this project received consent from Scottish Ministers in November 2011. The wind farm, which is near Gordonbush, will comprise 33 turbines over an area of around 950 hectares within Strathy North Forest, which is a commercial conifer plantation. The project is anticipated to enter construction in the next 18 months;
- **Keadby** (68MW): This is a fully consented project acquired from RES in May 2011. Adjacent to SSE's Keadby gas-fired power station, preparatory works began for the wind farm in February 2012 with construction expected to start later this year;
- **Calliachar** (32MW): This fully consented site, adjacent to SSE's Griffin project in Perthshire was acquired by SSE in 2010. SSE subsequently sought consent to increase the tip height of the turbines from 100m to 109.8m. In January 2012, consent was received from Perth and Kinross Council Development Control Committee subject to conditions. Work is ongoing to satisfy the conditions and construction is getting under way; and
- **Glenconway** (18MW): As part of the Slieve Kirk strategic area located in County Derry, Northern Ireland, Glenconway will add a further 18MW to the existing 27MW completed during 2011/12. The project began construction in early May and is expected to be completed during 2013.

In total, onshore wind farm projects in or near construction will add more than 150MW to the existing portfolio in 2012/13. In addition, SSE has over 550MW of fully consented projects across GB and Ireland including its 110MW share of the 170MW Galway Wind Park.

The amount with consent for development also includes SSE's share of the capacity contained in the proposal by Viking Energy, the joint venture between Viking Energy Ltd (which is 90% owned by the Shetland Charitable Trust) and SSE to develop a wind farm with a capacity expected to be around 370MW (SSE's share being 185MW) on Shetland's Central Mainland. This project has recently received consent from Scottish government Ministers, with a reduction in the number of turbines to 103. The Viking Energy

## Through the combination of investment and ideal weather conditions hydro-sourced generation has demonstrated its continuing success as a valued source of renewable energy.

Partnership will now prepare reports for its shareholders so they can consider the funding of the next steps in the project.

This provides a portfolio of options whereby SSE may select developments that deliver the best value and continue to support dividend growth.

In addition to its consented portfolio, SSE continues to assess high potential developments and has submitted for approval by the relevant planning authorities in the UK and Ireland proposals for onshore wind farms with a total capacity of over 500MW including Clyde Extension (171MW) and Dalnessie (70MW).

Progress on all of SSE's renewable projects is dependent on a continued favourable planning, policy and regulatory environment. The projects themselves would be developed over the next few years.

### Maximising electricity output from wind farms

With its onshore and offshore wind farms producing 3,199GWh of electricity in 2011/12, SSE is the largest operator and developer of wind power across GB and Ireland. From its Centre of Engineering Excellence in Renewable Energy in Glasgow, SSE's highly-skilled team of professionals ensure that maximum value is derived from its wind assets. Ensuring maximum value is founded in four critical factors, rigorously assessed through the development stages:

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

Carefully assessing each of these criteria ensures delivery of high quality projects, adding to business value and supporting sustained dividend growth.

### Developing options in Scandanavia

Further afield, SSE is actively pursuing a 295MW development pipeline in Sweden, of which 80MW has consent for development, and the Nordconnect interconnector. In an early stage of development, Nordconnect is a partnership between SSE, Energi, E-CO, Lyse and Vattenfall AB to plan, build and operate an HVDC interconnector between Norway and the UK. These projects align strategically to maximise the potential of the European energy market, while providing diversity to the portfolio of future SSE renewable development options.

### Managing constraint on the electricity system

Constraint occurs when there are limitations in electricity transmission capacity or for reasons of system frequency voltage control or stability. Transmission systems generally experience periods of constraint, and it is this that provides a market signal for additional investment in the grid infrastructure.

During 2011/12, across GB, 6TWh of generation was constrained at a value of around £300m. Of this, SSE wind generation was 80GWh or 1.3% of the total constraint over the whole system.

With additional volumes of variable renewable generation on the system, instances of constraint will occur from time to time at different locations. In Great Britain and Ireland an emergent issue centres on equitable compensation for constrained wind.

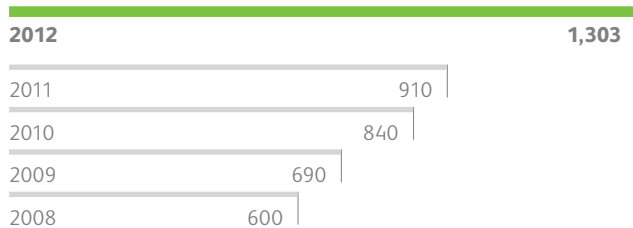
At times of constraint, generators in Great Britain are required to bid in their constrained generation capacity to National Grid. It has been SSE's policy to bid fair and reasonable prices at all times for its renewable generation and it believes that this is the equitable approach for all renewable generators and in the best interest of customers.

In Ireland's SEM market, compensation rules for wind generation recognise both the degree of control of an individual wind farm

## Wholesale (continued)

### Market-based businesses

#### Onshore wind capacity – MW



and the export capacity guaranteed in its connection agreement with the System Operator. In times of constraint, controllable wind farms are compensated for their lost output at market prices, while government support payments (REFIT in RoI and ROCs in NI) are paid on the basis of metered output. SSE works with the System Operator to ensure that its wind farms demonstrate the level of response required to be recognised as 'controllable'.

To minimise the impact of constraints, appropriate investment is needed in transmission infrastructure, an issue which is particularly acute in Ireland. At the same time, market arrangements in both GB and Ireland must provide equitable payment for constrained generation.

#### Creating local value from onshore renewable development

A leading differentiator and a source of pride for SSE is the economic benefit its onshore renewable investments bring to local communities. In particular this year, SSE:

- confirmed its ongoing commitment to the Highland region of Scotland with the announcement of 50 new roles created at its regional headquarters in Inverness. The new roles are being created primarily to support SSE's renewable ambitions in the north of Scotland. The local economic and employment value associated with the establishment of a corporate presence in Inverness helps to highlight the benefit of renewable development. SSE believes the new regional headquarters will support its endeavours in working with communities and stakeholders.
- established its Scotland Sustainable Energy Fund, an onshore wind community investment plan. The fund will be worth a potential £90m over 25 years if SSE is able to realise its ambitions for new onshore wind farms in Scotland. The fund will be available for organisations promoting skills development, community energy schemes and improving the built and

natural environment. The fund is in addition to the £150m SSE has already committed to support community projects in Scotland over the 25-year projected lifetime of the Company's existing and planned wind farms.

#### Building new offshore wind farms

Due to the significantly larger scale and cost of both consenting and constructing offshore wind farms compared with onshore, SSE recognises the inherent risks are best managed through partnership arrangements across a portfolio of projects. To this end SSE is building:

- Greater Gabbard, a 500MW development being built by Greater Gabbard Offshore Winds Limited (GGOWL), in which SSE has a 50% stake; and
- Walney, a 367MW development being built by Walney (UK) Offshore Windfarms Ltd, in which SSE has a 25.1% stake.

Total electricity output from SSE's offshore wind farms was 428GWh in 2011/12. This was the result of significant progress in the period to 31 March at:

- Greater Gabbard where all 140 turbines were in place, of which 62 had been commissioned, and not the subject of any claim and are successfully generating electricity. In addition, 46 of the 52 disputed turbines had also exported power; and
- Walney where all of the phase one turbines have been successfully commissioned and all 51 turbines in the second phase are producing power, of which 27 are fully commissioned.

Progress has continued at Greater Gabbard since the year end and currently 81 turbines which are not the subject of dispute have been commissioned. At Walney, an additional 19 turbines have also been commissioned.

#### Managing the issues at Greater Gabbard

Significant construction progress was made at Greater Gabbard during the financial year

with all 140 monopile foundations and turbines installed and to date, a total of 127 have produced power. Meanwhile, the third and final electricity export cable has been installed and is undergoing commissioning. All of this means that construction works should be completed, as planned, before the end of this year.

GGOWL remains in a contractual dispute with Fluor Limited, the principal contractor for the wind farm. The dispute relates to the quality of lower foundations (monopiles) and upper foundations (transition pieces) used in the early stages of the development and supporting 52 of the 140 turbines. The contractual dispute centres on:

- the claim by Fluor Limited of around £300m relating to time and costs Fluor Limited alleges it incurred in carrying out additional testing and repairs of some of the welds on these foundations; and
- GGOWL's need for assurance as to the structural integrity of these foundations, which resulted in GGOWL initiating its own programme of offshore testing to determine whether they meet the required contractual standards and will provide a full operating life of at least 25 years.

In relation to the claim by Fluor, GGOWL has submitted what it believes is a very robust defence. A formal arbitration process is beginning and will resolve the dispute in due course.

In relation to the second aspect of the dispute, in October 2011, on the basis of the available evidence, including from its own programme of testing, and independent advice, GGOWL notified Fluor Limited that all 52 of the relevant foundations are defective and do not meet the standard required by the contract between the two companies.

Of these 52 foundations, Fluor Limited previously corrected defects that had been identified in a number of the monopiles before they were installed, and GGOWL believes that these repaired monopiles are sound. The balance of the monopiles and all 52 of the transition pieces are believed to be defective.

GGOWL believes that the onus is currently on Fluor Limited to determine how it proposes to meet its contractual obligation to ensure that the transition pieces and monopiles comply with the contract and that Fluor Limited will be liable for all associated costs. In relation to this, GGOWL has initiated a formal

contractual claim against Fluor Limited, which is currently the subject of a formal arbitration process.

### Progress at Walney

The first phase of Walney is operational and commissioning of the second and final phase of the wind farm, 51 turbines with a total installed capacity of 183.6MW, is now well under way. All of the turbines have now been installed, and all have now exported electricity.

The progress at Walney has set the benchmark for future offshore development where DONG Energy has constructed the second phase of Walney in the fastest ever time for an offshore wind project. A new record was set for the sector following the installation of all turbines and cables in just five months and 13 days. This marks an important step in the drive toward further industrialising the sector. As a result of this progress it is expected that the full 102 turbine, 367MW wind farm will be completed in the next few months.

### Developing more new offshore wind farms

Undoubtedly, offshore wind will play an ever increasing role in the delivery of low-carbon energy for the UK. Already the GB offshore wind market is the largest in the world with 1.5GW in operation, 2.6GW under construction and a total of 11-18GW planned by 2020.

SSE has gained valuable experience of offshore wind farm development and construction through the Greater Gabbard and Walney projects and it is this experience that enables it to exercise informed and disciplined judgement when prioritising projects in its development pipeline. In the near-term, the main focus for SSE is the successful and timely completion and commissioning of these projects. The next two offshore wind farm projects then taking priority are:

- the 500MW Galloper wind farm, close to the existing Greater Gabbard development, a 50:50 partnership with RWE npower renewables; and
- the 1,000MW Beatrice wind farm in the Moray Firth, a 75:25 partnership with Repsol Nuevas Energias UK (25%) (formerly SeaEnergy Renewables).

Through 2011/12 significant progress was made in the planning phases of these projects, with Galloper receiving confirmation from the Infrastructure Planning Commission that it has accepted the Development Consent Order application.

At Beatrice, an application for consent to develop the Beatrice offshore wind farm in the Outer Moray Firth has been submitted to the Scottish government. The application is the first of the Scottish Territorial Waters sites to be submitted for consideration. The proposed wind farm builds on the success of the Beatrice Demonstrator Project and would have a maximum of 142 to 277 turbines, depending on turbine size.

Beyond this, SSE has secured from The Crown Estate rights for the potential development of up to 4.8GW (net) additional offshore wind farm assets later in the decade. Decisions regarding the build out of this pipeline will be reflective of SSE's disciplined approach and focus on taking forward only the best investments and achieve the strongest possible returns to support dividend growth.

### Building a supply chain for offshore wind

In order to meet the full potential of the UK's offshore wind resource it is essential to exert downward pressure on the cost of energy through the evolution of a sustainable supply chain. This will include the development of larger and simpler turbines and the effective industrialisation of the sector.

SSE has recently invested in a broad range of new initiatives to increase the effectiveness, and decrease the cost, of offshore wind deployment, including:

- taking a leading role in forming the 'G9' group of the world's largest renewable energy developers, which have come together to place health and safety at the forefront of all offshore wind activity and developments;
- consent from North Ayrshire Council to construct an offshore test facility at Hunterston in North Ayrshire. The facility will be Scotland's first offshore wind turbine test site and will be an extension of SSE's Centre of Engineering Excellence for Renewable Energy. In partnership with leading turbine suppliers, up to three prototype turbines will be tested at the site for a period of five years;
- identification of Dundee as a key strategic location for the development of a comprehensive supply chain to support Scotland's emerging offshore wind industry. Joining forces with Forth Ports, Scottish Enterprise and Dundee City Council, SSE has taken a proactive approach to the development of the offshore wind supply chain;
- formation of strategic alliances with companies such as Siemens and Mitsubishi

to collaborate on offshore wind development;

- ongoing participation in the Carbon Trust's Offshore Wind Accelerator; and
- acquisition of Wind Towers Ltd, a joint venture between SSE and Marsh Wind Technology Ltd in May 2011. In addition to producing wind turbine towers for onshore wind farms, this site is constructing new facilities to allow the production of turbine towers for offshore wind and therefore maximising the potential of its modern facilities in the expanding market for offshore wind turbine towers.

In seeking to reduce supply chain cost SSE is giving practical leadership in the delivery of the UK government's ambitious 2020 target to lower the levelised cost of energy from offshore wind to £100/MWh and believes this target can, and indeed should, be achieved.

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

SSE has advised external stakeholders that it intends to reorganise all of its offshore wind farm equity interests, including assets in operation, under construction or in development, into a newly-incorporated holding company. It will be wholly-owned by SSE for the foreseeable future and its establishment will give SSE a company through which to finance offshore renewable energy developments and the flexibility to introduce other sources of funding should this be required to support the development and construction of offshore wind farms. The incorporation of the new company should be completed shortly.



### Making energy better: → Producing biogas

**In Ayrshire, HRH The Prince of Wales officially opened our innovative Anaerobic Digestion plant where food waste and other matter is broken down to produce biogas.**



## Wholesale (continued) Market-based businesses

### Developing marine sources of electricity

While offshore wind is a rapidly evolving technology at deployment stage, marine-based wave and tidal energy is at an earlier stage of technology development. As a longer-term prospect, the UK's substantial marine energy resource coupled with a considerable commitment to technology testing facilities means this sector could start to make a significant energy contribution around the end of this decade and beyond.

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

#### Technology development:

- Aquamarine Power is a wave energy developer, in which SSE has invested £24.7m over the past three years. At the beginning of 2012 11% of SSE's shareholding was acquired by the Environmental Energies Fund (EEF) (see 'Investing in New Ventures' below). EEF is now one of Aquamarine Power's largest shareholders, along with SSE, multinational power and automation company ABB and Scottish Enterprise. The investment is a further step toward taking Aquamarine Power to commercialisation in 2014.
- In November 2011 Aquamarine installed its next-generation Oyster 800 wave energy device to its foundations on the seabed at Orkney. Final commissioning is under way and the device is expected to be fully operational this summer. In February 2012, consent was granted to install two further Oyster devices in the same location. With a maximum generating capacity of 2.4MW the three Oyster devices will demonstrate the feasibility of installing multiple Oysters in small arrays and ultimately in larger wave farms.

#### Sites development:

- SSE and its JV partners, including Aquamarine, Open Hydro and most recently, Alstom, have exclusive rights from The Crown Estate to develop 600MW of wave and tidal energy at sites in the Pentland Firth and Orkney Waters. This includes the 200MW Costa Head wave project, a new joint venture between SSE and Alstom agreed in January 2012. SSE also retains exclusive rights to develop a further 200MW of tidal energy. SSE is continuing to work closely with The Crown Estate and other stakeholders in advance of submitting consent applications for these projects, the first of which is expected in 2013.

### Investing in new ventures in energy

SSE Ventures (SSEV) was set up in 2007 to develop and grow a portfolio of investments in small- and medium-sized enterprises offering renewable, sustainable and energy efficiency-enhancing products and services.

In January 2012 it completed a deal with Scottish Equity Partners (SEP) that involves SEP's new EEF acquiring a portfolio of cleantech investments owned by SSEV. As part of the deal, SSEV has become a major partner in the new £95m green energy fund.

The new Fund has acquired nine investments from the SSEV portfolio, all of which are market leaders from across the clean energy spectrum. The fund will have substantial fresh capital available for investment in the portfolio and also has agreement to add up to five further SSE investments to the portfolio in future.

By moving investments into the EEF, cleantech companies can now also benefit from the track record and expertise of SEP, draw upon the financial resources of the new partners and ultimately deliver a better return on SSE's initial investment.

### Energy Portfolio Management and Electricity Generation priorities in 2012/13 and beyond

Over the coming year EPM will maintain its focus on value for money while further diversifying its range of energy options, including:

- continuing to improve wholesale market liquidity including forward markets;
- optimising SSE's energy portfolio, including upstream assets, fuel supply, purchase of storage services, and generation; and
- investigating additional long-term and geographically diverse fuel supply contracts across the fuel portfolio.

In Generation, SSE's 2012/13 priorities remain consistent with its established principles to:

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

SSE's Generation investment programme is designed to abate the environmental impact of existing assets and extend their working lives, and to deliver new assets, principally in renewable energy but also through trialling other forms of decarbonised generation, including carbon capture and storage. All of this is aimed at maintaining, for the long-term, a diverse, well balanced portfolio that will deliver a decarbonised, secure and affordable energy supply.

During 2012/13, SSE expects to invest around £750m in maintaining and upgrading existing generation assets and in developing new assets. Investment priorities for the coming year are to:

- invest in power stations to increase flexibility;
- complete asset maintenance and refurbishment programmes on time and on budget;
- meet key milestones in new asset development and construction, particularly on and offshore wind and multi-fuel; and
- make progress in developing the diverse range of investment options it has created for the second half of this decade.

SSE will also actively seek to maintain optionality and diversity in the future development of its generation portfolio so that it remains on course to reduce by 50% the CO<sub>2</sub> intensity of electricity produced at power stations in which it has an ownership or contractual interest, over the period from 2006 to 2020.

The future development of its portfolio will depend to a significant extent on the outcome of the UK government's consultation on electricity market reform. SSE believes a workable package of reforms can still emerge from this process, based around carbon price support, a mechanism to reward all electricity capacity that is available to generate electricity, and continuing support for the production of electricity from renewable sources. It retains concerns, however, about the proposed 'Contract for Difference' model and is continuing to work with the UK government and other stakeholders to ensure that the shortcomings associated with this proposal are addressed. The UK government is expected to introduce legislation later this year, after further consultations.

## Gas Production

### Producing upstream supplies of gas

A key milestone for SSE in 2011 was its acquisition from Hess Limited of North Sea natural gas and infrastructure assets. This acquisition was a measured entry by SSE into non-operated upstream assets. Following from the significant learning and experience gained, it is SSE's intention to increase its presence in the upstream fuel sector if assets can be acquired for a fair price. In doing so, SSE aims to diversify further its sources of primary fuel and provide a hedge for its gas-fired generation and gas supply activities.

Overall, Gas Production delivered an operating profit\* of £42.6m in 2011/12 compared with £4.6m for the short period after the assets were acquired in 2010/11. Total output during the year was 176.7Mth, compared with 27.6Mth in the period from acquisition in February 2011 to March 2011.

### Gas Production priorities in 2012/13 and beyond

In seeking to pursue further opportunities to secure upstream gas assets SSE will:

- focus on mature, producing, gas-weighted assets; and
- consider opportunities that include operatorship.

As well as pursuing such opportunities directly, SSE will work with Faroe Petroleum plc, in which it has a 5% holding. Future investment decisions will, however, continue to be considered in a careful, measured way, consistent with its financial principles and, therefore, only where fair value can be secured.

## Gas Storage

### Providing capacity to store gas

In 2011 the UK's gross imports of natural gas were greater than gross production for the first time since 1967 and over the coming decade UK gas imports are projected to increase significantly. This presents both a supply security and price risk associated with the potential for: operational failures in pipelines delivering gas to the UK; political disputes in gas-producing regions; increased demand from emerging economies; and periods of unexpected low temperatures.

The two leading solutions to abating this risk are gas storage and liquefied natural gas

(LNG), both of which are required to accommodate future growth in gas demand.

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

- **Hornsea** is the UK's largest onshore gas storage facility in which around 325mcm of gas can be stored in a total of nine caverns. Hornsea accounts for around 7% of the total gas storage capacity in the UK and 15% of deliverability. It can be injected with gas at a rate of 2mcm per day and delivered to the National Transmission System at a rate of 18mcm per day, equivalent to the demand of four million homes. During 2011/12, Hornsea was 100% available to customers, except in instances of planned maintenance. This enabled storage customers to manage their gas market risks and respond to gas trading opportunities.
- **Aldbrough** is one of the UK's newest onshore gas storage facilities, which SSE (66.6% share) is developing with Statoil (UK) Ltd. Aldbrough will ultimately have the capacity to store around 330mcm in nine under ground caverns (of which SSE will own two thirds). It will have the capacity to deliver gas to the National Transmission System at a rate of up to 40mcm per day, equivalent to the average daily consumption of eight million homes, and the ability to have up to 30mcm of gas per day injected. In parallel with completion of the project, the Aldbrough site has been in commercial operation since July 2009. During 2011/12 it performed well, with the surface plant delivering 94% availability,

### Gas Storage profitability

During 2011/12, gas storage delivered an operating profit\* of £23.8m, compared with £23.5m in the previous year. Profitability has been aided by the increased capacity available for storage as a result of the progress of the Aldbrough development.

However, this was offset by weaker prices for Standard Bundled Units arising from the very mild winter and a reduction in the differentials between forward summer and winter gas prices and reflecting the increased availability of LNG. While LNG has had a negative financial impact on gas storage in the near-term, the diversity offered by both options will be important for risk abatement for the reasons set out above.

### Completing the new gas storage facility at Aldbrough

To form caverns such as those at Aldbrough and Hornsea, salt deposits around 2km under

ground are leached out by seawater which, in turn, is replaced (dewatered) by gas under pressure. At Aldbrough, six of nine caverns are already storing gas at a capacity of 170mcm. Leaching at the remaining three caverns is completed and completion of dewatering through the injection of gas is expected shortly. They are expected to be fully operational by the summer of this calendar year. SSE's forecast total investment for the development remains around £290m.

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

### Conclusion

With a focus on flexibility and sustainability in its Wholesale businesses, SSE believes that its activities in EPM, Generation and Gas Production and Gas Storage will support the achievement of its first financial goal of sustained real growth in the dividend payable to shareholders.

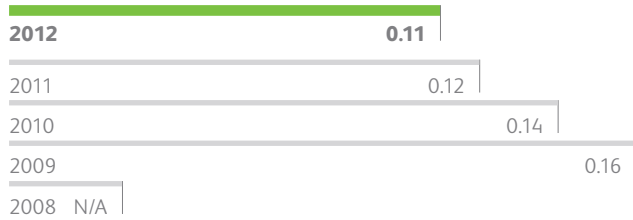
### Gas Storage priorities in 2012/13 and beyond

Gas storage priorities for the coming financial year include:

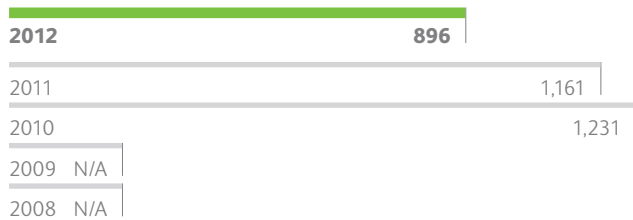
- completion of construction work at Aldbrough; and
- ensuring safe and effective operation of capacity at Hornsea and Aldbrough.

## Key performance indicators – SSE's core values

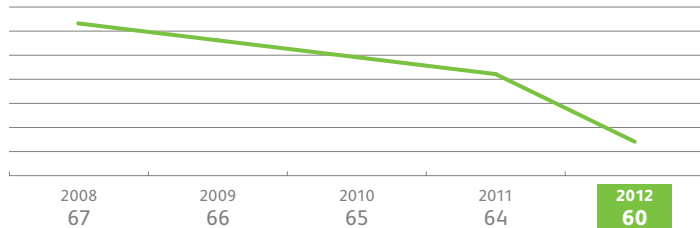
### Safety: Total Recordable Injury Rate – per 100,000 hours worked



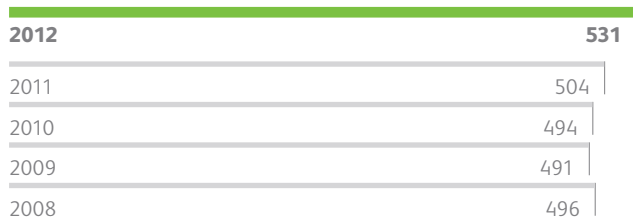
### Service: GB supply customer complaints to third parties



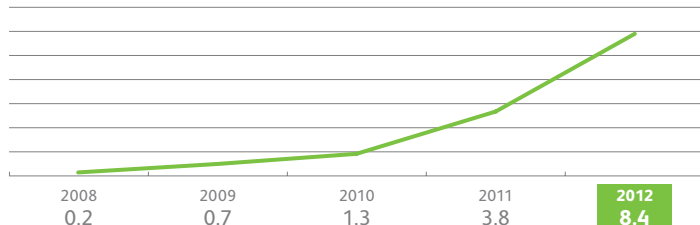
### Efficiency: Network customer minutes lost (South)



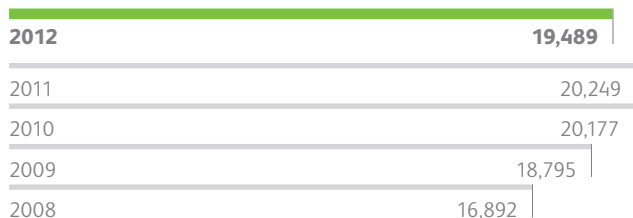
### Sustainability: Power station CO<sub>2</sub> emissions – g/kWh



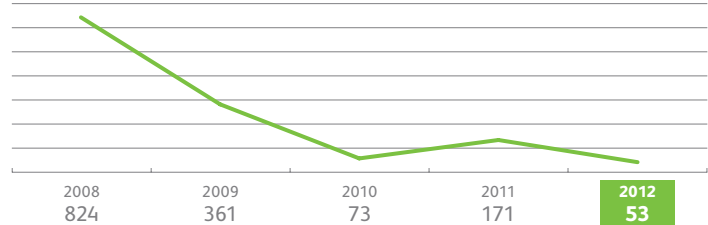
### Excellence: Investment in 'smart' electricity grids – £m



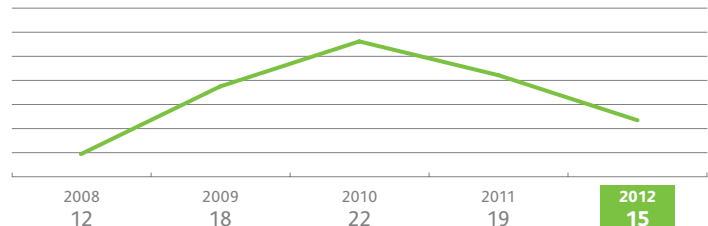
### Teamwork: Number of employees



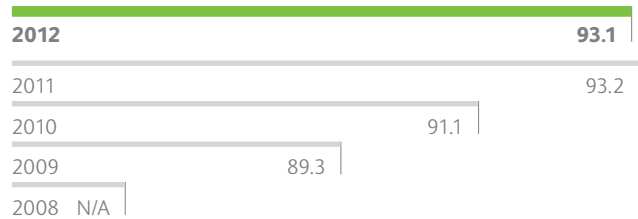
### Safety: Working days lost through injury



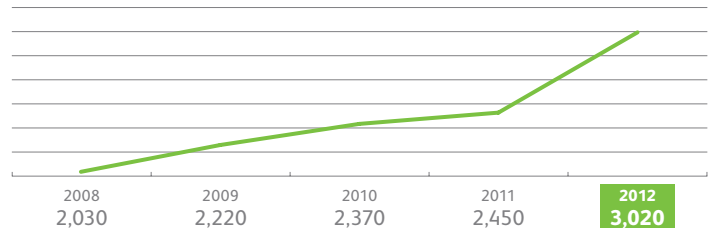
### Service: Network emergency calls response times – seconds



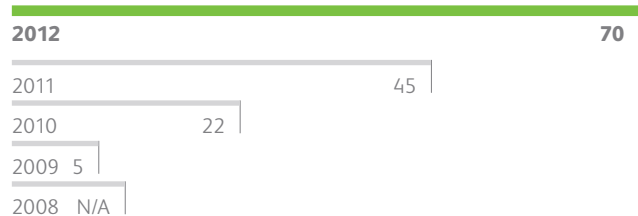
### Efficiency: Operational stock availability – %



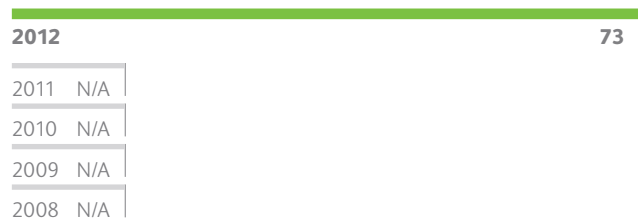
### Sustainability: Capacity of renewable energy – MW



### Excellence: Value creation from Licence to Innovate – £m



### Teamwork: Great place to work engagement score – %



## Chairman's introduction to SSE corporate governance



**Lord Smith of Kelvin**  
Chairman

Corporate governance is key to running SSE as a successful, responsible and sustainable business capable of delivering increases in the dividend payable to shareholders in the short, medium and long term.

Our corporate governance report for 2011/12 sets out our approach by describing the SSE team, how the Board works and risk management and includes separate reports on each of the Board Committees. I would like to highlight some specific points:

### UK Corporate Governance Code

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in The UK Corporate Governance Code adopted in June 2010. The Board has been fully briefed on the recent changes to the Code, in particular the annual re-appointment of Directors, Board diversity, the requirement for regular external Board evaluation, a greater emphasis on risk, and the need for a clear explanation of business model and strategy. We welcome these changes and are committed to complying with them.

### Changes to the Board

As part of our planned and continuing refreshment of the Board, we welcomed two new non-Executive Directors to the Board during the year – Jeremy Beeton and Katie Bickerstaffe. They bring specific experience which will be invaluable as SSE undertakes major capital projects and faces the challenges of changes in the domestic customer market. Jeremy has joined the Audit and Nomination Committees as well as the Safety, Health and Environment Advisory Committee. Katie has joined the Nomination and Remuneration Committees.

Colin Hood, SSE's Chief Operating Officer retired from the Board on 31 October 2011. His Board level responsibilities were reallocated among existing Executive Directors and his operational responsibilities were divided between members of the Management Board. I would like to thank Colin for his many years of leadership and service to the Company. Thomas Andersen, non-Executive Director, has taken over from Colin the Chairmanship of the Safety, Health and Environment Advisory Committee.

René Médori, non-Executive Director and Chairman of the Audit Committee, will step down from the Board on 25 June 2012. I would like to thank René for his nine years' service as a non-Executive Director and his Chairmanship of the Audit Committee.

Richard Gillingwater will take over as Chairman of the Audit Committee. He will also become Senior Independent Director on 24 July 2012 in place of Lady Rice, who will continue as an independent non-Executive Director and Chairman of the Remuneration Committee.

Following the Davies Review of 'Women on Boards' we have confirmed our commitment to diversity generally throughout SSE, and in particular diversity at Board and senior management level.

### Commitment

The non-Executive Directors devote significant time to SSE over and above attendance at Board and Committee meetings. During the year the non-Executive Directors had individual visits to key business locations and received briefings from members of the SSE management team on a range of matters. The visits included: onshore and offshore wind farms, coal-fired power stations, the gas storage facility, customer service facilities and joint venture offices, including SGN.

The full Board remains totally committed to the continued success of SSE, and to ensure that it is run to the highest standards of corporate governance.

**Lord Smith of Kelvin**  
Chairman  
15 May 2012



## Board of Directors

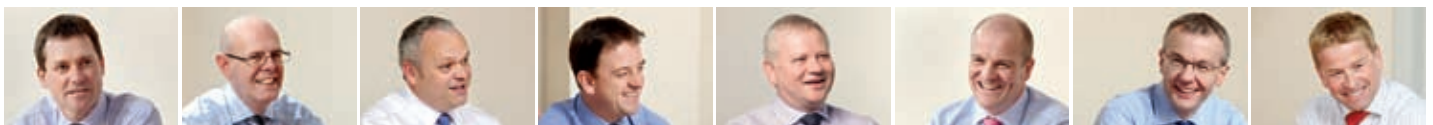


### The Board of Directors

**From left:** Ian Marchant, Lord Smith of Kelvin, Lady Rice CBE, Jeremy Beeton, Thomas Thune Andersen, Gregor Alexander, Alistair Phillips-Davies, Richard Gillingwater CBE, Katie Bickerstaffe, René Médori.

In March, the Board of Directors met at the UK's first 'Power of Now' exhibition and all-electric vehicle centre at the Scottish Hydro Centre for Renewable Excellence in Glasgow.

## The Management Board



**From left:** David Franklin, Rob McDonald, Jim McPhillimy, Mark Mathieson, Jim Smith, Paul Smith, Alan Young, John Morea (in attendance)

## The Board of Directors

### Lord Smith of Kelvin Chairman

Robert joined the Board as a non-Executive Director in June 2003 and became Chairman in January 2005. He is also: Chairman of the Weir Group plc; a non-Executive Director of Standard Bank Group Ltd; Chairman of Glasgow 2014 Ltd, the organising committee for the Commonwealth Games; and Chancellor of the University of the West of Scotland. Robert is Chairman of the Nomination Committee and a member of the Remuneration Committee.

### Ian Marchant Chief Executive

Ian was appointed Chief Executive in October 2002, having been Finance Director since 1998. He has worked in the energy industry since 1992, when he joined Southern Electric. He is Senior Independent Director of John Wood Group plc and a non-Executive Director of Maggie's Cancer Centres. He gets involved in a wide range of other business connected with his role as Chief Executive. Ian is a member of the Nomination Committee.

### Lady Rice CBE Senior Independent Director and Remuneration Committee Chairman

Susan joined the Board as non-Executive Director in July 2003 and was appointed Senior Independent Director in 2007. She is Managing Director of Lloyds Banking Group Scotland. Susan is also a non-Executive Director of the Court of the Bank of England, where she chairs the Audit and Risk Committee, of Big Society Capital and Scotland's Futures Forum. She chairs the Boards of the Edinburgh International Book Festival and the Edinburgh Festivals Forum and is a member of the First Minister's Council of Economic Advisers. Susan chairs the Remuneration Committee and is a member of the Nomination Committee.

### Gregor Alexander Finance Director

Gregor was appointed Finance Director in September 2002, having previously been Group Treasurer and Tax Manager. He has worked in the energy industry since 1990, when he joined Scottish Hydro Electric. He has Board level responsibility for Finance, Human Resources, IT, Procurement and other Group Services. Gregor is Chairman of SGN.

### Thomas Thune Andersen Non-Executive Director and Safety, Health and Environment Advisory Committee Chairman

Thomas joined the Board as a non-Executive Director in January 2009. He is the Chairman of Lloyd's Register Group, Chairman of DeepOcean Group, Vice-Chairman of the VKR Holding Group (VELUX) and a non-Executive Director of Petrofac Ltd. He was previously CEO of Maersk Oil and a partner in the A. P. Moeller Group. He is a member of the Audit and Nomination Committees and Chairman of the Safety, Health and Environment Advisory Committee.

### Changes to the Board

René Médori will step down from the Board of SSE on 25 June 2012. On that date, Richard Gillingwater, non-Executive Director, will become Chairman of the Audit Committee and he will become Senior Independent Director on 24 July 2012 in place of Lady Rice. A fuller explanation of these changes is set out on page 62.

### Jeremy Beeton Non-Executive Director

Jeremy joined the Board as non-Executive Director in July 2011. He is the Director General of the UK Government Olympic Executive. He was previously Principal Vice President of Bechtel Ltd, where he had responsibility for management and delivery of Bechtel's civil engineering projects in infrastructure and aviation business lines. He is a member of the Audit, Nomination, and Safety, Health and Environment Advisory Committees.

### Katie Bickerstaffe Non-Executive Director

Katie joined the Board as non-Executive Director in July 2011. She is Chief Executive – UK and Ireland of Dixons Retail plc. She was previously Managing Director of Kwik Save, and Group Retail Director and Group HR Director at Somerfield. Her earlier career included roles at Dyson, PepsiCo and Unilever. She is a member of the Nomination and Remuneration Committees.

### Richard Gillingwater CBE Non-Executive Director

Richard joined the Board as a non-Executive Director in May 2007. He is Dean of Cass Business School and is non-Executive Chairman of CDC Group plc and the Senior Independent Director of Hiscox Ltd. He was previously Chairman of European Investment Banking at CSFB. Richard is a member of the Audit, Remuneration and Nomination Committees.

### René Médori Non-Executive Director and Audit Committee Chairman

René joined the Board as a non-Executive Director in June 2003. He is Finance Director of Anglo American plc and is a non-Executive Director of Anglo Platinum, DB (De Beers) Investments and Petrofac Ltd. He is Chairman of the Audit Committee and a member of the Nomination Committee.

### Alistair Phillips-Davies Generation and Supply Director

Alistair was appointed Energy Supply Director in January 2002. He became Generation and Supply Director in December 2010 after taking responsibility for Generation Operations. He has worked in the energy industry since 1997, when he joined Southern Electric. He is a director of Energy UK. Alistair has Board level responsibility for Wholesale and Retail activities.

## Management Board

**David Franklin** is Managing Director, Energy Portfolio Management. He joined SSE in 1990 and is responsible for SSE's participation in wholesale markets for electricity, gas, coal, oil and carbon dioxide emissions allowances.

**Rob McDonald** is Managing Director, Regulation and Strategy. He joined SSE in 1997 and is responsible for regulation, energy economics, legal services, new ventures and strategy.

**Jim McPhillimy** is Managing Director, Group Services. He joined SSE in 1995 and is responsible for the Group's corporate services including safety, human resources, IT and procurement.

**Mark Mathieson** is Managing Director, Networks. He joined SSE in 1988 and is responsible for SSE's Electricity Networks, Lighting Services and Telecoms businesses.

**Jim Smith** is Managing Director, Renewables. He joined SSE in 1988 and is responsible for renewable energy development and construction.

**Paul Smith** is Managing Director, Generation. He joined SSE in 1998 and is responsible for operational generation and gas storage businesses, which include coal, gas, hydro and all operational onshore and offshore wind.

**Alan Young** is Managing Director, Corporate Affairs. He joined SSE in 2001 and is responsible for corporate communications, public affairs, community programmes and foresighting.

**John Morea** attends meetings of SSE's Management Board. He is the Chief Executive of SGN, which owns and operates gas distribution networks in Scotland and southern England and in which SSE has a 50% stake.

## The Board of SGN

SSE is entitled to appoint four out of the eight Directors on SGN's Board (reflecting its 50% shareholding in SGN). The SSE employees who serve on the Board of SGN are: **Gregor Alexander**, Finance Director; **Jim McPhillimy**, Managing Director, Group Services; **Natalie Bruce**, Head of Metering; and **Rob McDonald**, Managing Director, Regulation and Strategy.

## The SSE team

On 31 March 2012, SSE employed 19,489 people, a reduction of 760 on the previous year following the decision in July 2011 to stop doorstep selling of energy. Fundamental to the Company's success is the professionalism and enthusiasm of employees, guided by SSE's Teamwork value, which states: 'We support and value our colleagues and enjoy working together in an open and honest way.' SSE is committed to ensuring that it is a great place to work and its policies on human resources are developed and delivered in support of this.

### The Board of Directors and the Management Board

The Board is accountable to SSE's shareholders for the good conduct of the Company's affairs and is collectively responsible for creating and sustaining shareholder value through the overall management of the Company, while ensuring that a sound system of internal control and risk management is in place. 'How the Board Works' is set out on pages 61 to 64. The Management Board is the group of Executive Directors and Managing Directors which is responsible for implementing strategy and policy as agreed by the Main Board and for the operational management of all of SSE's businesses. The members of the Board and the Management Board are listed on page 57.

### Other employees

The Executive Directors, Managing Directors and other senior executives and managers are among the 19,489 people directly employed by SSE on 31 March 2012. Most of these people work in the United Kingdom; just over 600 are employed in the Republic of Ireland; and a total of 18 work in mainland Europe. Of all employees, 71% are men and 29% are women. The average age of SSE's employees is 38 years. In 2011/12, there was a 8.2% turnover of employees, compared with 9.5% in the previous year.

### Building the SSE team

SSE's strategy is to deliver sustained real growth in the dividend through the efficient operation of, and investment in, a balanced range of energy-related businesses. To deliver this strategy in a complex industry that is both long term and fast-changing requires the maintenance and development of a strong team of employees who have the technical knowledge required of participants in the energy sector and the professional and generic skills required to make SSE a successful company in the second and third decades of the 21st century and beyond.

This means that SSE's priorities in maintaining and developing the right team of employees are:

- making SSE a great place to work, therefore retaining motivated and committed people and attracting a strong number of quality applicants for new roles;
- making a long-term commitment to employees, giving them the time to build their professional skills and the opportunity to advance their careers;
- maintaining a preference for recruiting and promoting from within the organisation where possible, while recognising that some specialist skills may only be available through external recruitment;
- ensuring effective succession planning, based on a comprehensive annual review process which extends beyond the Board and the Management Board to other levels in the organisation and which features a range of options for the development of key individuals; and
- recognising that the most effective employees over the long term are those who are able to maintain a balance between their working and family lives.

### Recruitment

During 2011/12, SSE recruited externally a total of 2,225 people to jobs in England, Scotland, Wales, Northern Ireland and the Republic of Ireland. Of the people recruited during the year, 64% were men and 36% were women. While it was difficult to find candidates for a very small number of the jobs, because of the technical requirements or location issues, the vast majority were filled by appropriately-qualified people in a timely way and SSE remains pleased with the number of high quality applications that it receives.

The level of unemployment amongst 18 to 24 year olds has been a particular cause for concern as a result of the economic slowdown in the UK and Ireland in recent years. Overall 12% of SSE employees are aged under 25 (around 2,300 in total).

SSE also supports the Barnardo's Works programme, which aims to give long term unemployed young people the opportunity to gain comprehensive waged work opportunities, training and industry-related qualifications. Since it began in 2008, a total of 105 young people have taken part in the programme with SSE.

In addition, SSE offers a range of structured development programmes suited to the needs of school leavers, trainees, trainee engineers,

graduates and apprenticeships. The focus of each programme is to ensure that those participating gain skills that can be used for their future benefit and for the benefit of SSE. This sustainable creation of jobs is key to SSE. Currently 450 individuals are progressing through these programmes and SSE has been nationally recognised for the quality of these programmes, winning a number of awards during 2011/12.

In recognition that it operates in a competitive employment market, SSE has introduced a wide range of employee benefit offerings including a competitive pension, a range of salary sacrifice offerings and a wide range of employee benefits including its Extras programme.

### Diversity

In February 2011, the Davies Review of Women on Boards quoted evidence that companies with a strong female representation at board and top management level perform better than those without and that gender-diverse boards have a positive impact on performance. It said that boards make better decisions where a range of voices, drawing on different life experiences, can be heard and that this 'mix of voices must include women'.

Of the 54 senior managers who report directly to members of the Management Board, 12 are women; and of the 49 members of the five Committees of the Management Board, 12 are women. Although the number of women in senior and other management roles in SSE is increasing, it is recognised that more work needs to be done to secure greater gender diversity.

In support of this a number of steps are being taken, and a survey of over 200 senior managers in SSE was carried out to establish attitudes to, perceptions of and steps needed to support greater gender diversity in SSE. The principal finding of the survey was that SSE could do more to advance a culture of flexible and family-friendly working for both women and men. This and other actions will be addressed by SSE's newly-established Diversity Working Group in the course of 2012/13. SSE will continue to make appointments to all roles within the organisation on merit, but believes it must take steps to enhance the diversity of the lists of candidates from which appointments are made.

### Participation

SSE believes that there is a commonality of interest between employees and customers and shareholders. To reinforce that it:

- encourages all employees to become and remain customers by providing them with a 10% discount on its prices for electricity and gas supply, plus discounts on energy efficiency installations, central heating and wiring maintenance and telephone and broadband services;
- provides opportunities for employees to become and remain shareholders in SSE through a Share Incentive Plan and a Sharesave Scheme. Employee participation in these schemes is now 43% and 35% respectively; and
- provides opportunities for employees to be involved in its 'Community At Heart' employee volunteering scheme, which aims to give 20,000 days of employee time to assisting worthwhile projects within the communities that SSE serves.

Within SSE, employee participation is encouraged through adherence to the Company's Teamwork value. The appraisal process for employees, including the senior management team, specifically evaluates their performance in Teamwork, along with performance in respect of SSE's other core values: Safety, Service, Efficiency, Sustainability and Excellence. In keeping with these values, SSE produced and distributed an updated code of business practice, '*Doing the right thing*' in April 2011. It highlights, summarises and complements a range of ethics-related policies which SSE has in place. It takes account of recent legislation such as the UK's Bribery Act 2010.

In addition to a wide range of internal communication media and events, employee participation in SSE is also encouraged through the Chief Executive's Blog, inter-active online forums, division- and subject-specific employee surveys, Director-led regional roadshows and the Licence to Innovate scheme, which enables employees to research, review and test-trial new ideas.

### Employee engagement

SSE recognises the value in attracting and retaining an engaged workforce and runs an annual externally-facilitated survey of employee engagement. The results of the 2011 survey, which had a 70% response rate and was completed by almost 10,000 of the 14,000 employees invited to participate, showed that SSE has an above benchmark employee engagement score of 73%.

Following this survey, a series of actions have been put in place to address key employee engagement drivers identified in the surveys. The Management Board has also set an

ongoing improvement target for these survey results. The next engagement survey is being conducted in June 2012, when all employees across SSE will be invited to participate.

### Rights

SSE has in place a comprehensive range of policies to safeguard the interests of employees and potential employees. Like all responsible organisations it has in place an actively-managed equal opportunities policy, in keeping with the spirit as well as the letter of the law in the UK and elsewhere, designed to ensure fair and equal treatment of employees and potential employees across the seven protected characteristics, as defined in the Equality Act 2010 – sex, race, religion or belief, disability, pregnancy and maternity, disability, sexual orientation and gender reassignment. The Employment Equality (Age) Regulations 2006 have now been incorporated into the Equality Act 2010. There were no occasions during 2011/12 when SSE was found to have failed to comply with legislation on equality.

### Responsibilities

SSE also believes that employees have responsibilities, summarised in eight People Principles, adopted in 2008 and built around its core value of Teamwork:

- **Take** all active steps to ensure there is no intimidation or discrimination;
- **Engage** in safe, healthy and environmentally-friendly working practices;
- **Always** know and understand what is expected of you in your job;
- **Maintain** respect and support for colleagues at all times;
- **Work** continuously to improve team and individual performance;
- **Obtain** constructive feedback on your performance from your line manager;
- **Receive** appropriate training, development and rewards; and
- **Know** and embrace the Company's core values.

Through the application of these principles, SSE seeks to maintain a positive organisational culture and to provide a fulfilling place for people to work.

### Performance management, training and development

SSE has in place a wide-ranging performance management system, designed to make sure that employees are able to fulfil their potential and contribute as much as possible to the achievement of SSE's goals and the delivery in practice of SSE's values. For this reason, the performance appraisal system is focused

in part on performance against each of the SSE SET of core values (Safety, Service, Efficiency, Sustainability, Excellence and Teamwork). It is also designed to focus on agreed objectives for the following year and on personal development and professional aspirations.

Performance management therefore focuses on the skills and competencies of employees, which are critical to SSE and to the energy sector in the UK, the Republic of Ireland and elsewhere. SSE needs to ensure the safe and efficient operation of its businesses and the reliable provision of services to customers. In addition, SSE needs to develop new skills and flexibility to manage new technologies. It is, therefore, critical that employees of SSE have the training, development and work experience they need to fulfil their potential. In order to do this, SSE uses a range of delivery media for training.

During 2011/12, SSE invested £1.5m in externally-provided training and development, taking the total to £5.3m over the last three years. This helped to deliver training to 3,991 employees. Training interventions included the delivery of a number of development programmes run in partnership with selected universities focused on supporting the development of employees across the business. These programmes included an MSc in Leadership and degree programmes in Business and Customer Management.

SSE has technical and general training centres at Thatcham and Perth. These centres enable people to train in the types of environment in which they will eventually work, providing a realistic experience in a safe, controlled setting. This training is supplemented by operational awareness days, during which best-in-class working practices are demonstrated to employees through detailed coaching and assessment in operational environments. SSE also announced that it will open a new Smart Energy Training Centre in Treforest, Wales during 2012. This centre will focus on delivering skills to support the delivery of services in key areas of energy efficiency and smart metering.

### Joint Negotiating and Consultative Committee

SSE benefits from a well-established Joint Negotiating and Consultative Committee (JNCC) which includes lay and full-time representatives from four recognised trade unions. During 2011/12, SSE and the JNCC reached an agreement on a three-year package, featuring pay increases, performance pay, flexible working patterns, job stability,



## The SSE team (continued)

commitments around non-outsourcing of key core activities, family-friendly working policies and an additional day's holiday. Joint Business Committees have been established, complementing the work of the JNCC by focusing on issues that affect particular parts of SSE. Pay arrangements in SSE's Contracting division are in line with national construction agreements.

### Innovation, research and development

The SSE team of people has extensive knowledge, expertise and know-how. New ideas, improvements to process and design and innovation have been key to SSE's successes to date and are fundamental to the Company's ability to adapt to the challenges of the future. The Company's Excellence value states that: 'We strive to get better and smarter and more innovative and be the best in everything we do.'

As a spur to employee participation, idea generation, continuous improvement and operational excellence, SSE maintains and promotes a systematic approach to implementing ideas that add value. This is through the Licence to Innovate scheme, under which any employee can suggest ideas for improving the way SSE operates, consistent with its core values. People with ideas with significant potential are granted a Licence to Innovate, under which they can spend two months researching further their proposal. Subject to the outcome of the research, the idea may then be piloted prior to full implementation.

Over 9,700 Licences to Innovate were received from 3,400 employees during 2011/12, of which 497 were implemented. A number of these Licences have helped create value of around £70m, building on the £45m of value created in the previous year. Others have contributed to improved performance in specific areas, such as safety, service and sustainability.

To complement the Licence to Innovate scheme, an SSE Entrepreneur competition attracted over 100 entrants. The three winning ideas, which are receiving financial and other resources, covered micro generation, energy demand management and safety.

SSE's focus on innovation complements its work in research and development. For SSE, this means focusing on development, demonstration and deployment rather than on basic research. This reflects the fact that SSE is, fundamentally, an adopter of

technology. Against this background, SSE has two broad categories of research and development projects:

- thematic, addressing pre-selected knowledge gaps or development needs within SSE; and
- responsive, which arise when an opportunity (and associated funding) emerges that can add value to SSE.

There is a considerable amount of research and development-related work taking place in SSE. In total, during 2011/12, SSE initiated research and development projects with a value of £11.2m. The large majority of this was in Networks (for example low carbon networks) and in the electricity generation part of Wholesale (for example, carbon capture and storage). Most of SSE Ventures' investments, such as Aquamarine Power Ltd and Onzo Ltd, include an element of research and development activity.

SSE has also entered into an agreement with the University of Strathclyde to be a partner in its Technology Innovation Centre. The Centre is intended to share knowledge and find solutions to issues of economic and societal importance, including energy, and to help companies compete. It is intended to revolutionise the way researchers in academia and industry collaborate and innovate.

SSE also maintains a long-term outlook through the work of its Central Research Unit, which examines in detail issues which could affect SSE and its customers over the next 40 years. These range from developments in hydrogen to energy affordability and the impact of smart metering on customer behaviour.

### Community and charitable activities

In support of its core values such as Service, Sustainability and Teamwork, SSE has a wide-ranging programme of community-based activities. With its origins in the north of Scotland and central southern England, and with over 19,000 employees throughout the UK and Ireland, SSE can make a positive impact to hundreds of communities.

The programme has four principal features:

- employee volunteering, under which employees are given one day of leave to support community programmes. During 2011/12, 6,216 volunteer days were given to 570 projects in the UK and Ireland;

- visitor facilities in Dorset, Cheshire and Perthshire. During 2011/12 a fundamental review of the facilities was undertaken, with opportunities for future development being identified;
- financial support for community programmes near wind farm developments and in the wider regions where wind farms are developed; and
- support for the work of schools through Eco Schools programmes.

Through these and other schemes, SSE made payments of £6.1m to charitable and community programmes in the UK and Ireland during 2011/12.

During 2012/13, SSE expects to develop plans for new visitor facilities at some of its major sites, with enhanced educational links to partnership schools.

### Suppliers and contractors

SSE depends upon an extended team of suppliers and contractors for the long-term success of its business. It aims to promote responsible practices within its supplier and contractor base. SSE's aims in this area include:

- improving contractors' safety performance; and
- reducing the CO<sub>2</sub> footprint.

As part of this, SSE has adopted a supplier relationship management approach to managing its most strategic supplier relationships. More broadly, SSE is joining The Total Supplier Management System hosted by an independent company, Achilles Information Limited. This will provide SSE with online information on suppliers, including categories relating to where they work on site, data on safety, health and the environment and quality.

The Achilles carbon reduction programme allows suppliers to measure, manage and report their organisational footprint via CEMARS (Certified Emissions Management and Reduction Scheme). By the end of 2011/12, SSE had successfully encouraged 47 of its main suppliers to sign up to the scheme. SSE also successfully completed the process itself and again achieved CEMARS certification. •

## How the Board works

# The Board is collectively responsible to the Company's shareholders for the long-term success of SSE and for its overall strategic direction, its values and its governance.

### The framework of corporate governance

This report explains how the Company applies the principles of The UK Corporate Governance Code (the Code) issued by the Financial Reporting Council in June 2010.

The Board confirms that the Company has, throughout the period under review, complied with all provisions set out in the Code, except in the following respect:

Code Provision D.2.1 states: 'The Board should establish a Remuneration Committee of at least three, or in the case of smaller companies two, independent non-executive directors.' SSE was not compliant with this Code Provision from 1 April 2011 until 1 July 2011. This was due to the resignation of Nick Baldwin as a non-Executive Director on 1 April 2011 following his appointment as the interim chair of the Office for Nuclear Regulation. The appointment of Katie Bickerstaffe as a non-Executive Director and member of the Remuneration Committee did not take effect until she joined the Board on 1 July 2011. Since then the Company has been fully compliant with the Code.

### Organisation and structure

#### Role of the Board

The Board is collectively responsible to the Company's shareholders for the long-term success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary for the Group to meet its business objectives whilst ensuring that a sound system of internal control and risk management is in place.

#### Articles of Association

The powers and duties of the Directors are determined by legislation and by the Company's Articles of Association, which are available on the SSE website.

#### Board decisions

A formal list of matters is specifically reserved to the Board for its decision, including:

- Group strategy;
- annual budget;

- approval of interim and final financial statements;
- interim dividend payments and recommendation of final dividends;
- significant changes in accounting policy and practice;
- the Group's corporate governance and system of internal control;
- Board and Committee membership;
- major acquisitions, mergers, disposals and capital expenditure;
- changes in the capital and structure of the Group;
- approval of key policies such as safety, health and environment; and
- regulatory matters including approval of Price Control Reviews proposed by Ofgem and tariffs.

The list is reviewed regularly by the Board and is published on the SSE website.

The Board also has overall responsibility for risk management, which is reported in detail on pages 65 to 70.

### Attendance at Board and Board Committee meetings

The Board has six scheduled Board meetings each year. These start with an evening meeting when the Board is often given a presentation by senior management on a particular topic. Occasionally the evening is used for discussions with external stakeholders. The Board meeting then continues the following day and is often followed by a meeting of one of the Board Committees such as the Remuneration Committee or the Safety, Health and Environment Advisory Committee. In addition to the scheduled meetings the Board has six update conference calls which are held in the months between the bi-monthly scheduled Board meetings. These calls usually last for around one hour and are used to update the Board on the business performance and to brief the Board on any current issues. A Board decision or approval may be required at the update conference call if the matter cannot wait until the following scheduled Board meeting. In these circumstances the decision of the Board is recorded by written resolution or minute.

There is normally full attendance at Board and Committee meetings, although occasionally there may be non-attendance due to unforeseen circumstances or prior commitments which could not be rearranged. If unable to attend a meeting, the Director will provide comments and feedback to the Chairman, Committee Chairman or Company Secretary who ensures that the comments received are raised at the meeting. Members of the Management Board are invited to attend Board meetings on a rotational basis.

The table below sets out the attendance of the Directors at the scheduled Board meetings.

#### Attendance at Board meetings

|                          | Attended/scheduled |
|--------------------------|--------------------|
| Lord Smith of Kelvin     | 6/6                |
| Gregor Alexander         | 6/6                |
| Thomas Thune Andersen    | 6/6                |
| Jeremy Beeton            | 5/5                |
| Katie Bickerstaffe       | 5/5                |
| Richard Gillingwater     | 6/6                |
| Colin Hood               | 3/3                |
| Ian Marchant             | 6/6                |
| René Médori              | 6/6                |
| Alistair Phillips-Davies | 6/6                |
| Lady Rice                | 6/6                |

### Roles of Chairman and Chief Executive

The roles of the Chairman and the Chief Executive are separate and clearly defined.

#### The Chairman:

- is responsible for the operation, leadership and governance of the Board ensuring that the Board operates effectively whilst providing appropriate challenge to management;
- identifies individual Director training needs and conducts the performance evaluation; and
- meets with shareholders, analysts and other representatives of institutional investors, and participates in both the interim and annual results presentations and the AGM.

The Chairman regularly meets with managers and employees at locations and key sites throughout the Group.

#### The Chief Executive:

- leads the other Executive Directors, the Managing Directors and the management team in the day-to-day running and operations of the Group;
- implements the strategy and policy as agreed by the Board; and

## How the Board works (continued)

→ represents the Company to external stakeholders, including shareholders, customers, suppliers, regulatory and government authorities, and the community.

In discharging his responsibilities, the Chief Executive is advised and assisted by the Management Board and its Committees which oversee the operational and financial performance of, and issues facing, the Company. The Management Board was set up in January 2011, and its role is explained on page 63.

### Role of non-Executive Directors

The non-Executive Directors are chosen for their diversity of skills and experience. Each non-Executive Director is appointed for a fixed term of three years. This term may then be renewed by mutual agreement. The non-Executive Directors' appointment letters are available on the SSE website.

The non-Executive Directors:

- scrutinise, measure and review the performance of management;
- assist in the development of strategy;
- review the Group financial information;
- ensure systems of internal control and risk management are appropriate and effective;
- through the Audit Committee, review the relationship with the external Auditors; and
- review the remuneration of and succession planning for the Board.

The Chairman and non-Executive Directors met twice during the year without the Executive Directors being present.

### Senior Independent Director

Lady Rice is the Senior Independent Director and acts as a sounding board for the Chairman and serves as intermediary to other Directors when necessary. Lady Rice carried out the Chairman's performance evaluation, together with the other non-Executive Directors and with input from the Executive Directors. She also undertook management visits during the year. From 24 July 2012 the position of Senior Independent Director will be taken by Richard Gillingwater.

### Balance of the Board

The composition of the Board and its Committees is regularly reviewed to ensure that the balance and mix of skills and experience is maintained.

On 1 April 2011, Nick Baldwin resigned from his position as non-Executive Director. Colin

Hood retired as an Executive Director on 31 October 2011. On 1 July 2011 Katie Bickerstaffe and Jeremy Beeton were appointed to the Board as independent non-Executive Directors. René Médori will resign from the Board on 25 June 2012.

After all of these changes have taken place, the Board will comprise the Chairman, three Executive Directors and five independent non-Executive Directors. This gives the Board a good balance of independence and experience, ensuring that no one individual or group of individuals has undue influence over the Board's decision-making.

### Diversity on the Board

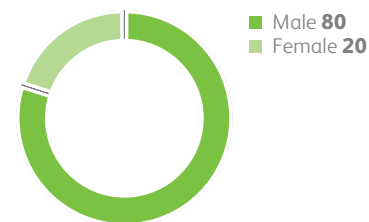
The Davies Review, published in February 2011 contained a review of Women on Boards and recommended that FTSE 100 Boards should aim for a minimum of 25% female representation by 2015. Upon the retirement of René Médori from the Board on 25 June 2012 female representation on the Board will be 22%. The Company is committed to the approach on diversity set out in the Davies Review, and will continue to take diversity matters into account for future Board and management appointments.

### Director independence

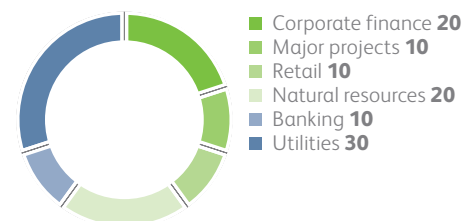
The Board considers that the Chairman was independent on appointment and all non-Executive Directors are independent for the purposes of the Code. The continuing independent and objective judgement of the non-Executive Directors was confirmed in the annual Board performance evaluation process. On 24 July 2012 Lady Rice will have served for nine years on the Board. The Board has considered the length of service of Lady Rice and continues to view her as independent in character and judgement. She continues to have a broad range of external experience which she brings to the Board. She is a valuable member of the Board, and contributes significantly to the Board's deliberations. She will continue to chair the Remuneration Committee. Her position and independence will continue to be regularly reviewed and scrutinised by the Nomination Committee and the Board.

The Board evaluation process also confirmed that the performance of the Directors continued to be effective and that they continue to demonstrate commitment in their respective roles. The Board has agreed that each Director shall be subject to annual re-appointment and as such all Directors (other than René Médori) will stand for re-appointment at the 2012 AGM.

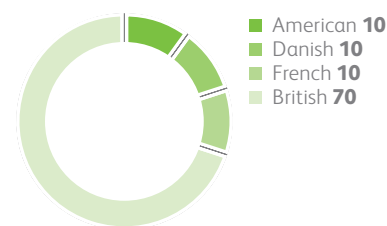
### Board composition, gender – %



### Board composition, sector – %



### Board composition, nationality – %



Biographical details for all the Directors are set out on page 57.

### Board committees

There are four Board committees. The terms of reference of these committees are set by the Board, are reviewed regularly, and are available on the SSE website. Membership is determined by the Board on the recommendation of the Nomination Committee and in consultation with each Committee chairman. Minutes of Board Committee meetings (apart from the Remuneration Committee minutes) are included on the agenda of the next Board meeting for information.

The relationship between the Board, Board Committees and the management of the Company is summarised in the chart to the right. Details of each Board Committee, including membership, meetings, role and activities in 2011/12, are set out in the Committee reports on pages 71 to 86.

### Management Board

The Management Board is responsible for implementing policy and strategy set by the

Board and for the operational management of all SSE's businesses. The Management Board comprises the three Executive Directors and the seven Managing Directors representing the key areas of the business. The Chief Executive of SGN also attends meetings of the Management Board. The Management Board meets monthly and the minutes of the meeting are also provided to the Board for information.

## Board effectiveness

### Information and professional development

The Directors receive detailed financial and operational information to allow them to monitor effectively the performance of the business. Board and Committee papers are issued for review in advance of meetings. At each Board meeting, the Chief Executive presents an update report on any major current matters from the Group's business; the Finance Director presents a report on financial performance and the Board receives a detailed business report from the Management Board. The Board also receives regular updates on the progress and performance of investments, and a detailed key performance indicator report.

During the year, the Board and Committees were kept up to date with developments through a programme of briefings by Executive Directors and senior management on the full range of business areas. Specialist briefings and presentations were given on areas such as corporate governance, regulatory development, risk, strategy, energy trading, health and safety, major projects, and SSE's major business activities generally. Separate more informal meetings were also

held between individual Directors and senior management.

Meetings, briefings and site visits were arranged for the non-Executive Directors during the year. The briefings covered subjects such as operational activities and major projects, and the visits included wind farms and other major operational sites.

On joining the Board, Directors receive a comprehensive induction course tailored to their individual requirements which includes meetings with the Executive Directors and senior management, visits to key sites, and meetings with key stakeholders. It also covers a review of the Group's governance, policies, structure and business including details of the risks and operational issues facing SSE. Katie Bickerstaffe and Jeremy Beeton received a full induction programme, which included two days at SSE's Head Office in Perth, visiting various parts of the business. In addition, Jeremy Beeton visited Peterhead Power Station and Katie Bickerstaffe visited the major customer contact and IT centre at Havant and the zero-carbon homes development at Slough. They both also had a full briefing with the Company's brokers.

As part of the annual Board evaluation process the training and development needs of individual Directors are reviewed by the Chairman. The Company makes the necessary resources available should any Director require training.

There is an agreed procedure for Directors to be able to take independent professional advice, if necessary, at the Company's expense. The prior approval of the Chairman is required where the cost of such advice is likely to exceed

£10,000. Any advice obtained shall be made available to the other members of the Board, if the Board so requests. This procedure was not required to be used during the year. All Directors have access to the advice and services of the Company Secretary.

The Company operates performance coaching for some of the Executive Directors and for other members of senior management which is designed to develop and enhance individual and Company performance.

### Executive Directors' other directorships

Executive Directors may be invited to become non-Executive Directors of other companies. Approval may be given to accept such invitations recognising the benefit to the individual and to the Company. Any such appointments are included in the biographical information set out on page 57 and any fees are disclosed in the Remuneration report.

### Conflicts of interest

During the year a review of the Directors' interests and appointments was carried out by the Company Secretary and a report was provided to the Nomination Committee for review and recommendation to the Board. The full Board then considered and authorised each Director's reported actual or potential conflicts of interest at the Board meeting in January 2012. In accordance with the Company's Articles of Association and relevant legislation, each Director abstained from approval of their own position. The Board continues to monitor and review potential conflicts of interest on a regular basis.

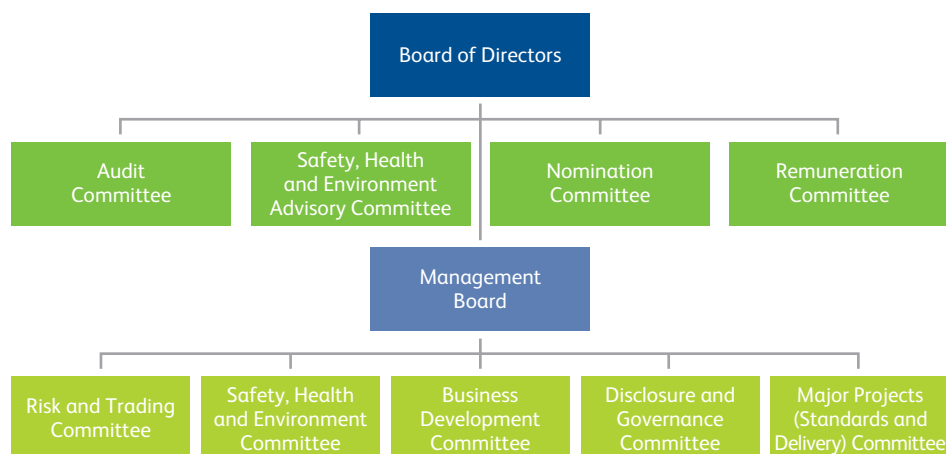
### Performance evaluation

The Board, its Committees and the individual Directors participate in an annual evaluation of performance.

The Board evaluation process this year was carried out by internal questionnaire and individual meetings, following an external-led review in 2010. The outcome of the evaluation process was considered at the Board meeting held in January 2012. The findings of the evaluation continued to be positive and the suggestions included further consideration of diversity and succession planning, more specific briefings on matters such as Energy Trading and Risk, and wider sector-related topics to be brought to future meetings.

The Directors also participated in detailed reviews of individual performance which were carried out in separate meetings with the Chairman. The process for evaluating the Chairman was managed by the Senior

## Governance structure





## How the Board works (continued)

Independent Director which involved a separate meeting with the non-Executive Directors and included feedback from the Executive Directors. All of the Directors continued to make an effective contribution to the work of the Board and its Committees, were well informed and demonstrated full commitment to their duties. The Board was satisfied that the performance evaluation process identified the main areas for further review. An external evaluation process is carried out every three years as recommended by the Code, with the next one due in 2012/13.

### Engagement with shareholders and major stakeholders

#### Disclosure and Governance Committee

The Disclosure and Governance Committee is responsible for overseeing the Company's framework for the identification, release and control of announcements and other information of interest to shareholders and the investment community. The Committee assists in developing the investor relations strategy and reviews and implements governance developments. The Committee comprises: the Chief Executive; Finance Director; Company Secretary; Managing Director, Corporate Affairs; Head of Investor Relations and Analysis; and the Assistant Company Secretary. The Committee meets as required and had five meetings in the year.

#### Relations with shareholders

The Company continued to maintain an effective dialogue with shareholders, based on a mutual understanding of objectives. The Board believes that this is fundamental to ensuring that the Company's strategy is understood and that any questions or issues are dealt with in a constructive way.

The Company maintains regular contact with institutional shareholders, fund managers and analysts through a programme of dialogue, meetings, presentations, events and site visits led by the Chief Executive and Finance Director. The Head of Investor Relations and Analysis has day-to-day responsibility for communications with institutional shareholders. Brokers' reports and analysts' briefings are distributed to the Directors. The Board receives regular reports on the various issues raised by institutional shareholders, fund managers and analysts which allow the Directors to form a view of the priorities and concerns of the Company's stakeholders.

The Chairman participated in the Company's results presentations in May 2011 and November 2011. The Chairman meets major

institutional shareholders from time to time to gain a first-hand understanding of key issues.

Lady Rice, the Senior Independent Director, is available to shareholders if they have concerns that contact through the normal channels has either failed to resolve or is deemed inappropriate. She attended the interim results presentation in November 2011.

#### Communications with shareholders

SSE's website contains up-to-date information for shareholders and other interested parties including share price information, announcements and news releases, investor and analyst presentations, and a section containing information on shareholder services. The Company's Annual Report and other shareholder circulars are also published on the SSE website.

Shareholders have a choice of how to receive their Company communications such as the Annual Report. The Company recognises the benefit of electronic communications and encourages shareholders to receive electronic communication. In recognition of the reduced cost and environmental impact of this form of communication, the Company, on behalf of shareholders, makes a donation to the World Wildlife Fund's International Forest Programme for every shareholder that elects for email communication or receives Company documentation via the SSE website.

#### Annual General Meeting

The Company's AGM will be held at the Bournemouth International Centre, Exeter Road, Bournemouth BH2 5BH on 26 July 2012 at 12 noon. Details of the business to be proposed at the meeting are contained in the Notice of Annual General Meeting.

The AGM provides an opportunity for the Board to meet with shareholders and provide an update on the performance and plans of the Company. Shareholders are invited to ask questions at the AGM and to meet the Directors and senior managers. Jeremy Beeton may be unable to attend the 2012 AGM due to a prior commitment as Director General of the UK Government Olympic Executive.

#### Communications with other stakeholders

The Directors have a programme of events to meet with a range of external stakeholders representing the public sector, investment community, environmental affairs, and consumer interests. The purpose of these events is to discuss the Company's position on a range of business, policy and public interest issues and to learn more about stakeholders'

views, hear their suggestions and address any areas of concern.

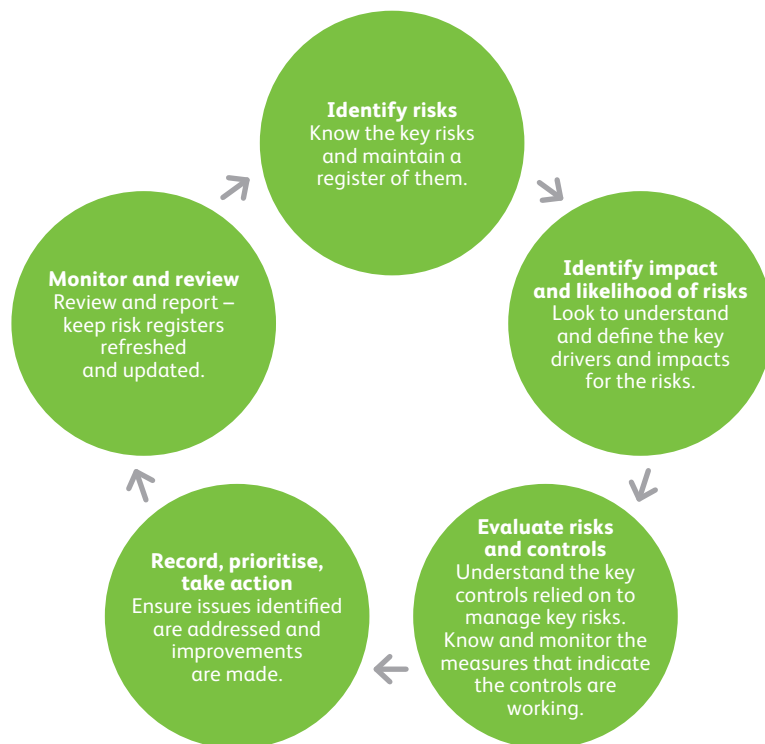
More generally, working with public policy makers is a vital area for the Company, given the high profile of energy and environment-related issues in the UK and elsewhere. The Company engages with stakeholders in several ways:

- constructive engagement where appropriate with Ofgem, which is responsible for promoting competition, and regulating the monopoly companies which run the gas and electricity networks;
- ongoing dialogue with Ministers and officials in government, including the devolved administrations in the UK;
- submissions to government and Parliamentary consultations and inquiries;
- meetings with, and briefings of, elected members of all parties in legislatures;
- engagement with local authority elected members and officials;
- active participation in relevant trade associations and bodies; and
- discussions with non-governmental organisations and other relevant organisations such as charities.

The Company's objective is to ensure that it is able to perform its core purpose of providing the energy people need in a reliable and sustainable way. Its principal public policy goal at present is to ensure that there is in place a framework to enable it to invest in secure and lower-carbon supplies of energy in the UK and Ireland. In pursuing public policy goals, SSE always aims to deploy evidence and arguments that are consistent with its purpose, values and strategy as outlined in this Report and to do so in a way that is appropriate and responsible. •

## Risk management

### Risk management model



#### Introduction

The Board of SSE acknowledges its clear responsibility for risk management. SSE's approach to risk management is that any sustainable and successful business requires clear risk management in all aspects of its activities.

Equally important for SSE is the belief that risk management is first and foremost an integral part of how managers run their activities every day. Therefore SSE has focussed on looking at each business area individually and putting in place a framework that works effectively for that area. SSE recognises that this is an ongoing process as it needs to react to changes in the risk environment by constantly revisiting its internal processes. This report includes a summary of the developments in SSE's approach to risk management during 2011/12.

The need for good risk governance is critical to ensure the overall business model is effective in practice. Risk management in SSE is characterised by: the clarity of its financial goal; its strategy and business model which help to limit the value at risk; the culture and limited appetite for risk; and its work on risk identification and risk management.

#### Limited appetite for risk

The Teamwork value, combined with other factors such as the clear goal of sustained real growth in the dividend, means SSE has adopted a limited appetite for risk. The appetite varies between businesses. This means that SSE's approach in respect of economically-regulated businesses, which in themselves are lower risk, is more risk averse than is the case in other market-based activities. In these areas, such as electricity generation, SSE might consider taking on additional risk where the risk is very well understood and can be mitigated and the potential returns are clearly attractive.

Some examples of the way in which appetite for risk is limited are:

- energy trading – levels of exposure are strictly monitored through risk models and clear reporting limits;
- major project construction – the Company has in place a detailed governance and risk process for all its large capital projects;
- the Company has a selective and disciplined approach to acquisitions, and sets demanding hurdle rates for expected returns;
- in treasury and funding matters, there is a clear and prudent approach to liquidity levels, and a mix of maturities and currencies; and

- where available on acceptable terms insurances are in place for all relevant major risks, while maintaining an appropriate balance with self insurance where appropriate.

#### Risk monitoring

Risks are monitored by the relevant business units within SSE, with an overview provided by the Group Audit Department for the Audit Committee meetings held in May and November of each year. The Board reviews all aspects of risk management and internal control at least twice a year, usually in March and September. At its meeting in March 2012, the Board held a specific review of the developments within the Company during the year to ensure good risk management is in place; it revisited the approach to risk appetite; and reviewed the management reporting arrangements to ensure proper controls are in place.

In addition to the Board bi-annual risk reviews, the Board undertook a review of the Company's principal risks at its meeting in May 2011 and approved the list of principal Group risks which were referenced in last year's Annual Report.

During the year, the Group Audit department carried out over 65 separate audits of functions, activities and issues managed by SSE, providing senior management with a robust internal control assurance. These included environmental audits carried out by SSE's Group Environmental Auditor. Each audit report included agreed management actions to improve the overall management of risk. Group Audit reviews complement the work done by business-specific compliance functions in areas such as Safety, Energy Trading, Energy Efficiency, Energy Supply, IT and Customer Service.

#### Developments in SSE risk management during the year

As part of the SSE approach to risk management, the Company continues to review and strengthen its internal control processes. Examples of this approach during 2011/12 are:

- The top 19 risks reported last year were reviewed in detail at the Board meeting in May 2011. At the Management Board risk workshop held in August 2011 these risks were modified, and a new risk category, management of Joint Ventures, was agreed.
- All the top 20 Group risks are actively monitored and reviewed. Each principal risk has an assigned risk owner who is a member

## Risk management (continued)

All employees are expected to adhere to SSE's code of business practice and to the SSE SET of values – Safety, Service, Efficiency, Sustainability, Excellence and Teamwork – which are embedded in the culture.

of the Management Board. The risk owner is responsible for ensuring that key controls for the risk are in place and operating.

- The Group Insurance department facilitated an extensive review of the existing risk management framework. The output from this review led to guidelines to promote a consistent categorisation and scoring of the enterprise risks facing the business.
- The Large Capital Projects Governance Framework has now been extended to all major projects, such as IT, Telecoms and Property. In October 2011, the Management Board established a Major Projects (Standards and Delivery) Committee to oversee all major projects.
- Cyber/information security risk is being addressed with a significant investment programme which was approved during the year.

### Internal control

Risk management depends on a strong system of internal control, which is fundamental to achieving SSE's strategic objectives. The Board is responsible for the overall system of internal control and risk management, and it either directly, or through its committees, sets performance targets and policies for the management of key risks facing SSE. The system of internal control is designed to manage, rather than eliminate, risk of failure to achieve business

objectives and can provide only reasonable and not absolute assurance against material misstatement or loss. The Internal Control Assurance Process below provides an overview of the key committees and related assurance activities currently in place within the Group.

All employees are expected to adhere to the Company's code of business practice and the SSE values – Safety, Service, Efficiency, Sustainability, Excellence and Teamwork – which are embedded in the culture. Their consistent application is central to all activities in SSE. The Teamwork value, the emphasis on people's knowledge rather than status, and the maintenance of a very experienced team, complemented by the recruitment of additional specialist skills where necessary, are all designed to ensure that the risks associated with operations are fully understood and actively managed. Reporting within the Company is structured so that the key issues are escalated through the management team, ultimately to the Board if appropriate.

The key elements of SSE's internal control and financial reporting processes are summarised below:

### The Board:

- approves the policies, procedures and framework for the maintenance

of a sound and effective system of internal control ensuring:

- the provision of quality internal reporting to the Audit Committee and other Board Committees by management and Group Audit;
- the provision of quality reporting by the external Auditors to the Audit Committee;
- compliance with the Turnbull Guidance on Internal Control; and
- compliance with statutory and regulatory obligations;
- reviews the significant risks identified by each business unit as well as the mitigating action against those risks following review by the Audit Committee;
- determines the nature and extent of the significant risks it is willing to take in achieving its strategic objectives;
- approves and regularly reviews and updates SSE's strategy and business development;
- reviews the financial reporting process and performance through: annual operating and capital expenditure budgets; monthly reviews against actual results; analysis of variances; and evaluation of key performance indicators;
- receives regular reports from the Chief Executive, the Finance Director and the Management Board members; and
- undertakes an annual evaluation of the Board, its Committees and individual Directors.

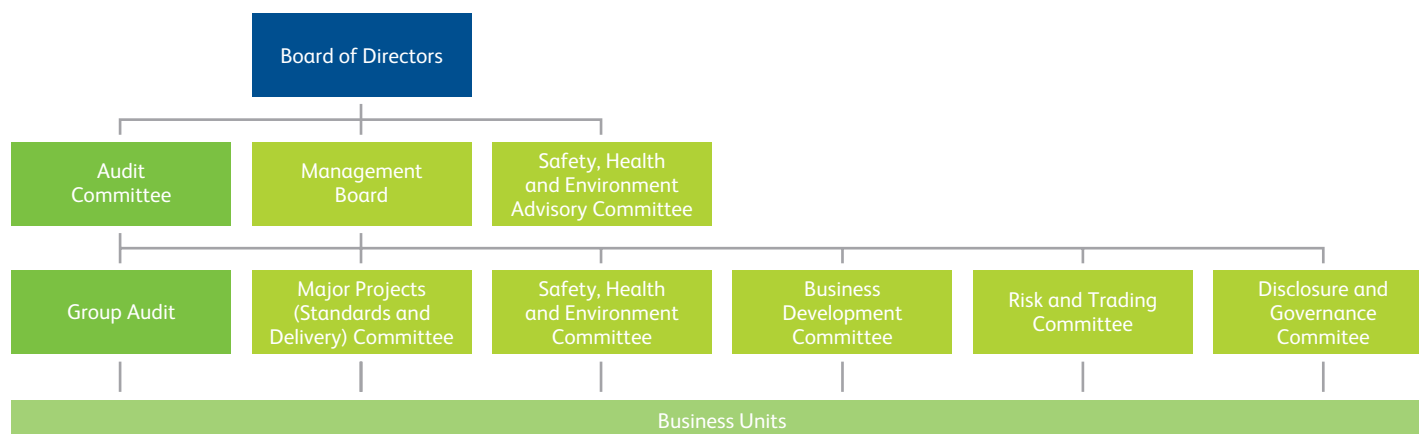
### The Management Board:

- monitors operational and financial performance of SSE;
- develops and implements: SSE strategy; operational plans; policies; procedures; and budgets;
- assesses and controls all SSE risks;
- monitors competitive forces in each area of operation;
- receives and reviews reports from its

## SSE SET of values to manage risk



## Internal Control Assurance Process



committees, namely: the Risk and Trading Committee; the Safety, Health, and Environment Committee; the Major Projects (Standards and Delivery) Committee; the Disclosure and Governance Committee; and the Business Development Committee; and

- receives and reviews regular presentations and reports from all the main Group businesses.

### The Group Audit department:

- works with the business units to develop and improve risk-management tools and processes in their business operations;
- ensures that business risks are identified, managed and regularly reviewed and that the key risks are reported to the Audit Committee and Board;
- ensures that the business units carry out regular reviews on their internal controls relating to the key risks;
- monitors the effectiveness of SSE's system of internal control through audit reviews, exercises and reports and, where appropriate, action plans to senior managers, Directors, the Audit Committee and external Auditors;
- monitors adherence to SSE's key policies and principles; and
- provides the Audit Committee and Board with objective assurance on SSE's control environment.

### Role of committees

The role of the Audit Committee, and the Safety, Health and Environment Advisory Committee in the Group's system of internal control and risk management is set out in the individual committee reports.

### The Board's review of internal control

While the Board retains overall responsibility, reviewing the system of internal control and monitoring its effectiveness is primarily dealt with by the Audit Committee, and its output is reviewed at least annually by the Board. The Board and the Audit Committee have reviewed the effectiveness of the Company's risk management and internal control system in accordance with the Code for the period from 1 April 2011 to 15 May 2012 (being the last practical day prior to the printing of this Annual Report). The Board confirms that appropriate action would have been taken to address any significant failings or weaknesses identified; however, no intervention has been required.

The internal control procedures described in this section have not been extended to cover its interests in joint ventures. The Group has Board representation on its joint venture companies where separate systems of internal control have been adopted. •

Risk management depends on a strong system of internal control, which is fundamental to achieving SSE's strategic objectives.



## Risk management *(continued)*

### Principal risks and their management

#### Risk definition

##### Safety management

Unsafe working practices, equipment and inadequate training may lead to accidents or incidents involving employees, contractors, members of the public or plant and equipment.

##### Regulatory change

An adverse change to the current regulatory framework in all parts of SSE could have a significant effect on its business.

##### Legislative change

Risks to SSE from unfavourable legislative developments at EU level and in the jurisdictions in which it operates.

##### Energy portfolio management

Failure to identify and effectively manage the physical and financial exposures that result from SSE's operational involvement in Generation, Gas Storage, Fuel Procurement, Wholesale Trading and Retail Supply.

##### Asset and plant management

Loss or extended disruption to key Group Infrastructure caused by failure/loss of containment of key plant.

##### Networks management

Loss or extended disruption to key Group network Infrastructure.

##### Cyber/information security

Unauthorised access or disclosure of data either within the SSE Group or between SSE and external environments and markets.

#### Key controls overview

Safety is the first of SSE's core values. The Safety, Health and Environment Advisory Committee (SHEAC) of the Board is responsible for ensuring SSE's health and safety policy is adhered to. The detailed report from this Committee is on page 74. The Management Board also has a SHE Committee.

An experienced Regulation Department manages SSE's relationships and interface with Ofgem, Ofwat, Ofcom and other regulators. SSE assesses and anticipates regulatory issues in its decision-making and operations.

SSE has Policy and Public Affairs specialists based in Brussels, London, Edinburgh, Cardiff, Belfast and Dublin who engage openly and constructively with legislators, officials and other policy-makers on all aspects of energy and related environment policy.

The Board approves levels of exposure which are strictly monitored through sophisticated reporting and clear reporting limits. The Management Board has a Risk and Trading Committee, with members drawn from a number of key functions across SSE.

SSE's Engineering Centre oversees a process of asset life management and risk-based management. Regular testing, review and updating of major incident handling processes takes place. Capital spending and maintenance programmes are maintained and the Risk and Trading Committee provides oversight.

Substantial refurbishment and upgrade programmes are designed to prevent network failures. There is a rigorous post-event analysis following each major network event such as storms. Business continuity plans, supported by contingency sites and regular testing, are well-established.

SSE has in place an actively managed Information Security programme across all of its activities to ensure resilient business operations.

#### Developments during the year

The Terms of Reference for the SHEAC were reviewed and updated during 2011/12. There is now greater non-Executive membership on the SHEAC. The SHE Committee of the Management Board is also fully established, with key priority areas including a Company-wide safety behaviour programme.

The GB energy regulator, Ofgem, adopted a high profile during 2011/12, with a particular emphasis on the Retail Market Review and the RIIO process for determining regulated networks' price control – all of which emphasised the ongoing significance of regulation to SSE.

The UK government is engaged in a process of electricity market reform which could lead to profound changes in the energy market in Great Britain. In addition, the Scottish and UK governments have consulted on proposals for a referendum on Scottish independence which has a risk to SSE of uncertainty until the result is known.

The process of the UK energy prices becoming increasingly integrated into the wider global energy market is continuing and as a result there is an increasing focus on macro-economic and geopolitical issues in the ongoing management of the portfolio.

SSE has always emphasised the need for flexibility in its generation assets to ensure that changes in supply of and demand for electricity can be managed. In 2011/12 it decided to start a comprehensive programme of maintenance at two gas-fired power stations to support more flexible operations.

The winter of 2011/12 represented the biggest challenge to electricity network resilience for a generation, with a succession of major weather events resulting in significant losses of electricity supply. The implications of this will be reflected in future networks planning.

Cyber security has been a particularly prominent issue in the UK and elsewhere during 2011/12, with individual sectors and organisations being targeted. SSE is increasing its investment in information security.

## Principal risks and their management

| Risk definition  | Key controls overview  | Developments during the year  |
|--|--|---|
| <p><b>Supply chain</b><br/>Delivery of large-scale investment programme is impacted through failure to establish, contract and maintain adequate supply chains and strategic alliances.</p>  | <p>SSE's diverse businesses help reduce reliance on specific supply chains and the sustainability value requires a long-term view to be taken. Well-established procurement teams ensure varying supply chains are identified and counterparty exposures monitored.</p>  | <p>A supplier relationship model has been put in place to build relationships with strategic suppliers and put SSE in the position of being a key customer. In the high risk categories long-term contracts are being implemented and tendering has commenced. This is designed to secure supply chains and ensure value for money.</p>   |
| <p><b>Treasury management</b><br/>Failure to identify and effectively manage treasury and tax exposures and to meet the organisation's funding requirements and obligations.</p>   | <p>The Risk and Trading Committee oversees any major changes to treasury policy or objectives. Regular reporting of treasury activity is made to the Audit Committee and Board. Strong internal controls are maintained and independent reviews take place.</p>  | <p>During 2011/12, SSE continued its approach of maintaining diversity in its funding sources through successfully reopening the European corporate bond market in September 2011 and undertaking a private placement of senior notes with US-based investors in February 2012.</p>   |
| <p><b>Credit management</b><br/>Failure to effectively manage billing and collection/counterparty risk.</p>  | <p>There is Executive Director-level representation in debt steering group meetings. Ongoing credit monitoring and reporting are supported by credit management teams throughout the Company.</p>  | <p>The general economic climate in the UK and Ireland has resulted in significant debt management challenges, with the volume of work increasing and with the need to deploy practical steps to work with customers becoming increasingly critical.</p>   |
| <p><b>Pension liabilities</b><br/>Liabilities increase due to market conditions or demographic changes and investments under perform.</p>  | <p>There are periodic formal valuations of pension schemes and contributions supported by continual monitoring of scheme investments and valuations. Performance of investment managers are reviewed regularly by the pension trustees.</p>  | <p>Continued improvements of member longevity will likely add to the liabilities of both the Scottish Hydro-Electric and Southern Electric Pension Schemes. Uncertainty of markets in Eurozone could detract from investment performance directly impacting scheme funding levels.</p>  |
| <p><b>Sector developments</b><br/>Failure to identify/tardiness in identifying step changes in the industry sectors and reacting appropriately.</p>  | <p>There is a strong external focus to ensure developments are anticipated and, where appropriate, addressed. Senior managers have responsibility for areas such as policy and research, strategy and business development. Participation in these areas is broad, to ensure all relevant sector developments are addressed.</p> | <p>2011/12 saw four significant developments which will influence the sector for the long term: electricity market reform; the Retail Market Review and the RIIO model for economic regulation in Great Britain; and the process of harmonisation affecting energy markets on the island of Ireland. SSE is actively involved in giving input to policy and regulatory developments in each of these areas.</p> |
| <p><b>Large capital projects management</b><br/>Failure to deliver quality projects on time and on budget.</p>   | <p>The deployment and updating of SSE's Large Capital Project Governance Framework is designed to ensure projects are governed, developed, approved and executed in an effective manner.</p>   | <p>During 2011/12, SSE reallocated responsibility for large capital projects, focusing on three key areas: renewable energy; thermal generation; and networks. The Management Board established a Major Projects (Standards and Delivery) Committee.</p>  |
| <p><b>Transformation projects management</b><br/>Failure to deliver quality projects on time and on budget to implement required upgrades to customer systems in relation to Smart Metering and the Energy Supply business requirements.</p> | <p>SSE works with experienced advisers and suppliers and implements a strong governance and assurance framework for all aspects of major change programmes. The approach increasingly reflects the governance framework originally developed for large capital projects.</p>   | <p>In the course of 2011/12, the remit of SSE's Project Services team was extended to include centralised expertise and support for all of SSE's significant projects, not just large capital projects. The new Management Board Major Projects (Standards and Delivery) Committee reviews all major projects.</p>  |

## Risk management *(continued)*

| Principal risks and their management   |   |   |
|--|---|---|
| Risk definition  | Key controls overview   | Developments during the year  |
| <p><b>Compliance management</b><br/>Any significant or multiple compliance failures could result in an adverse effect on SSE, including the possibility of financial penalties being levied.</p>   | <p>Wide-ranging consultation and review of all relevant regulatory, legal and accounting frameworks takes place. Regulation, Compliance and Group Audit teams develop and monitor compliance processes.</p>   | <p>During 2011/12 SSE was prosecuted in relation to the use of direct sales aids by doorstep sellers. SSE took the lead by being the first of the big six energy suppliers to stop doorstep selling activities in the UK, which is an example of the seriousness with which SSE regards compliance with all its obligations.</p>  |
| <p><b>Crisis management</b><br/>Inadequate response to a major emergency/contingency event. If something goes wrong, how well can SSE deal with it?</p>  | <p>The corporate crisis management policy and procedure are updated and issued annually. There is Executive training and regular test exercises are undertaken. A member of the Management Board 'champions' crisis management.</p>   | <p>In 2011/12, SSE refreshed its crisis management and emergency planning approach. Senior roles and responsibilities have been defined, facilities have been enhanced and Group-level exercises have been undertaken to practise SSE's response capabilities.</p>  |
| <p><b>Management of joint ventures</b><br/>Failure to effectively manage SSE Joint Venture assets results in reputational damage or destruction in value.</p>  | <p>Joint ventures are in themselves a means of managing risk, but SSE's interests in them also require careful management and oversight. This is provided through clear governance arrangements, senior manager representation on Boards, and effective reporting within SSE – to the Management Board and the Board as required.</p> | <p>SSE continues to enter into joint venture arrangements, particularly for large renewable generation projects. Joint ventures are particularly critical in the development and construction of wind farms offshore and during the year the new role of Head of JV Management was created within SSE's renewable energy division, to reinforce oversight and management of joint ventures.</p> |
| <p><b>Succession planning</b><br/>Not having cover for the Board and the Management Board and their direct reports.</p>  | <p>The Nomination Committee of the Board is responsible for reviewing the leadership needs of senior management in general and succession plans for the Executive Directors in particular. The detailed report for this Committee is on page 71.</p>  | <p>Colin Hood, Chief Operating Officer, stepped down from the Board in October 2011. His Board-level responsibilities were reallocated among existing Executive Directors and his operational responsibilities were divided between members of the Management Board. The handover and transition proved to be effective.</p>  |
| <p><b>Resource and internal infrastructure</b><br/>Inability to establish and maintain a competent workforce. Failure to forward plan and identify a capabilities matrix to match growth plans. Portfolio of assets (Buildings, transport and IT) not maintained and enhanced to support business plans.</p> | <p>An integrated Group Services function is in place to ensure optimum resource management, including Safety, HR, IT, Facilities Management and Procurement.</p>  | <p>In the course of 2011/12, SSE sought to strike the balance between cost efficiency and investment in adequate resources for the future. A particular focus was IT, where the new Director of IT led the implementation of plans to improve operational performance, service delivery and project delivery.</p>   |
| <p><b>Corporate arrogance or hubris</b><br/>Unwarranted belief in SSE's own abilities, failure to keep listening and to keep challenging conventional wisdom.</p>  | <p>There is Board oversight of this, and practical application throughout SSE, including through the performance appraisal system, of the 'SSE SET' of core values: Safety, Service, Efficiency, Sustainability, Excellence and Teamwork.</p>   | <p>External criticism of energy suppliers was substantial during 2011/12. In response, SSE developed its proposals to 'build trust' in energy supply – which explicitly accepted Ofgem's analysis that in an environment of higher prices, suppliers have to transform the way they deal with customers.</p>  |

## Nomination Committee



**Lord Smith of Kelvin**  
Nomination Committee Chairman

### Members and meetings

| Membership            | Attended/<br>scheduled |
|-----------------------|------------------------|
| Lord Smith of Kelvin  | 2/2                    |
| Thomas Thune Andersen | 2/2                    |
| Jeremy Beeton         | 2/2                    |
| Katie Bickerstaffe    | 2/2                    |
| Richard Gillingwater  | 2/2                    |
| Ian Marchant          | 2/2                    |
| René Médori           | 2/2                    |
| Lady Rice             | 2/2                    |

I chair the Nomination Committee. The membership also includes all of the non-Executive Directors and the Chief Executive.

As Company Chairman, I would not chair the meeting if it was dealing with any matter concerning the chairmanship of the Board. In this case the meeting would be chaired by a non-Executive Director elected by the remaining members. Members of the Committee do not take part in discussions when their own performance or when their continued appointment is being considered.

The Company Secretary is Secretary to the Nomination Committee.

### Role

The Nomination Committee's role is to review the leadership needs of the Board and senior management, with a view to ensuring SSE's continued ability to compete effectively in the marketplace. The Nomination Committee's remit, which is set out in its terms of reference, includes responsibility for:

- reviewing the structure, size and composition of the Board and its Committees and making recommendations to the Board on any desired changes;
- reviewing the succession plans for the Executive Directors;
- making recommendations to the Board on suitable candidates to fill vacancies for both non-Executive and Executive Directors;
- ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit and against objective criteria;
- reviewing potential conflicts of interest of Directors; and
- reviewing the external commitments of the Directors and the time required to discharge their responsibilities effectively.

Before a Board appointment is made, the Committee evaluates the skills, knowledge and experience of the Board to ensure that any new appointment complements these qualities.

Candidates from a wide range of backgrounds are considered and appointments are made on merit, with due regard for the benefits of diversity on the Board, including gender. The selection process generally involves interviews with a number of candidates, using the services of a professional search firm specialising in Board level recruitment.

The Committee also reviews succession planning and leadership needs in the course of its work taking into account the risks and opportunities facing the Company, and from this identifies the skills and expertise required from the Board and senior management team.

### Activities in 2011/12

The Nomination Committee had two meetings during the year. The business covered at the meetings included the following:

- a full review of Committee chairmanship and membership following the appointment of Katie Bickerstaffe and Jeremy Beeton to the Board;
- consideration of proposals for management succession on the retirement of Colin Hood as Chief Operating Officer;
- the review and re-appointment of certain non-Executive Directors for further fixed periods and review of the position of Senior Independent Director;
- consideration of the Company's approach and response to the Davies Review on Women on Boards; and
- the annual review of the Directors' Conflicts of Interests declaration.

As part of the Board evaluation process, the operation of the Nomination Committee was evaluated and it was confirmed that the Committee was operating effectively.

**Lord Smith of Kelvin**  
Chairman



## Audit Committee



**René Médori**  
Audit Committee Chairman

### Members and meetings

| Membership            | Attended/<br>scheduled |
|-----------------------|------------------------|
| René Médori           | 3/3                    |
| Thomas Thune Andersen | 3/3                    |
| Jeremy Beeton         | 2/2                    |
| Richard Gillingwater  | 3/3                    |

I was pleased to welcome Jeremy Beeton as a member of the Audit Committee when he joined the Board on 1 July 2011. After nine years on the Board, including eight years as Chairman of the Audit Committee, I will step down as non-Executive Director on 25 June 2012. Richard Gillingwater will become Chairman of the Audit Committee on that date. Richard Gillingwater and I are identified as having recent and relevant financial experience.

The Board confirms that each member of the Committee is independent and that the membership meets the requirements of the Code.

The Finance Director, Head of Group Internal Audit and the external Auditors attend and report at Audit Committee meetings. The Company Chairman and the Generation and Supply Director also regularly attend Audit Committee meetings. Senior management including the Group Treasurer, Group Financial Controller and Managing Director, Energy Portfolio Management, may also be invited to present reports. During the year, the Committee met privately with the external Auditors, and separately with the Head of Group Internal Audit.

The Assistant Company Secretary is Secretary to the Audit Committee.

The Committee has unrestricted access to Company documents and information as well as to management and the external Auditors. As Audit Committee Chairman, I report the outcome of Committee meetings to the Board.

### Role

The Audit Committee assists the Board in the effective discharge of its responsibilities for financial reporting and internal control, together with the procedures for the identification, assessment and reporting of risks. The Audit Committee's remit, which is set out in its terms of reference, includes responsibility for:

- reviewing the Company's financial reports and formal announcements to ensure they represent an accurate, clear and balanced

assessment of the Company's position and prospects;

- monitoring and reviewing the effectiveness of the Company's accounting systems, internal control policies and procedures and risk management systems;
- monitoring and reviewing the effectiveness of the Company's internal audit function;
- monitoring and reviewing the objectivity and independence of the external Auditors taking into consideration the scope of their work and fees paid for both audit and non-audit services;
- monitoring and reviewing the significant risks identified by each business unit as well as the mitigating action against those risks;
- monitoring and reviewing the arrangements by which employees can in confidence raise concerns about any possible improprieties in financial and other matters; and
- reviewing the significant financial reporting issues and judgements.

### Activities in 2011/12

The Audit Committee had three meetings in the year. The key activities of the Audit Committee during the year are set out below:

#### Financial statements

- reviewed the financial statements in the 2011 Annual Report and accounts and the interim results. As part of this review the Committee received from the external Auditors a report on their audit of the Annual Report and accounts and their review of the interim results;
- reviewed the impairment of assets and related accounting matters;
- reviewed the annual and interim results announcements; and
- reviewed the reportable segments to be included in the financial statements of the 2012 Annual Report and accounts.

#### Control environment and risk management

- received six-monthly reports by Group Internal Audit setting out the audit programme, its progress against the programme, the results of key audits and other significant findings, the adequacy of management's response and the timeliness of resolution of actions;
- reviewed and agreed the Group Internal Audit Plan for the year ending 31 March 2013;
- received six-monthly reports from Energy Trading and Treasury setting out strategy, market developments, any significant risks and the controls in place to mitigate these risks;
- received six-monthly reviews from Group Internal Audit on the Internal Control Risk

Assessment setting out the Group Risk Map and Residual Risk Map;

- reviewed aged debts and bad debts;
- reviewed Post-Investment Appraisal Reports; and
- received reports under the Group whistleblowing policy and reviewed the implementation of this policy.

#### External audit process

- reviewed the effectiveness of the overall audit process for 2010/11, meeting with the external Auditors and management separately to identify any areas of concern in the preparation of the financial statements;
- reviewed independence and objectivity and agreed the terms of appointment, areas of responsibility, associated duties and scope of the audit as set out in the engagement letter for the forthcoming year;
- reviewed and agreed the audit fees, fees for non-recurring work and the regulatory reporting fee;
- reviewed internal control and key accounting and audit issues; and
- reviewed recommendations made by the external Auditors and the adequacy of management's response.

#### Independence of Auditors

- reviewed changes in the Audit team; and
- reviewed the extent of non-audit services provided by the Auditors in accordance with the established policy where:
  - a competitive tender process is required where non-audit fees exceed a threshold of £30,000 for general advice and £75,000 for tax-related advice;
  - the Committee must be satisfied that the work was best handled by the external Auditors because of their knowledge of the Group; and
  - the Committee must be satisfied that the objectivity and independence of the external Auditors was not affected by the work.

The Audit Committee continued to monitor the level of non-audit work undertaken by the Auditors. The non-audit work awarded during the year included:

- taxation advice including general consultancy, acquisitions and disposals; and
- accounting due diligence.

Full disclosure of the audit and non-audit fees paid during the year is made in note 4 to the Financial Statements.

Following a competitive tender, KPMG Audit Plc has been the external auditor of the

enlarged Group since 1999. Under its terms of reference, the Audit Committee has responsibility for recommending to the Board the appointment, re-appointment and removal of the external Auditors. The Audit Committee considers that the relationship with the Auditors is working well and remains satisfied with their effectiveness. Accordingly, it has not considered it necessary to require the firm to tender for the audit work. There are no contractual obligations restricting the Company's choice of external auditor. The external Auditors are required to rotate the audit partners responsible for the Group audit every five years and the current lead partner has been in place for three years.

Upon the recommendation of the Audit Committee and approval of the Board, resolutions to re-appoint KPMG Audit Plc as Auditors, and to authorise the Directors to fix their remuneration, will be proposed at the forthcoming AGM.

As part of the Board evaluation process, the operation of the Audit Committee was evaluated, and it was confirmed that the Committee was operating effectively.

**René Médori**  
Chairman

## Safety, Health and Environment Advisory Committee



**Thomas Thune Andersen**  
Safety, Health and Environment  
Advisory Committee Chairman

### Members and meetings

| Membership                    | Attended/<br>scheduled |
|-------------------------------|------------------------|
| Thomas Thune Andersen         | 3/3                    |
| Jeremy Beeton                 | 2/2                    |
| Colin Hood (retired 31/10/11) | 1/1                    |

I was very pleased to be given the opportunity to succeed Colin Hood as Chairman of the Committee. Colin gave SSE many years of outstanding leadership in all aspects of safety, health and the environment.

The membership also comprises the Managing Director, Group Services; the Managing Director, Generation; and the Group Safety, Health and Environment Manager. The Chief Executive also attends when required.

The Assistant Company Secretary is Secretary to the Committee.

The Committee had three meetings during the year. Its remit includes responsibility for:

- ensuring that SSE's health and safety policy and environment policy statements are adhered to;
- setting safety, health and environmental (SHE) targets for improved performance;
- monitoring SHE performance in SSE;
- encouraging greater awareness throughout SSE of the importance of SHE management and higher achievement in SHE performance; and
- providing a link between the non-Executive Directors of the Board, the Management Board and other members of the management team with responsibility for SHE management.

### Policy

People in SSE have many different working environments – from full-scale industrial processes to offices – but the Committee is clear that the Company's policy statements mean everyone must play a part in achieving safe working conditions. SSE's Safety

Management System focuses on five 'Ps':

- **Policy:** defining how things get done;
- **People:** helping employees to act safely;
- **Processes:** managing risks and delivering safe systems of work;
- **Plant:** maintaining the integrity of plant and equipment; and
- **Performance:** managing and improving SHE performance.

### Safety performance

The Committee monitored carefully SSE's safety performance during 2011/12. The results in key areas were as follows (previous year's performance in brackets):

- the Lost Time/Reportable Injury Rate was 0.02 (0.04);
- the Total Recordable Injury Rate (TRIR), covering lost-time, reportable and medical treatment injuries, was 0.11 per 100,000 hours worked (0.12);
- the total number of working days lost as a result of injuries was 53 (171); and
- the number of dangerous or potentially dangerous road traffic accidents involving SSE employees driving Company vehicles was 0.23 per 100 vehicles (0.31).

By many companies' standards, this was a strong safety performance. During the year, however, the Committee endorsed the new goal adopted by SSE: work without anyone getting injured. Until this goal is achieved, the Committee, and SSE as a whole, will not be satisfied. For this reason the Committee places particular emphasis on the successful delivery of SSE's behavioural safety programme, The Safety Family, in which every employee will take part.

### Contractors' safety performance

The safety of contractors working on SSE projects and sites is fundamentally the responsibility of their employers, but is an increasingly significant issue for SSE. The Committee believes SSE must work closely with its contractors in increasing their safety standards. For this group, the TRIR was 0.56 per 100,000 hours worked, compared with 0.36 in the previous year.

Amongst the safety-related issues on which SSE is working with contractors, the construction and operation of wind farms offshore is particularly important because they present new challenges and risks. Along with other leading developers of renewable energy, SSE has established the G9 Offshore Wind Health and Safety Association, which aims to deliver world-class safety performance in offshore wind activities.

### Health promotion

SSE's Health and Well-being Action Plan provides the basis for workplace health programmes and initiatives, all designed to help employees be in good shape for work. SSE's policy is to deal with all sickness absence in a sympathetic and constructive way, helping people make a speedy return to health and to work. During 2011/12, the average number of days of absence from work was 5.87, compared with 5.38 in the previous year.

### Environmental management

SSE's main environmental impact is generally regarded as emissions of CO<sub>2</sub> from electricity generation. Many of the Company's day-to-day operations take place in environmentally sensitive areas. The priority is to make sure that the five 'Ps' apply to environmental management and that negative impacts such as pollution to the local environment are prevented.

The key target in any single year is to ensure there are no environmental incidents which result in SSE receiving an enforcement notice from an environment regulator. There were no such incidents during 2011/12.

Good environmental stewardship involves on-site energy efficiency and management of waste. A key goal is to minimise waste and unnecessary use of natural resources by re-using and recycling materials. During 2011/12, 13,214 tonnes of waste were sent from SSE's networks and offices for disposal at landfill sites, compared with 20,821 tonnes in the previous year.

### Priorities for 2012/13

The Committee's priorities are to:

- support progress towards SSE's ultimate goal of working without anyone getting injured;
- promote the health and well-being of people working for SSE; and
- encourage effective environmental management throughout SSE.

The progress towards working without anyone getting injured will be supported by four specific initiatives:

- all employees' safety-related behaviours;
- safe working offshore;
- safe working by contractors; and
- management of 'leading' safety indicators.

**Thomas Thune Andersen**  
Chairman

## Remuneration Report Introduction



**Lady Rice CBE**  
Remuneration Committee Chairman

In last year's report, I noted that executive remuneration was 'a high profile issue, and rightly so'. A year on, the profile of the issue has become even higher. Business has seen renewed investor activism. But activism should start within a business itself. And while investors mainly look back as they judge remuneration, a business can and should look ahead as well.

In January 2012, the UK Secretary of State for Business told the House of Commons that a 'major transformation' needs to get under way, as he set out a series of remuneration reforms. SSE endorses in principle what the reforms are trying to achieve. In particular, what Executive Directors earn needs to be clear and easily understood and should help shareholders to hold companies to account for their performance. But we need to consider as well what counts as performance; the traditional focus on short-term results alone simply isn't good enough. Reward should also reflect longer-term aspects of the business – both repercussions of decisions in the past and expectations for the future. And it should respond to the external economic environment, especially at times of constraint.

### Transparency

SSE sets great store by transparency in remuneration reporting; its overall approach is straightforward. What Executive Directors earn is made up of: base salary, plus some benefits-in-kind; cash and shares awarded under an annual incentive scheme; and a long-term incentive scheme, also with shares. Three of the elements are performance-related and two of the elements can only be earned through continued service, to help encourage Executive Directors to remain with the Company. The focus on performance is also being emphasised by the introduction of a mechanism to 'claw back' share awards if the need arises. Retention and ongoing service is further recognised through the pension arrangements in place for the Executive Directors, which reward ongoing tenure of service.

To assess performance, targets are set each year that are clear, robust and objective. At the same time, there has to be a realistic appraisal of performance in the context of the wider economic and energy environment. Unexpected situations or issues can arise that take priority and test the skills and resilience of the Executive Directors and other members of the management team, and these should be taken account of as well.

### Judgement

The Executive Directors at SSE are clearly well-paid, relative to the average employee, but a key feature of our remuneration policy is to make sure they are fairly rewarded and not overpaid. While the actual position may vary from one year to the next, the goal is to keep reward below market median for FTSE 20-50 companies (excluding financial services) and below median against other benchmarks such as FTSE 100, industrial companies and direct competitors. At the same time, it is designed to reflect the responsibility and contribution of the individual and to make sure that SSE is able to retain people of the necessary calibre.

In terms of contribution, SSE's Executive Directors have each worked for the Group for at least 15 years and given a total of over 30 years' service to the Board. This is a sustained, long-term commitment and their contribution has helped SSE to deliver an above-inflation increase in the dividend every year since it was formed in 1998. Very few companies in the UK can say that.

Much of the debate on executive remuneration centres on what is perceived as reward for failure. Equally, success must be genuine and sustained or it isn't really success. SSE's achievement in fulfilling, year after year, its first financial responsibility to shareholders – dividend growth – is a success to which the Executive Directors, individually and collectively, have contributed enormously year after year.

### Fairness

The responsibilities of the Executive Directors are extensive, and growing. They lead an organisation which operates major assets such as power stations and electricity lines and which looks after millions of customers' energy needs. The standards which are expected in asset operation, as in customer service, are rightly increasing. Providing the necessary leadership, and living with the associated responsibility, requires fair remuneration.

Fairness works both ways, however. When things go wrong, a company's remuneration

policy has to be able to respond. SSE should never have found itself in the position it did in relation to doorstep selling activities. It's for this reason that the Remuneration Committee agreed that the Executive Directors should forego the Corporate Performance element of the Annual Incentive Scheme, despite the fact that an award could have been made on the basis of the targets set at the start of the financial year.

### Teamwork

While reward must reflect the responsibility and contribution of the individual, for us teamwork is one of the essential elements on which individuals are rewarded.

Teamwork must also extend beyond the Executive Directors, to the other employees of the organisation. Restraint in remuneration contributes to that culture of teamwork by ensuring that Executive Directors and other senior managers do not become remote or detached from the people they are leading.

Similarly, effective remuneration for Executive Directors can only be a sound investment if that investment extends to other people. One of the important issues that the debate on executive remuneration has raised is the link between reward at the top of organisations and elsewhere in those organisations. SSE continues to make that link when assessing the position for Executive Directors.

Fundamentally, SSE's remuneration policy remained unchanged in 2011/12 and no major changes are planned in 2012/13. We believe it is important that there is stability in remuneration policy to ensure that criticisms of complexity, opaqueness and lack of transparency cannot be levelled against SSE. The Remuneration Committee continues to stay close to the concerns of shareholders and other stakeholders, and we continue to welcome shareholder feedback on any issue related to executive remuneration.

Straightforward, performance-related, retention-focused, and below median – these are the characteristics of SSE's remuneration policy, looking back and looking ahead. Responsibility, commitment and leadership – these are the characteristics expected of SSE's Executive Directors. In presenting this remuneration report to shareholders, I believe that these characteristics have all been demonstrated.

**Lady Rice CBE**  
Chairman



## Remuneration Report (continued)

### Introduction

#### Role of the Remuneration Committee

##### Governance

The Remuneration Committee's composition, responsibilities and operation complied with Section D of the UK Corporate Governance Code other than in respect of the membership of the Committee for the period from 1 April 2011 until the appointment of Katie Bickerstaffe to the Committee on joining the Board on 1 July 2011. This is fully explained on page 61 of the Corporate Governance Report. In forming remuneration policy, the Committee has given full consideration to the best practice provisions set out in the Code. This report sets out the Company's policy on Executive Directors' remuneration for the year ended 31 March 2012 and complies with the regulations made under the Companies Act 2006. The report will be presented at the AGM on 26 July 2012 for approval and shareholders will be able to ask questions on the report at the AGM.

#### Members and meetings

| Membership                     | Attended/<br>scheduled |
|--------------------------------|------------------------|
| Lady Rice (Committee Chairman) | 5/5                    |
| Richard Gillingwater           | 5/5                    |
| Lord Smith of Kelvin           | 5/5                    |
| Katie Bickerstaffe             | 4/4                    |

The membership of the Committee comprises three independent non-Executive Directors plus the Chairman of SSE. They represent diverse backgrounds and experience. This is designed to provide balance and diversity within the Committee. Informal consultation among the Committee members, and also with other non-Executive Directors, takes place outside the scheduled meetings as necessary.

#### Terms of Reference of the Committee

- sets the Total Remuneration Policy on behalf of the Board;
- approves the detailed remuneration terms of the Executive Directors including their service contract and the impact on senior management remuneration;
- approves the remuneration of the Chairman, however the Chairman is not present for discussions on his own remuneration;
- approves the design and performance targets of incentive schemes;
- grants awards under the Company's Long-term Incentive Plan to all senior managers; and
- reviews the total remuneration of the Management Board and other senior executives below Board level.

#### Advisors

- the Chief Executive, the Director of Human Resources, and SSE's Head of Reward, advised the Committee on matters relating to the appropriateness of awards for the Executive Directors and senior executives although they were not present for any discussions on their own remuneration;
- the Director of Human Resources and SSE's Head of Reward advised on HR strategy and the application of policies across the organisation;
- Deloitte LLP provided a range of advice to the Committee which included market information drawn from published surveys, governance developments and their application to the Company, advice on the appropriate structure of short-term incentives, long-term incentives, and comparator group pay and performance. Deloitte LLP received fees of £70,000 in relation to their work for the Committee. They were appointed by the Committee and also provide ad hoc tax advice to SSE plc; and
- Bank of America Merrill Lynch provided advice on shareholder views. They were

appointed by the Committee for these services. They did not receive any fees relating specifically to these services, and they are retained as SSE's brokers.

#### Stakeholder engagement and consultation

As referred to in last year's Remuneration Report, Lady Rice, on behalf of the Committee, undertook a consultation with a number of institutional shareholders in June 2011 regarding the likely non vesting of the 2009-12 Performance Share Plan, and sought their views on potential changes to the performance criteria of current awards which had not yet vested. The outcome of the consultation was considered, and the Committee decided that there should be no alteration to the performance targets.

The Committee also took the opportunity to respond to the Department for Business, Innovation and Skills (BIS) Executive Remuneration consultation in November 2011. The Committee was supportive of a number of the proposals set out in the consultation, and Lady Rice has since participated in discussions with BIS. The Committee also responded to the follow-up 2012 BIS Consultation Document.

#### Employee representatives

The Director of Human Resources provided an update to all SSE-recognised trade unions in March 2012 explaining the Company's position on Executive remuneration. This covered many of the policy positions covered in this report and its view on current items such as the recent BIS proposals. Pay awards for senior executives take into account the general environment and the approach to employee pay. For example, this year, the Chief Executive received a percentage increase award equal to the Company-wide pay review. It is the Company's intention to continue to liaise with employee representative bodies in the future.

#### Remuneration agenda 2011/12

|                  | Regular items   | Other items  |
|------------------|---|--|
| <b>May</b>       | Directors' Remuneration Report. Approval of Performance Share Targets and 2011 Grants. Approval of Vesting Awards. 2011 annual incentive out-turn approval.   |  |
| <b>July</b>      |   | Performance Share Plan – shareholder consultation feedback.  |
| <b>September</b> |   | Colin Hood retiral, remuneration approvals. Review of Total Remuneration arrangements for Executive Directors.                         |
| <b>November</b>  | External governance environment update.   | Review of base salary for Alistair Phillips-Davies and Gregor Alexander following allocation of extra responsibilities.                |
| <b>March</b>     | Review of Chief Executive's salary and Chairman's fee. Establishment of the 2012/13 annual incentive Performance targets. Performance Share Plan Forecast Results. Approval of 2012/13 PSP targets. | Review of BIS executive remuneration consultation exercise and proposals. Introduction of 'claw back' arrangements on incentive plans. |

## Remuneration Report (continued)

### Remuneration in 2011/12

#### At a glance

##### How has this Remuneration Report been put together?

In January 2012 the UK government recommended that remuneration reports should comprise two sections: one setting out how remuneration policy has been implemented in the previous year (for SSE, 2011/12); and one setting out future policy for Executive remuneration. With sections on Remuneration in 2011/12 (pages 75 to 79) and on Remuneration for 2012/13 and beyond (pages 80 to 83), this Report follows that structure.

##### What are the principles of the SSE Executive Remuneration Policy?

- attract and retain Executive Directors who run the Company effectively for the benefit of shareholders, customers and employees;
- adopt a competitive and straightforward approach to total remuneration, which meets shareholder expectation;
- reinforce the culture and teamwork to deliver the long-term growth and sustainability of the business; and
- set Total Remuneration Policy at levels which promote the long-term development of the business and reward individuals in line with performance.

##### What was new in 2011/12?

Colin Hood (Chief Operating Officer) retired from the Company in October 2011. The Remuneration Committee confirmed the remuneration terms on exit which provided exactly what he was due under either his contract of employment or through the rules of the relevant incentive plans.

Colin Hood's existing responsibilities were shared between Gregor Alexander, Alistair Phillips-Davies, and selected Management Board members. With the new responsibilities in mind, Alistair Phillips-Davies and Gregor Alexander's remuneration arrangements were reviewed, resulting in both receiving an increase in basic pay of 10% with effect from 1 November 2011. There was no increase in salaries for the Executive Directors in 2010/11. No other terms were adjusted and their next formal pay review will be in April 2013. The cost of Colin Hood's retiral, including the pay enhancements to those taking on more responsibilities as a result, will be absorbed within a period of less than one year.

BIS launched a consultation exercise to improve both the reporting and governance arrangements in Executive remuneration. The Committee participated in the consultation exercise putting forward SSE's views. At the

March 2012 meeting the Committee agreed to adopt a number of the proposals at an early stage rather than wait until they become a formal requirement in 2013.

During the last year the Committee discussed the need to put in place a 'claw back' arrangement in both the main incentive plans from 2012 grants onwards. This would allow the Committee potentially to reduce payouts under these arrangements should there be any events such as material mis-statement of accounts, gross misconduct, or something which causes significant reputational damage to the Company.

##### What issues did the Remuneration Committee take account of in making its decisions?

The Remuneration Committee Chairman's Introduction on page 75 and the table on page 79 summarise the issues that the Committee took account of in making its

decisions for 2011/12. They included positive aspects of performance, including effective teamworking, achievement of important personal objectives and another increase in adjusted profit before tax\*. They also reflect the decision to adjust payments under the Annual Incentive Scheme to reflect the difficulties in which SSE found itself in relating to the use of sales aids in doorstep selling.

##### How has SSE presented one single figure for total remuneration for each Executive Director?

At SSE, what Executive Directors earn is made up of:

- base salary;
- benefits-in-kind;
- cash awarded under the Annual Incentive Scheme;
- shares awarded under the Annual Incentive Scheme and secured through continued employment; and

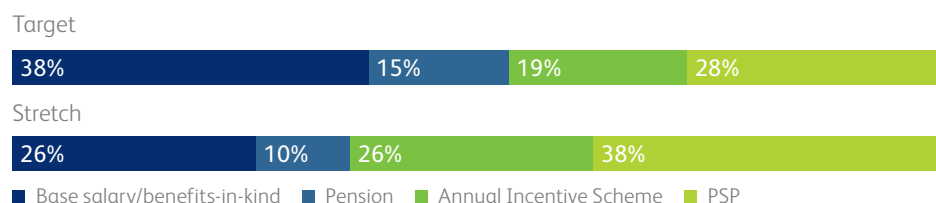
##### What is SSE's Total Executive Remuneration Policy?

###### Summary of remuneration policy

| Fixed remuneration   | Variable remuneration  |   |
|--|--|---|
| Base salary  | <b>Short-term – annual</b><br>Annual Incentive Scheme – 75% maximum cash and 25% deferred shares<br>Linked to individual and team performance, corporate, financial and operational measures | <b>Long-term – three years</b><br>Performance Share Plan (PSP) – 3 years<br>25% linked to relative FTSE 100 TSR, 25% MSCI Eur. Utilities TSR, 25% dividend growth, 25% adjusted annual EPS growth |
| Pension – final salary                                     |  |   |
| Benefits-in-kind – car, private medical                    |  |   |
| Minimum shareholding requirement equal to 100% base salary |  |   |

##### How is the remuneration package structured?

###### Total Remuneration Policy (% each component element)



- Base salary includes 1% to cover benefits-in-kind, namely a car allowance and private medical plan.
- The pension element is the average of the present value of providing a single year of pension for the Executive Directors.
- Target performance comprises annual incentive scheme awarded at target level (ie 50% of base salary) and, for the Performance Share Plan, an assumption that 50% of shares under award will vest.
- Stretch performance is based on an annual incentive of 100% of base salary with exceptional targets being met and the Performance Share Plan is calculated based on the maximum grant at 150% salary which gives a range between 47%-64% in variable pay to recognise exceptional performance.

## Remuneration Report (continued)

### Remuneration in 2011/12

→ shares awarded under the Performance Share Plan, secured through continued employment and attaining performance criteria.

The calculation of what Executive Directors earned in 2011/12 is made up of salary, benefits-in-kind, cash awarded under the Annual Incentive Scheme for 2011/12 and shares awarded under the Annual Incentive Scheme and Performance Share Plan in 2008/09, but earned in 2011/12 as a result of continued employment (and, in the case of the Performance Share Plan, through performance over the three years against the criteria for awards).

The table opposite sets out what each Executive Director earned in 2011/12 on this basis.

#### What is the position with regard to members of the Management Board?

In addition to the three Executive Directors, SSE has seven Managing Directors who are also members of the Management Board, the role of which is summarised on page 58. On the same basis as that used for determining Executive Directors' earnings in 2011/12, the total earnings of the seven Managing Directors in 2011/12 was £2,313,000.

#### How does Executive Directors' remuneration compare with other financial dispersals?

The UK government has said that, to provide context, companies should outline how remuneration for Executive Directors compares with other dispersals such as dividends, capital and investment expenditure, taxation and general staffing costs.

SSE has set out the position for each of these areas in the table opposite. It shows that for every £1 spent on Executive Directors' earnings by SSE in 2011/12, £122 was paid in tax, £192 was spent on employee costs, £220 was made in dividend payments to shareholders and £524 was spent on capital and investment expenditure.

SSE's contribution to government revenues in the UK is also included in the table, and the overall position on taxation is set out on page 23. It is important to note that:

- Executive Directors' earnings as described in this report are subject to taxation in the UK; and
- in line with the countries in which it has substantial commercial operations, SSE is liable for taxation in the UK and Ireland only and does not use so-called 'tax havens' to avoid paying tax.

#### What did the Executive Directors earn during the year ending 31 March 2012?

|                          | Base salary<br>£000s | Benefits<br>£000s | Cash incentive<br>£000s | Subtotal<br>£000s | DBP vesting value<br>£000s | PSP vesting value<br>£000s | Total (2012)<br>£000s | Total (2011)<br>£000s |
|--------------------------|----------------------|-------------------|-------------------------|-------------------|----------------------------|----------------------------|-----------------------|-----------------------|
| Ian Marchant             | 840                  | 19                | 158                     | <b>1,017</b>      | 170                        | –                          | <b>1,187</b>          | 1,382                 |
| Colin Hood               | 377                  | 10                | 94                      | <b>481</b>        | 125                        | –                          | <b>606</b>            | 1,059                 |
| Gregor Alexander         | 516                  | 16                | 123                     | <b>655</b>        | 98                         | –                          | <b>753</b>            | 816                   |
| Alistair Phillips-Davies | 516                  | 16                | 102                     | <b>634</b>        | 98                         | –                          | <b>732</b>            | 815                   |
| Total remuneration       | 2,249                | 61                | 477                     | <b>2,787</b>      | 491                        | –                          | <b>3,278</b>          | 4,072                 |

Note: The shares earned under the DBP were awarded in respect of performance in the year to 31 March 2009 but were subject to continued employment with SSE until at least 31 March 2012, excluding Colin Hood who retired on 31 October 2011 and received these shares on his retirement. The value is based on the shares disclosed in table D and, in addition, dividend shares as follows: Ian Marchant – 2,076 shares, Gregor Alexander and Alistair Phillips-Davies – 1,192 shares, and Colin Hood – 1,385 shares. The shares earned under the PSP were granted in 2009 but were subject to continued employment with SSE until at least 31 March 2012 and to SSE's performance over the three years to that date in respect of Total Shareholder Return and Adjusted Earnings Per Share\*. The valuation of the shares of both schemes is based on the closing price of 1,329p as at 31 March 2012. They will vest in June 2012. The cash payment under the Annual Incentive Scheme will be made in June 2012.

In addition, the Directors also participated in pension arrangements during the year to 31 March 2012 and accrued additional benefits under these arrangements. More information is given in table B on page 84.

Colin Hood's salary reflects earnings up to his leaving date of 31 October 2011 and his DBP vesting value reflects the vesting of the 2009 award. Alistair Phillips-Davies' and Gregor Alexander's salary reflects an increase in basic salary from £495,000 to £544,500 from 1 November 2011.

#### How do the earnings of the Executive Directors compare with other financial dispersals?

|  | 2008<br>£m | 2009<br>£m | 2010<br>£m | 2011<br>£m | 2012<br>£m     |
|--|------------|------------|------------|------------|----------------|
| Executive Directors' earnings <sup>1</sup>             | 5.1        | 7.0        | 4.5        | 4.1        | <b>3.3</b>     |
| Dividend payments to shareholders                      | 502.8      | 551.9      | 618.5      | 659.8      | <b>716.9</b>   |
| Capital and investment expenditure                     | 810.3      | 1,279.8    | 1,315.2    | 1,443.7    | <b>1,706.9</b> |
| Contribution to government revenues in UK <sup>2</sup> | 413.6      | 402.0      | 460.7      | 343.8      | <b>396.4</b>   |
| Staffing costs <sup>3</sup>                            | 438.8      | 537.4      | 585.3      | 615.2      | <b>624.9</b>   |

1. On same basis as 'What did the Executive Directors earn?' table.

2. Includes Corporation Tax, Employer's National Insurance Contributions and Business Rates.

3. Wages and salaries and share-based remuneration for all staff, as per note 6(i) of the accounts, excluding Executive Directors.

The Executive earnings show a reduction despite strong business performance for two main reasons:

- a reduction in the number of Executive Directors during 2011/12 from four to three; and
- the fact that despite strong underlying performance the long-term incentive plan did not pay out in 2010/11 or 2011/12 although it should pay out in future years if performance criteria are met.

#### Remuneration glossary of terms

**STI** – Short Term Incentive  
**LTI** – Long Term Incentive  
**PSP** – Performance Share Plan  
**BIK** – Benefits-in-Kind  
**MSCI** – Morgan Stanley Capital Index  
**TSR** – Total Shareholder Return  
**EPS** – Earnings Per Share  
**DBP** – Deferred Annual Incentive Scheme

#### Executive Directors' earnings compared with dividend payments



## Remuneration and performance

### Executive Directors' salary and incentive plans 2011/12

| Performance measure  | Purpose – link to strategy   | Policy and decisions   |
|--|--|--|
| <b>Base salary</b>   |  |  |
|  | Reflects market data, role, business and individual performance measured against SSE's strategy as set out on pages 1 to 53.   | Following an increase in responsibilities the Finance Director and the Generation and Supply Director received a one-off increase of 10%. Following the annual review in March 2012 the salary for the Chief Executive was increased by 3.5%, the first increase since January 2009.   |
| <b>Annual Incentive Scheme</b>   |  |  |
| <p>The Annual Incentive Scheme is determined by the Remuneration Committee's assessment of the performance during the year, based on the three key areas below: corporate performance; teamwork; and achievement of objectives.</p> <p><b>Corporate performance (60%)</b><br/>Group corporate performance is measured by adjusted profit before tax*, which reflects the underlying profits of SSE's business and the basis on which it is managed.</p> <p><b>Teamwork (20%)</b><br/>Teamwork is measured by performance against the 'SSE SET' of core values: Safety; Service; Efficiency; Sustainability; Excellence; and Teamwork. Performance against these values is assessed through SSE's performance management process.</p> <p><b>Personal objectives (20%)</b><br/>SSE believes personal objectives should form a part of the Annual Incentive Scheme. In keeping with its Teamwork value, SSE seeks to avoid potentially conflicting personal objectives. Focusing on operations and the investment programme, they are designed to support achievement of SSE's strategy and reinforce its values.</p> | <p>The performance targets are clearly linked to SSE's strategy, which is to deliver sustained real growth in the dividend through the efficient operation of, and investment in, a balanced range of energy businesses.</p> <p><b>Corporate performance (60%)</b><br/>Sustained real dividend growth can only be delivered if it is supported by an adequate level of adjusted profit before tax*. At the same time, the long-term nature of SSE's dividend commitments means that adjusted profit before tax* has to be earned in a way that is responsible and durable.</p> <p><b>Teamwork (20%)</b><br/>SSE believes it will only be successful financially if it exercises a wider corporate responsibility to others, such as customers and employees, on whom its success ultimately depends. Its core values summarise this approach.</p> <p><b>Personal objectives (20%)</b><br/>Personal objectives set during the year covered areas such as performance in respect of safety, customer service and delivery of new sources for generating electricity from renewable sources. Success in each of these areas is central to SSE's emphasis on efficient operations and investment to support dividend growth.</p> | <p><b>Range of 25%-30% awarded</b></p> <p>Maximum award of up to 100% of base salary: 75% in cash (non-pensionable); 25% compulsorily deferred into shares which only vest, subject to continued service, after three years. There is no share matching award in place.</p> <p><b>Corporate performance (max 60%)</b><br/>During 2011/12, SSE delivered a 2% increase in adjusted profit before tax*, which would have resulted in a payment under this element. It was, however, decided that there should be no payment in view of the situation in respect of SSE's doorstep selling activities.</p> <p><b>Teamwork (max 20%)</b><br/><b>Safety:</b> Total Recordable Injury Rate and working days lost through injury lowest ever. <b>Service:</b> Leading position among the major energy suppliers. <b>Efficiency:</b> Lowest-ever customer minutes lost in Southern distribution network. <b>Sustainability:</b> Renewable generation capacity up. <b>Excellence:</b> Culture of innovation reinforced around £70m of benefit from Licence to Innovate Scheme. <b>Teamwork:</b> Employee engagement score above average and upper quartile for first-time company. All of this resulted in an above-target payment of 75% of the maximum.</p> <p><b>Personal objectives (max 20%)</b><br/>Overall, the Remuneration Committee concluded that progress was made in areas such as safety, customer service and renewable energy during 2011/12 and that individually and collectively the Executive Directors delivered strong performance during the year – resulting in payment in the range of 50%-75% of maximum.</p> |
| <b>Performance Share Plan 2009-2012</b>  |  |  |
| <p>For awards granted in 2009 performance is measured against the following two elements over a three-year period.</p> <p><b>Total Shareholder Return (TSR)</b></p> <ul style="list-style-type: none"> <li>→ 100% vests at or above 75th percentile</li> <li>→ 25% vests at median</li> <li>→ straight-line basis between median and 75th percentile</li> <li>→ no vesting of award if median performance not achieved</li> </ul> <p><b>Adjusted Earnings per Share* (EPS)</b></p> <ul style="list-style-type: none"> <li>→ 100% vests where EPS is 9% RPI</li> <li>→ 25% vests where EPS is 3% above RPI</li> <li>→ straight-line basis between 3% and 9% above RPI</li> <li>→ no vesting if EPS minimum growth of RPI +3% is not achieved</li> </ul>   | <p>The two elements of TSR and EPS reflect relative and absolute measures of performance.</p> <p>The relative TSR measure is dependent on SSE's relative long-term share price performance and dividend return. It is therefore directly linked to the strategic objective of sustained real dividend growth.</p> <p>Adjusted EPS* is used to monitor SSE's performance over the medium term because it is straightforward: it defines the amount of profit after tax that has been earned for each Ordinary Share. Profit is required to support the payment of, and increases in, the dividend.</p>  | <p><b>0% awarded</b></p> <p>Maximum award of 150% of base salary each year. Awards are released to the extent performance conditions are met.</p> <p><b>TSR (max 50%)</b><br/>Out-turn below median of FTSE 100 and 0% of TSR element awarded; the graph on page 81 reflects performance over a five-year period.</p> <p><b>EPS (max 50%)</b><br/>Out-turn growth below the EPS minimum growth target RPI+3% and 0% of EPS element awarded.</p>  |



## Remuneration Report (continued)

### Remuneration for 2012/13 and beyond

#### 2012/13 and beyond

During 2012/13 the Committee:

- will continue to review its Total Remuneration Policy to ensure it is aligned to the long-term needs of the business, shareholders and customers;
- will introduce a 'claw back' arrangement on its incentive plans to maintain a strong focus on performance; and
- continue to engage with key stakeholders and in particular, participate in the ongoing BIS consultation.

#### Total Remuneration Policy

Total Remuneration Policy is integral to overall HR Strategy and the SSE set of core values are supported in the objectives, plan design and application of the policy.

##### The principles

The core principles of the Company's remuneration policy are outlined in the 'SSE – a balanced range of energy businesses' section as shown on pages 12 and 13 together with policy details and charts which illustrate performance variation between the target and maximum values of the packages.

The policy comprises:

- base salary;
- benefits, including a defined benefit pension plan;
- an Annual Incentive Scheme; and
- a long-term incentive plan.

The current incentive plans are shown in the chart on page 79.

##### Total Remuneration Policy

Remuneration policy for Executive Directors is to remain below median of the FTSE 20-50, excluding financial services, and to be positioned generally conservatively against direct peers and UK listed companies in related sectors. SSE's goal is to retain Executive Directors who are motivated by the long-term success of the Company, rather than short-term remuneration.

This policy and goal reflects the SSE culture in which Executive Directors and Senior Managers are motivated by developing the Company for the future, and explains why long-term growth and sustainability of the business are of such importance when determining remuneration policy.

- The Committee reviews regularly the total compensation, including pensions, of the

Executive Directors compared to FTSE benchmarks to make sure that the Company is not disadvantaged by the current position nor are there any adverse consequences stemming from the long service of the leadership team.

- A number of institutional shareholders were consulted on key aspects of the Total Remuneration Policy as part of a regular dialogue between shareholders and the Remuneration Committee.
- As a matter of policy the Committee takes account of any changing or increasing responsibilities when determining the appropriate remuneration.
- The Committee reviews the long-term total reward of the Executive Directors, to ensure that it is suitably aligned with the long-term performance of the business.

##### The balance of fixed and variable remuneration

Taking into account the SSE business profile, the Remuneration Committee believes that around 50% of the total remuneration should be performance-related, increasing up to around two thirds for exceptional performance as shown in the table on page 79 as this rewards performance sufficiently without causing undue risk taking.

##### Senior executives, managers and employees

The Committee appreciates the importance of an appropriate relationship between the remuneration levels of the Executive Directors, senior executives, managers and other employees within the Group. There is a wider group of senior executives who have a significant influence on Group performance. The Committee seeks assurance that there is a consistency of approach to remuneration and that remuneration is of sufficient value to attract and retain key executives for the longer term.

##### Base salary

The Committee is mindful of the remuneration of different groups of employees and considers wider internal pay arrangements and other relevant external indices such as inflation in the process of reviewing base salary for the Executive Directors.

The Committee conducted a review of salaries for Executive Directors in November 2011 and March 2012. It considered the following factors in the light of recent market and governance trends:

- the Executive Directors continue to deliver a strong financial performance with significant results to shareholders in a difficult trading

year as dividend growth has exceeded RPI inflation for the thirteenth consecutive year;

- management and Collective Agreements which provide an average 3.5% salary increase this year; and
- total remuneration and basic salary, when benchmarked where relevant to FTSE 20-50 excluding Financial Services, remain behind market median for the Executive Directors.

After taking careful consideration of all factors, the Committee decided to increase the base salary of the Chief Executive by 3.5% (the first increase since January 2009), in line with the wider employee population, effective from 1 April 2012. For the two other Executive Directors an increase of 10% of base salary was approved, effective from 1 November 2011, to reflect the additional responsibilities, which they have absorbed since the retirement of Colin Hood. The next planned salary review for all Executive Directors will be in April 2013.

##### Current incentive plans Annual Incentive Scheme

The purpose of the Annual Incentive Scheme is to reward Executive Directors' performance during the year, based on an analysis of corporate performance, team working and personal objectives. Performance is considered in the context of targets set in each of the areas at the start of the financial year. In addition, the Remuneration Committee considers Executive Directors' management of, and performance in, all of the business issues that arose during the year.

For 2011/12, the total annual incentive paid to the Executive Directors was in the range of 20%-30% of salary, compared to 60% in the previous year, both against a maximum payable of 100%. The portion of the annual incentive that would have been payable in respect of corporate performance was withheld in recognition of the position SSE found itself in with regards to the use of sales aids in doorstep selling. The incentive payable for 2011/12 reflects the elements in respect of team working and performance against personal objectives. 'Executive Directors' salary and incentive plans 2011/12', on page 79, sets out performance metrics used in the assessment of the annual incentive for the year.

For 2012/13, the structure of the annual incentive will remain the same as in 2011/12. The maximum annual incentive payable will be 100% of salary, split between:

- corporate performance (60%);
- team working (20%); and
- personal objectives (20%).

In any single year, it is expected that the annual incentive paid will be around 50% of Executive Directors' salary for on-target performance. The annual incentive is paid 75% in cash, and 25% deferred into shares which vest after three years, subject to continued service. The Committee retains the discretion to vary this award level in exceptional circumstances as illustrated for 2011/12.

For the Management Board and other senior executives a 'safety modifier' applies to any annual incentive awards as safety is of paramount importance to SSE. This modifier applies to team working and personal objectives and allows an additional incentive to be earned for exceptional safety leadership but also a reduction for poor safety leadership. This modifier does not apply to the Executive Directors' annual incentive scheme, which already takes account of the Company's safety performance.

#### Long-term incentive plan

The Performance Share Plan rewards Executive Directors and other senior executives over a three-year period for the continued profitable growth of SSE as measured, up to 2010/11, by Earnings Per Share (EPS) and the Total Shareholder Return (TSR) compared to the FTSE 100. Awards equivalent to 150% of salary are granted annually to Executive Directors and at lower rates to other senior executives.

Awards will be released after three years subject to meeting demanding performance conditions relating to the Company's relative TSR performance and the Company's adjusted EPS\* growth. Further details of the performance targets are in the table on page 79. The TSR performance measure is dependent on the Company's relative long-term share price performance within the FTSE 100, bringing a market perspective to the plan. The vesting of this element requires the Committee to be satisfied with the underlying financial performance of the Company. The TSR measure is balanced by a key internal measure, adjusted EPS\* growth, which is critical to the Company's long-term success and ties in with the Group's strategic goals.

The 2008 PSP award which was due to vest in May 2011 did not achieve the performance criteria and therefore did not vest although the PSP should pay out in future years if performance criteria are met. The TSR out-turn was below median for FTSE 100 and EPS growth was below target.

The 2009 PSP award will also not vest as the TSR and EPS measures are below target.

#### Changes to performance share plan 2010 awards

Since 2010, awards have had four performance criteria of 25% each. Threshold vesting delivers 25% of each element, with full vesting delivering 100% of each element as follows:

- relative TSR performance compared to FTSE 100 (threshold vesting for median performance and full vesting for upper quartile performance);
- relative TSR performance compared to a selected peer group of UK and other European utilities (threshold vesting for median performance and full vesting for upper quartile performance);
- EPS growth of RPI plus 2% (threshold vesting) to 8% (full vesting); and
- dividend per share growth of RPI plus 2% (threshold vesting) to 6% (full vesting).

The introduction of TSR performance compared to a selected peer group of UK and other European utilities (the MSCI Europe Utilities) thereby provides sector emphasis and market perspective to the plan.

The dividend per share growth target reflects the fact that the Company's core financial objective is to deliver continued real dividend growth in the future while maintaining a good dividend cover.

The Committee believes that the two additional measures provide a focus on the performance of SSE's wider competitive group, its key financial goals and the level of dividend paid.

#### 'Claw back'

During the year the Committee agreed to the introduction of a 'claw back' arrangement which will apply to all awards made under the deferred Annual Incentive Scheme and Performance Share Plan from 2012 onwards. This amendment to the schemes rules will give the Committee powers to review the final award of shares under these arrangements when they vest. Should the Committee conclude that

during the period between the granting and vesting of awards there has been an event such as material mis-statement of accounts, gross misconduct or something which causes significant reputational damage to the Company, it will have the ability to reduce the final award or deem it to have lapsed.

#### Share ownership policy

Employee share ownership is a key part of Total Remuneration Policy and is designed to help maintain long-term employee commitment and business understanding, offering the opportunity to benefit from any growth in shareholder value.

- The interests of the Executive Directors and other senior executives are closely aligned with those of other shareholders. The Performance Share Plan, the deferral of 25% of the annual incentive award and employee share schemes facilitate this alignment.
- The Executive Directors and certain other senior executives are required to maintain a shareholding equivalent to one year's salary built up within a reasonable timescale. Consent to sell shares is not normally given (unless in exceptional circumstances or to fund a connected tax liability) until this level of shareholding is reached.
- It is also expected that all non-Executive Directors should hold a minimum of 2,000 shares in the Company.
- As reported on page 59, 43% of SSE employees are members of the Share Incentive Plan.
- 35% of employees are members of the Sharesave Scheme.

#### Directors' shareholdings as percentage of annual salary

|                          | 2012<br>% salary | 2011<br>% salary |
|--------------------------|------------------|------------------|
| Ian Marchant             | 367              | 338              |
| Gregor Alexander         | 242              | 230              |
| Alistair Phillips-Davies | 268              | 256              |

Based on a share price at 31 March 2012 of £13.29.

#### SSE TSR performance: 31 March 2007 to 31 March 2012

Rebased to 100



## Remuneration Report (continued)

### Remuneration for 2012/13 and beyond

#### All-employee share schemes

Executive Directors are eligible to participate in the Company's all-employee share schemes on the same terms as other employees. These schemes comprise:

- the Sharesave Scheme which allows employees options to acquire shares using the proceeds of a monthly savings contract of up to £250 per month. Exercise of the options is not subject to satisfaction of any performance target. The option price is set at a discount maximum of 20% to market value;
- the Share Incentive Plan (the SIP) which allows employees to allocate part of their pre-tax salary to purchase shares up to a maximum of £125 per month. Participants receive two free matching shares monthly for each share purchased up to a maximum of six free shares; and
- the long service award scheme which purchases 10, 20, 30, 40 or 50 shares on behalf of an employee on the occasion of the employee reaching 10, 20, 30, 40 or 50 years' service respectively with the Group.

#### Funding of share schemes and dilution

Shares are purchased in the market to satisfy the exercise of awards under the deferred Annual Incentive Scheme, the Performance Share Plan, and the SIP.

The Company's Sharesave Scheme uses unissued shares to satisfy the exercise of share options. As at 31 March 2012, there were approximately six million share options outstanding under this scheme, and if all the outstanding options were exercised this would amount to 0.63% of the issued share capital of the Company at that date.

#### Pensions policy

Pension planning is an important part of the remuneration strategy because it is consistent with the long-term goals and horizons of the business. Each employee is encouraged to join the relevant pension plan. In response to government and fiscal changes, the Company has provided cash allowance options in exchange for reduced accrual at no extra cost to the Company.

In common with all members of the pension schemes who joined at the same time as the Executive Directors, the following provisions relating to leaving the Company apply:

- for retirement through ill-health an unreduced pension based on service to expected retirement is paid;
- in the event of any reorganisation or

redundancy an unreduced accrued pension is paid to a member who is aged 50 or above, with at least five years' service or, for a member who has not yet reached that age, it will be payable with effect from 50; and

- from the age of 55, a scheme member is entitled to leave the Company and receive a pension, reduced for early payment, unless the Company gives consent and funds this pension being paid on an unreduced basis.

The Executive Directors are members of either the Southern Electric Pension Scheme or the Scottish Hydro-Electric Pension Scheme and their plan membership predates their Board appointments. These are both funded final salary pension schemes and the terms of these schemes apply equally to all members.

The Directors' service contracts provide for a possible maximum pension of two thirds final salary from the age of 60. In relation to Executive Directors who are subject to the scheme-specific salary cap (which mirrors the provisions of the previous HM Revenue and Customs cap arrangements) the Company provides top-up (unfunded) arrangements which are designed to provide an equivalent pension on retirement from the age of 60 to that which they would have earned if they had not been subject to the salary cap. There are no arrangements to compensate members for any change in their personal tax

liability. Dependent upon the circumstances surrounding the departure of the Executive Director and financial health of the Company at the time, the Committee's policy is to give consideration to a cash commutation of the unfunded unapproved retirement benefit (UURB) pension at the time of leaving. Any cash commutation would limit SSE's liability, taking into account valuations provided by independent actuarial advisors, and would be undertaken on what was judged to be a cost neutral basis to SSE. The Committee has agreed to consider a cash commutation of the UURBs, if requested, when Colin Hood is age 60. Prior to that, the benefit from Colin Hood's UURBs will be paid monthly. In determining whether it is appropriate to offer a cash commutation, the Committee will apply the policy stated above.

Full details of the Executive Directors' pension plans can be found in Table B of the audited information on page 84.

#### Service contracts

It is the Company's policy that Executive Directors should have service contracts with the Company which can be terminated on 12 months' notice given by either party.

The current Executive Directors' service contracts contain the key items shown in the table below.

#### Service contract key items

| Provision           | Detailed terms  |
|---------------------|---|
| Notice period       | → 12 months by either Company or Director   |
| Termination payment | → Up to 12 months' salary (excluding any annual incentive or other enhancement)<br>→ Payment in lieu of notice in staged payments subject to the Executive gaining new employment<br>→ No special change of control provisions<br>→ Obligation on departing Executives to mitigate loss |
| Remuneration        | → Salary, pension and benefits<br>→ Company car or cash allowance<br>→ Participation in Annual Incentive Scheme, employee share schemes and Executive incentive plans<br>→ Private health insurance   |
| Non competition     | → During employment and for six months after leaving  |
| Contract dates      | → All contracts dated 11 March 2005   |

#### Length of service

|                          | Industry service | Length of Board service |
|--------------------------|------------------|-------------------------|
| Ian Marchant             | 20               | 16 years*               |
| Gregor Alexander         | 21               | 9 years                 |
| Alistair Phillips-Davies | 15               | 10 years                |

\* Including two years as Finance Director of Southern Electric plc.

The Company may at its discretion terminate any Executive Director's contract by making a payment in lieu of notice equal to the base salary which would have been received during the notice period (excluding any annual incentive and any other emolument referable to the employment). Payment may be made in staged payments, and will either reduce or cease completely where the departing Executive Director gains new employment.

If an Executive Director retires or is made redundant, the PSP shares will be reduced to reflect the point during the three-year performance period when the Director leaves and will remain subject to performance. If the Executive Director leaves for any other reason, PSP share awards will lapse.

In the event of a change of control of the Company, performance in the PSP will be measured to that date and the award will normally be scaled down to reflect the period prior to the change of control.

#### Outside appointments

Executive Directors are able to accept a non-Executive appointment outside the Company with the consent of the Board, as such appointments can enhance Directors' experience and value to the Company. Any fees received are retained by the Director.

In 2011/12 Ian Marchant was a non-Executive Director with John Wood Group plc, and received £45,000 in fees. Colin Hood was a non-Executive Director of FirstGroup plc, and received £29,200 in fees, he was a non-Executive Director in Southern Water Services Ltd and received £58,300 in fees and he was a non-Executive Director of HSI Ltd and received £17,500 in fees, all in respect of the period to cessation of his employment on 31 October 2011.

#### Retirement of Colin Hood

Colin Hood retired as a Director and ceased employment on 31 October 2011. He was employed under a service contract dated 11 March 2005, and did not receive a termination payment on retirement. Details of his pension arrangements are set out on page 84. The Committee awarded Mr Hood a payment under the Annual Incentive Scheme for his period of service in 2011/12; this was subject to performance and will be paid in cash in June 2012 (rather than part being deferred into shares). In relation to his share awards under the DBP from 2009 and 2010, the Committee permitted Mr Hood to call for these shares within six months of his retirement date. Mr Hood's 2009 and 2010

awards under the Performance Share Plan were preserved by the Committee on his retirement, to vest at the normal time to the extent that the performance targets are met (but subject to prorating for Mr Hood's actual service during the three year performance period). Mr Hood's 2009 award did not vest.

### Non-Executive Directors

The non-Executive Directors have letters of appointment, and are appointed for fixed terms of three years, subject to retirement by rotation and re-appointment at AGMs.

They do not participate in the Annual Incentive Scheme, deferred Annual Incentive Scheme, any of the share option schemes, or contribute to any Group pension scheme although as indicated above they are required to hold 2,000 Company shares.

The fees of the independent non-Executive Directors are agreed by the Board, with the non-Executive Directors concerned not participating in this process.

The fees are reviewed against companies of similar size and complexity. To be consistent with wider remuneration policy, fees are set at below median.

The non-Executive Directors do not receive any additional fees for Committee Membership. Reasonable travelling and other expenses for costs incurred in the course of their duties are reimbursed.

| Fee history                         | 2012  | 2011  |
|-------------------------------------|-------|-------|
|                                     | £000s | £000s |
| Board                               | 54    | 54    |
| Audit Committee Chairmanship        | 14    | 12    |
| Remuneration Committee Chairmanship | 12    | 10    |
| Senior Independent Director         | 10    | 10    |
| Company Chairman                    | 341   | 341   |

From 1 April 2012, the fees for all non-Executive Director roles were increased by 3.5% in line with the average salary increase of SSE's employees in general. •

## Remuneration Report (continued)

### Remuneration in detail

The Auditors are required to report on the information contained in Tables A, B and D.

**Table A – Directors' remuneration excluding LTIP and pension information**

|                                 | Salary/fee<br>£000s | Cash incentives<br>£000s | 2012<br>Benefits<br>£000s | Total<br>£000s | 2011<br>Total<br>£000s |
|---------------------------------|---------------------|--------------------------|---------------------------|----------------|------------------------|
| <b>Executive Directors</b>      |                     |                          |                           |                |                        |
| Ian Marchant                    | 840                 | 158                      | 19                        | 1,017          | 1,237                  |
| Gregor Alexander                | 516                 | 123                      | 16                        | 655            | 734                    |
| Colin Hood (retired 31/10/11)   | 377                 | 94                       | 10                        | 481            | 954                    |
| Alistair Phillips-Davies        | 516                 | 102                      | 16                        | 634            | 734                    |
| <b>Non-Executive Directors</b>  |                     |                          |                           |                |                        |
| Thomas Thune Andersen           | 54                  | –                        | –                         | 54             | 54                     |
| Jeremy Beeton                   | 41                  | –                        | –                         | 41             | –                      |
| Katie Bickerstaffe              | 41                  | –                        | –                         | 41             | –                      |
| Richard Gillingwater            | 54                  | –                        | –                         | 54             | 54                     |
| René Médori                     | 68                  | –                        | –                         | 68             | 66                     |
| Lady Rice                       | 76                  | –                        | –                         | 76             | 74                     |
| Lord Smith of Kelvin (Chairman) | 341                 | –                        | –                         | 341            | 341                    |
| <b>Former Director</b>          |                     |                          |                           |                |                        |
| Nick Baldwin (retired 01/04/11) | –                   | –                        | –                         | –              | 54                     |
|                                 | <b>2,924</b>        | <b>477</b>               | <b>61</b>                 | <b>3,462</b>   | 4,302                  |

#### Notes

In addition to the annual cash incentive amount for this year, Ian Marchant, Gregor Alexander and Alistair Phillips-Davies will be awarded £52,500, £40,800 and £34,000 respectively in the form of deferred shares in respect of the annual incentive due to them for 2011/12. These share awards will not be made until June 2012 and therefore the number of shares to which the Executive Directors will be entitled will not be known until that date. These shares will, subject to continued employment, be released on the third anniversary of grant in June 2015.

Colin Hood's appointment ceased with effect from 31 October 2011, therefore total benefits are pro-rata up to this date. Colin Hood's pro-rated annual incentive will be paid entirely in cash.

**Table B – Directors' pension information**

|                          | Years of<br>industry<br>service | At 31 March<br>2012<br>£000s | Accrued benefit                                     |   | Transfer value of accrued benefit |                              |   |   |
|--------------------------|---------------------------------|------------------------------|---|---|-----------------------------------|------------------------------|---|---|
|                          |                                 |                              | Increase in year<br>including<br>inflation<br>£000s | Increase in year<br>excluding<br>inflation<br>£000s | At 31 March<br>2012<br>£000s      | At 31 March<br>2011<br>£000s | Increase less<br>Directors'<br>contributions<br>£000s | Increase in year<br>excluding<br>inflation<br>£000s |
| Ian Marchant             | 20                              | 388                          | 19  | 6   | 9,188                             | 6,191                        | 2,978   | 437   |
| Gregor Alexander         | 21                              | 230                          | 17  | 7   | 4,999                             | 3,545                        | 1,435   | 357   |
| Alistair Phillips-Davies | 15                              | 177                          | 16  | 10  | 3,676                             | 2,394                        | 1,263   | 345   |
| Colin Hood               | 34                              | 366                          | 11  | –   | 9,962                             | 7,267                        | 2,673   | 382   |

The transfer value of the accrued benefit has increased over the year. There has been no change in the Directors' pension entitlements over the year and the increase in value is largely the result of the change in financial conditions since 31 March 2011, notably the significant reduction in bond yields. If bond yields were to go up, the value would go down.

Members of the scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the table above. If a member's accrued fund exceeds the lifetime allowance (LTA), the benefits payable by the scheme from that excess will be subject to a higher rate of income tax. The Company has maximised the use of the allowance to provide Executive Directors with the maximum benefits via the registered schemes.

The following is information relating to the pension of Gregor Alexander as a participant in the HM Revenue & Customs approved Scottish Hydro-Electric Pension Scheme.

- (i) Dependants' pensions on death are half of members' pension entitlements, together with a capital sum equal to four times pensionable pay. On death in retirement, the Director's spouse will receive a pension equal to half of that payable to the Director. In addition, on death within the first five years of retirement, a lump sum is payable equal to the balance outstanding of the first five years' pension payments.



(ii) Post retirement increases are expected to be in line with inflation.

The following is information relating to the Directors' pensions of Colin Hood, Ian Marchant and Alistair Phillips-Davies, as participants in the HM Revenue & Customs approved Southern Electric Group of the Electricity Supply Pension Scheme.

(i) Dependants' pensions on death are four-ninths of the member's pensionable pay, together with a capital sum equal to four times pensionable pay. If death occurs after attaining the age of 55 an additional lump sum between three to five times notional pension is payable dependent upon age and length of service.

(ii) On death in retirement, the Director's spouse will receive a pension equal to two-thirds of that payable to the Director. In addition, on death within the first five years of retirement, a lump sum is payable equal to the balance outstanding of the first five years' pension payments.

(iii) Post retirement increases are expected to be in line with inflation (guaranteed up to the level of 5% per annum and discretionary above that level).

All the Executive Directors have unfunded retirement benefits which are included in their pension benefits above with provision in respect of their accrued value included in the Company's Balance Sheet.

**Table C – Directors' share interests**

|                          | 31 March 2012 |                     | 31 March 2011 |                     |
|--------------------------|---------------|---------------------|---------------|---------------------|
|                          | Shares held   | Shares under option | Shares held   | Shares under option |
| Gregor Alexander         | 93,915        | 204,019             | 90,504        | 193,304             |
| Thomas Thune Andersen    | 2,000         | –                   | 2,000         | –                   |
| Jeremy Beeton            | 4,000         | –                   | –             | –                   |
| Katie Bickerstaffe       | 2,000         | –                   | –             | –                   |
| Richard Gillingwater     | 2,000         | –                   | 2,000         | –                   |
| Colin Hood               | 144,519       | 184,716             | 138,659       | 250,056             |
| Ian Marchant             | 232,023       | 349,978             | 225,773       | 334,522             |
| René Médori              | 2,050         | –                   | 2,050         | –                   |
| Alistair Phillips-Davies | 104,062       | 202,483             | 100,703       | 191,738             |
| Lady Rice                | 5,533         | –                   | 5,216         | –                   |
| Lord Smith of Kelvin     | 22,600        | –                   | 22,600        | –                   |

#### Notes

From 31 March 2012 to 15 May 2012, the following changes to the interests of Directors took place:

Under a standing order for reinvestment of an ISA, on 10 April 2012 Gregor Alexander acquired 15 shares.

Under the SIP, on 5 April 2012 Ian Marchant and Gregor Alexander each acquired 15 shares and Alistair Phillips-Davies acquired 16 shares. On 4 May 2012, Ian Marchant and Gregor Alexander each acquired 16 shares and Alistair Phillips-Davies acquired 15 shares.

The Register of Directors' Interests (which is open to shareholder inspection) contains full details of Directors' shareholdings and options to subscribe for shares.

Colin Hood's holding covers to the date of leaving on 31 October 2011.

Table D (page 86) shows the interests of the Executive Directors in awards granted under the DBP 2006 and the PSP during the year ended 31 March 2012.

## Remuneration Report (continued)

### Remuneration in detail

**Table D – Directors' long term incentive plan interests**

|                          | Share plan            | Date of award         | Normal exercise period (or vesting date) | No. of shares under award as at 1 April 2011 | Option exercise price | Additional shares awarded during the year | No. of shares lapsed during the year | No. of shares realised during the year | No. of shares under award at 31 March 2012 |
|--------------------------|-----------------------|-----------------------|--|--|-----------------------|---|--------------------------------------|--|--|
| Ian Marchant             | DBP 2006 <sup>2</sup> | 10/06/2008            | 10/06/2011                               | 9,709  |                       |   |                                      | 9,709 <sup>4</sup>                     |  |
|                          | DBP 2006 <sup>2</sup> | 02/06/2009            | 02/06/2012                               | 10,730                                       |                       |   |                                      |  | 10,730                                     |
|                          | DBP 2006 <sup>2</sup> | 02/06/2010            | 02/06/2013                               | 11,482                                       |                       |   |                                      |  | 11,482                                     |
|                          | DBP 2006 <sup>2</sup> | 14/06/2011            | 14/06/2014                               |  |                       | 9,388 <sup>3</sup>                        |                                      |  | 9,388                                      |
|                          | PSP <sup>1</sup>      | 10/06/2008            | May 2011                                 | 77,670                                       |                       |   | 77,670                               |  |  |
|                          | PSP <sup>1</sup>      | 02/06/2009            | May 2012                                 | 107,302                                      |                       |   |                                      |  | 107,302                                    |
|                          | PSP <sup>1</sup>      | 02/06/2010            | May 2013                                 | 116,774                                      |                       |   |                                      |  | 116,774                                    |
|                          | PSP <sup>1</sup>      | 14/06/2011            | May 2014                                 |  |                       | 93,889 <sup>3</sup>                       |                                      |  | 93,889                                     |
|                          | Sharesave             | 22/07/2008            | 01/10/2011-31/03/2012                    | 442  | 1,274p                |   |                                      | 442 <sup>5</sup>                       |  |
| Sharesave                | 30/06/2010            | 01/10/2013-31/03/2014 | 413                                      | 871p   |                       |   |                                      | 413                                    |  |
| Gregor Alexander         | DBP 2006 <sup>2</sup> | 10/06/2008            | 10/06/2011                               | 5,493  |                       |   |                                      | 5,493 <sup>4</sup>                     |  |
|                          | DBP 2006 <sup>2</sup> | 02/06/2009            | 02/06/2012                               | 6,169  |                       |   |                                      |  | 6,169                                      |
|                          | DBP 2006 <sup>2</sup> | 02/06/2010            | 02/06/2013                               | 6,602  |                       |   |                                      |  | 6,602                                      |
|                          | DBP 2006 <sup>2</sup> | 14/06/2011            | 14/06/2014                               |  |                       | 5,533 <sup>3</sup>                        |                                      |  | 5,533                                      |
|                          | PSP <sup>1</sup>      | 10/06/2008            | May 2011                                 | 44,661                                       |                       |   | 44,661                               |  |  |
|                          | PSP <sup>1</sup>      | 02/06/2009            | May 2012                                 | 61,698                                       |                       |   |                                      |  | 61,698                                     |
|                          | PSP <sup>1</sup>      | 02/06/2010            | May 2013                                 | 67,145                                       |                       |   |                                      |  | 67,145                                     |
|                          | PSP <sup>1</sup>      | 14/06/2011            | May 2014                                 |  |                       | 55,336 <sup>3</sup>                       |                                      |  | 55,336                                     |
|                          | Sharesave             | 30/06/2009            | 01/10/2014-31/03/2015                    | 1,253  | 1,042p                |   |                                      |  | 1,253                                      |
| Sharesave                | 30/06/2010            | 01/10/2015-31/03/2016 | 283                                      | 871p   |                       |   |                                      | 283                                    |  |
| Alistair Phillips-Davies | DBP 2006 <sup>2</sup> | 10/06/2008            | 10/06/2011                               | 5,463  |                       |   |                                      | 5,463 <sup>4</sup>                     |  |
|                          | DBP 2006 <sup>2</sup> | 02/06/2009            | 02/06/2012                               | 6,169  |                       |   |                                      |  | 6,169                                      |
|                          | DBP 2006 <sup>2</sup> | 02/06/2010            | 02/06/2013                               | 6,602  |                       |   |                                      |  | 6,602                                      |
|                          | DBP 2006 <sup>2</sup> | 14/06/2011            | 14/06/2014                               |  |                       | 5,533 <sup>3</sup>                        |                                      |  | 5,533                                      |
|                          | PSP <sup>1</sup>      | 10/06/2008            | May 2011                                 | 44,661                                       |                       |   | 44,661                               |  |  |
|                          | PSP <sup>1</sup>      | 02/06/2009            | May 2012                                 | 61,698                                       |                       |   |                                      |  | 61,698                                     |
|                          | PSP <sup>1</sup>      | 02/06/2010            | May 2013                                 | 67,145                                       |                       |   |                                      |  | 67,145                                     |
|                          | PSP <sup>1</sup>      | 14/06/2011            | May 2014                                 |  |                       | 55,336 <sup>3</sup>                       |                                      |  | 55,336                                     |
| Colin Hood               | DBP 2006 <sup>2</sup> | 10/06/2008            | 10/06/2011                               | 7,087  |                       |   |                                      | 7,087 <sup>4</sup>                     |  |
|                          | DBP 2006 <sup>2</sup> | 02/06/2009            | 02/06/2012                               | 8,047  |                       |   |                                      | 8,047 <sup>6</sup>                     |  |
|                          | DBP 2006 <sup>2</sup> | 02/06/2010            | 02/06/2013                               | 8,612  |                       |   |                                      | 8,612 <sup>6</sup>                     |  |
|                          | PSP <sup>1</sup>      | 10/06/2008            | May 2011                                 | 58,253                                       |                       |   | 58,253                               |  |  |
|                          | PSP <sup>1</sup>      | 02/06/2009            | May 2012                                 | 80,476                                       |                       |   |                                      |  | 80,476 <sup>7</sup>                        |
|                          | PSP <sup>1</sup>      | 02/06/2010            | May 2013                                 | 87,581                                       |                       |   |                                      |  | 87,581 <sup>7</sup>                        |

Shares which are released under the DBP 2006 and PSP attract additional shares in respect of the notional reinvestment of dividends. In addition to the shares released under the DBP 2006, as indicated in the table above, the following shares were realised arising from such notional reinvestment of dividends: Ian Marchant – 1,748 shares, Gregor Alexander – 987 shares, Alistair Phillips-Davies – 983 Shares, Colin Hood – 2,297 shares.

1. The performance conditions applicable to awards under the PSP since 2007 are described on page 81. The 2008 award under the PSP did not vest.
2. 25% of annual incentive payable to Executive Directors and senior managers is satisfied as a conditional award of shares under the DBP 2006. Vesting of shares is dependent on continued service over a three year period. In view of the linkage to annual incentive, no further performance condition applies to the vesting of DBP 2006 awards.
3. The market value of a share on the date on which these awards were made was 1,374p.
4. The market value of a share on the date on which these awards were realised was 1,384p.
5. The market value of a share on the date on which these awards were exercised was 1,312p.
6. The market value of a share on the date on which these awards were realised was 1,277p.
7. Colin Hood's shareholdings cover the period to date of leaving on 31 October 2011.

The closing market price of shares at 31 March 2012 was 1,329p and the range for the year was 1,193p to 1,423p. Awards granted during the year were granted under the DBP 2006 and the PSP. The aggregate amount of gains made by the Directors on the exercise of share options and realisation of awards during the year was £337,629 (2011 – £446,597).

This report was approved by the Board and signed on its behalf by:

**Lady Rice CBE**

Remuneration Committee Chairman  
15 May 2012

## Other statutory information

### Principal activities

SSE plc is the holding company of the Group. Its subsidiaries are organised into the main businesses of:

- Networks – the economically-regulated transmission and distribution of electricity and gas and other related networks;
- Retail – the supply of electricity, gas and other services to household and business customers; and
- Wholesale – the production, storage and generation of energy and energy portfolio management.

### Business review

The Company is required to set out a fair review of the business of the Group and a description of the principal risks and uncertainties facing the Group (known as a Business Review). The Business Review is required to set out a balanced and comprehensive analysis of the development and performance of the Group's business during the financial year ended 31 March 2012 and of the position of the Group at the end of that financial year. The information that fulfils these requirements, and is deemed to be the Directors' Report, is contained within pages 1 to 88 of this Annual Report. The management report for the year, as required by the Disclosure and Transparency Rules, is incorporated by reference within the Directors' Report.

### Directors

The Directors during the year and at the date of this report are:

#### Executive

Ian Marchant (Chief Executive)  
Gregor Alexander  
Colin Hood (retired 31 October 2011)  
Alistair Phillips-Davies

#### Non-Executive

Lord Smith of Kelvin (Chairman)  
Thomas Thune Andersen  
Nick Baldwin (resigned 1 April 2011)  
Jeremy Beeton (appointed 1 July 2011)  
Katie Bickerstaffe (appointed 1 July 2011)  
Richard Gillingwater  
René Médori  
Lady Rice (Senior Independent Director)

At the 2012 AGM all of the current Directors (apart from René Médori) will retire and offer themselves for re-appointment. René Médori will resign from the Board on 25 June 2012. Richard Gillingwater will assume the position of Senior Independent Director on 24 July 2012 in place of Lady Rice who will remain an independent non-Executive Director.

Biographical details of all Directors are set out on page 57. Details of the service contracts for the Executive Directors and the letters of appointment for the non-Executive Directors are set out in the Remuneration Report on pages 82 and 83 respectively.

The interests of the Directors in the Ordinary Shares of the Company at 31 March 2012 are set out in the Remuneration Report on pages 85 and 86.

### Directors' insurance and indemnities

The Directors have the benefit of the indemnity provision contained in the Company's Articles of Association. The Directors of the Company have been granted a qualifying third party indemnity provision which was in force throughout the financial year and remains in force. The Company also purchased and maintained throughout the financial year directors' and officers' liability insurance in respect of itself and for its Directors and Officers.

### Results and dividends

The Group profit attributable to Ordinary Shareholders for the financial year amounted to £197.8m. The Directors recommend a final dividend of 56.1p per Ordinary Share which, subject to approval at the AGM, will be payable on 21 September 2012 to shareholders on the Register of Members at close of business on 27 July 2012. With the interim dividend of 24.0p per Ordinary Share paid on 23 March 2012, this makes a total dividend of 80.1p per Ordinary Share.

### Going concern

After making enquiries, the Directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. The Financial Statements are therefore prepared on a going concern basis. Further details of the Group's liquidity position and going concern review are provided in note 31 to the Financial Statements.

### Share capital

Details of the Company's issued share capital at 31 March 2012, which includes options granted under the Group's employee share

option schemes, are set out in notes 26 and 30 to the Financial Statements.

### Authority to purchase shares

The Company was authorised at the 2011 AGM to purchase its own shares within certain limits. During 2011/12, SSE did not purchase any shares under this authority. The Directors will, however, seek renewal of their authority to purchase in the market the Company's own shares at the AGM on 26 July 2012, and this remains a benchmark against which financial decisions are taken.

### Annual General Meeting 2012

The 23rd AGM of the Company will be held on 26 July 2012 at 12 noon at the Bournemouth International Centre, Exeter Road, Bournemouth BH2 5BH. The Notice of Annual General Meeting 2012, which contains full explanations of the business to be conducted at the AGM, is set out in a separate shareholder circular.

### Substantial shareholdings

As at 15 May 2012 the Company has been notified under Rule 5 of the Disclosure and Transparency Rules of the interests in its shares as shown in the table below.

### Creditor payment policy

It is the Company's policy that payment terms are agreed at the outset of a transaction and are adhered to; that bills are paid in accordance with the contract; and that there are no alterations to payment terms without prior agreement. The number of suppliers' days represented by trade creditors was 37 days at 31 March 2012.

### Accounting policies, financial instruments and risk

Details of the Group's accounting policies, together with details of financial instruments and risk, are provided in notes 1 and 31 to the Financial Statements.

### Additional information

Where not provided elsewhere in the Directors' Report, the following provides the information required to be disclosed by Section 992 of the Companies Act 2006.

Each Ordinary Share of the Company carries one vote at general meetings of the Company.

### Substantial shareholdings

| Entity                                  | Number of shares* | Percentage* | Nature of holding |
|---|-------------------|-------------|-------------------|
| Capital Research and Management Company | 46,267,405        | 5.02%       | Indirect          |
| Legal & General Group Plc               | 37,426,851        | 3.99%       | Direct            |

\* At date of disclosure by relevant entity.

Since the date of disclosure to the Company, the interests of the shareholders listed above may have increased or decreased.

## Other statutory information (continued)

There are no restrictions on the transfer of Ordinary Shares in the capital of the Company other than certain restrictions which may from time-to-time be imposed by law (for example, insider trading law). In accordance with the Listing Rules of the Financial Services Authority, certain employees are required to seek the approval of the Company to deal in its shares.

Employees who participate in the Share Incentive Plan whose shares remain in the schemes' trusts give directions to the trustees to vote on their behalf by way of a Form of Direction.

The Company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights. The rules governing the appointment and replacement of Directors are set out in the Company's Articles of Association. The Company's Articles of Association may only be amended by a special resolution at a general meeting of shareholders.

The Company is not aware of any significant agreements to which it is party that take effect, alter or terminate upon a change of control of the Company following a takeover. The Company is not aware of any contractual or other agreements which are essential to its business which ought to be disclosed in this Directors' Report.

Details of any post balance sheet events are provided in note 34 to the Financial Statements.

### Auditors

Upon the recommendation of the Audit Committee and approval of the Board, resolutions to re-appoint KPMG Audit Plc as Auditors, and to authorise the Directors to fix their remuneration, will be proposed at the forthcoming AGM.

Each of the Directors who held office at the date of approval of this Directors' Report confirms that, so far as each Director is aware, there is no relevant audit information of which the Company's Auditors are unaware and each Director has taken all the steps that ought to have been taken in his or her duty as a Director to make himself or herself aware of any relevant audit information and to establish that the Company's Auditors are aware of that information.

By Order of the Board

**Vincent Donnelly**  
Company Secretary  
15 May 2012

### Statement of Directors' responsibilities in respect of the annual report and the financial statements

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements on the same basis.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent company and of their profit or loss for that period. In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole; and
- the Directors' Report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

For and on behalf of the Board

**Ian Marchant**  
Chief Executive  
15 May 2012

**Gregor Alexander**  
Finance Director

# Financial statements

## Contents

### Financial statements

|            |  |
|------------|--|
| <b>90</b>  | Independent auditor's report                         |
| <b>91</b>  | Consolidated income statement                        |
| <b>92</b>  | Statement of comprehensive income                    |
| <b>93</b>  | Balance sheets                                       |
| <b>94</b>  | Statement of changes in equity                       |
| <b>96</b>  | Cash flow statements                                 |
| <b>98</b>  | Notes on the financial statements                    |
| <b>98</b>  | 1. Significant accounting policies                   |
| <b>108</b> | 2. Change of reportable segments                     |
| <b>111</b> | 3. Segmental information                             |
| <b>114</b> | 4. Other operating income and expense                |
| <b>115</b> | 5. Exceptional items and certain remeasurements      |
| <b>117</b> | 6. Directors and employees                           |
| <b>118</b> | 7. Finance income and costs                          |
| <b>119</b> | 8. Taxation  |
| <b>121</b> | 9. Dividends   |
| <b>121</b> | 10. Earnings per share                               |
| <b>122</b> | 11. Intangible assets                                |
| <b>126</b> | 12. Property, plant and equipment                    |
| <b>127</b> | 13. Biological assets                                |
| <b>128</b> | 14. Investments                                      |
| <b>131</b> | 15. Subsidiary undertakings                          |
| <b>133</b> | 16. Acquisitions, disposals and held for sale assets |
| <b>134</b> | 17. Inventories                                      |
| <b>135</b> | 18. Trade and other receivables                      |
| <b>135</b> | 19. Cash and cash equivalents                        |
| <b>135</b> | 20. Trade and other payables                         |
| <b>136</b> | 21. Current tax liabilities                          |
| <b>136</b> | 22. Construction contracts                           |
| <b>136</b> | 23. Loans and other borrowings                       |
| <b>139</b> | 24. Deferred taxation                                |
| <b>140</b> | 25. Provisions                                       |
| <b>141</b> | 26. Share capital                                    |
| <b>141</b> | 27. Reserves   |
| <b>142</b> | 28. Hybrid capital                                   |
| <b>142</b> | 29. Retirement benefit obligations                   |
| <b>146</b> | 30. Employee share-based payments                    |
| <b>151</b> | 31. Financial instruments and risk                   |
| <b>165</b> | 32. Related party transactions                       |
| <b>166</b> | 33. Commitments and contingencies                    |
| <b>167</b> | 34. Post balance sheet events                        |

### Shareholder information

|            |                         |
|------------|-------------------------|
| <b>168</b> | Shareholder information |
|------------|-------------------------|



## Independent auditor's report to the members of SSE plc

We have audited the financial statements of SSE plc for the year ended 31 March 2012 set out on pages 91 to 167. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of Directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 88, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

### Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at [www.frc.org.uk/apb/scope/private.cfm](http://www.frc.org.uk/apb/scope/private.cfm).

### Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 March 2012 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

### Opinion on other matters prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

### Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of Directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Under the Listing Rules we are required to review:

- the Directors' statement, set out on page 87, in relation to going concern;
- the part of the Corporate Governance Statement on pages 61 to 64 relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review; and
- certain elements of the report to shareholders by the Board on Directors' remuneration.

### John Luke

For and on behalf of KPMG Audit Plc, Statutory Auditor  
Chartered Accountants  
Saltire Court  
20 Castle Terrace  
Edinburgh  
EH1 2EG  
15 May 2012

## Consolidated income statement

for the year ended 31 March

|   | Note | 2012  |  |                 | 2011  |  |             |
|---|------|---|--|-----------------|---|--|-------------|
|   |      | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>(note 5)<br>£m | Total<br>£m     | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>(note 5)<br>£m | Total<br>£m |
| <b>Revenue</b>  | 2,3  | <b>31,723.9</b>   | <b>-</b>   | <b>31,723.9</b> | 28,334.2  | -  | 28,334.2    |
| Cost of sales   |      | (29,464.4)  | (903.3)  | (30,367.7)      | (26,094.1)  | 948.8  | (25,145.3)  |
| <b>Gross profit</b>   |      | <b>2,259.5</b>  | <b>(903.3)</b>   | <b>1,356.2</b>  | 2,240.1   | 948.8  | 3,188.9     |
| Operating costs   | 4    | (888.0)   | (82.0)   | (970.0)         | (902.0)   | -  | (902.0)     |
| Other operating income  |      | 8.0   | -  | 8.0             | 16.0  | -  | 16.0        |
| <b>Operating profit before jointly controlled entities and associates</b> |      | <b>1,379.5</b>  | <b>(985.3)</b>   | <b>394.2</b>    | 1,354.1   | 948.8  | 2,302.9     |
| Jointly controlled entities and associates:                               |      |   |  |                 |   |  |             |
| Share of operating profit   |      | 278.3   | -  | 278.3           | 298.8   | (103.2)  | 195.6       |
| Share of interest   |      | (146.5)   | -  | (146.5)         | (139.9)   | -  | (139.9)     |
| Share of movement on derivatives  |      | -   | 14.2   | 14.2            | -   | 5.9  | 5.9         |
| Share of tax  |      | (44.9)  | 38.3   | (6.6)           | (58.2)  | 61.5   | 3.3         |
| <b>Share of profit on jointly controlled entities and associates</b>      | 14   | <b>86.9</b>   | <b>52.5</b>  | <b>139.4</b>    | 100.7   | (35.8)   | 64.9        |
| <b>Operating profit</b>   | 2,3  | <b>1,466.4</b>  | <b>(932.8)</b>   | <b>533.6</b>    | 1,454.8   | 913.0  | 2,367.8     |
| Finance income  | 7    | 250.1   | -  | 250.1           | 250.2   | -  | 250.2       |
| Finance costs   | 7    | (425.7)   | (89.5)   | (515.2)         | (453.1)   | (53.2)   | (506.3)     |
| <b>Profit before taxation</b>   |      | <b>1,290.8</b>  | <b>(1,022.3)</b>   | <b>268.5</b>    | 1,251.9   | 859.8  | 2,111.7     |
| Taxation  | 8    | (324.8)   | 319.6  | (5.2)           | (354.8)   | (252.4)  | (607.2)     |
| <b>Profit for the year</b>  |      | <b>966.0</b>  | <b>(702.7)</b>   | <b>263.3</b>    | 897.1   | 607.4  | 1,504.5     |
| <b>Attributable to:</b>   |      |   |  |                 |   |  |             |
| Ordinary Shareholders of the parent                                       |      | 900.5   | (702.7)  | 197.8           | 897.1   | 607.4  | 1,504.5     |
| Other equity holders  |      | 65.5  | -  | 65.5            | -   | -  | -           |
| Basic earnings per share (pence)  | 10   |   |  | <b>21.1p</b>    |   |  | 162.2p      |
| Diluted earnings per share (pence)  | 10   |   |  | <b>21.1p</b>    |   |  | 162.0p      |
| Dividends in the year (£m)  | 9    |   |  | <b>£716.9m</b>  |   |  | £659.8m     |

The accompanying notes are an integral part of these financial statements.

## Statement of comprehensive income

for the year ended 31 March

|  | Consolidated   |            |
|--|----------------|------------|
|  | 2012<br>£m     | 2011<br>£m |
| <b>Profit for the year</b>   | <b>263.3</b>   | 1,504.5    |
| <b>Other comprehensive income:</b>   |                |            |
| (Losses)/gains effective portion of cash flow hedges                       | (15.3)         | 32.3       |
| Transferred to assets and liabilities on cash flow hedges                  | 0.2            | (7.0)      |
| Taxation on cash flow hedges   | 4.0            | (5.9)      |
|  | (11.1)         | 19.4       |
| Exchange difference on translation of foreign operations                   | (65.3)         | (78.3)     |
| Gains on net investment hedge  | 29.8           | 4.3        |
| Taxation on net investment hedge   | (7.7)          | (1.2)      |
|  | (43.2)         | (75.2)     |
| Actuarial losses on retirement benefit schemes                             | (161.1)        | (8.8)      |
| Taxation on actuarial losses on defined benefit pension schemes            | 30.3           | (7.9)      |
|  | (130.8)        | (16.7)     |
| Jointly controlled entities and associates:                                |                |            |
| Share of (loss) on effective portion of cash flow hedges                   | (20.8)         | (4.1)      |
| Share of taxation on cash flow hedges                                      | 3.7            | (0.3)      |
|  | (17.1)         | (4.4)      |
| Share of actuarial gain/(losses) on retirement benefit schemes             | 5.6            | (11.6)     |
| Share of taxation of actuarial gain/(losses) on retirement benefit schemes | (3.9)          | 1.8        |
|  | 1.7            | (9.8)      |
| <b>Net share from jointly controlled entities and associates</b>           | <b>(15.4)</b>  | (14.2)     |
| <b>Other comprehensive income, net of taxation</b>                         | <b>(200.5)</b> | (86.7)     |
| <b>Total comprehensive income for the period</b>                           | <b>62.8</b>    | 1,417.8    |
| <b>Attributable to:</b>  |                |            |
| Ordinary Shareholders of the parent  | (2.7)          | 1,417.8    |
| Other equity holders   | 65.5           | –          |
|  | 62.8           | 1,417.8    |

## Balance sheets as at 31 March

|   | Note | Consolidated    |            | Company         |            |
|---|------|-----------------|------------|-----------------|------------|
|   |      | 2012<br>£m      | 2011<br>£m | 2012<br>£m      | 2011<br>£m |
| <b>Assets</b>   |      |                 |            |                 |            |
| Property, plant and equipment                                     | 12   | 9,153.1         | 8,513.1    | –               | –          |
| Biological assets   | 13   | 3.4             | 4.4        | –               | –          |
| Intangible assets:  |      |                 |            |                 |            |
| Goodwill  | 11   | 627.5           | 685.3      | –               | –          |
| Other intangible assets   | 11   | 218.8           | 287.8      | –               | –          |
| Equity investments in associates and jointly controlled entities  | 14   | 911.7           | 760.8      | 190.0           | 190.0      |
| Loans to associates and jointly controlled entities               | 14   | 1,191.9         | 1,124.6    | 1,140.0         | 1,029.5    |
| Other investments   | 14   | 36.1            | 39.6       | 18.0            | 18.0       |
| Investments in subsidiaries                                       | 15   | –               | –          | 2,349.1         | 2,318.4    |
| Trade and other receivables                                       | 18   | –               | –          | 3,790.6         | 3,661.2    |
| Deferred tax assets   | 24   | 222.1           | 161.7      | 115.9           | 122.1      |
| Derivative financial assets                                       | 31   | 348.0           | 990.1      | 94.7            | 48.0       |
| <b>Non-current assets</b>   |      | <b>12,712.6</b> | 12,567.4   | <b>7,698.3</b>  | 7,387.2    |
| Other intangible assets   | 11   | 365.7           | 325.6      | –               | –          |
| Inventories   | 17   | 323.7           | 217.5      | –               | –          |
| Trade and other receivables                                       | 18   | 5,174.6         | 5,068.1    | 2,935.6         | 2,285.9    |
| Cash and cash equivalents   | 19   | 189.2           | 476.9      | 14.3            | 319.1      |
| Derivative financial assets                                       | 31   | 851.2           | 2,525.5    | 12.2            | 30.0       |
| Current assets held for sale                                      | 16   | 68.0            | 269.4      | –               | –          |
| <b>Current assets</b>   |      | <b>6,972.4</b>  | 8,883.0    | <b>2,962.1</b>  | 2,635.0    |
| <b>Total assets</b>   |      | <b>19,685.0</b> | 21,450.4   | <b>10,660.4</b> | 10,022.2   |
| <b>Liabilities</b>  |      |                 |            |                 |            |
| Loans and other borrowings  | 23   | 708.6           | 446.5      | 440.1           | 106.8      |
| Trade and other payables  | 20   | 5,182.7         | 5,078.0    | 2,514.9         | 2,792.3    |
| Current tax liabilities   | 21   | 231.8           | 268.2      | 10.7            | 22.9       |
| Provisions  | 25   | 55.3            | 9.9        | –               | –          |
| Derivative financial liabilities                                  | 31   | 817.6           | 2,307.5    | 8.5             | 15.5       |
| <b>Current liabilities</b>  |      | <b>6,996.0</b>  | 8,110.1    | <b>2,974.2</b>  | 2,937.5    |
| Loans and other borrowings  | 23   | 5,537.0         | 5,159.9    | 4,223.4         | 3,756.9    |
| Deferred tax liabilities  | 24   | 921.8           | 1,068.3    | –               | –          |
| Trade and other payables  | 20   | 332.7           | 304.2      | –               | –          |
| Provisions  | 25   | 182.3           | 169.2      | –               | –          |
| Retirement benefit obligations                                    | 29   | 731.9           | 668.6      | 196.2           | 239.8      |
| Derivative financial liabilities                                  | 31   | 399.2           | 769.3      | 206.3           | 136.7      |
| <b>Non-current liabilities</b>                                    |      | <b>8,104.9</b>  | 8,139.5    | <b>4,625.9</b>  | 4,133.4    |
| <b>Total liabilities</b>  |      | <b>15,100.9</b> | 16,249.6   | <b>7,600.1</b>  | 7,070.9    |
| <b>Net assets</b>   |      | <b>4,584.1</b>  | 5,200.8    | <b>3,060.3</b>  | 2,951.3    |
| <b>Equity:</b>  |      |                 |            |                 |            |
| Share capital   | 26   | 472.3           | 468.4      | 472.3           | 468.4      |
| Share premium   |      | 862.0           | 859.8      | 862.0           | 859.8      |
| Capital redemption reserve  |      | 22.0            | 22.0       | 22.0            | 22.0       |
| Hedge reserve   |      | (29.4)          | (1.2)      | 5.8             | 19.2       |
| Translation reserve   |      | (5.0)           | 38.2       | –               | –          |
| Retained earnings   |      | 2,100.8         | 2,652.2    | 536.8           | 420.5      |
| <b>Equity attributable to Ordinary Shareholders of the parent</b> |      | <b>3,422.7</b>  | 4,039.4    | <b>1,898.9</b>  | 1,789.9    |
| Hybrid capital  | 28   | 1,161.4         | 1,161.4    | 1,161.4         | 1,161.4    |
| <b>Total equity attributable to equity holders of the parent</b>  |      | <b>4,584.1</b>  | 5,200.8    | <b>3,060.3</b>  | 2,951.3    |

These financial statements were approved by the Board of Directors on 15 May 2012 and signed on their behalf by:

**Gregor Alexander**  
Finance Director

**Lord Smith of Kelvin**  
Chairman

SSE plc, Registered No: SC117119

Overview

Strategy

Group performance

Segmental performance

Corporate governance

Financial statements

Shareholder information

## Statement of changes in equity

### for the year ended 31 March

#### Consolidated Statement of changes in equity

|   | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Hedge reserve<br>£m | Translation reserve<br>£m | Retained earnings<br>£m | Hybrid capital<br>£m | Total<br>£m    |
|---|---------------------|-----------------------------|----------------------------------|---------------------|---------------------------|-------------------------|----------------------|----------------|
| At 1 April 2011   | 468.4               | 859.8                       | 22.0                             | (1.2)               | 38.2                      | 2,652.2                 | 1,161.4              | <b>5,200.8</b> |
| Profit for the year   | –                   | –                           | –                                | –                   | –                         | 197.8                   | 65.5                 | <b>263.3</b>   |
| Effective portion of changes in fair value of cash flow hedges (net of tax) | –                   | –                           | –                                | (11.3)              | –                         | –                       | –                    | <b>(11.3)</b>  |
| Transferred to balance sheet on cash flow hedges (net of tax)               | –                   | –                           | –                                | 0.2                 | –                         | –                       | –                    | <b>0.2</b>     |
| Effective net investment hedge (net of tax)                                 | –                   | –                           | –                                | –                   | 22.1                      | –                       | –                    | <b>22.1</b>    |
| Exchange differences on translation of foreign operation                    | –                   | –                           | –                                | –                   | (65.3)                    | –                       | –                    | <b>(65.3)</b>  |
| Actuarial losses on retirement benefit schemes (net of tax)                 | –                   | –                           | –                                | –                   | –                         | (130.8)                 | –                    | <b>(130.8)</b> |
| Jointly controlled entities and associates:                                 |                     |                             |                                  |                     |                           |                         |                      |                |
| Share of change in fair value of effective cash flow hedges                 | –                   | –                           | –                                | (17.1)              | –                         | –                       | –                    | <b>(17.1)</b>  |
| Share of actuarial gains on retirement benefit schemes (net of tax)         | –                   | –                           | –                                | –                   | –                         | 1.7                     | –                    | <b>1.7</b>     |
| Total comprehensive income for the year                                     | –                   | –                           | –                                | (28.2)              | (43.2)                    | 68.7                    | 65.5                 | <b>62.8</b>    |
| Dividends to shareholders   | –                   | –                           | –                                | –                   | –                         | (716.9)                 | –                    | <b>(716.9)</b> |
| Scrip dividend related share issue  | 3.6                 | (3.6)                       | –                                | –                   | –                         | 88.2                    | –                    | <b>88.2</b>    |
| Distributions to hybrid capital holders                                     | –                   | –                           | –                                | –                   | –                         | –                       | (65.5)               | <b>(65.5)</b>  |
| Issue of shares   | 0.3                 | 5.8                         | –                                | –                   | –                         | –                       | –                    | <b>6.1</b>     |
| Credit in respect of employee share awards                                  | –                   | –                           | –                                | –                   | –                         | 13.5                    | –                    | <b>13.5</b>    |
| Investment in own shares  | –                   | –                           | –                                | –                   | –                         | (4.9)                   | –                    | <b>(4.9)</b>   |
| <b>At 31 March 2012</b>   | <b>472.3</b>        | <b>862.0</b>                | <b>22.0</b>                      | <b>(29.4)</b>       | <b>(5.0)</b>              | <b>2,100.8</b>          | <b>1,161.4</b>       | <b>4,584.1</b> |

#### Company Statement of changes in equity

|   | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Hedge reserve<br>£m | Retained earnings<br>£m | Hybrid capital<br>£m | Total<br>£m    |
|---|---------------------|-----------------------------|----------------------------------|---------------------|-------------------------|----------------------|----------------|
| At 1 April 2011   | 468.4               | 859.8                       | 22.0                             | 19.2                | 420.5                   | 1,161.4              | <b>2,951.3</b> |
| Profit for the year   | –                   | –                           | –                                | –                   | 739.0                   | 65.5                 | <b>804.5</b>   |
| Effective portion of changes in fair value of cash flow hedges (net of tax) | –                   | –                           | –                                | (13.4)              | –                       | –                    | <b>(13.4)</b>  |
| Actuarial losses on retirement benefit schemes (net of tax)                 | –                   | –                           | –                                | –                   | (2.6)                   | –                    | <b>(2.6)</b>   |
| Total comprehensive income for the year                                     | –                   | –                           | –                                | (13.4)              | 736.4                   | 65.5                 | <b>788.5</b>   |
| Dividends to shareholders   | –                   | –                           | –                                | –                   | (716.9)                 | –                    | <b>(716.9)</b> |
| Scrip dividend related share issue  | 3.6                 | (3.6)                       | –                                | –                   | 88.2                    | –                    | <b>88.2</b>    |
| Distributions to hybrid capital holders                                     | –                   | –                           | –                                | –                   | –                       | (65.5)               | <b>(65.5)</b>  |
| Issue of shares   | 0.3                 | 5.8                         | –                                | –                   | –                       | –                    | <b>6.1</b>     |
| Increase in investment in subsidiaries                                      | –                   | –                           | –                                | –                   | 13.5                    | –                    | <b>13.5</b>    |
| Investment in own shares  | –                   | –                           | –                                | –                   | (4.9)                   | –                    | <b>(4.9)</b>   |
| <b>At 31 March 2012</b>   | <b>472.3</b>        | <b>862.0</b>                | <b>22.0</b>                      | <b>5.8</b>          | <b>536.8</b>            | <b>1,161.4</b>       | <b>3,060.3</b> |



### Consolidated Statement of changes in equity

|   | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Hedge reserve<br>£m | Translation reserve<br>£m | Retained earnings<br>£m | Non-controlling interest<br>£m | Hybrid capital<br>£m | Total<br>£m    |
|---|---------------------|-----------------------------|----------------------------------|---------------------|---------------------------|-------------------------|--------------------------------|----------------------|----------------|
| At 1 April 2010   | 461.5               | 857.5                       | 22.0                             | (16.2)              | 113.4                     | 1,686.6                 | (3.8)                          | –                    | <b>3,121.0</b> |
| Profit for the year   | –                   | –                           | –                                | –                   | –                         | 1,504.5                 | –                              | –                    | <b>1,504.5</b> |
| Effective portion of changes in fair value of cash flow hedges (net of tax)       | –                   | –                           | –                                | 26.4                | –                         | –                       | –                              | –                    | <b>26.4</b>    |
| Transferred to balance sheet on cash flow hedges (net of tax)                     | –                   | –                           | –                                | (7.0)               | –                         | –                       | –                              | –                    | <b>(7.0)</b>   |
| Effective net investment hedge (net of tax)                                       | –                   | –                           | –                                | –                   | 3.1                       | –                       | –                              | –                    | <b>3.1</b>     |
| Exchange differences on translation of foreign operation                          | –                   | –                           | –                                | –                   | (78.3)                    | –                       | –                              | –                    | <b>(78.3)</b>  |
| Actuarial losses on retirement benefit schemes (net of tax)                       | –                   | –                           | –                                | –                   | –                         | (16.7)                  | –                              | –                    | <b>(16.7)</b>  |
| Jointly controlled entities and associates:                                       |                     |                             |                                  |                     |                           |                         |                                |                      |                |
| Share of change in fair value of effective cash flow hedges                       | –                   | –                           | –                                | (4.4)               | –                         | –                       | –                              | –                    | <b>(4.4)</b>   |
| Share of actuarial losses on retirement benefit schemes (net of tax)              | –                   | –                           | –                                | –                   | –                         | (9.8)                   | –                              | –                    | <b>(9.8)</b>   |
| Total comprehensive income for the year   | –                   | –                           | –                                | 15.0                | (75.2)                    | 1,478.0                 | –                              | –                    | <b>1,417.8</b> |
| Dividends to shareholders   | –                   | –                           | –                                | –                   | –                         | (659.8)                 | –                              | –                    | <b>(659.8)</b> |
| Scrip dividend related share issue  | 6.4                 | (6.4)                       | –                                | –                   | –                         | 146.1                   | –                              | –                    | <b>146.1</b>   |
| Issue of hybrid capital   | –                   | –                           | –                                | –                   | –                         | –                       | –                              | 1,161.4              | <b>1,161.4</b> |
| Issue of shares   | 0.5                 | 8.7                         | –                                | –                   | –                         | –                       | –                              | –                    | <b>9.2</b>     |
| Transactions with shareholders  | –                   | –                           | –                                | –                   | –                         | –                       | 3.8                            | –                    | <b>3.8</b>     |
| Credit in respect of employee share awards  | –                   | –                           | –                                | –                   | –                         | 9.9                     | –                              | –                    | <b>9.9</b>     |
| Investment in own shares  | –                   | –                           | –                                | –                   | –                         | (9.2)                   | –                              | –                    | <b>(9.2)</b>   |
| Current and deferred tax recognised in equity in respect of employee share awards | –                   | –                           | –                                | –                   | –                         | 0.6                     | –                              | –                    | <b>0.6</b>     |
| <b>At 31 March 2011</b>   | <b>468.4</b>        | <b>859.8</b>                | <b>22.0</b>                      | <b>(1.2)</b>        | <b>38.2</b>               | <b>2,652.2</b>          | <b>–</b>                       | <b>1,161.4</b>       | <b>5,200.8</b> |

### Company Statement of changes in equity

|   | Share capital<br>£m | Share premium account<br>£m | Capital redemption reserve<br>£m | Hedge reserve<br>£m | Retained earnings<br>£m | Hybrid capital<br>£m | Total<br>£m    |
|---|---------------------|-----------------------------|----------------------------------|---------------------|-------------------------|----------------------|----------------|
| At 1 April 2010   | 461.5               | 857.5                       | 22.0                             | 21.0                | 329.4                   | –                    | <b>1,691.4</b> |
| Profit for the year   | –                   | –                           | –                                | –                   | 627.3                   | –                    | <b>627.3</b>   |
| Effective portion of changes in fair value of cash flow hedges (net of tax)       | –                   | –                           | –                                | (1.8)               | –                       | –                    | <b>(1.8)</b>   |
| Actuarial losses on retirement benefit schemes (net of tax)                       | –                   | –                           | –                                | –                   | (23.8)                  | –                    | <b>(23.8)</b>  |
| Total comprehensive income for the year   | –                   | –                           | –                                | (1.8)               | 603.5                   | –                    | <b>601.7</b>   |
| Dividends to shareholders   | –                   | –                           | –                                | –                   | (659.8)                 | –                    | <b>(659.8)</b> |
| Scrip dividend related share issue  | 6.4                 | (6.4)                       | –                                | –                   | 146.1                   | –                    | <b>146.1</b>   |
| Issue of hybrid capital   | –                   | –                           | –                                | –                   | –                       | 1,161.4              | <b>1,161.4</b> |
| Issue of shares   | 0.5                 | 8.7                         | –                                | –                   | –                       | –                    | <b>9.2</b>     |
| Increase in investment in subsidiaries  | –                   | –                           | –                                | –                   | 9.9                     | –                    | <b>9.9</b>     |
| Investment in own shares  | –                   | –                           | –                                | –                   | (9.2)                   | –                    | <b>(9.2)</b>   |
| Current and deferred tax recognised in equity in respect of employee share awards | –                   | –                           | –                                | –                   | 0.6                     | –                    | <b>0.6</b>     |
| <b>At 31 March 2011</b>   | <b>468.4</b>        | <b>859.8</b>                | <b>22.0</b>                      | <b>19.2</b>         | <b>420.5</b>            | <b>1,161.4</b>       | <b>2,951.3</b> |

## Cash flow statements

### for the year ended 31 March

|  | Note | Consolidated     |                        | Company        |                |
|--|------|------------------|------------------------|----------------|----------------|
|  |      | 2012<br>£m       | 2011<br>Restated<br>£m | 2012<br>£m     | 2011<br>£m     |
| <b>Cash flows from operating activities</b>  |      |                  |                        |                |                |
| Profit for the year after tax  |      | 263.3            | 1,504.5                | 804.5          | 627.3          |
| Taxation   |      | 5.2              | 607.2                  | 8.9            | 15.9           |
| Movement on financing and operating derivatives                                    |      | 523.2            | (1,417.4)              | 76.6           | 47.3           |
| Finance costs  |      | 425.7            | 453.1                  | 335.9          | 204.3          |
| Finance income   |      | (250.1)          | (250.2)                | (464.0)        | (291.1)        |
| Share of profit/loss of jointly controlled entities and associates                 |      | (139.4)          | (64.9)                 | –              | –              |
| Income from investment in subsidiaries, jointly controlled entities and associates |      | –                | –                      | (747.6)        | (601.9)        |
| Pension service charges less contributions paid                                    |      | (100.2)          | (68.8)                 | (47.9)         | (48.5)         |
| Exceptional impairment of assets   |      | 478.6            | 521.8                  | –              | 13.7           |
| Other exceptional items  |      | 73.0             | –                      | –              | –              |
| Depreciation of assets   |      | 561.8            | 496.7                  | –              | –              |
| Amortisation and impairment of intangible assets                                   |      | 13.5             | 21.5                   | –              | –              |
| Impairment of inventories  |      | 1.1              | 6.6                    | –              | –              |
| Release of provisions  |      | (7.3)            | (6.0)                  | –              | –              |
| Release of deferred income   |      | (14.7)           | (19.6)                 | –              | –              |
| (Increase)/decrease in inventories   |      | (107.3)          | 48.4                   | –              | –              |
| (Increase) in receivables  |      | (133.7)          | (95.4)                 | (582.7)        | (88.3)         |
| Increase/(decrease) in payables  |      | 342.9            | 635.2                  | (278.9)        | (214.3)        |
| Increase in provisions   |      | 5.9              | 1.9                    | –              | –              |
| Charge in respect of employee share awards (before tax)                            |      | 13.5             | 9.9                    | –              | –              |
| Gain on disposal of property, plant and equipment                                  |      | (4.6)            | (5.8)                  | –              | –              |
| Loss on disposal of fixed asset investments  |      | 2.1              | –                      | –              | –              |
| Gain on disposal of business and subsidiaries                                      | 16   | (5.5)            | (10.2)                 | –              | –              |
| <b>Cash generated from operations</b>  |      | <b>1,947.0</b>   | <b>2,368.5</b>         | <b>(895.2)</b> | <b>(335.6)</b> |
| Dividends received from jointly controlled entities and associates                 |      | 111.4            | 81.7                   | 65.0           | 30.0           |
| Dividends received from subsidiaries   |      | –                | –                      | 682.6          | 571.9          |
| Finance income   |      | 108.3            | 109.7                  | 397.7          | 252.5          |
| Finance costs  |      | (242.2)          | (316.0)                | (267.6)        | (181.9)        |
| Income taxes paid  |      | (211.4)          | (172.6)                | (212.8)        | (205.8)        |
| Payment for consortium relief  |      | (4.9)            | (21.2)                 | –              | (21.2)         |
| <b>Net cash from operating activities</b>  |      | <b>1,708.2</b>   | <b>2,050.1</b>         | <b>(230.3)</b> | <b>109.9</b>   |
| <b>Cash flows from investing activities</b>  |      |                  |                        |                |                |
| Purchase of property, plant and equipment  |      | (1,501.2)        | (1,079.0)              | –              | –              |
| Purchase of other intangible assets  |      | (400.9)          | (297.3)                | –              | –              |
| Deferred income received   |      | 0.5              | –                      | –              | –              |
| Proceeds from sale of property, plant and equipment                                |      | 22.2             | 7.9                    | –              | –              |
| Proceeds from sale of fixed asset investment                                       |      | 23.5             | –                      | –              | –              |
| Proceeds from sale of business and subsidiaries                                    | 16   | 185.5            | 31.9                   | –              | –              |
| Other loans to jointly controlled entities   | 14   | (138.6)          | (204.4)                | (118.9)        | (194.2)        |
| Purchase of businesses and subsidiaries  | 16   | (3.6)            | (241.3)                | –              | –              |
| Cash included in disposals   |      | –                | (5.5)                  | –              | –              |
| Cash included in held for sale assets  |      | (3.9)            | (23.0)                 | –              | –              |
| Investment in jointly controlled entities and associates                           |      | (138.8)          | (221.6)                | –              | (35.1)         |
| Loans and equity repaid by jointly controlled entities                             |      | 25.9             | 13.3                   | 8.4            | –              |
| Increase in other investments  |      | (2.1)            | (30.4)                 | –              | –              |
| <b>Net cash from investing activities</b>  |      | <b>(1,931.5)</b> | <b>(2,049.4)</b>       | <b>(110.5)</b> | <b>(229.3)</b> |

|   | Note | Consolidated   |            | Company        |            |
|---|------|----------------|------------|----------------|------------|
|   |      | 2012<br>£m     | 2011<br>£m | 2012<br>£m     | 2011<br>£m |
| <b>Cash flows from financing activities</b>                 |      |                |            |                |            |
| Proceeds from issue of share capital                        |      | 6.1            | 9.2        | 6.1            | 9.2        |
| Dividends paid to Company's equity holders                  |      | (628.7)        | (513.7)    | (628.7)        | (513.7)    |
| Hybrid capital dividend payment                             |      | (65.5)         | –          | (65.5)         | –          |
| Issue of hybrid capital                                     |      | –              | 1,161.4    | –              | 1,161.4    |
| Employee share awards share purchase                        |      | (4.9)          | (9.2)      | (4.9)          | (9.2)      |
| New borrowings  |      | 1,024.1        | 765.1      | 835.8          | 506.7      |
| Repayment of borrowings                                     |      | (393.0)        | (1,187.1)  | (106.8)        | (815.6)    |
| <b>Net cash from financing activities</b>                   |      | <b>(61.9)</b>  | 225.7      | <b>36.0</b>    | 338.8      |
| <b>Net (decrease)/increase in cash and cash equivalents</b> |      | <b>(285.2)</b> | 226.4      | <b>(304.8)</b> | 219.4      |
| Cash and cash equivalents at the start of year              | 19   | 471.6          | 252.5      | 319.1          | 99.7       |
| Net (decrease)/increase in cash and cash equivalents        |      | (285.2)        | 226.4      | (304.8)        | 219.4      |
| Effect of foreign exchange rate changes                     |      | (0.9)          | (7.3)      | –              | –          |
| <b>Cash and cash equivalents at the end of year</b>         | 19   | <b>185.5</b>   | 471.6      | <b>14.3</b>    | 319.1      |

The accompanying notes are an integral part of these financial statements.

# Notes on the financial statements

## for the year ended 31 March

### 1. SIGNIFICANT ACCOUNTING POLICIES

#### General information

SSE plc (the Company) is a company domiciled in Scotland. The Company changed its name from Scottish and Southern Energy plc to SSE plc on 1 October 2011. The address of the registered office is given on the back cover. The Group's operations and its principal activities are set out earlier in this Report at pages 9 to 54. The consolidated financial statements for the year ended 31 March 2012 comprise those of the Company and its subsidiaries (together referred to as the Group). The Company financial statements present information about the Company as a separate entity and not about the Group. Under section 408 of the Companies Act 2006 the Company is exempt from the requirement to present its own income statement and related notes.

#### Basis of preparation

##### Statement of compliance

The financial statements were authorised for issue by the Directors on 15 May 2012. The financial statements have been prepared in accordance with International Financial Reporting Standards and its interpretations as adopted by the European Union (adopted IFRS).

##### Going concern

The Directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future taking account of net current liabilities of £23.6m. The financial statements are therefore prepared on a going concern basis. Further details of the Group's liquidity position and going concern review are provided in note 31 of the Financial Statements on page 151.

##### Basis of measurement

The financial statements of the Group and the Company are prepared on the historical cost basis except for derivative financial instruments, biological assets and the assets of the Group pension scheme which are stated at their fair value, and the liabilities of the Group pension schemes which are measured using the projected unit credit method. The Directors believe the financial statements present a true and fair view. The financial statements of the Group and Company are presented in pounds Sterling. Operations and transactions conducted in currencies other than pounds Sterling are included in the consolidated financial statements in accordance with the Group's foreign currencies accounting policy.

##### Use of estimates and judgements

The preparation of financial statements conforming with adopted IFRS requires the use of certain accounting estimates. It also requires management to exercise judgement in the process of applying the accounting policies. The areas involving a higher level of judgement or estimation are summarised at page 106.

##### Exceptional items and certain remeasurements

As permitted by IAS 1 Presentation of Financial Statements, the Group has disclosed additional information in respect of jointly controlled entities and associates, exceptional items and certain remeasurements on the face of the income statement to aid understanding of the Group's financial performance. An item is treated as exceptional if it is considered unusual by nature and scale and of such significance that separate disclosure is required for the financial statements to be properly understood. Certain remeasurements are remeasurements arising on certain commodity, interest rate and currency contracts which are accounted for as held for trading or as fair value hedges in accordance with the Group's policy for such financial instruments. This excludes commodity contracts not treated as financial instruments under IAS 39 where held for the Group's own use requirements.

##### Standards, amendments and interpretations

There are no new standards, amendments or interpretations that are effective for the first time for the current financial year that have had a material impact on the Group.

At the date of authorisation of these financial statements, the following standards, amendments to existing standards and interpretations have been issued, which have not been adopted in these consolidated financial statements, were in issue but not yet effective:

|                       |   |                                      |
|-----------------------|---|--------------------------------------|
| → Amendment to IFRS 7 | Disclosures – transfers of financial assets         | Effective on or after 1 July 2011    |
| → IFRS 9              | Financial instruments                               | Effective on or after 1 January 2015 |
| → IFRS 10             | Consolidated financial statements                   | Effective on or after 1 January 2013 |
| → IFRS 11             | Joint arrangements                                  | Effective on or after 1 January 2013 |
| → IFRS 12             | Disclosure of interests in other entities           | Effective on or after 1 January 2013 |
| → IFRS 13             | Fair value measurement                              | Effective on or after 1 January 2013 |
| → Amendment to IAS 1  | Presentation of items of other comprehensive income | Effective on or after 1 July 2012    |
| → Amendment to IAS12  | Deferred tax – recovery of underlying assets        | Effective on or after 1 January 2012 |
| → IAS 19              | Employee benefits                                   | Effective on or after 1 January 2013 |
| → IAS 27              | Separate financial statements                       | Effective on or after 1 January 2013 |
| → IAS 28              | Investments in associates and joint ventures        | Effective on or after 1 January 2013 |

The above, with the exception of the IFRS 7 amendment, are awaiting EU endorsement and as such have not been early adopted by the Group. The impact of adopting these standards and amendments to existing standards is currently being assessed.

### Basis of consolidation

The financial statements consolidate the financial statements of the Company and its subsidiaries together with the Group's share of the results and net assets of its jointly controlled entities and associates.

### Subsidiaries

Subsidiaries (including special purpose entities) are those entities controlled by the Group or the Company. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity in order to obtain benefits from its activities. In assessing control, potential voting rights that are currently exercisable or convertible are taken into account. The financial statements of subsidiaries acquired are consolidated in the financial statements of the Group from the date that control commences until the date control ceases. All business combinations are accounted for by applying the purchase method of accounting.

The special purpose entities referred to relate to entities in which the Group has a 50% shareholding but whose activities the Group is deemed to control under SIC-12 Consolidation – Special Purpose Entities.

In the Company, investments in subsidiaries are carried at cost less any impairment charges.

### Associates

Associates are those entities in which the Group has significant influence but not control over the financial and operating policies, normally where the Group has a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method and are recognised initially at cost. The cost of the investment includes transaction costs. The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of associates, from the date that significant influence commences until the date that significant influence ceases.

In the Company, investments in associates are carried at cost less any impairment charges.

### Joint ventures

Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement. In the consolidated financial statements, investments are accounted for under the equity method of accounting and are recognised initially at cost. The cost of the investment includes transaction costs. The consolidated financial statements include the Group's share of the profit or loss and other comprehensive income of jointly controlled entities, after adjustments to align the accounting policies with those of the Group.

Jointly controlled operations are businesses which use assets and liabilities that are separable from the rest of the Group. In these arrangements, the Group accounts for its own share of property, plant and equipment, carries its own inventories, incurs its own expenses and liabilities and raises its own finance.

In the Company, investments in jointly controlled entities are carried at cost less any impairment charges.

### Transactions eliminated on consolidation

Intra-Group balances and any unrealised gains and losses or income and expenses arising from Intra-Group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains and losses arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Group's interest in the entity.

### Accounting policies

#### Revenue recognition: energy, services and goods relating to the sale of energy

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and that the revenue can be reliably measured. Revenue comprises sales of energy, use of system income, gas production revenue, gas storage facility revenue, the value of contracted services and facilities provided and goods sold during the year in the normal course of business.

Revenue on energy sales comprises sales to retail end-user customers including an estimate of the value of electricity and gas supplied to customers between the date of the last meter reading and the year end. Revenue on energy sales also includes monies received from the electricity and gas balancing markets in the UK and other wholesale market energy sales. Unread energy sales are estimated using historical consumption patterns taking account of industry volume reconciliation processes.

Revenue from sales and optimisation trades in physical and financial energy and commodity contracts is recognised gross in the income statement.

Revenue associated with business interruption insurance claims is recognised as revenue in the income statement only when it is virtually certain that the claim will be successful.



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue from use of energy systems includes an estimation of the volume of electricity distributed or transmitted by customers based on independently procured electricity settlement systems data. Annual revenue is dependent on being approved by the industry regulator, Ofgem. Certain circumstances may result in the regulatory 'allowed' income being over- or under-recovered in the financial year. Any over- or under-recovery is included in the calculation of the following year's regulatory use of system revenue within agreed parameters. No adjustment is made for over- or under-recoveries in the year that they arise.

Revenue from the production of natural gas, crude oil and condensates is recognised when title passes to the customer. The Group has an interest with other producers in jointly controlled operations for the production of such products. Revenue under these arrangements is recognised based on the entitlement method in reference to the Group's interest and the relevant production sharing terms. Where there are differences between the Group's share of production and the volume sold, an overlift or underlift is recorded (see below).

Where the Group has an ongoing obligation to provide services, revenues are recognised as the service is performed and amounts billed in advance are treated as deferred income and excluded from current revenue. For network connections activity from 1 November 2009, the revenue recognition rules of IFRIC 18 have been applied, whereby income is recognised over the course of completion of the associated capital works unless there is a future service obligation, in which case revenue is recognised over the service period. Revenue from fixed-fee service contracts is recognised over the life of the contract, in relation to the benefit received by the customer.

Gas storage facilities revenues are recognised evenly over the contract period, whilst revenues for the injection and withdrawal of gas are recognised at the point of gas flowing into or out of the storage facilities.

Sales of goods are recognised when goods are delivered and title has passed, along with the risks and rewards of ownership.

#### Exploration, evaluation and production assets

The Group uses the successful efforts method of accounting for exploration and evaluation expenditure associated with exploration wells or 'prospects'. This expenditure will be capitalised initially within intangible assets and will include licence acquisition costs associated with the prospects. If the prospects are subsequently determined to be successful on completion of the evaluation period, the relevant expenditure will be transferred to property, plant and equipment and depreciated on a unit of production basis. If the prospects are subsequently determined to be unsuccessful on completion of the evaluation period, the intangible asset will be expensed in the period in which that determination is made.

All field development costs, including rights and concessions related to production activities, are capitalised as property, plant and equipment. Capitalised costs relate to the acquisition and installation of production assets and facilities and includes specialist engineering, drilling and technical services costs. These property, plant and equipment assets are depreciated from the commencement of production in the fields concerned, using the unit of production method, based on the proven and probable reserves of those fields. Changes in these estimates are dealt with prospectively.

The carrying value of exploration prospects is regularly compared on an individual field basis with the expected discounted future net revenues associated with the remaining commercial reserves. An impairment loss will be recognised where it is considered that recorded amounts are unlikely to be fully recovered from the net present value of future net revenues. All exploration and production assets are reviewed annually for indicators of impairment.

#### Government grants

A government grant is recognised in the balance sheet initially as deferred income when there is reasonable assurance that it will be received and that the Group will comply with the conditions attaching to it. Grants that compensate the Group for expenses incurred are recognised in the income statement on a systematic basis in the same years in which the expenses are incurred. Grants that compensate the Group for the cost of an asset are recognised in the income statement on a systematic basis over the useful life of the asset to match the depreciation charge.

#### Leases

The determination of whether an arrangement contains a lease is dependent on whether the arrangement relates to use and control of a specific asset. Leases are classified as finance leases if the arrangement transfers substantially all the risks and rewards of ownership to the lessee. All other leases are categorised as operating leases.

- (i) Operating lease obligations
  - Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.
  - Lease incentives received are recognised in the income statement as an integral part of the total lease expense.
- (ii) Finance lease obligations
  - Assets held under finance leases are capitalised and held as part of property, plant and equipment. The accounting policy for such arrangements is described on page 102.

## Foreign currencies

The consolidated financial statements are presented in pounds Sterling, which is the functional currency of the Company and the Group's presentational currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured accordingly.

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date. Any gain or loss arising on the restatement of such items is taken to the income statement with the exception of exchange gains or losses on foreign currency borrowings that provide a hedge against a net investment in a foreign entity or exchange gains or losses incurred as part of a qualifying cash flow hedge. Exchange gains or losses on net investment hedges are taken against the consolidated translation reserve, a separate component of equity, to the extent the hedge is effective. Non-monetary assets that are measured in terms of historical cost in a foreign currency are translated at the historic rate at the date of transaction.

For the purpose of presenting the consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into pounds Sterling at the balance sheet closing rate. The results of these operations are translated at the average rate in the relevant period. Exchange differences on retranslation of the opening net assets and the results are transferred to the translation reserve and are reported in the statement of recognised income and expense. Exchange differences on foreign currency borrowings, foreign exchange contracts or foreign currency swaps used as part of a hedge against net investment in a foreign entity are transferred to the translation reserve.

## Finance income and costs

Finance income comprises interest receivable on funds invested and expected returns on pension scheme assets recognised in the income statement. Finance costs comprise interest payable on borrowings and finance leases, the release of discounting on provisions, interest on pension scheme liabilities and accretion of the debt component on the convertible loan less capitalised interest.

Interest on the funding attributable to major capital projects is capitalised during the years of construction and depreciated as part of the total cost over the useful life of the asset.

Interest income and costs are recognised in the income statement as they accrue, on an effective interest method. The issue costs and interest payable on bonds and all other interest payable and receivable is reflected in the income statement on the same basis.

## Taxation

Taxation on the profit for the year comprises current and deferred tax. Taxation is recognised in the income statement unless it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is calculated using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities other than in business combinations that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

Deferred tax assets and liabilities are offset where there is a legally enforceable right of offset within the same tax authority and where the Company intends to either settle them on a net basis, or to realise the asset and settle the liability simultaneously. A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

## Dividends

Dividend income is recognised on the date the Group's right to receive payments is established. Dividend liabilities are recognised on the date the Group's obligation to pay dividends is established.

## Property, plant and equipment

### (i) Owned assets

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairments. The cost of self-constructed assets includes the cost of materials, direct labour and other directly attributable costs. All items of property, plant and equipment are accounted for under the cost model within IAS 16. The purchase price of an asset will include the fair value of the consideration paid to acquire the asset.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

Where an item of property, plant and equipment comprises major components having different useful lives, the components are accounted for as separate items of property, plant and equipment, and depreciated accordingly.

##### (ii) Leased assets

Leases where the Group assumes substantially all the risks and rewards of ownership are classified as finance leases.

Assets held under finance leases are recognised as part of the property, plant and equipment of the Group at the fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's general policy on borrowing costs.

Benefits received and receivable as an incentive to enter into an operating lease are also allocated on a straight line basis over the lease term.

##### (iii) Hydro civil assets

The Group is obliged under the Reservoirs Act 1975 to maintain its hydro infrastructure network, including its dams, tunnels and other hydro civil engineering structures (hydro civil assets). All items of property, plant and equipment within hydro civil assets, with the exception of land, are subject to depreciation.

In accordance with the transition provisions of IFRS 1, the Group identified the carrying value of these assets at privatisation and has treated this value as deemed cost. Following this assessment, the assets, and all subsequent enhancement and replacement expenditure, has been subject to depreciation over a useful economic life of 100 years. All subsequent maintenance expenditure is chargeable directly to the income statement.

##### (iv) Depreciation

Depreciation is charged to the income statement to write off cost, less residual values, on a straight line basis over their estimated useful lives with the exception of Gas and Oil Production Assets which are depreciated on the Units of Production basis. Heritable and freehold land is not depreciated. Depreciation policy, useful lives and residual values are reviewed at least annually, for all asset classes to ensure that the current method is the most appropriate. Depreciation commences following the asset commissioning period and when the asset is available for commercial operation. The estimated useful lives for assets depreciated on a straight line basis are as follows:

|   | Years    |
|---|----------|
| Hydro civil assets  | 100      |
| Thermal and hydro power stations including electrical and mechanical assets   | 20 to 60 |
| Operating wind farms  | 20 to 25 |
| Overhead lines, under ground cables and other network assets                  | 40 to 80 |
| Gas storage facilities  | 25 to 50 |
| Other transmission and distribution buildings, plant and equipment            | 10 to 45 |
| Office buildings  | 30 to 40 |
| Shop and office refurbishment, fixtures, IT assets, vehicles and mobile plant | 3 to 10  |

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

##### (v) Subsequent expenditure

It is the Group policy to capitalise qualifying replacement expenditure and depreciate it over the expected useful life of the replaced asset. Replaced assets are derecognised at this point and the costs recorded as costs of disposal. Where an item of property, plant and equipment is replaced and it is not practicable to determine the carrying amount of the replaced part, the cost of the replacement adjusted for inflation will be used as an approximation of the cost of the replaced part at the time it was acquired or constructed.

Expenditure incurred to replace a component of an item of property, plant and equipment that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits of the item of property, plant and equipment to which it relates.

##### Biological assets

Biological assets, such as living trees, are measured at their fair value less estimated point of sale costs. The valuation of forest assets is based on discounted cash flow models whereby the fair value of the biological asset is calculated using cash flows from continuous operations, that is, each forest asset is split into an appropriate grouping based on the maturity and/or type of trees. An expected future volume of Timber that will be produced from each of these groups is then derived. The expected volume is used to apply a market value to the groups of trees based on the market value of Standing Timber. These market values are discounted based on the time to full maturity to appropriately value each grouping.

Periodic changes resulting from growth, felling prices, discount rate, costs and other premise changes are included in operating profit on the income statement.

### Business Combinations

The acquisition of subsidiaries is accounted for under the purchase method. The acquired business is measured at the date of acquisition as the aggregate fair value of assets, liabilities and contingent liabilities as required under IFRS 3 *Business Combinations*. The excess of the cost of acquisition over the fair value of the acquired business is represented as goodwill. For combinations taking place from 1 April 2010, contingent consideration classified as a liability will be subsequently remeasured through the income statement under the requirements of the revised IFRS 3. Pre-existing relationships are recognised and, together with all acquisition-related costs, are expensed.

### Intangible assets

#### (i) Goodwill and impairment testing

Goodwill arising on a business combination represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment at least on an annual basis.

For the purpose of impairment testing, goodwill is allocated on initial recognition to those cash-generating units expected to benefit from the combination's synergies. The cash-generating units used for goodwill impairment testing purposes will represent how goodwill was attributed but may not represent reportable business segments.

If the carrying amount of the cash-generating unit exceeds its recoverable amount, an impairment charge will be recognised immediately in the income statement and, in relation to the impairment of goodwill, will not be subsequently reversed. The recoverable amount is the higher of the cash-generating unit's fair value less costs to sell and its value-in-use. The impairment charge will initially be adjusted against the goodwill allocated to the cash-generating unit. Thereafter, the remaining assets of the cash-generating unit will be written-down proportionately.

Goodwill may also arise upon investments in jointly-controlled entities and associates. Such goodwill is recorded within the carrying amount of the Group's investment and any impairment loss is included within the share of result from jointly-controlled entities and associates.

On disposal or closure of a previously acquired business, any attributed goodwill will be included in determining the profit or loss on disposal.

#### (ii) Research and development

Expenditure on research activities is charged to the income statement as incurred. Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products or processes, is capitalised if the product or process is considered to be technically and commercially feasible and the Group intends to complete the intangible asset for use or for sale.

#### (iii) Allowances and emissions

The European Emissions trading scheme (EU ETS) has been in operation since 1 January 2005. The IASB withdrew IFRIC 3 *Emission Rights* in June 2005 and it has not been replaced with definitive guidance or interpretation for CO<sub>2</sub> ('carbon') emissions trading. The Group recognises carbon allowances granted in a period at nominal value (nil value). Carbon allowances purchased are recorded at cost within intangible assets. A liability is recognised when the level of emissions in any compliance period exceed the level of allowances held and this is recorded as a current liability. Up to the level of allowances held the liability is measured at the cost of purchased allowances. When the carbon emission liability exceeds the carbon allowances held, the net liability is measured at the anticipated selling price. Movements in the market value of the liability are recognised in operating profit. Forward carbon contracts are measured at fair value with gains or losses arising on remeasurement being recognised in the income statement.

The intangible asset is surrendered at the end of the compliance period reflecting the consumption of the economic benefit and is derecognised at its carrying value. As a result, no amortisation is booked but an impairment charge may be recognised should the carrying value exceed market or fair value. Where allowances granted are used to settle a liability relating to a previous period, a creditor balance is recorded for the increased liability in the current period.

Under the Renewable Obligations Certificates (ROCs) scheme, certificates obtained from own generation are awarded by a third party, Ofgem. Self-generated certificates are recorded at market value and purchased certificates are recognised at cost, both within intangible assets. The liability under the renewables obligation is recognised based on electricity supplied to customers, the percentages set by Ofgem and the prevailing market price. The intangible asset is surrendered at the end of the compliance period reflecting the consumption of economic benefit. As a result no amortisation is recorded during the period.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

##### (iv) Development assets

Costs capitalised as development intangibles represent the costs incurred in bringing individual projects to the consented stage. These include wind farm developments, thermal generation and gas storage projects, prospective gas production assets and other developments relating to proven technologies. Costs associated with reaching the consent stage include options over land rights, planning application costs and environmental impact studies. These may be costs incurred directly or part of the fair value exercise on acquisition of a controlling interest in a project. The asset is subject to impairment testing on an annual basis until this time. At the point that the project reaches the consent stage and is approved by the Board, the carrying value of the project is transferred to property, plant and equipment as assets under construction. Depreciation will then be charged over the expected useful life of the related operational asset. The asset is derecognised on disposal, or when no future economic benefits are expected from their use.

##### (v) Other intangible assets

Other intangible assets that have been acquired by the Group including brands are stated at cost less accumulated amortisation and impairment losses. Software licenses are stated at cost less accumulated amortisation. Expenditure on internally generated brands is expensed as incurred. Amortisation is charged to the income statement on a straight-line basis over the estimated useful life of these other intangible assets. The amortisation periods utilised are as follows:

|                               | Years                         |
|-------------------------------|-------------------------------|
| Brand values                  | 10                            |
| Application software licences | 5                             |
| Customer lists                | 5                             |
| Contracts                     | Shorter of contract term or 5 |

##### Impairment review

The carrying amounts of the Group's assets, other than inventories or deferred tax, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If there is evidence of impairment, the recoverable amount associated with the asset, being the higher of the fair value less costs to sell and the value-in-use of the asset, is estimated to determine the extent of any such impairment. For goodwill and other intangible assets with an indefinite life or which are not ready for use, the test for impairment is carried out annually. For financial assets measured at amortised cost the impairment is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. For property, plant and equipment assets exhibiting indications of impairment, the review of impairment will be performed annually until there is evidence that any potential impairment loss has been appropriately recognised.

##### Inventories and work in progress

Inventories are valued at the lower of cost (on a first-in, first-out basis) and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses. The cost of fuel stocks is based on the weighted average principle. The valuation of work in progress is based on the cost of labour, the cost of contractors, the cost of materials plus other directly attributable costs.

##### Recognition of revenue and profit on construction contracts

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date. This is normally measured as the proportion of cost incurred on work performed to date compared to the estimated total contract cost, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer. When it becomes probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately in the income statement.

##### Employee benefit obligations

###### (i) Defined benefit pension schemes

The Group operates two defined benefit pension schemes, one of which is operated by the Company. Pension scheme assets are measured using bid market values. Pension scheme liabilities are measured using the projected unit credit actuarial method and are discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

Any increase in the present value of liabilities within the Group's defined benefit pension schemes expected to arise from employee service in the year is charged as service costs to operating profit.

The expected return on the schemes' assets and the increase during the year in the present value of the schemes' liabilities arising from the passage of time are included in finance income and finance costs, respectively. Actuarial gains and losses are recognised in full in the consolidated statement of comprehensive income. Pension scheme surpluses, to the extent that they are considered recoverable, or deficits are recognised in full and presented on the face of the balance sheet.



**(ii) Defined contribution pension schemes**

The Group also operates a number of defined contribution pension schemes. The assets of the schemes are held separately from those of the Group in independently administered funds. The amounts charged represent the contributions payable to the schemes in the year and are charged directly to the income statement.

**(iii) Equity and equity-related compensation benefits**

The Group operates a number of employee share schemes as described in the Remuneration Report and note 30. These schemes enable Group employees to acquire shares of the Company.

The exercise prices of the sharesave scheme are set at a discount to market price at the date of the grant. The fair value of the sharesave scheme option granted is measured at the grant date by use of a Black-Scholes model. The fair value of the options granted is recognised as an expense on a straight-line basis over the period that the scheme vests. Estimates are updated for non-market conditions at each balance sheet date with any adjustment in respect of the current and prior years being recognised in the income statement.

The costs associated with the other main employee schemes are recognised over the period to which they relate.

The charge related to the equity shares in the Company awarded under the share schemes is treated as an increase in the cost of investment held by the Company in the subsidiary companies of the Group.

**Financial instruments**

The Group uses a range of financial instruments to hedge exposures to financial risks, such as interest rate, foreign exchange and energy price fluctuations in its normal course of business and in accordance with the Group's risk management policies. The Group's risk management policies are further explained in note 31.

**(i) Interest rate and foreign exchange derivatives**

Financial derivative instruments are used by the Group to hedge interest rate and currency exposures. All such derivatives are recognised at fair value and are remeasured to fair value each reporting period. Certain derivative financial instruments are designated as being held for hedging purposes. The designation of the hedge relationship is established at the inception of the hedge and procedures are applied to ensure the derivative is highly effective in achieving its objective and that the effectiveness of the hedge can be reliably measured. The treatment of gains and losses on remeasurement is dependent on the classification of the hedge and whether the hedge relationship is designated as either a 'fair value' or 'cash flow' hedge. Derivatives that are not designated as hedges are treated as if held for trading, with all fair value movements being recorded through the income statement.

A derivative classified as a 'fair value' hedge recognises gains and losses from remeasurement immediately in the income statement. Loans and borrowings are measured at cost except where they form the underlying transaction in an effective fair value hedge relationship. In such cases, the carrying value of the loan or borrowing is adjusted to reflect fair value movements with the gain or loss being reported in the income statement.

A derivative classified as a 'cash flow' hedge recognises the portion of gains or losses on the derivative which are deemed to be effective directly in equity in the hedge reserve. Any ineffective portion of the gains or losses is recognised in the consolidated income statement. When hedged cash flows result in the recognition of a non-financial asset or liability, the associated gains or losses previously recognised in equity are included in the initial measurement of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same period in which the hedged cash flows affect the income statement.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At the point of discontinuation, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the forecast transaction affects profit or loss. On settlement, the cumulative gain or loss recognised in equity is recognised in the income statement.

**(ii) Commodity derivatives**

Within its regular course of business, the Group routinely enters into sale and purchase derivative contracts for commodities such as electricity, gas, coal and oil. Where the contract was entered into and continues to be held for the purpose of receipt or delivery in accordance with the Group's expected sale, purchase or usage requirements, the contracts are designated as 'own use' contracts and are measured at cost. These contracts are not within the scope of IAS 39.

Derivative commodity contracts which are not designated as own use contracts are accounted for as trading derivatives and are recognised in the balance sheet at fair value. Where a hedge accounting relationship is designated and is proven to be effective, the changes in fair value will be recognised in accordance with the rules noted in part (i) to this note.

Other commodity contracts, where own use is not established and a hedge accounting relationship is not designated, are measured at fair value with gains and losses on remeasurement being recognised in the income statement in cost of sales.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 1. SIGNIFICANT ACCOUNTING POLICIES (continued)

##### (iii) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives where the characteristics of the derivatives are not closely related to those of the host contracts.

##### (iv) Net investment hedges

Hedges of net investments in foreign operations are accounted in a manner similar to effective cash flow hedges. Any gain or loss on the effective portion of the hedge is recognised in equity, in the translation reserve, and any gain or loss on the ineffective portion of the hedge is recognised in the income statement. On disposal of the foreign operation, the cumulative value of any gains or losses recognised directly in equity is transferred to the income statement.

##### (v) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

##### (vi) Trade receivables

Trade receivables do not carry any interest and are measured at cost less an appropriate allowance for irrecoverable receivables.

##### (vii) Interest-bearing loans and borrowings

All such loans and borrowings are initially recognised at fair value including transaction costs and are subsequently measured at amortised cost, except where the loan or borrowing is the hedged item in an effective fair value hedge relationship.

##### (viii) Share capital

Ordinary Shares are accounted for as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds received.

##### (ix) Hybrid capital

The Group issued hybrid capital in the year ended 31 March 2011. Hybrid capital comprises issued bonds that qualify for recognition as equity. Accordingly, any coupon payments are accounted for as dividends and are recognised directly in equity at the time the payment obligation arises. This is because the coupon payments are discretionary and relate to equity. Coupon payments consequently do not have any impact on the income statement. Coupon payments are recognised in the cash flow statement in the same way as dividends to Ordinary Shareholders.

#### Provisions

A provision is recognised in the balance sheet when the Group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

#### Decommissioning costs

The estimated cost of decommissioning at the end of the useful lives of certain assets is reviewed periodically. Provision is made for the net present value of the estimated cost of decommissioning gas production facilities at the end of the producing lives of fields, and gas storage facilities and power stations at the end of the useful life of the facilities. The estimates are based on technology and prices at the balance sheet date. A corresponding decommissioning asset is recognised and is included within property, plant and equipment when the provision gives access to future economic benefits. Changes in these provisions are recognised prospectively. For offshore wind assets, power stations and gas storage facilities the unwinding of the discount on the provision is included in finance costs and the depreciation of the asset is straight-line over the expected useful life of the asset. For gas production facilities the decommissioning asset is amortised using the unit of production method, based on proven and probable reserves.

#### Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, management necessarily makes judgements and estimates that have a significant effect on the amounts recognised in the financial statements. Changes in the assumptions underlying the estimates could result in a significant impact to the financial statements. The most critical of these accounting judgement and estimation areas are noted.

**(i) Revenue recognition**

Revenue on energy sales includes an estimate of the value of electricity or gas supplied to customers between the date of the last meter reading and the year end. This will have been estimated by using historical consumption patterns and takes into consideration industry reconciliation processes for total consumption by supplier. At the balance sheet date, the estimated consumption by customers will either have been billed (estimated billed revenue) or accrued (unbilled revenue). Management apply judgement to the measurement of the quantum of the estimated consumption and to the valuation of that consumption. The judgements applied, and the assumptions underpinning these judgements are considered to be appropriate. However, a change in these assumptions would impact upon the amount of revenue recognised.

**(ii) Retirement benefits**

The assumptions in relation to the cost of providing post-retirement benefits during the period are set after consultation with qualified actuaries. While these assumptions are believed to be appropriate, a change in these assumptions would impact the earnings of the Group. The value of scheme assets is impacted by the asset ceiling test which restricts the surplus that can be recognised to assets that can be recovered fully through refunds or reductions in future contributions.

**(iii) Impairment testing**

The Group reviews the carrying amounts of its goodwill, other intangible assets and property, plant and equipment to determine whether there is any indication that the value of those assets is impaired.

In assessing for impairment, assets that do not generate independent cash flows are allocated to an appropriate cash generating unit (CGU) on initial recognition. The recoverable amount of the assets, or the CGU where appropriate, is measured as the higher of their fair value less costs to sell and value in use. Value in use calculations require the estimation of future cash flows to be derived from the respective assets or CGUs and the selection of an appropriate discount rate in order to calculate their present value. The fair value less costs to sell methodology used for the wind farms CGUs also requires the discounting of cash flows from the projects within the respective CGUs. The estimation of the timing and value of underlying projected cash flows and the selection of appropriate discount rates involves management judgement. Where assets under review are able to be assessed independently, for example thermal generation plants, the value-in-use method will be applied to ascertain the extent of any potential impairment charge.

Subsequent changes to these estimates or judgements may impact the carrying value of the assets within the respective CGUs. Gas production and development assets are assessed under the fair value less costs method for the respective CGUs. This is deemed more appropriate as it is based on post-tax cash flows arising from each field within the respective CGUs, which is consistent with the approach taken by management in determining the economic value of the underlying assets. This is determined by discounting the post-tax cash flows expected to be generated by the CGU, net of associated selling costs, and takes into account assumptions market participants would use in estimating fair value.

**(iv) Provisions and contingencies**

The assessments undertaken in recognising provisions and contingencies have been made in accordance with IAS 37. The Group has entered into a number of commodity contracts relating to specific assets. Where the unavoidable costs of meeting the obligations under the contracts exceed the expected net revenues from the assets in the normal course of business, an onerous provision has been recognised. The provisions are calculated based on estimations. The evaluation of the likelihood of the contingent events has required best judgement by management regarding the probability of exposure to potential loss. Should circumstances change following unforeseeable developments, this likelihood could alter.

**(v) Decommissioning costs**

The estimated costs of decommissioning at the end of the useful lives of assets is reviewed periodically. Decommissioning costs in relation to gas exploration and production assets are based on expected lives of the fields and costs of decommissioning and are currently expected to be incurred predominantly between 2017 and 2030.

**(vi) Gas and liquids reserves**

The volume of proven and probable gas and liquids reserves is an estimate that affects the unit of production depreciation of Gas Production property, plant and equipment. This is also a significant input estimate to the associated impairment and decommissioning calculations. The impact of a change in estimated proven and probable reserves is dealt with prospectively by depreciating the remaining book value of producing assets over the revised expected future production. If proven and probable reserves estimates are revised downwards, earnings could be affected by higher depreciation expense or an immediate write-down (impairment) of the asset's book value.

**(vii) Exceptionals and remeasurements**

The criteria for identifying what constitutes an exceptional item are outlined in note 1 Exceptional items and certain remeasurements on page 98.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 2. CHANGE OF REPORTABLE SEGMENTS

Following changes to the structure of the Group's internal organisation, and subsequent changes to the way in which financial and management information is presented to both the Board and Management Board in the current year, the composition of the Group's reportable segments has changed.

The activities included in the new reportable segments are explained in more detail in note 3. The main changes to the segments have been:

- Power Systems, previously split on a geographical basis, is now presented as Electricity Distribution and Electricity Transmission. The Electricity Connections activity is now included in Electricity Distribution.
- Generation and Supply, previously a single reportable segment, will now be reported as two new main segments, (i) Energy Supply and (ii) Energy Portfolio Management and Electricity Generation, reflecting the new management structure and change in basis of management reporting. Other activities previously included in this segment, such as other energy-related services provided to end-user customers, are disclosed in Energy-related Services.
- The Other businesses segment, previously disclosed as an aggregation of less significant activities are now disclosed in the segment which corresponds to the Group's new management structure, excepting corporate costs which remain unallocated. These new segments include Other Networks, Gas Storage and Gas Production.

The impact of the change in the segments on the prior year can be summarised as follows:

#### (a) Revenue

The Revenue by segment disclosure note for the year to March 2011 was as follows:

|                              | External<br>revenue<br>£m | Intra-segment<br>revenue<br>£m | Total<br>revenue<br>£m |
|------------------------------|---------------------------|--------------------------------|------------------------|
| <b>Power Systems</b>         |                           |                                |                        |
| Scotland                     | 245.7                     | 111.0                          | 356.7                  |
| England                      | 303.1                     | 214.1                          | 517.2                  |
|                              | <b>548.8</b>              | <b>325.1</b>                   | <b>873.9</b>           |
| <b>Generation and Supply</b> |                           |                                |                        |
| Retail                       | 8,044.4                   | –                              | 8,044.4                |
| Wholesale and Trading        | 18,882.8                  | 17.1                           | 18,899.9               |
| Other                        | 207.1                     | 15.8                           | 222.9                  |
|                              | <b>27,134.3</b>           | <b>32.9</b>                    | <b>27,167.2</b>        |
| <b>Other businesses</b>      | <b>651.1</b>              | <b>568.8</b>                   | <b>1,219.9</b>         |
|                              | <b>28,334.2</b>           | <b>926.8</b>                   | <b>29,261.0</b>        |

Following the change in the composition of segments, this has been restated as follows:

|  | External<br>revenue<br>£m | Intra-segment<br>revenue<br>£m | Total<br>revenue<br>£m |
|--|---------------------------|--------------------------------|------------------------|
| <b>Networks</b>  |                           |                                |                        |
| Electricity Distribution                               | 559.8                     | 325.0                          | 884.8                  |
| Electricity Transmission                               | 94.1                      | 0.1                            | 94.2                   |
| Other Networks   | 148.9                     | 40.7                           | 189.6                  |
|  | <b>802.8</b>              | <b>365.8</b>                   | <b>1,168.6</b>         |
| <b>Retail</b>  |                           |                                |                        |
| Energy Supply  | 8,008.1                   | 15.8                           | 8,023.9                |
| Energy-related Services                                | 429.7                     | 164.6                          | 594.3                  |
|  | <b>8,437.8</b>            | <b>180.4</b>                   | <b>8,618.2</b>         |
| <b>Wholesale</b>                                       |                           |                                |                        |
| Energy Portfolio Management and Electricity Generation | 19,014.1                  | 4,547.1                        | 23,561.2               |
| Gas Storage  | 30.5                      | 42.2                           | 72.7                   |
| Gas Production   | 0.2                       | 15.6                           | 15.8                   |
|  | <b>19,044.8</b>           | <b>4,604.9</b>                 | <b>23,649.7</b>        |
| Corporate unallocated                                  | 48.8                      | 305.7                          | 354.5                  |
| <b>Total</b>   | <b>28,334.2</b>           | <b>5,456.8</b>                 | <b>33,791.0</b>        |

The increase in intra-segment revenue relates to electricity and gas provided to Energy Supply from the Energy Portfolio Management and Electricity Generation segment (£4,530.0m).

### (b) Operating profit by segment

The operating profit by segment disclosure note for the year to March 2011 was as follows:

|                              | 2011  |   |   |  |                |
|------------------------------|---|---|---|--|----------------|
|                              | Adjusted operating profit reported to the Board<br>£m | JCE/Associate share of interest and tax<br>£m | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>£m | Total<br>£m    |
| <b>Power Systems</b>         |   |   |   |  |                |
| Scotland                     | 168.1   | –   | 168.1   | –  | 168.1          |
| England                      | 287.4   | –   | 287.4   | –  | 287.4          |
|                              | <b>455.5</b>  | <b>–</b>                                      | <b>455.5</b>  | <b>–</b>   | <b>455.5</b>   |
| Scotia Gas Networks          | 186.8   | (150.7)                                       | 36.1  | 38.4   | 74.5           |
| <b>Energy Systems</b>        | <b>642.3</b>  | <b>(150.7)</b>                                | <b>491.6</b>  | <b>38.4</b>  | <b>530.0</b>   |
| <b>Generation and Supply</b> | 882.8   | (47.1)  | 835.7   | 874.6  | 1,710.3        |
| <b>Other businesses</b>      | 136.8   | (0.3)   | 136.5   | –  | 136.5          |
|                              | <b>1,661.9</b>  | <b>(198.1)</b>                                | <b>1,463.8</b>  | <b>913.0</b>                                       | <b>2,376.8</b> |
| Unallocated expenses         | (9.0)   | –   | (9.0)   | –  | (9.0)          |
|                              | <b>1,652.9</b>  | <b>(198.1)</b>                                | <b>1,454.8</b>  | <b>913.0</b>                                       | <b>2,367.8</b> |

Following the change in the composition of segments, this has been restated as follows:

|  | 2011  |   |   |  |                |
|--|---|---|---|--|----------------|
|  | Adjusted operating profit reported to the Board<br>£m | JCE/Associate share of interest and tax<br>£m | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>£m | Total<br>£m    |
| <b>Networks</b>  |   |   |   |  |                |
| Electricity Distribution                               | 418.9   | –   | 418.9   | –  | 418.9          |
| Electricity Transmission                               | 47.7  | –   | 47.7  | –  | 47.7           |
| Gas Distribution                                       | 186.8   | (150.7)                                       | 36.1  | 38.4   | 74.5           |
| Other Networks   | 37.1  | –   | 37.1  | –  | 37.1           |
|  | <b>690.5</b>  | <b>(150.7)</b>                                | <b>539.8</b>  | <b>38.4</b>  | <b>578.2</b>   |
| <b>Retail</b>  |   |   |   |  |                |
| Energy Supply  | 347.7   | –   | 347.7   | –  | 347.7          |
| Energy-related Services                                | 52.8  | (0.3)   | 52.5  | –  | 52.5           |
|  | <b>400.5</b>  | <b>(0.3)</b>                                  | <b>400.2</b>  | <b>–</b>   | <b>400.2</b>   |
| <b>Wholesale</b>                                       |   |   |   |  |                |
| Energy Portfolio Management and Electricity Generation | 543.4   | (47.1)  | 496.3   | 874.6  | 1,370.9        |
| Gas Storage  | 23.5  | –   | 23.5  | –  | 23.5           |
| Gas Production   | 4.6   | –   | 4.6   | –  | 4.6            |
|  | <b>571.5</b>  | <b>(47.1)</b>                                 | <b>524.4</b>  | <b>874.6</b>                                       | <b>1,399.0</b> |
| Corporate unallocated                                  | (9.6)   | –   | (9.6)   | –  | (9.6)          |
| <b>Total</b>   | <b>1,652.9</b>  | <b>(198.1)</b>                                | <b>1,454.8</b>  | <b>913.0</b>                                       | <b>2,367.8</b> |



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 2. CHANGE OF REPORTABLE SEGMENTS (continued)

##### (c) Capital expenditure by segment

The Capital Expenditure by segment disclosure note for the year to March 2011 was as follows:

|                                  | Capital additions<br>to intangible<br>assets<br>2011<br>£m | Capital additions<br>to property, plant<br>and equipment<br>2011<br>£m |
|----------------------------------|--|--|
| <b>Power Systems</b>             |  |  |
| Scotland                         | –  | 216.2  |
| England                          | –  | 207.9  |
|                                  | <b>–</b>   | <b>424.1</b>   |
| <b>Generation and Supply</b>     | 432.7  | 560.4  |
| <b>Other businesses</b>          | –  | 175.0  |
| <b>Corporate and unallocated</b> | 1.3  | –  |
|                                  | <b>434.0</b>   | <b>1,159.5</b>   |

Following the change in the composition of segments, this has been restated as follows:

|  | Capital additions<br>to intangible<br>assets<br>2011<br>£m | Capital additions<br>to property, plant<br>and equipment<br>2011<br>£m |
|--|--|--|
| <b>Networks</b>  |  |  |
| Electricity Distribution                               | –  | 307.6  |
| Electricity Transmission                               | –  | 117.4  |
| Other Networks   | 0.2  | 55.0   |
|  | <b>0.2</b>   | <b>480.0</b>   |
| <b>Retail</b>  |  |  |
| Energy Supply  | –  | –  |
| Energy-related Services                                | –  | 27.9   |
|  | <b>–</b>   | <b>27.9</b>  |
| <b>Wholesale</b>                                       |  |  |
| Energy Portfolio Management and Electricity Generation | 430.9  | 563.7  |
| Gas Storage  | 1.6  | 52.6   |
| Gas Production   | –  | –  |
|  | <b>432.5</b>   | <b>616.3</b>   |
| Corporate unallocated                                  | 1.3  | 35.3   |
| <b>Total</b>   | <b>434.0</b>   | <b>1,159.5</b>   |

##### (d) Items included in operating profit by segment

The operating profit by segment disclosure note for the year to March 2011 was as follows:

|                                  | Depreciation/impairment on property,<br>plant and equipment |                                      |                     | Amortisation/<br>impairment of<br>intangible assets |
|----------------------------------|---|--------------------------------------|---------------------|---|
|                                  | Before<br>exceptional<br>items<br>2011<br>£m                | Exceptional<br>charges<br>2011<br>£m | Total<br>2011<br>£m | 2011<br>£m  |
| <b>Power Systems</b>             |   |                                      |                     |   |
| Scotland                         | 108.6   | –                                    | 108.6               | –   |
| England                          | 149.3   | –                                    | 149.3               | –   |
|                                  | <b>257.9</b>  | <b>–</b>                             | <b>257.9</b>        | <b>–</b>  |
| <b>Generation and Supply</b>     | 175.9   | 442.7                                | 618.6               | 98.9  |
| <b>Other businesses</b>          | 62.9  | –                                    | 62.9                | 1.1   |
|                                  | <b>496.7</b>  | <b>442.7</b>                         | <b>939.4</b>        | <b>100.0</b>  |
| <b>Corporate and unallocated</b> | –   | –                                    | –                   | 3.7   |
|                                  | <b>496.7</b>  | <b>442.7</b>                         | <b>939.4</b>        | <b>103.7</b>  |

Following the change in the composition of segments, this has been restated as follows:

|  | Depreciation/impairment on property, plant and equipment |                                |                  | Amortisation/impairment of intangible assets |                                |                  |
|--|--|--------------------------------|------------------|--|--------------------------------|------------------|
|  | Before exceptional items 2011<br>£m                      | Exceptional charges 2011<br>£m | Total 2011<br>£m | Before exceptional items 2011<br>£m          | Exceptional charges 2011<br>£m | Total 2011<br>£m |
| <b>Networks</b>  |  |                                |                  |  |                                |                  |
| Electricity Distribution                               | 229.8  | –                              | 229.8            | –  | –                              | –                |
| Electricity Transmission                               | 28.2   | –                              | 28.2             | –  | –                              | –                |
| Other Networks   | 25.5   | –                              | 25.5             | 1.1  | –                              | 1.1              |
|  | <b>283.5</b>   | <b>–</b>                       | <b>283.5</b>     | <b>1.1</b>                                   | <b>–</b>                       | <b>1.1</b>       |
| <b>Retail</b>  |  |                                |                  |  |                                |                  |
| Energy Supply  | –  | –                              | –                | 2.6  | –                              | 2.6              |
| Energy-related Services                                | 3.3  | –                              | 3.3              | –  | –                              | –                |
|  | <b>3.3</b>   | <b>–</b>                       | <b>3.3</b>       | <b>2.6</b>                                   | <b>–</b>                       | <b>2.6</b>       |
| <b>Wholesale</b>                                       |  |                                |                  |  |                                |                  |
| Energy Portfolio Management and Electricity Generation | 175.8  | 442.7                          | 618.5            | 12.5   | 82.2                           | 94.7             |
| Gas Storage  | 7.1  | –                              | 7.1              | 1.6  | –                              | 1.6              |
| Gas Production   | 7.1  | –                              | 7.1              | –  | –                              | –                |
|  | <b>190.0</b>   | <b>442.7</b>                   | <b>632.7</b>     | <b>14.1</b>                                  | <b>82.2</b>                    | <b>96.3</b>      |
| Corporate unallocated                                  | 19.9   | –                              | 19.9             | 3.7  | –                              | 3.7              |
| <b>Total</b>   | <b>496.7</b>   | <b>442.7</b>                   | <b>939.4</b>     | <b>21.5</b>                                  | <b>82.2</b>                    | <b>103.7</b>     |

### 3. SEGMENTAL INFORMATION

The Group's operating segments are those used internally by the Board to run the business, allocate resources and make strategic decisions. The Group's main businesses and operating segments are the **Networks** business comprising Electricity Distribution, Electricity Transmission, Gas Distribution and Other Networks; the **Retail** business comprising Energy Supply and Energy-related Services, and; **Wholesale** comprising Energy Portfolio Management and Electricity Generation, Gas Storage and Gas Production.

The types of products and services from which each reportable segment derives its revenues are:

| Business area    | Reported segments                                      | Description   |
|------------------|--|---|
| <b>Networks</b>  | Electricity Distribution                               | The economically regulated lower voltage distribution of electricity to customer premises in the North of Scotland and the South of England   |
|                  | Electricity Transmission                               | The economically regulated high voltage transmission of electricity from generating plant to the distribution network in the North of Scotland  |
|                  | Gas Distribution                                       | SSE's share of Scotia Gas Networks, which operates two economically regulated gas distribution networks in Scotland and the South of England  |
|                  | Other Networks   | Operation of other networks and services including telecoms capacity and bandwidth, out-of-area local networks in the UK and streetlighting services in the UK and Ireland  |
| <b>Retail</b>    | Energy Supply  | The supply of electricity and gas to residential and business customers in the UK and Ireland   |
|                  | Energy-related Services                                | The provision of energy-related goods and services to customers in the UK including electrical contracting, meter reading and installation, telecommunication and broadband services, boiler maintenance and installation and the sale of electrical appliances |
| <b>Wholesale</b> | Energy Portfolio Management and Electricity Generation | The generation of power from renewable and thermal plant in the UK, Ireland and Europe and the optimisation of SSE's power and gas contracts and requirements   |
|                  | Gas Storage  | The operation of gas storage facilities in the UK   |
|                  | Gas Production   | The production and processing of gas and oil from North Sea fields  |

The measure of profit used by the Board is adjusted operating profit which is before exceptional items, remeasurements arising from IAS 39 and after the removal of taxation and interest on profits from jointly controlled entities and associates.

Analysis of revenue, operating profit, assets and other items by segment is provided below. All revenue and profit before taxation arise from operations within Great Britain, Ireland and mainland Europe.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 3. SEGMENTAL INFORMATION (continued)

##### (a) Revenue by segment

|  | External<br>revenue<br>2012<br>£m | Intra-segment<br>revenue (i)<br>2012<br>£m | Total<br>revenue<br>2012<br>£m |
|--|-----------------------------------|--|--------------------------------|
| <b>Networks</b>  |                                   |  |                                |
| Electricity Distribution                               | 542.1                             | 336.9                                      | 879.0                          |
| Electricity Transmission                               | 117.7                             | 0.1  | 117.8                          |
| Other Networks   | 249.0                             | 49.4                                       | 298.4                          |
|  | <b>908.8</b>                      | <b>386.4</b>                               | <b>1,295.2</b>                 |
| <b>Retail</b>  |                                   |  |                                |
| Energy Supply  | 7,787.3                           | 23.1                                       | 7,810.4                        |
| Energy-related Services                                | 280.4                             | 184.8                                      | 465.2                          |
|  | <b>8,067.7</b>                    | <b>207.9</b>                               | <b>8,275.6</b>                 |
| <b>Wholesale</b>                                       |                                   |  |                                |
| Energy Portfolio Management and Electricity Generation | 22,664.2                          | 4,447.5                                    | 27,111.7                       |
| Gas Storage  | 30.3                              | 51.9                                       | 82.2                           |
| Gas Production   | 3.0                               | 99.3                                       | 102.3                          |
|  | <b>22,697.5</b>                   | <b>4,598.7</b>                             | <b>27,296.2</b>                |
| Corporate unallocated                                  | 49.9                              | 264.3                                      | 314.2                          |
| <b>Total</b>   | <b>31,723.9</b>                   | <b>5,457.3</b>                             | <b>37,181.2</b>                |

The comparative information for the previous financial year is shown in note 2.

(i) Significant intra-segment revenue is derived from use of system income received by the Electricity Distribution business from Energy Supply; Other Networks provide Telecoms and other infrastructure charges to other Group companies; Energy Supply provides internal heat and light power supplies to other Group companies; Energy-related Services provides Contracting, Metering and other services to other Group companies; Energy Portfolio Management and Electricity Generation provides power and gas to the Energy Supply segment; Gas Storage provide the use of Gas Storage facilities to Energy Portfolio Management, Gas Production sells gas from producing North Sea fields to the Energy Portfolio Management and Electricity Generation segment and corporate unallocated provides corporate and infrastructure services to the operating businesses. All are provided at arm's length basis.

Revenue within Energy Portfolio Management and Electricity Generation includes revenues from generation plant output and the gross value of all wholesale power and gas sales including settled physical and financial trades. These are entered into to optimise the performance of the generation plants and to support the Energy Supply segment. Purchase trades are included in cost of sales.

Revenue from the Group's investment in Scotia Gas Networks (SSE share being: 2012 – £454.3m; 2011 – £392.5m) is not recorded in the revenue line in the income statement.

Revenue by geographical location is as follows:

|                                 | 2012<br>£m      | 2011<br>£m |
|---------------------------------|-----------------|------------|
| UK                              | <b>31,069.7</b> | 27,666.6   |
| Ireland plus Continental Europe | <b>654.2</b>    | 667.6      |
|                                 | <b>31,723.9</b> | 28,334.2   |

**(b) Operating profit/(loss) by segment**

|  | Adjusted operating profit reported to the Board<br>£m | JCE/Associate share of interest and tax (i)<br>£m | 2012  |  | Total<br>£m    |
|--|---|---|---|--|----------------|
|  |   |   | Before exceptional items and certain remeasurements<br>£m | Exceptional items and certain remeasurements<br>£m |                |
| <b>Networks</b>  |   |   |   |  |                |
| Electricity Distribution                               | 396.5   | –   | 396.5   | –  | 396.5          |
| Electricity Transmission                               | 73.7  | –   | 73.7  | –  | 73.7           |
| Gas Distribution                                       | 234.8   | (164.5)   | 70.3  | 48.5   | 118.8          |
| Other Networks   | 32.1  | –   | 32.1  | –  | 32.1           |
|  | <b>737.1</b>  | <b>(164.5)</b>                                    | <b>572.6</b>  | <b>48.5</b>  | <b>621.1</b>   |
| <b>Retail</b>  |   |   |   |  |                |
| Energy Supply  | 271.7   | –   | 271.7   | (20.0)   | 251.7          |
| Energy-related Services                                | 49.9  | (0.2)   | 49.7  | (40.0)   | 9.7            |
|  | <b>321.6</b>  | <b>(0.2)</b>                                      | <b>321.4</b>  | <b>(60.0)</b>                                      | <b>261.4</b>   |
| <b>Wholesale</b>                                       |   |   |   |  |                |
| Energy Portfolio Management and Electricity Generation | 541.5   | (26.7)  | 514.8   | (869.3)  | (354.5)        |
| Gas Storage  | 23.8  | –   | 23.8  | (30.0)   | (6.2)          |
| Gas Production   | 42.6  | –   | 42.6  | (22.0)   | 20.6           |
|  | <b>607.9</b>  | <b>(26.7)</b>                                     | <b>581.2</b>  | <b>(921.3)</b>                                     | <b>(340.1)</b> |
| Corporate unallocated                                  | (8.8)   | –   | (8.8)   | –  | (8.8)          |
| <b>Total</b>   | <b>1,657.8</b>  | <b>(191.4)</b>                                    | <b>1,466.4</b>  | <b>(932.8)</b>                                     | <b>533.6</b>   |

The comparative information for the previous financial year is shown in note 2.

- (i) The adjusted operating profit of the Group is reported after removal of the Group's share of interest, fair value movements on financing derivatives and tax from jointly controlled entities and associates. The share of Scotia Gas Networks Limited interest includes loan stock interest payable to the consortium shareholders (included in Gas Distribution). The Group has accounted for its 50% share of this, £33.4m (2011 – £33.4m), as finance income (note 7).

The Group's share of operating profit from jointly controlled entities and associates has been recognised in the Energy Portfolio Management and Electricity Generation segment other than that for Scotia Gas Networks Limited, which is recorded in Gas Distribution, and PriDE (SERP), which is recognised in Energy-related Services (£0.2m before tax; 2011 – £0.3m before tax).

**(c) Capital expenditure by segment**

|  | 2012   |  |
|--|--|--|
|  | Capital additions to intangible assets<br>£m | Capital additions to property, plant and equipment<br>£m |
| <b>Networks</b>  |  |  |
| Electricity Distribution                               | –  | 347.5  |
| Electricity Transmission                               | –  | 228.7  |
| Other Networks   | –  | 48.0   |
|  | <b>–</b>                                     | <b>624.2</b>   |
| <b>Retail</b>  |  |  |
| Energy Supply  | –  | –  |
| Energy-related Services                                | –  | 25.7   |
|  | <b>–</b>                                     | <b>25.7</b>  |
| <b>Wholesale</b>                                       |  |  |
| Energy Portfolio Management and Electricity Generation | 539.8  | 664.3  |
| Gas Storage  | –  | 51.0   |
| Gas Production   | –  | 6.1  |
|  | <b>539.8</b>                                 | <b>721.4</b>   |
| Corporate unallocated                                  | 0.1  | 105.2  |
| <b>Total</b>   | <b>539.9</b>                                 | <b>1,476.5</b>   |

The comparative information for the previous financial year is shown in note 2.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 3. SEGMENTAL INFORMATION (continued)

Capital additions does not include assets acquired in acquisitions or assets acquired under finance leases. Capital additions to Intangible Assets includes the purchase of emissions allowances and certificates (2012 – £503.7m; 2011 – £399.3m).

No segmental analysis of assets requires to be disclosed as this information is not presented to the Board.

#### (d) Items included in operating profit by segment

|  | Depreciation/impairment on property, plant and equipment |                     |              | Amortisation/impairment of intangible assets |                     |              |
|--|--|---------------------|--------------|--|---------------------|--------------|
|  | Before exceptional items                                 | Exceptional charges | Total        | Before exceptional items                     | Exceptional charges | Total        |
|  | 2012   | 2012                | 2012         | 2012   | 2012                | 2012         |
|  | £m   | £m                  | £m           | £m   | £m                  | £m           |
| <b>Networks</b>  |  |                     |              |  |                     |              |
| Electricity Distribution                               | 224.6  | –                   | 224.6        | –  | –                   | –            |
| Electricity Transmission                               | 26.7   | –                   | 26.7         | –  | –                   | –            |
| Other Networks   | 29.7   | –                   | 29.7         | 5.1  | –                   | 5.1          |
|  | <b>281.0</b>   | <b>–</b>            | <b>281.0</b> | <b>5.1</b>                                   | <b>–</b>            | <b>5.1</b>   |
| <b>Retail</b>  |  |                     |              |  |                     |              |
| Energy Supply  | –  | –                   | –            | 3.2  | –                   | 3.2          |
| Energy-related Services                                | 4.7  | 30.0                | 34.7         | 0.1  | –                   | 0.1          |
|  | <b>4.7</b>   | <b>30.0</b>         | <b>34.7</b>  | <b>3.3</b>                                   | <b>–</b>            | <b>3.3</b>   |
| <b>Wholesale</b>                                       |  |                     |              |  |                     |              |
| Energy Portfolio Management and Electricity Generation | 212.4  | 275.1               | 487.5        | 2.3  | 106.6               | 108.9        |
| Gas Storage  | 8.8  | –                   | 8.8          | –  | 30.0                | 30.0         |
| Gas Production   | 30.5   | –                   | 30.5         | –  | 22.0                | 22.0         |
|  | <b>251.7</b>   | <b>275.1</b>        | <b>526.8</b> | <b>2.3</b>                                   | <b>158.6</b>        | <b>160.9</b> |
| Corporate unallocated                                  | 24.4   | –                   | 24.4         | 2.8  | –                   | 2.8          |
| <b>Total</b>   | <b>561.8</b>   | <b>305.1</b>        | <b>866.9</b> | <b>13.5</b>                                  | <b>158.6</b>        | <b>172.1</b> |

The comparative information for the previous financial year is shown in note 2.

The Group's share of Scotia Gas Networks Limited depreciation (2012 – £57.9m; 2011 – £52.3m) and amortisation (2012 – £4.8m; 2011 – £4.8m) is not included within operating costs.

#### 4. OTHER OPERATING INCOME AND EXPENSE

Group operating costs before exceptional items and certain remeasurements can be analysed thus:

|                      | 2012<br>£m   | 2011<br>£m |
|----------------------|--------------|------------|
| Distribution costs   | 370.0        | 371.1      |
| Administration costs | 518.0        | 530.9      |
|                      | <b>888.0</b> | 902.0      |

Group operating profit is stated after charging (or crediting) the following items:

|  | 2012<br>£m | 2011<br>£m |
|--|------------|------------|
| Depreciation and impairment of property, plant and equipment (note 12) (i)                   | 561.8      | 496.7      |
| Exceptional impairment charges (note 5)  | 478.6      | 524.9      |
| Impairment of inventories (note 17)  | 1.1        | 6.6        |
| Research and development costs   | 11.2       | 9.0        |
| Operating lease rentals (note 33)  | 169.9      | 235.3      |
| Release of deferred income in relation to capital grants and historic customer contributions | (14.7)     | (19.6)     |
| (Gain) on disposal of property, plant and equipment  | (4.6)      | (5.8)      |
| Loss on disposal of fixed asset investments  | 2.1        | –          |
| (Gain) on disposal of businesses and subsidiaries  | (5.5)      | (10.2)     |
| Amortisation of brand costs (note 11)  | 1.2        | 0.9        |
| Amortisation and impairment of intangible assets (note 11) (i)                               | 12.3       | 20.6       |

(i) Does not include exceptional impairment charges.



| Auditor's remuneration                                   | 2012<br>£m | 2011<br>£m |
|--|------------|------------|
| Statutory audit services – audit of the Group's accounts | 0.3        | 0.3        |
| Statutory audit of subsidiary accounts                   | 0.7        | 0.7        |
| Audit of parent and subsidiary entities                  | 1.0        | 1.0        |
| Tax services   | 0.1        | 0.2        |
| Other services   | 0.1        | 0.1        |

Tax service fees incurred in the year were £0.1m (2011 – £0.2m). Other service fees include fees incurred in relation to regulatory accounts and returns required by Ofgem. A description of the work of the Audit Committee is set out on page 72 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

Amounts paid to the Company's auditor in respect of services to the Company other than the audit of the Company's financial statements have not been disclosed as the information is required instead to be disclosed on a consolidated basis.

## 5. EXCEPTIONAL ITEMS AND CERTAIN REMEASUREMENTS

### (i) Exceptional items

In the year to 31 March 2012, the following exceptional items were recorded:

**Impairment of Generation-related assets arising from changing market conditions.** Exceptional charges have been recognised in relation to the impairment of goodwill (£19.3m), property, plant and equipment (£275.1m), current receivables (£5.0m), held for sale assets (£9.9m) and intangible assets (£87.3m), in relation to Generation-related assets.

These were recognised as a result of the long-term view of spark spreads at Medway and Keadby, which will change the way the plants are operationally configured. In addition, further impairment charges in respect of the station running hours at Ferrybridge and in respect of the future prospects for the European wind portfolio were recognised. Carbon dioxide emissions allowances intangible assets purchased to cover the future emissions liabilities at the Group's thermal plants have been impaired based on current market prices.

**Impairment of Other assets.** Exceptional charges have been recognised in relation to goodwill (£30.0m, note 14), property, plant and equipment (£30.0m) and intangible assets (£22.0m). These were recognised following the goodwill impairment review of the Gas Storage CGU and as a result from changing operational conditions and updated development expectations associated with legacy Metering assets and North Sea exploration assets.

**Provisions for onerous contracts, restructuring and other liabilities.** Exceptional charges have been recognised in relation to commodity contracts associated with thermal Generation assets (£37.4m). In addition, costs associated with Retail restructuring and other charges and the impairment of other financial assets (£35.6m) have been recognised as exceptional in the year.

**Changes in UK corporation tax rates.** The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate would reduce from 28% to 24% over a period of four years from 2011. The first changes from 28% to 27% and, after the March 2011 Budget, accelerated to 26% had been substantively enacted and applied by 1 April 2011. The March 2012 Budget confirmed a further acceleration of the reduction in rate to 24% effective from 1 April 2012, this being substantively enacted on 26 March 2012, with a revised rate of 22% expected to be enacted by 2014.

These changes will reduce the Group's future current tax charge accordingly. As the rate change to 24% has been substantively enacted it has the effect of reducing the Group's net deferred tax liabilities recognised at 31 March 2012 by £45.7m (2011 – £49.4m). It has not yet been possible to quantify the full anticipated effect of the announced further 2% rate reduction due to legislation not being enacted, although this will further reduce the Group's future current tax charge and reduce the Group's deferred tax liabilities/assets accordingly.

In addition, in the previous year, the March 2011 Budget increased the rate of supplementary corporation tax (SCT) from 20% to 32%. This had been substantively enacted on 29 March 2011. This had the effect of increasing the Group's deferred tax liabilities and assets in relation to the Group's Gas Production business to which this supplementary tax applies. The impact on the Group's net deferred tax liabilities was an increase of £31.7m.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 5. EXCEPTIONAL ITEMS AND CERTAIN REMEASUREMENTS (continued)

In the year to 31 March 2011 the following exceptional items were recorded:

**Impairment of thermal and renewable generation portfolio assets arising from changing market conditions.** Exceptional charges were recognised in relation to the impairment of goodwill (£42.5m), property, plant and equipment (£442.7m), development intangible assets (£39.7m) and financial assets (£7.6m). In addition, related net credits of £10.6m were recognised, including £8.8m relating to finance costs.

These were recognised as a consequence of changing regulatory and economic conditions, in particular, (i) the impact of the Industrial Emissions Directive on station running hours and useful economic lives at certain plants including the Fiddler's Ferry and Ferrybridge power stations; (ii) the consequential impact on the ash remediation plant at Fiddler's Ferry, (iii) changes in the economic prospects of certain older, less flexible thermal plants, and, (iv) the decision to concentrate continental Europe wind generation activities on the Sweden and Netherlands markets.

**Impairment of Investments in Associates.** Exceptional impairment charges were recognised in relation to the Group's investments in Barking Power Limited and Derwent Cogeneration Limited following the expiry of long-term power purchase agreements at both stations. In addition, certain other investments were impaired. The combined impairment charges were £76.3m net of deferred tax.

#### (ii) Certain remeasurements

Certain remeasurements arising from IAS 39 are disclosed separately to aid understanding of the underlying performance of the Group. This category includes the movement on derivatives as described in note 31.

#### (iii) Taxation

The Group has separately recognised the tax effect of the exceptional items and certain remeasurements summarised above.

These transactions can be summarised thus:

|   | 2012<br>£m       | 2011<br>£m |
|---|------------------|------------|
| Exceptional items (i)   |                  |            |
| Impairments and other charges:  |                  |            |
| Impairment of Generation assets arising from changing market conditions   | (396.6)          | (521.8)    |
| Impairment of Other assets  | (82.0)           | –          |
| Provisions for onerous contracts, restructuring and other liabilities   | (73.0)           | –          |
| Impairment of Investments in Associates (share of result, net of tax)   | –                | (76.3)     |
| Share of effect of change in UK corporation tax on deferred tax liabilities and assets of associate and joint venture investments | 42.0             | 36.3       |
|   | <b>(509.6)</b>   | (561.8)    |
| Certain remeasurements (ii)   |                  |            |
| Movement on operating derivatives (note 31)   | (433.7)          | 1,461.8    |
| Movement on financing derivatives (note 31)   | (89.5)           | (44.4)     |
| Share of movement on derivatives in jointly controlled entities (net of tax)  | 10.5             | 4.2        |
|   | <b>(512.7)</b>   | 1,421.6    |
| <b>Exceptional items before taxation</b>  | <b>(1,022.3)</b> | 859.8      |
| Exceptional items (iii)   |                  |            |
| Effect of change in UK corporation tax rate on deferred tax liabilities and assets  | 45.7             | 49.4       |
| Effect of change in UK supplementary corporation tax rate   | –                | (31.7)     |
| Taxation on other exceptional items   | 137.4            | 126.1      |
|   | <b>183.1</b>     | 143.8      |
| Taxation on certain remeasurements  | 136.5            | (396.2)    |
| <b>Taxation</b>   | <b>319.6</b>     | (252.4)    |
| <b>Exceptional items after taxation</b>   | <b>(702.7)</b>   | 607.4      |

## 6. DIRECTORS AND EMPLOYEES

### (i) Staff costs

|  | Consolidated |            |
|--|--------------|------------|
|  | 2012<br>£m   | 2011<br>£m |
| Staff costs:                                       |              |            |
| Wages and salaries                                 | 614.7        | 609.4      |
| Social security costs                              | 62.2         | 63.1       |
| Share-based remuneration (note 30)                 | 13.5         | 9.9        |
| Pension costs (note 29)                            | 56.9         | 54.6       |
|  | 747.3        | 737.0      |
| Less: capitalised as property, plant and equipment | (123.2)      | (108.6)    |
|  | 624.1        | 628.4      |

### Employee numbers:

|                              | Consolidated   |                | Company        |                |
|------------------------------|----------------|----------------|----------------|----------------|
|                              | 2012<br>Number | 2011<br>Number | 2012<br>Number | 2011<br>Number |
| Numbers employed at 31 March | 19,489         | 20,249         | 3              | 3              |

The average number of people employed by the Group (including Executive Directors) during the year was:

|  | Consolidated   |                | Company        |                |
|--|----------------|----------------|----------------|----------------|
|  | 2012<br>Number | 2011<br>Number | 2012<br>Number | 2011<br>Number |
| <b>Networks</b>  |                |                |                |                |
| Electricity Distribution                               | 2,085          | 2,054          | –              | –              |
| Electricity Transmission                               | 201            | 85             | –              | –              |
| Other Networks   | 361            | 241            | –              | –              |
|  | 2,647          | 2,380          | –              | –              |
| <b>Retail</b>  |                |                |                |                |
| Energy Supply  | 6,389          | 7,083          | –              | –              |
| Energy-related Services                                | 7,203          | 7,386          | –              | –              |
|  | 13,592         | 14,469         | –              | –              |
| <b>Wholesale</b>                                       |                |                |                |                |
| Energy Portfolio Management and Electricity Generation | 1,370          | 1,368          | –              | –              |
| Gas Storage  | 86             | 88             | –              | –              |
| Gas Production   | 4              | –              | –              | –              |
|  | 1,460          | 1,456          | –              | –              |
| Corporate unallocated                                  | 1,948          | 1,961          | 4              | 4              |
| <b>Total</b>   | <b>19,647</b>  | <b>20,266</b>  | <b>4</b>       | <b>4</b>       |

The costs associated with the employees of the Company, who are the Executive Directors of the Group, are borne by Group companies. No amounts are charged to the Company.

### (ii) Directors' remuneration and interests

Information concerning Directors' remuneration, shareholdings, options, long term incentive schemes and pensions is shown in the Remuneration Report on pages 75 to 86. No Director had, during or at the end of the year, any material interest in any other contract of significance in relation to the Group's business.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 7. FINANCE INCOME AND COSTS

##### Recognised in income statement

|   | 2012   |  |                | 2011   |  |                |
|---|--|--|----------------|--|--|----------------|
|   | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>(note 5)<br>£m | Total<br>£m    | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>(note 5)<br>£m | Total<br>£m    |
| <b>Finance income:</b>  |  |  |                |  |  |                |
| Return on pension scheme assets   | 147.4  | –  | 147.4          | 141.9  | –  | 141.9          |
| Interest income from short term deposits  | 2.0  | –  | 2.0            | 2.7  | –  | 2.7            |
| Other interest receivable:  |  |  |                |  |  |                |
| Scotia Gas Networks loan stock  | 33.4   | –  | 33.4           | 33.4   | –  | 33.4           |
| Other jointly controlled entities and associates  | 23.8   | –  | 23.8           | 23.1   | –  | 23.1           |
| Other receivable  | 43.5   | –  | 43.5           | 49.1   | –  | 49.1           |
|   | 100.7  | –  | 100.7          | 105.6  | –  | 105.6          |
| <b>Total finance income</b>   | <b>250.1</b>   | <b>–</b>   | <b>250.1</b>   | <b>250.2</b>   | <b>–</b>   | <b>250.2</b>   |
| <b>Finance costs:</b>   |  |  |                |  |  |                |
| Bank loans and overdrafts   | (25.0)   | –  | (25.0)         | (58.1)   | –  | (58.1)         |
| Other loans and charges   | (280.3)  | –  | (280.3)        | (247.1)  | (8.8)  | (255.9)        |
| Interest on pension scheme liabilities  | (149.8)  | –  | (149.8)        | (150.2)  | –  | (150.2)        |
| Notional interest arising on discounted provisions  | (7.8)  | –  | (7.8)          | (4.3)  | –  | (4.3)          |
| Finance lease charges   | (38.4)   | –  | (38.4)         | (39.7)   | –  | (39.7)         |
| Foreign exchange translation of monetary assets<br>and liabilities  | (0.3)  | –  | (0.3)          | (13.2)   | –  | (13.2)         |
| Less: interest capitalised (i)  | 75.9   | –  | 75.9           | 59.5   | –  | 59.5           |
| <b>Total finance costs</b>  | <b>(425.7)</b>   | <b>–</b>   | <b>(425.7)</b> | <b>(453.1)</b>   | <b>(8.8)</b>   | <b>(461.9)</b> |
| Changes in fair value of financing derivative assets<br>or liabilities at fair value through profit or loss | –  | (89.5)   | (89.5)         | –  | (44.4)   | (44.4)         |
| <b>Net finance costs</b>  | <b>(175.6)</b>   | <b>(89.5)</b>  | <b>(265.1)</b> | <b>(202.9)</b>   | <b>(53.2)</b>  | <b>(256.1)</b> |
| Finance income  | 250.1  | –  | 250.1          | 250.2  | –  | 250.2          |
| Finance costs   | (425.7)  | (89.5)   | (515.2)        | (453.1)  | (53.2)   | (506.3)        |
| <b>Net finance costs</b>  | <b>(175.6)</b>   | <b>(89.5)</b>  | <b>(265.1)</b> | <b>(202.9)</b>   | <b>(53.2)</b>  | <b>(256.1)</b> |

(i) The capitalisation rate applied in determining the amount of borrowing costs to capitalise in the period was 5.36% (2011 – 5.74%).

##### Recognised in equity

|  | 2012<br>£m | 2011<br>£m |
|--|------------|------------|
| (Loss)/gain on effective portion of cash flow hedges (i)   | (15.3)     | 32.3       |
| Share of jointly controlled entity/associate (loss) on effective portion of cash flow hedges (i) | (20.8)     | (4.1)      |
|  | (36.1)     | 28.2       |

(i) Before deduction of tax

Adjusted net finance costs are arrived at after the following adjustments:

|  | 2012<br>£m     | 2011<br>£m |
|--|----------------|------------|
| Net finance costs (add)/less:  | <b>(265.1)</b> | (256.1)    |
| Share of interest from jointly controlled entities and associates:                           |                |            |
| Scotia Gas Networks loan stock   | <b>(33.4)</b>  | (33.4)     |
| Other jointly controlled entities and associates   | <b>(113.1)</b> | (106.5)    |
|  | <b>(146.5)</b> | (139.9)    |
| Exceptional charges  | –              | 8.8        |
| Movement on financing derivatives  | <b>89.5</b>    | 44.4       |
| <b>Adjusted finance income and costs (add)/less:</b>   | <b>(322.1)</b> | (342.8)    |
| Return on pension scheme assets  | <b>(147.4)</b> | (141.9)    |
| Interest on pension scheme liabilities   | <b>149.8</b>   | 150.2      |
| Notional interest arising on discounted provisions   | <b>7.8</b>     | 4.3        |
| Finance lease charges  | <b>38.4</b>    | 39.7       |
| Hybrid coupon payment (note 28)  | <b>(65.5)</b>  | –          |
| Adjusted finance income and costs and hybrid coupon payments for interest cover calculations | <b>(339.0)</b> | (290.5)    |

## 8. TAXATION

Analysis of charge recognised in the income statement:

|  | 2012   |  |                | 2011   |  |             |
|--|--|--|----------------|--|--|-------------|
|  | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>(note 5)<br>£m | Total<br>£m    | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>(note 5)<br>£m | Total<br>£m |
| <b>Current tax</b>                       |  |  |                |  |  |             |
| UK corporation tax                       | <b>224.2</b>   | <b>(16.9)</b>  | <b>207.3</b>   | 270.2  | –  | 270.2       |
| Adjustments in respect of previous years | <b>(22.3)</b>  | –  | <b>(22.3)</b>  | (25.0)   | –  | (25.0)      |
| Total current tax                        | <b>201.9</b>   | <b>(16.9)</b>  | <b>185.0</b>   | 245.2  | –  | 245.2       |
| <b>Deferred tax</b>                      |  |  |                |  |  |             |
| Current year                             | <b>93.3</b>  | <b>(257.0)</b>   | <b>(163.7)</b> | 60.8   | 234.7  | 295.5       |
| Effect of change in tax rate             | –  | <b>(45.7)</b>  | <b>(45.7)</b>  | –  | 17.7   | 17.7        |
| Adjustments in respect of previous years | <b>29.6</b>  | –  | <b>29.6</b>    | 48.8   | –  | 48.8        |
| Total deferred tax                       | <b>122.9</b>   | <b>(302.7)</b>   | <b>(179.8)</b> | 109.6  | 252.4  | 362.0       |
| Total taxation charge                    | <b>324.8</b>   | <b>(319.6)</b>   | <b>5.2</b>     | 354.8  | 252.4  | 607.2       |



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 8. TAXATION (continued)

The charge for the year can be reconciled to the profit per the income statement as follows:

|  | 2012<br>£m     | 2012<br>%     | 2011<br>£m | 2011<br>% |
|--|----------------|---------------|------------|-----------|
| Group profit before tax  | <b>268.5</b>   |               | 2,111.7    |           |
| Less: share of results of associates and jointly controlled entities                         | <b>(139.4)</b> |               | (64.9)     |           |
| <b>Profit before tax</b>   | <b>129.1</b>   |               | 2,046.8    |           |
| Tax on profit on ordinary activities at standard UK corporation tax rate of 26% (2011 – 28%) | <b>33.6</b>    | <b>26.0</b>   | 573.1      | 28.0      |
| Tax effect of:   |                |               |            |           |
| Change in rate of UK corporation tax   | <b>(45.7)</b>  | <b>(35.4)</b> | (49.4)     | (2.4)     |
| Change in rate of UK supplementary corporation tax   | –              | –             | 31.7       | 1.5       |
| Expenses not deductible for tax purposes   | <b>16.8</b>    | <b>13.0</b>   | 27.6       | 1.3       |
| Impact of supplementary corporation tax  | <b>22.7</b>    | <b>17.6</b>   | 2.2        | 0.1       |
| Non taxable income   | –              | –             | (4.3)      | (0.2)     |
| Impact of foreign tax rates and foreign dividends  | <b>(3.8)</b>   | <b>(2.9)</b>  | 6.4        | 0.3       |
| Adjustments to tax charge in respect of previous years                                       | <b>7.3</b>     | <b>5.7</b>    | 23.8       | 1.2       |
| Hybrid capital coupon payments   | <b>(16.6)</b>  | <b>(12.9)</b> | –          | –         |
| Consortium relief not paid for   | <b>(8.6)</b>   | <b>(6.7)</b>  | (9.0)      | (0.4)     |
| Other items  | <b>(0.5)</b>   | <b>(0.4)</b>  | 5.1        | 0.3       |
| <b>Group tax charge and effective rate</b>   | <b>5.2</b>     | <b>4.0</b>    | 607.2      | 29.7      |

The adjusted current tax charge is arrived at after the following adjustments:

|  | 2012<br>£m     | 2012<br>%    | 2011<br>£m | 2011<br>% |
|--|----------------|--------------|------------|-----------|
| Total taxation charge  | <b>5.2</b>     | <b>4.0</b>   | 607.2      | 29.7      |
| Effect of adjusting items (see below)                                | –              | <b>(3.6)</b> | –          | 16.6      |
| Total taxation charge on adjusted basis                              | <b>5.2</b>     | <b>0.4</b>   | 607.2      | 46.3      |
| add/(less):  |                |              |            |           |
| Share of current tax from jointly controlled entities and associates | <b>11.5</b>    | <b>0.9</b>   | 23.0       | 1.8       |
| Exceptional items  | <b>183.1</b>   | <b>13.7</b>  | 143.8      | 11.0      |
| Tax on movement on derivatives                                       | <b>136.5</b>   | <b>10.2</b>  | (396.2)    | (30.2)    |
| Deferred tax (excluding share of jointly controlled entities)        | <b>(122.9)</b> | <b>(9.2)</b> | (109.6)    | (8.4)     |
| Adjusted current tax charge and effective rate                       | <b>213.4</b>   | <b>16.0</b>  | 268.2      | 20.5      |

The adjusted effective rate is based on adjusted profit before tax being:

|  | 2012<br>£m     | 2011<br>£m |
|--|----------------|------------|
| Profit before tax  | <b>268.5</b>   | 2,111.7    |
| add/(less):  |                |            |
| Exceptional items and certain remeasurements                 | <b>1,022.3</b> | (859.8)    |
| Share of tax from jointly controlled entities and associates | <b>44.9</b>    | 58.2       |
| Adjusted profit before tax                                   | <b>1,335.7</b> | 1,310.1    |

Tax (credit)/charge recognised directly in equity

|  | 2012<br>£m    | 2011<br>£m |
|--|---------------|------------|
| Relating to:                                 |               |            |
| Pension scheme actuarial movements           | <b>(30.3)</b> | 7.9        |
| Cash flow and net investment hedge movements | <b>3.7</b>    | 7.1        |
| Share-based payments                         | –             | 0.6        |
|  | <b>(26.6)</b> | 15.6       |

All tax recognised directly in equity is deferred tax.

## 9. DIVIDENDS

### Ordinary dividends

|                                    | Year ended<br>31 March 2012 | Settled<br>via scrip | Pence per<br>Ordinary Share | Year ended<br>31 March 2011 | Settled<br>via scrip | Pence per<br>Ordinary Share |
|------------------------------------|-----------------------------|----------------------|-----------------------------|-----------------------------|----------------------|-----------------------------|
|                                    | Total<br>£m                 | £m                   |                             | Total<br>£m                 | £m                   |                             |
| Interim – year ended 31 March 2012 | 224.8                       | 76.3                 | 24.0                        | –                           | –                    | –                           |
| Final – year ended 31 March 2011   | 492.1                       | 11.9                 | 52.6                        | –                           | –                    | –                           |
| Interim – year ended 31 March 2011 | –                           | –                    | –                           | 208.3                       | 61.7                 | 22.4                        |
| Final – year ended 31 March 2010   | –                           | –                    | –                           | 451.5                       | 84.4                 | 49.0                        |
|                                    | <b>716.9</b>                | <b>88.2</b>          |                             | 659.8                       | 146.1                |                             |

The final dividend of 52.6p per Ordinary Share declared in the financial year ended 31 March 2011 (2010 – 49.0p) was approved at the Annual General Meeting on 21 July 2011 and was paid to shareholders on 23 September 2011. Shareholders were able to elect to receive Ordinary Shares credited as fully paid instead of the cash dividend under the terms of the Company's scrip dividend scheme.

An interim dividend of 24.0p per Ordinary Share (2011 – 22.4p) was declared and paid on 23 March 2012 to those shareholders on the SSE plc share register on 27 January 2012. Shareholders were able to elect to receive Ordinary Shares credited as fully paid instead of the interim cash dividend under the terms of the Company's scrip dividend scheme.

The proposed final dividend of 56.1p per Ordinary Share is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

## 10. EARNINGS PER SHARE

### Basic earnings per share

The calculation of basic earnings per Ordinary Share at 31 March 2012 is based on the net profit attributable to Ordinary Shareholders and a weighted average number of Ordinary Shares outstanding during the year ended 31 March 2012. All earnings are from continuing operations.

### Adjusted earnings per share

Adjusted earnings per share has been calculated by excluding the charge for deferred tax, items disclosed as exceptional, and the impact of certain remeasurements as described in note 5.

|   | Year ended<br>31 March 2012 | Year ended<br>31 March 2012    | Year ended<br>31 March 2011 | Year ended<br>31 March 2011    |
|---|-----------------------------|--------------------------------|-----------------------------|--------------------------------|
|   | Earnings<br>£m              | Earnings<br>per share<br>pence | Earnings<br>£m              | Earnings<br>per share<br>pence |
| <b>Basic</b>  | <b>197.8</b>                | <b>21.1</b>                    | 1,504.5                     | 162.2                          |
| Exceptional items and certain remeasurements (note 5)                         | 702.7                       | 74.9                           | (607.4)                     | (65.5)                         |
| Basic excluding exceptional items and certain remeasurements                  | 900.5                       | 96.0                           | 897.1                       | 96.7                           |
| Adjusted for:   |                             |                                |                             |                                |
| Deferred tax (note 8)   | 122.9                       | 13.1                           | 109.6                       | 11.8                           |
| Deferred tax from share of jointly controlled entities and associates results | 33.4                        | 3.6                            | 35.2                        | 3.8                            |
| <b>Adjusted</b>   | <b>1,056.8</b>              | <b>112.7</b>                   | 1,041.9                     | 112.3                          |
| <b>Basic</b>  | <b>197.8</b>                | <b>21.1</b>                    | 1,504.5                     | 162.2                          |
| Dilutive effect of outstanding share options                                  | –                           | –                              | –                           | (0.2)                          |
| <b>Diluted</b>  | <b>197.8</b>                | <b>21.1</b>                    | 1,504.5                     | 162.0                          |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 10. EARNINGS PER SHARE (continued)

The weighted average number of shares used in each calculation is as follows:

|   | 31 March 2012<br>Number of<br>shares<br>(millions) | 31 March 2011<br>Number of<br>shares<br>(millions) |
|---|--|--|
| For basic and adjusted earnings per share | 937.8  | 927.6  |
| Effect of exercise of share options       | 1.5  | 1.1  |
| For diluted earnings per share            | 939.3  | 928.7  |

#### 11. INTANGIBLE ASSETS

##### Consolidated

|  | Goodwill<br>£m | Allowances and<br>certificates<br>£m | Development<br>assets<br>£m | Brands<br>£m | Other<br>intangibles<br>£m | Total<br>£m    |
|--|----------------|--------------------------------------|-----------------------------|--------------|----------------------------|----------------|
| <b>Cost:</b>                                       |                |                                      |                             |              |                            |                |
| At 1 April 2010                                    | 726.3          | 229.7                                | 264.1                       | 11.8         | 63.4                       | 1,295.3        |
| Additions  | 3.8            | 399.3                                | 29.6                        | –            | 1.3                        | 434.0          |
| Acquisitions (note 16)                             | 39.9           | –                                    | 56.4                        | –            | –                          | 96.3           |
| Transfer to Property Plant and Equipment (note 11) | –              | –                                    | (3.8)                       | –            | –                          | (3.8)          |
| Transfer to Assets Held For Sale (note 16)         | –              | –                                    | (10.7)                      | –            | –                          | (10.7)         |
| Disposals/utilised                                 | –              | (287.0)                              | (0.6)                       | –            | –                          | (287.6)        |
| Exchange adjustments                               | (42.2)         | –                                    | (11.5)                      | –            | 0.1                        | (53.6)         |
| At 31 March 2011                                   | 727.8          | 342.0                                | 323.5                       | 11.8         | 64.8                       | 1,469.9        |
| Additions  | –              | 503.7                                | 36.1                        | –            | 0.1                        | 539.9          |
| Acquisitions (note 16)                             | 0.3            | –                                    | 3.6                         | –            | –                          | 3.9            |
| Transfer to Property Plant and Equipment (note 12) | –              | –                                    | (52.5)                      | –            | –                          | (52.5)         |
| Disposals/utilised                                 | –              | (391.7)                              | –                           | –            | –                          | (391.7)        |
| Exchange adjustments                               | (8.8)          | –                                    | (2.5)                       | (0.2)        | (2.7)                      | (14.2)         |
| <b>At 31 March 2012</b>                            | <b>719.3</b>   | <b>454.0</b>                         | <b>308.2</b>                | <b>11.6</b>  | <b>62.2</b>                | <b>1,555.3</b> |
| <b>Aggregate amortisation and impairment:</b>      |                |                                      |                             |              |                            |                |
| At 1 April 2010                                    | –              | (16.4)                               | (7.3)                       | (5.8)        | (38.0)                     | (67.5)         |
| Charge for the year                                | –              | –                                    | (15.1)                      | (0.9)        | (5.5)                      | (21.5)         |
| Exceptional impairment (note 5)                    | (42.5)         | –                                    | (39.7)                      | –            | –                          | (82.2)         |
| At 31 March 2011                                   | (42.5)         | (16.4)                               | (62.1)                      | (6.7)        | (43.5)                     | (171.2)        |
| Charge for the year                                | –              | –                                    | (2.3)                       | (1.2)        | (10.0)                     | (13.5)         |
| Exceptional impairment (note 5)                    | (49.3)         | (71.9)                               | (37.4)                      | –            | –                          | (158.6)        |
| <b>At 31 March 2012</b>                            | <b>(91.8)</b>  | <b>(88.3)</b>                        | <b>(101.8)</b>              | <b>(7.9)</b> | <b>(53.5)</b>              | <b>(343.3)</b> |
| <b>Carrying amount:</b>                            |                |                                      |                             |              |                            |                |
| <b>At 31 March 2012</b>                            | <b>627.5</b>   | <b>365.7</b>                         | <b>206.4</b>                | <b>3.7</b>   | <b>8.7</b>                 | <b>1,212.0</b> |
| At 31 March 2011                                   | 685.3          | 325.6                                | 261.4                       | 5.1          | 21.3                       | 1,298.7        |
| At 1 April 2010                                    | 726.3          | 213.3                                | 256.8                       | 6.0          | 25.4                       | 1,227.8        |

The Company does not hold intangible assets.

Intangible assets have been analysed as current and non-current as follows:

|              | 2012<br>£m     | 2011<br>£m |
|--------------|----------------|------------|
| Current      | 365.7          | 325.6      |
| Non-current: |                |            |
| Goodwill     | 627.5          | 685.3      |
| Other        | 218.8          | 287.8      |
|              | <b>1,212.0</b> | 1,298.7    |

**(a) Impairment review of goodwill and basis of other impairment reviews**

Goodwill is allocated to those cash-generating units (CGUs) expected to benefit from the respective business combination for impairment testing purposes. Certain goodwill valuations have changed in the current year following retranslation.

A summary of the goodwill allocated to CGUs and the Group's operating segments is presented below:

| Cash-generating unit        | Operating Segment                                      | 2012<br>£m   | 2011<br>£m |
|-----------------------------|--|--------------|------------|
| Ireland wind farms          | Energy Portfolio Management and Electricity Generation | 153.1        | 159.9      |
| UK wind farms               | Energy Portfolio Management and Electricity Generation | 199.9        | 199.9      |
| European wind farms         | Energy Portfolio Management and Electricity Generation | –            | 20.3       |
| UK Supply                   | Energy Supply  | 187.0        | 187.0      |
| UK Generation               | Energy Portfolio Management and Electricity Generation | 10.1         | 10.1       |
| Gas Storage                 | Gas Storage  | 26.2         | 56.2       |
| Exploration and Production  | Gas Production   | 38.1         | 38.1       |
| Other Networks (i)          | Other Networks   | 10.6         | 11.3       |
| Energy-related Services (i) | Energy-related Services                                | 2.5          | 2.5        |
|                             |  | <b>627.5</b> | 685.3      |

(i) Represents goodwill balances related to acquisitions of Telecoms, Streetlighting (Other Networks) and Contracting businesses (Energy-related Services). The amount of goodwill is not significant compared to the aggregate carrying value of the business units or the aggregate value of goodwill held by the Group. Following review, it is concluded that no impairment is required.

The recoverable amount of the UK Supply, Gas Storage and Exploration and Production CGUs is determined by reference to value-in-use calculations. The impairment review of the UK Generation CGU has been discontinued and is commented upon below. The value-in-use calculations use, as a starting point, pre-tax cash flow projections based on the Group's five year business model as approved by the Board. The Group's business model is based on past experience and reflects the Group's forward view of markets, prices, risks and its strategic objectives. Commodity prices used are based on observable market data and, where this is not available, on internal estimates.

The recoverable amount of the various wind farm CGUs is based on the fair value less costs to sell methodology. The basis applied has been deemed appropriate as it is consistent with the way in which the economic value of the individual CGUs are assessed by management and would be by other market participants. The method applied is to determine fair value by assessing the discounted pre-tax cash flows expected to be earned by the individual wind farm projects within the respective CGUs. The three identified CGUs (Ireland wind farms, UK wind farms, European wind farms) share many of the same risk factors and are discounted accordingly.

The key assumptions used for the main value-in-use calculations are as follows:

| Cash-generating unit  | Operating Segment                                      | 2012<br>Discount rate<br>(%) | 2011<br>Discount rate<br>(%) | 2012 and 2011<br>Cash flow<br>projection period<br>(years) |
|---|--|------------------------------|------------------------------|--|
| Ireland, UK and Europe wind farms<br>(onshore and offshore) | Energy Portfolio Management and Electricity Generation | 7.0%-9.0%                    | 7.0%-9.0%                    | 25   |
| UK Supply   | Energy Supply  | 8.3%                         | 8.3%                         | 5  |
| UK Generation (excluding wind)                              | Energy Portfolio Management and Electricity Generation | 8.3%                         | 8.3%                         | 15   |
| Gas Storage   | Gas Storage  | 8.3%                         | 8.3%                         | 20   |
| Exploration and Production                                  | Gas Production   | 8.0%-10.0%                   | 8.0%-10.0%                   | Life of field  |

Management have determined the pre-tax cash flows of each CGU based on past performance and its expectations of market development. Further detail on how the cash flow projections have been derived is included in the specific commentaries. The discount rates used are pre-tax real and reflect specific risks attributable to the relevant operating segments. The discount rates used have been benchmarked against externally published rates used by comparable quoted companies operating in the respective market sectors. The recoverable amount derived from the value-in-use calculation is compared to the carrying amount of each CGU to determine whether the respective CGUs require to be impaired.

Specific comments on the key value-in-use and fair value less costs to sell calculations for the main CGUs and the results of the tests conducted follow:

**All wind farm CGUs**

For goodwill impairment testing purposes, the significant wind farm CGUs were established following the acquisition of the SSE Renewables (formerly Airtricity) business in 2008. In order to assess the respective recoverable amounts against an appropriate carrying value, goodwill was allocated to the main geographic regions in which the business operates. The established CGUs (Ireland, UK, rest of Europe) have subsequently been assessed by considering the specific market attributes of those regions. Currency cash flows are set at the exchange rate at the time the impairment test is conducted. Aside from these specific market factors, the basis of review of the respective CGUs is identical.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 11. INTANGIBLE ASSETS (continued)

Wind farm projects have an estimated useful life of up to 25 years and it is considered appropriate by management to assess the carrying amount against cash flow projections covering this period. The Ireland and UK wind CGUs include wind farms in operation and all CGUs include projects in the construction phase or in the development portfolio phase. These development projects are those which have not received consent or have not concluded all environmental or planning studies and as a consequence the associated cash flows have been probability adjusted.

Cash inflows for all projects are based on expected generation output from projects based on wind studies and past experience and are valued at forward power prices based on market information, where available, continuing government support for wind ROCs and internal model assumptions.

Cash outflows are based on planned capital expenditure and expected maintenance costs. The power prices and costs of operation are the most significant distinguishing factors in the respective CGU regions. Growth is based on the expected output of the respective wind farms at their available operational capacity over their life cycle and on delivery of projects in the development pipeline.

##### Outcome of tests

The recoverable amounts of the UK and Ireland wind farm CGUs, following the impairment of £20.3m of property, plant and equipment and intangible development assets in the Ireland CGU, exceeded the respective carrying values at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the fair value less costs-to-sell would not cause a change to the conclusion reached.

Following review of the economic prospects in relation to the European portfolio, including developments in Italy, Portugal, Sweden and Germany, the goodwill associated with the CGU has been fully impaired. Accordingly, an exceptional charge of £19.3m has been recognised (note 5).

##### UK Supply

Goodwill carried in relation to the acquisition, in 2001, of the Swalec supply business is attributed to the Group's UK retail electricity and gas supply business CGU. The activities within CGU equate to the new energy supply reportable segment with the exception of the Airtricity supply business in Ireland. Margins assumed in the value in use calculations are based on current contractual terms and historic gross margin percentages earned. Revenues are based on the expected market share derived from the market share at the time of the approval of the business model adjusted for forecasted growth. Growth in customer numbers is moderate over the forecast period and cash outflows associated with increased customer service are incorporated accordingly. This growth rate is supported by reference to both past performance and management expectation. Margin assumptions also take account of forward wholesale energy price curves for both electricity and gas.

##### Outcome of test

The recoverable amount of the UK Supply CGU exceeded the respective carrying value at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the value-in-use would not cause a change to the conclusion reached.

##### UK Generation (excluding wind)

Goodwill of £10.1m is carried by the Group in relation to acquired deferred tax temporary differences. No other goodwill balances related to the previously identified UK Generation CGU were held at March 2011 and March 2012. The operational plants in Energy Portfolio Management and Electricity Generation are operated as part of the integrated business segment. An impairment review of goodwill is not necessary in the year to March 2012, and consequently the Group's measurement on the CGU basis applied in previous years on the projected cash flows of the main UK Generation plants has been discontinued. Instead, all plants exhibiting indications of impairment have been reviewed independently to derive the extent of any potential impairment (see note 12).

##### Gas Storage

Goodwill was recognised on the acquisition of the Hornsea gas storage facility in 2003. Initial cash flow projections are based on gross margins expected to be achieved in the period of the five year business model. Beyond this period, cash flows have been extrapolated at a growth rate lower than the long-term growth rate of the economy to the end of the assets' expected economic lives. This longer period is necessary due to the long-term infrastructure nature of these assets but will consequently introduce less certainty into the valuation process. Assumptions on margin for the business plan period are based on expected demand for gas storage and take into account published and projected gas wholesale prices, planned capital expenditure required to maintain the value of the facility and estimated operating costs.

##### Outcome of test

The review indicated that the prospects in the medium term for the CGU had been impacted by lower volatility in the gas market and lower demand for gas from generating plants. As a consequence, an impairment charge of £30.0m has been recognised against the value of goodwill held. There is an inherent uncertainty in the valuation process but reasonably possible changes in the key assumptions applied in assessing the value-in-use may potentially require further impairment. The impact of these changes is dependent upon a number of factors but reasonably possible changes could further impair the remaining goodwill balance of £26.2m.



## Exploration and Production

Goodwill was recognised on the purchase of North Sea assets in 2011 (note 16). On acquisition, goodwill was attributed to three cash generating units being the three main field development areas. Indications of impairment at asset/field level are investigated separately. All goodwill derived from the recognition of deferred tax temporary liabilities.

The impairment test assumptions are based on forward prices of gas or oil, timing of cash flows including capital and abandonment costs, reserves information and discount rates.

### Outcome of test

Following impairment charges relating to a development field in the Lomond/Everest CGU, the recoverable amount of all Exploration and Production CGUs exceeded its carrying value at the time of the impairment test. While cash flow projections are subject to inherent uncertainty, reasonably possible changes in the key assumptions applied in assessing the recoverable amount would not cause a change to the test outcome.

### (b) Other intangible assets

#### (i) Allowances and Certificates

Allowances and Certificates consist of purchased carbon emissions allowances and generated or purchased renewable obligations certificates (ROCs). In the year to 31 March 2012, the Group recognised an exceptional impairment charge of £71.9m against the value of carbon emissions allowances held following the impairment reviews of its thermal generation assets and the economic prospects for those plants. See also note 5.

#### (ii) Development assets

Development costs relate to the design, construction and testing of thermal networks and renewable generation sites and devices, including wind farms, which the Group believes will generate probable future economic benefits. Costs capitalised as development intangibles assets include options over land rights, planning application costs, environmental impact studies and other costs incurred in bringing wind farm and other generation and network development projects to the consented stage. These may be costs incurred directly or at a cost as part of the fair value attribution on acquisition. Development assets also includes the Group's exploration and evaluation expenditure in relation to exploration wells in its Gas Production business.

At the point the development reaches the consent stage and is approved for construction, the carrying value is transferred to Property, Plant and Equipment (note 12). At the point a project is no longer expected to reach the consented stage, the carrying amount of the project is impaired. The acquisitions in the year are summarised in note 16. Exceptional impairment charges of £37.4m were recognised in relation to an offshore wind development project and prospective oil exploration field following review of its future development prospects. In the prior year, an exceptional charge was recognised in relation to European Wind Farms (£39.7m). Both years' impairments are commented in more detail at note 5.

#### (iii) Brands

Included within brands are the acquired brands of Atlantic Electric and Gas and the Airtricity supply brand used in Ireland. The Group has assessed the economic life of brands to be 10 years and the brands are being amortised over this period. The charge is reported as part of operating costs.

#### (iv) Other intangible assets

Included within other intangible assets are customer lists, contracts, application software license fees, software development work, software upgrades and purchased PC software packages. Amortisation is over the shorter of the contract term or five years.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 12. PROPERTY, PLANT AND EQUIPMENT

##### Consolidated

|   | Power generation assets (i)<br>£m | Gas storage and production assets (ii)<br>£m | Land and buildings<br>£m | Network and Metering assets<br>£m | Vehicles and miscellaneous equipment<br>£m | Total<br>£m     |
|---|-----------------------------------|--|--------------------------|-----------------------------------|--|-----------------|
| <b>Cost:</b>                                    |                                   |  |                          |                                   |  |                 |
| At 31 March 2010                                | 5,424.6                           | 376.9  | 247.8                    | 5,670.7                           | 273.2                                      | 11,993.2        |
| Additions                                       | 554.7                             | 52.6   | 12.4                     | 489.5                             | 50.3                                       | 1,159.5         |
| Acquisitions (note 16)                          | 63.9                              | 305.2  | 19.5                     | –                                 | –  | 388.6           |
| Change in decommissioning asset values          | 32.7                              | –  | –                        | –                                 | –  | 32.7            |
| Transfer from intangible assets (note 11) (iii) | 3.8                               | –  | –                        | –                                 | –  | 3.8             |
| Transfer to held for sale                       | (253.6)                           | –  | –                        | –                                 | –  | (253.6)         |
| Disposals                                       | (73.2)                            | –  | (0.8)                    | (0.7)                             | (3.1)                                      | (77.8)          |
| Exchange rate adjustments                       | (72.0)                            | –  | –                        | –                                 | –  | (72.0)          |
| At 31 March 2011                                | 5,680.9                           | 734.7  | 278.9                    | 6,159.5                           | 320.4                                      | 13,174.4        |
| Additions                                       | 646.0                             | 57.0   | 18.1                     | 636.0                             | 119.4                                      | 1,476.5         |
| Transfer from intangible assets (note 11) (iii) | 52.5                              | –  | –                        | –                                 | –  | 52.5            |
| Disposals                                       | (0.2)                             | –  | (2.6)                    | (0.4)                             | (35.4)                                     | (38.6)          |
| Transfer between categories                     | 3.2                               | –  | –                        | (7.5)                             | 4.3  | –               |
| Exchange rate adjustments                       | (28.8)                            | –  | –                        | –                                 | (2.0)                                      | (30.8)          |
| <b>At 31 March 2012</b>                         | <b>6,353.6</b>                    | <b>791.7</b>                                 | <b>294.4</b>             | <b>6,787.6</b>                    | <b>406.7</b>                               | <b>14,634.0</b> |

##### Depreciation:

|                              |                |              |             |                |              |                |
|------------------------------|----------------|--------------|-------------|----------------|--------------|----------------|
| At 1 April 2010              | 1,257.8        | 52.3         | 37.3        | 2,260.9        | 180.7        | 3,789.0        |
| Charge for the year          | 176.3          | 14.2         | 7.3         | 279.9          | 19.0         | 496.7          |
| Exceptional impairments (iv) | 442.7          | –            | –           | –              | –            | 442.7          |
| Transfer to held for sale    | (48.7)         | –            | –           | –              | –            | (48.7)         |
| Disposals                    | (13.3)         | –            | (0.8)       | (0.1)          | (3.1)        | (17.3)         |
| Exchange rate adjustments    | (1.1)          | –            | –           | –              | –            | (1.1)          |
| At 31 March 2011             | 1,813.7        | 66.5         | 43.8        | 2,540.7        | 196.6        | 4,661.3        |
| Charge for the year          | 209.7          | 39.3         | 7.6         | 281.7          | 23.5         | 561.8          |
| Exceptional impairments (iv) | 275.1          | –            | –           | 30.0           | –            | 305.1          |
| Disposals                    | (0.2)          | –            | (1.8)       | (0.4)          | (33.6)       | (36.0)         |
| Exchange rate adjustments    | (10.0)         | –            | –           | –              | (1.3)        | (11.3)         |
| <b>At 31 March 2012</b>      | <b>2,288.3</b> | <b>105.8</b> | <b>49.6</b> | <b>2,852.0</b> | <b>185.2</b> | <b>5,480.9</b> |

##### Consolidated

|                         | Power generation assets (i)<br>£m | Gas storage and production assets (ii)<br>£m | Land and buildings<br>£m | Network assets<br>£m | Vehicles and miscellaneous equipment (ii)<br>£m | Total<br>£m    |
|-------------------------|-----------------------------------|--|--------------------------|----------------------|---|----------------|
| <b>Net book value</b>   |                                   |  |                          |                      |   |                |
| <b>At 31 March 2012</b> | <b>4,065.3</b>                    | <b>685.9</b>                                 | <b>244.8</b>             | <b>3,935.6</b>       | <b>221.5</b>                                    | <b>9,153.1</b> |
| At 31 March 2011        | 3,867.2                           | 668.2  | 235.1                    | 3,618.8              | 123.8   | 8,513.1        |
| At 1 April 2010         | 4,166.8                           | 324.6  | 210.5                    | 3,409.8              | 92.5  | 8,204.2        |

(i) Power generation assets comprise thermal and renewable generating stations, related buildings, plant and machinery and include all hydro civil and operating wind farm assets. The net book value of generation assets includes decommissioning costs with a net book value of £37.6m (2011 – £62.3m).

(ii) Gas storage and production assets include decommissioning costs with a net book value of £68.6m (2011 – £81.7m).

(iii) Represents the carrying value of development assets transferred from intangible assets (note 11) which have reached the consent stage and have been approved for construction.

(iv) Assets displaying indications of impairment, such as the Keadby and Medway gas-fired power stations, are impairment reviewed under the value-in-use methodology (see page 107 for explanation of key accounting judgements).

The current year property, plant and equipment impairment charges in relation to the Keadby and Medway gas-fired power stations assumes the current over-capacity in the power generation market will decrease following the closure of plants in the latter part of the current decade, with SSE's refurbished plants returning to merit at that point. Assumptions on market prices are made by reference to forward market prices and published market estimations, where available, and to internal model inputs beyond the observable period. Prices forecast include wholesale power prices and input costs such as wholesale gas prices, coal and oil prices as well as carbon emissions costs. Forecasts of availability and efficiency are based on management expectation and past performance. The discount rates applied was a pre-tax real rate of 8.3%. Total exceptional impairment of £305.1m (2011 – £447.7m) were recognised.

At the balance sheet date the cumulative amounts capitalised in respect of assets in the course of construction were as follows:

|                                   | <b>2012</b><br><b>£m</b> | 2011<br>£m |
|-----------------------------------|--------------------------|------------|
| Power generation assets           | <b>560.1</b>             | 647.0      |
| Gas storage and production assets | <b>171.1</b>             | 120.4      |
| Network and metering assets       | <b>377.1</b>             | 188.2      |
| Corporate assets                  | <b>64.6</b>              | 5.7        |
|                                   | <b>1,172.9</b>           | 961.3      |

The Company does not hold any property, plant or equipment.

Included within property, plant and equipment are the following assets held under finance leases:

|                                  | Power<br>generation<br>assets<br>£m | Network<br>assets<br>£m | Vehicles and<br>miscellaneous<br>equipment<br>£m | Total<br>£m  |
|----------------------------------|-------------------------------------|-------------------------|--|--------------|
| <b>Cost</b>                      |                                     |                         |  |              |
| At 1 April 2010 and 1 April 2011 | 387.8                               | 5.0                     | 7.0  | 399.8        |
| Additions                        | –                                   | –                       | –  | –            |
| <b>At 31 March 2012</b>          | <b>387.8</b>                        | <b>5.0</b>              | <b>7.0</b>                                       | <b>399.8</b> |
| <b>Depreciation</b>              |                                     |                         |  |              |
| At 31 March 2010                 | 11.3                                | 5.0                     | 7.0  | 23.3         |
| Charge for the year              | 18.5                                | –                       | –  | 18.5         |
| At 31 March 2011                 | 29.8                                | 5.0                     | 7.0  | 41.8         |
| Charge for the year              | 18.5                                | –                       | –  | 18.5         |
| <b>At 31 March 2012</b>          | <b>48.3</b>                         | <b>5.0</b>              | <b>7.0</b>                                       | <b>60.3</b>  |
| <b>Net book value</b>            |                                     |                         |  |              |
| <b>At 31 March 2012</b>          | <b>339.5</b>                        | <b>–</b>                | <b>–</b>   | <b>339.5</b> |
| At 31 March 2011                 | 358.0                               | –                       | –  | 358.0        |
| At 1 April 2010                  | 376.5                               | –                       | –  | 376.5        |

### 13. BIOLOGICAL ASSETS

The Group owns 2,394 hectares of forest land including planted trees. The living trees are accounted for as biological assets and are subject to revaluation each year.

|                                   | <b>2011</b><br><b>£m</b> |
|-----------------------------------|--------------------------|
| At 1 April 2011                   | <b>4.4</b>               |
| Changes in fair value assumptions | <b>(1.0)</b>             |
| At 31 March 2012                  | <b>3.4</b>               |

The pre-tax discount rate used in determining the fair value in 2012 was 8% (2011 – 8%). A 2.0% decrease/(increase) in the discount rate would increase/(decrease) the fair value of biological assets by approximately £0.5m (2011 – £0.6m). No trees were harvested during the year, however changes to other fair value assumptions led to a £1.0m reduction in value. The Company does not hold any biological assets.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 14. INVESTMENTS

##### (a) Associates and Joint Ventures

###### Consolidated

|                                     | Equity       |              |                  |                    | Loans        |              |                  | Loans total<br>£m | Total<br>£m    |
|-------------------------------------|--------------|--------------|------------------|--------------------|--------------|--------------|------------------|-------------------|----------------|
|                                     | SGN<br>£m    | JCEs<br>£m   | Associates<br>£m | Equity total<br>£m | SGN<br>£m    | JCEs<br>£m   | Associates<br>£m |                   |                |
| <b>Share of net assets/cost</b>     |              |              |                  |                    |              |              |                  |                   |                |
| At 31 March 2010                    | 155.4        | 264.0        | 215.8            | <b>635.2</b>       | 266.9        | 657.3        | 46.3             | <b>970.5</b>      | <b>1,605.7</b> |
| New equity investments              | –            | 24.0         | 176.3            | <b>200.3</b>       | –            | –            | –                | <b>–</b>          | <b>200.3</b>   |
| Increase in shareholder loans       | –            | –            | –                | <b>–</b>           | –            | 199.8        | 4.6              | <b>204.4</b>      | <b>204.4</b>   |
| Repayment of shareholder loans      | –            | –            | –                | <b>–</b>           | –            | (13.3)       | –                | <b>(13.3)</b>     | <b>(13.3)</b>  |
| Conversion of loan to equity        | –            | –            | 37.0             | <b>37.0</b>        | –            | –            | (37.0)           | <b>(37.0)</b>     | <b>–</b>       |
| Transfer to Held For Sale           | –            | (63.7)       | –                | <b>(63.7)</b>      | –            | –            | –                | <b>–</b>          | <b>(63.7)</b>  |
| Dividends received                  | (30.0)       | (26.5)       | (25.2)           | <b>(81.7)</b>      | –            | –            | –                | <b>–</b>          | <b>(81.7)</b>  |
| Share of profit after tax           | 74.5         | 56.0         | (65.6)           | <b>64.9</b>        | –            | –            | –                | <b>–</b>          | <b>64.9</b>    |
| Share of other reserves adjustments | (8.9)        | (5.2)        | –                | <b>(14.1)</b>      | –            | –            | –                | <b>–</b>          | <b>(14.1)</b>  |
| Disposal                            | –            | (13.7)       | –                | <b>(13.7)</b>      | –            | –            | –                | <b>–</b>          | <b>(13.7)</b>  |
| Exchange rate adjustments           | –            | (3.4)        | –                | <b>(3.4)</b>       | –            | –            | –                | <b>–</b>          | <b>(3.4)</b>   |
| At 31 March 2011                    | 191.0        | 231.5        | 338.3            | <b>760.8</b>       | 266.9        | 843.8        | 13.9             | <b>1,124.6</b>    | <b>1,885.4</b> |
| New equity investments              | –            | 25.5         | 130.0            | <b>155.5</b>       | –            | –            | –                | <b>–</b>          | <b>155.5</b>   |
| Increase in shareholder loans       | –            | –            | –                | <b>–</b>           | –            | 128.9        | 9.7              | <b>138.6</b>      | <b>138.6</b>   |
| Repayment of shareholder loans      | –            | –            | –                | <b>–</b>           | –            | (20.4)       | (5.5)            | <b>(25.9)</b>     | <b>(25.9)</b>  |
| Conversion of loan to equity        | –            | 35.4         | –                | <b>35.4</b>        | –            | (35.4)       | –                | <b>(35.4)</b>     | <b>–</b>       |
| Disposal of shareholder loan        | –            | –            | –                | <b>–</b>           | –            | –            | (10.0)           | <b>(10.0)</b>     | <b>(10.0)</b>  |
| Transfer to Held For Sale           | –            | (7.5)        | –                | <b>(7.5)</b>       | –            | –            | –                | <b>–</b>          | <b>(7.5)</b>   |
| Dividends received                  | (65.0)       | (8.0)        | (38.4)           | <b>(111.4)</b>     | –            | –            | –                | <b>–</b>          | <b>(111.4)</b> |
| Share of profit/(loss) after tax    | 118.8        | 24.1         | (3.5)            | <b>139.4</b>       | –            | –            | –                | <b>–</b>          | <b>139.4</b>   |
| Share of other reserves adjustments | (12.2)       | (3.2)        | –                | <b>(15.4)</b>      | –            | –            | –                | <b>–</b>          | <b>(15.4)</b>  |
| Disposal                            | –            | (12.1)       | (26.5)           | <b>(38.6)</b>      | –            | –            | –                | <b>–</b>          | <b>(38.6)</b>  |
| Exchange rate adjustments           | –            | (6.5)        | –                | <b>(6.5)</b>       | –            | –            | –                | <b>–</b>          | <b>(6.5)</b>   |
| <b>At 31 March 2012</b>             | <b>232.6</b> | <b>279.2</b> | <b>399.9</b>     | <b>911.7</b>       | <b>266.9</b> | <b>916.9</b> | <b>8.1</b>       | <b>1,191.9</b>    | <b>2,103.6</b> |

The investment in Scotia Gas Networks (SGN) is disclosed separately to aid understanding of the Group's financial performance.

On 21 Dec 2012, the Group disposed of a portfolio of investments to EEF Consortium SPV Ltd in return for cash consideration of £16.4m and a 49.5% share in the Environment Energies Fund Limited partnership. In addition, the Group disposed of its investment in the NuGen Limited venture and diluted its investment in Onzo Limited. In combination, total proceeds of £40.0m were received, of which £23.5m was cash, and a loss on disposal of £2.1m was recognised. Further consideration will potentially be received subject to certain contingent events.

###### Company

|                                 | Equity    |                                       |                    | Loans         |                                       |              | Loans total<br>£m | Total<br>£m    |
|---------------------------------|-----------|---------------------------------------|--------------------|---------------|---------------------------------------|--------------|-------------------|----------------|
|                                 | SGN<br>£m | Other<br>JCEs and<br>Associates<br>£m | Equity total<br>£m | SGN<br>£m     | Other<br>JCEs and<br>Associates<br>£m |              |                   |                |
| <b>Share of net assets/cost</b> |           |                                       |                    |               |                                       |              |                   |                |
| At 31 March 2010                | –         | 190.0                                 | 17.0               | <b>207.0</b>  | 266.9                                 | 568.4        | <b>835.3</b>      | <b>1,042.3</b> |
| Increase in shareholder loans   | –         | –                                     | –                  | <b>–</b>      | –                                     | 194.2        | <b>194.2</b>      | <b>194.2</b>   |
| Disposal                        | –         | –                                     | (17.0)             | <b>(17.0)</b> | –                                     | –            | <b>–</b>          | <b>(17.0)</b>  |
| At 31 March 2011                | –         | 190.0                                 | –                  | <b>190.0</b>  | 266.9                                 | 762.6        | <b>1,029.5</b>    | <b>1,219.5</b> |
| Increase in shareholder loans   | –         | –                                     | –                  | <b>–</b>      | –                                     | 118.9        | <b>118.9</b>      | <b>118.9</b>   |
| Repayment of shareholder loans  | –         | –                                     | –                  | <b>–</b>      | –                                     | (8.4)        | <b>(8.4)</b>      | <b>(8.4)</b>   |
| <b>At 31 March 2012</b>         | <b>–</b>  | <b>190.0</b>                          | <b>–</b>           | <b>190.0</b>  | <b>266.9</b>                          | <b>873.1</b> | <b>1,140.0</b>    | <b>1,330.0</b> |

Details of the principal jointly controlled entities, operations and associates are as follows:

|   | Country of incorporation | 31 March 2012<br>Holding % | 31 March 2011<br>Holding % | Principal activity         |
|---|--------------------------|----------------------------|----------------------------|----------------------------|
| <b>Jointly Controlled Entities</b>          |                          |                            |                            |                            |
| Scotia Gas Networks Limited (v)             | England and Wales        | 50.0                       | 50.0                       | Gas distribution networks  |
| Greater Gabbard Offshore Winds Limited (vi) | England and Wales        | 50.0                       | 50.0                       | Offshore wind development  |
| Marchwood Power Limited (i)                 | England and Wales        | 50.0                       | 50.0                       | Electricity generation     |
| PriDE (SERP) Limited (ii)                   | England and Wales        | 50.0                       | 50.0                       | Defence estates contractor |
| Seabank Power Limited (iii)                 | England and Wales        | 50.0                       | 50.0                       | Electricity generation     |
| <b>Associates</b>                           |                          |                            |                            |                            |
| Walney (UK) Offshore Windfarms Limited (vi) | England and Wales        | 25.1                       | 25.1                       | Offshore wind development  |
| Barking Power Limited (i)                   | England and Wales        | 30.4                       | 30.4                       | Electricity generation     |
| Derwent Co-generation Limited (i)           | England and Wales        | 49.5                       | 49.5                       | Electricity generation     |
| Aquamarine Power Limited (iv)               | Scotland                 | 27.5                       | 43.2                       | Marine energy conversion   |

|   | Location of operations | 31 March 2012<br>Holding % | 31 March 2011<br>Holding % | Principal activity                  |
|---|------------------------|----------------------------|----------------------------|-------------------------------------|
| <b>Jointly Controlled Operations (unincorporated)</b> |                        |                            |                            |                                     |
| Aldbrough   | England                | 66.7                       | 66.7                       | Development of gas storage facility |

The above companies' shares consist of Ordinary Shares only with the exception of Aquamarine Power Limited, which has issued preference shares. All companies operate in Great Britain and Ireland. Seabank Power Limited and Marchwood Power Limited have accounting periods ending on 31 December. All other companies have accounting periods ending on 31 March. The Group has a number of other joint and associate investments that are not considered significant in relation to the results or position in these financial statements.

- (i) Shares held by SSE Generation Limited
- (ii) Shares held by SSE Contracting Limited
- (iii) Shares held by SSE Seabank Investments Limited
- (iv) Shares held by SSE Venture Capital Limited
- (v) Shares held by SSE plc
- (vi) Shares held by SSE Renewables Holdings Limited (or subsidiaries)

Scotia Gas Networks Limited is deemed to warrant separate disclosure from other jointly controlled entities to aid understanding of the Group's financial performance, and the share of result is reported as a separate segment in the analysis of Group operating profit (note 3). The results of Scotia Gas Networks Limited, of which the Group has a 50% share, can be illustrated thus:

|                                       | 2012   |  |             | 2011   |  | Total<br>£m |
|---------------------------------------|--|--|-------------|--|--|-------------|
|                                       | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>£m | Total<br>£m | Before<br>exceptional<br>items and certain<br>remeasurements<br>£m | Exceptional<br>items and certain<br>remeasurements<br>£m |             |
| Operating profit                      | 469.6  | –  | 469.6       | 373.6  | –  | 373.6       |
| Finance costs: excluding loan stock   | (193.0)  | 28.3   | (164.7)     | (180.9)  | 12.8   | (168.1)     |
| Finance costs: interest on loan stock | (66.8)   | –  | (66.8)      | (66.7)   | –  | (66.7)      |
| Profit before tax                     | 209.8  | 28.3   | 238.1       | 126.0  | 12.8   | 138.8       |
| Taxation                              | (69.2)   | 68.7   | (0.5)       | (53.9)   | 64.1   | 10.2        |
| Profit for the year                   | 140.6  | 97.0   | 237.6       | 72.1   | 76.9   | 149.0       |
| SSE share of profit                   | 70.3   | 48.5   | 118.8       | 36.1   | 38.4   | 74.5        |

As an investor, SSE plc received £33.4m (2011 – £33.4m) in relation to loan stock interest payable to the Group.



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 14. INVESTMENTS (continued)

The balance sheet of Scotia Gas Networks Limited can be summarised as follows (100%):

|                                    | Non-current<br>assets<br>£m | Current<br>assets<br>£m | Current<br>liabilities<br>£m | Non-current<br>liabilities<br>£m |
|------------------------------------|-----------------------------|-------------------------|------------------------------|----------------------------------|
| <b>Scotia Gas Networks Limited</b> |                             |                         |                              |                                  |
| <b>31 March 2012</b>               | <b>5,870.4</b>              | <b>159.8</b>            | <b>(429.3)</b>               | <b>(5,135.5)</b>                 |
| 31 March 2011                      | 5,603.4                     | 110.3                   | (416.6)                      | (4,914.6)                        |

The financial statements of the Group's other jointly controlled entities and associates can be summarised as follows (100%):

|                                    | Current<br>assets<br>£m | Non-current<br>assets<br>£m | Current<br>liabilities<br>£m | Non-current<br>liabilities<br>£m | Revenues<br>£m | Profit<br>after tax<br>£m |
|------------------------------------|-------------------------|-----------------------------|------------------------------|----------------------------------|----------------|---------------------------|
| <b>Jointly Controlled Entities</b> |                         |                             |                              |                                  |                |                           |
| <b>31 March 2012</b>               | <b>133.6</b>            | <b>1,721.8</b>              | <b>(135.7)</b>               | <b>(1,195.3)</b>                 | <b>268.4</b>   | <b>40.7</b>               |
| 31 March 2011                      | 170.8                   | 1,430.2                     | (131.3)                      | (1,239.6)                        | 319.7          | 117.0                     |
| <b>Associates</b>                  |                         |                             |                              |                                  |                |                           |
| <b>31 March 2012</b>               | <b>114.1</b>            | <b>203.3</b>                | <b>(45.5)</b>                | <b>(42.5)</b>                    | <b>186.8</b>   | <b>2.7</b>                |
| 31 March 2011                      | 144.9                   | 277.7                       | (62.6)                       | (44.6)                           | 313.4          | 46.9                      |

In addition to Scotia Gas Networks, the Group has investments in a number of materially significant joint ventures and associates. At 31 March 2012, the Group has provided loans of £740.3m (2011 – £624.6m) to Greater Gabbard Offshore Winds Limited, £132.9m (2011 – £141.4m) to Marchwood Power Limited and had invested equity and loans of £298.3m (2011 – £238.2m) in Walney (UK) Offshore Winds Limited.

#### (b) Other investments

##### Consolidated

|                         | Faroe Petroleum<br>£m | BiFab<br>£m | Solar Century<br>£m | Sigma<br>£m | Other<br>£m | Total<br>£m |
|-------------------------|-----------------------|-------------|---------------------|-------------|-------------|-------------|
| At 31 March 2010        | –                     | –           | 4.1                 | 2.9         | 2.2         | 9.2         |
| Additions in the year   | 18.0                  | 11.0        | –                   | 0.3         | 1.1         | 30.4        |
| At 31 March 2011        | 18.0                  | 11.0        | 4.1                 | 3.2         | 3.3         | 39.6        |
| Additions in the year   | –                     | –           | 1.1                 | 0.3         | 0.7         | 2.1         |
| Disposals (i)           | –                     | –           | (5.2)               | –           | (0.4)       | (5.6)       |
| <b>At 31 March 2012</b> | <b>18.0</b>           | <b>11.0</b> | <b>–</b>            | <b>3.5</b>  | <b>3.6</b>  | <b>36.1</b> |

(i) Disposals in the year were made as part of the Group's investment in the Environment Energies Fund limited partnership, details of which are noted on page 128.

##### Company

|   | Faroe Petroleum<br>£m | Total<br>£m |
|---|-----------------------|-------------|
| <b>At 31 March 2011 and 31 March 2012</b> | <b>18.0</b>           | <b>18.0</b> |

## 15. SUBSIDIARY UNDERTAKINGS

Details of the principal subsidiary undertakings are as follows:

|   | Country of incorporation | 31 March 2012<br>Holding % | 31 March 2011<br>Holding % | Principal activity               |
|---|--------------------------|----------------------------|----------------------------|----------------------------------|
| SSE Services plc (i)                                    | England and Wales        | 100                        | 100                        | Corporate support services       |
| SSE Energy Supply Limited (i)                           | England and Wales        | 100                        | 100                        | Electricity supply               |
| SSE Generation Limited (i)                              | England and Wales        | 100                        | 100                        | Electricity generation           |
| Medway Power Limited (ii)                               | England and Wales        | 100                        | 100                        | Electricity generation           |
| Keadby Generation Limited (viii)                        | England and Wales        | 100                        | 100                        | Electricity generation           |
| Southern Electric Gas Limited (vi)                      | England and Wales        | 100                        | 100                        | Gas supply                       |
| Clyde Windfarm (Scotland) Limited (xi)                  | Scotland                 | 100                        | 100                        | Renewable electricity generation |
| Griffin Wind Farm Limited (xii)                         | Scotland                 | 100                        | 100                        | Renewable electricity generation |
| SSE Renewables Holdings Limited (i)                     | Ireland                  | 100                        | 100                        | Renewables holding company       |
| SSE Renewables Developments (UK) Limited (ix)           | Northern Ireland         | 100                        | 100                        | Wind generation development      |
| SSE Renewables (Ireland) Limited (iii)                  | Ireland                  | 100                        | 100                        | Wind generation development      |
| Airtricity Limited (iii)                                | Ireland                  | 100                        | 100                        | Energy supply                    |
| Airtricity Energy Supply (Northern Ireland) Limited (x) | Northern Ireland         | 100                        | 100                        | Energy supply                    |
| Scottish Hydro Electric Transmission Limited (iv)       | Scotland                 | 100                        | 100                        | Transmission of electricity      |
| Scottish Hydro Electric Power Distribution plc (iv)     | Scotland                 | 100                        | 100                        | Distribution of electricity      |
| Southern Electric Power Distribution plc (iv)           | England and Wales        | 100                        | 100                        | Distribution of electricity      |
| SSE Metering Limited (i)                                | Scotland                 | 100                        | 100                        | Meter reader and operator        |
| SSE Contracting Limited (v)                             | England and Wales        | 100                        | 100                        | Electrical contractor            |
| SSE Hornsea Limited (i)                                 | England and Wales        | 100                        | 100                        | Gas storage                      |
| SSE E&P (UK) Limited (i)                                | Scotland                 | 100                        | 100                        | Gas exploration and production   |
| SSE Telecommunications Limited (i)                      | Scotland                 | 100                        | 100                        | Telecommunication services       |
| Neos Networks Limited (vii)                             | England and Wales        | 100                        | 100                        | Telecommunication services       |

The above companies' shares consist of Ordinary Shares only. All companies operate in the UK and Ireland except for SSE Insurance Limited which operates in the Isle of Man. All companies have accounting periods ending on 31 March. The Group has other subsidiary undertakings which do not significantly affect the results and position disclosed in these financial statements. A full list of the subsidiary undertakings will be included in the Company's annual return.

Shares in the above subsidiaries are held by:

- (i) SSE plc
- (ii) SSE Generation Limited
- (iii) SSE Renewables Holdings Limited
- (iv) Scottish and Southern Energy Power Distribution Limited
- (v) SSE Contracting Group Limited
- (vi) SSE Energy Supply Limited
- (vii) SSE Telecommunications Limited
- (viii) Keadby Power Limited
- (ix) SSE Renewables Holdings (UK) Limited
- (x) SSE Renewables Group (UK) Limited
- (xi) SSE Renewables Development (UK) Limited
- (xii) Griffin Wind Farm (Holdings) Limited

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 15. SUBSIDIARY UNDERTAKINGS (continued)

##### Investment in subsidiaries

##### Company

|                                      | Total<br>£m    |
|--------------------------------------|----------------|
| At 31 March 2010                     | 2,172.1        |
| Increase in existing investments     | 13.6           |
| Transfers in (ii)                    | 132.7          |
| <b>At 31 March 2011</b>              | <b>2,318.4</b> |
| Increase in existing investments (i) | 30.7           |
| <b>At 31 March 2012</b>              | <b>2,349.1</b> |

(i) The increase in existing investments held by the Company relates to equity shares in the Company awarded to the employees of the subsidiaries of the Group under the Group's share schemes, which are recognised as an increase in the cost of investment in those subsidiaries as directed by IFRIC 11 (2012 – £13.5m, 2011 – £9.9m) and also to shares issued in the subsidiary SSE E&P (UK) Limited in the current year (£17.2m).

(ii) The equity held in SSE Hornsea Limited was transferred from SSE Energy Supply Limited at book value during the previous year.

##### Service concession arrangements

In partnership with Royal Bank Leasing Limited, the Group has a 50% holding in three companies which provide streetlighting services to councils under the Private Finance Initiative (PFI). These services are thereafter sub-contracted to SSE Contracting Limited, a wholly owned subsidiary. These companies are as follows:

| Company  | Council                      |
|--|------------------------------|
| Tay Valley Lighting (Stoke on Trent) Limited               | Stoke-on-Trent               |
| Tay Valley Lighting (Newcastle and North Tyneside) Limited | Newcastle and North Tyneside |
| Tay Valley Lighting (Leeds) Limited                        | Leeds City Council           |

Under SIC-12 Consolidation – Special Purpose Entities, despite being 50% owned, the three companies are categorised as subsidiaries and are accounted for accordingly since the Group bears the majority of the risks and rewards. The debt associated with these companies is non-recourse to the Group. The arrangements for all three companies are materially similar.

In addition to these, the Group owns 100% of the share capital of entities which perform similar services under eight PFI contracts. The terms of the service concession arrangement are similar to those operated by the three companies noted above. The council and contract holder within the acquired group are as follows:

| Company                                   | Council                               |
|---|---------------------------------------|
| Dorset Lighting Limited                   | Dorset County Council                 |
| Ealing Lighting Limited                   | London Borough of Ealing              |
| Islington Lighting Limited                | London Borough of Islington           |
| Tay Valley Lighting (Hampshire) Limited   | Hampshire County Council              |
| Tay Valley Lighting (Southampton) Limited | Southampton City Council              |
| Tay Valley Lighting (West Sussex) Limited | West Sussex County Council            |
| Tay Valley Lighting (Nottingham) Limited  | Nottingham County Council             |
| Tay Valley Lighting (Knowsley) Limited    | Knowsley Metropolitan Borough Council |

The service commencement date for Tay Valley Lighting (Knowsley) Limited was 20 April 2011.

##### Characteristics of the arrangements

##### Description

The contracts are 25 year arrangements to replace ageing streetlighting stock and to subsequently maintain the new assets throughout each Councils' areas.

##### Significant terms

The cash flows under the PFI arrangements come from the unitary charge for these services paid by the Councils. The unitary charge can only be adjusted if performance under the contract falls below the required standards. Any significant change to the services proposed by either party is subject to a formal change procedure and agreement to such a change is required by the other party.

### Nature and extent of rights and obligations

The assets are part of the public highway and ownership of the assets remains with the Councils. The contract holding companies are licensed to replace and maintain the assets for the period of the contract. This obligation is passed down to SSE Contracting Limited or to other companies within the SSE Contracting group of companies through operating sub-contracts. Any failure to provide the services to the required standards will result in financial penalties which are taken from the unitary charge.

The companies have 25 year contracts with no extension options. Termination during this period can be initiated through a number of routes including service provider default, force majeure or the event of a risk becoming uninsurable, authority default, voluntary authority termination, or termination for a prohibited act or breach of refinancing provisions. In all cases, a formula exists for calculating compensation payments to the service provider.

Throughout the contract period there are a number of circumstances under which the companies could potentially be required to provide additional services:

#### (i) Changes in the law

If circumstances arise where by a change in legislation would mean a change in the way the services are to be provided the companies would be liable for part of the cost of this change. This liability is capped.

#### (ii) Final survey

The Councils have the ability to deduct a percentage of the unitary charge in the last two years if an independent survey indicates the assets are unlikely to have a 5-year residual life.

## 16. ACQUISITIONS, DISPOSALS AND HELD FOR SALE ASSETS

### (a) Additions

During the year, the Group acquired full ownership of three wind farm development companies including the acquisition of the remaining holding in St John's Hill Limited, a 50% owned joint venture that was designated as held for sale at March 2011. Total consideration paid for these businesses was £3.6m. The net assets acquired can be summarised in the following table:

|                               | £m         |
|-------------------------------|------------|
| Assets acquired:              |            |
| Goodwill                      | 0.3        |
| Intangible development assets | 3.6        |
| Deferred tax                  | (0.3)      |
| <b>Net assets</b>             | <b>3.6</b> |

St John's Hill Limited was subsequently disposed for cash consideration of £2.3m, which gave rise to a £0.3m gain on disposal.

### (b) Disposals

In addition to the disposal of St John's Hill Limited, the Group disposed of three 100% owned wind farms for cash consideration of £176.4m on 14 April 2011. These wind farms were disclosed as held for sale assets at 31 March 2011. No gain or loss was recognised on the transaction. Consideration of £6.8m was received in respect of additional disposals of subsidiary investments, which realised a gain on disposal of £5.2m.

### (c) Held for sale assets

At 31 March 2011, a number of wind generation and development assets were presented as held for sale following the decision of the Group's management to sell the respective companies and their related assets. In addition, certain items of plant were also held for sale at that date. In the year to 31 March 2012, the Group disposed of a number of the assets held for sale at the previous year end generating a net loss of £0.3m and cash proceeds of £184.5m. In addition, an impairment charge of £9.9m was recognised on certain development assets held for sale. The assets and liabilities classified as held for sale, and the comparative balances at 31 March 2011, are as follows:

|  | 2012<br>£m  | 2011<br>£m   |
|--|-------------|--------------|
| Property, plant and equipment                    | 5.5         | 204.9        |
| Intangible development assets                    | -           | 10.7         |
| Equity investment in jointly controlled entities | 58.3        | 63.7         |
| Cash and cash equivalents                        | 3.9         | 23.0         |
| Other net current liabilities                    | 0.3         | (9.6)        |
| Deferred tax                                     | -           | (23.3)       |
|  | <b>68.0</b> | <b>269.4</b> |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 16. ACQUISITIONS, DISPOSALS AND HELD FOR SALE ASSETS (continued)

##### (d) Acquisitions and disposals in the previous year

###### (i) Acquisitions in the previous year

On 2 February 2011, the Group, through its subsidiary SSE E&P (UK) Limited acquired, for consideration of £197.2m, joint operating interests in various North Sea natural gas and infrastructure assets in three main geographical areas from Hess Limited following a completion period where partner and regulatory approvals were received.

The assets and liabilities acquired can be summarised thus:

|  | Total<br>£m  |
|--|--------------|
| Goodwill                                       | 38.1         |
| Production and infrastructure assets (note 12) | 305.2        |
| Exploration and evaluation assets              | 50.0         |
| Decommissioning provision                      | (71.5)       |
| Accruals and provisions                        | (11.4)       |
| Deferred tax asset                             | 22.9         |
| Deferred tax liability                         | (136.1)      |
|  | <b>197.2</b> |

The Group acquired other businesses for a combined consideration of £59.4m in the previous year. No significant changes to the fair values recognised have been identified.

###### (ii) Ardrossan acquisition and disposal

On 21 April 2010, the Group acquired the residual 49% of Ardrossan Windfarm (Scotland) Limited, an operating wind farm company based in Scotland, for a cash consideration of £13.0m. This took the Group's investment in the company to 100%. Non-controlling interests of £3.8m were derecognised on completion of the acquisition. On 20 May 2010, the Group disposed of its 100% holding in Ardrossan Wind Farm (Scotland) Limited to Wind Acquisitions 1 (Infinis) for net cash proceeds of £28.1m. The net result of the acquisition on 21 April 2011 and the disposal on 20 May 2011 was a gain of £8.3m.

#### 17. INVENTORIES

|                       | Consolidated |            |
|-----------------------|--------------|------------|
|                       | 2012<br>£m   | 2011<br>£m |
| Fuel and consumables  | 308.2        | 190.5      |
| Work in progress      | 26.1         | 37.1       |
| Goods for resale      | 2.8          | 2.9        |
| Less: provisions held | (13.4)       | (13.0)     |
|                       | <b>323.7</b> | 217.5      |

The Group has expensed inventory costs of £1,505.5m within cost of sales in the year (2011 – £718.2m) and has also recognised £1.1m (2011 – £6.6m) relating to stock write-downs and increases in provisions held. The Company does not hold any inventories.

## 18. TRADE AND OTHER RECEIVABLES

|  | Consolidated |            | Company    |            |
|--|--------------|------------|------------|------------|
|  | 2012<br>£m   | 2011<br>£m | 2012<br>£m | 2011<br>£m |
| <b>Current assets</b>                    |              |            |            |            |
| Retail trade receivables                 | 597.3        | 733.8      | –          | –          |
| Wholesale trade receivables              | 2,553.3      | 2,423.1    | –          | –          |
| Networks and corporate trade receivables | 194.5        | 174.8      | –          | –          |
| Trade receivables                        | 3,345.1      | 3,331.7    | –          | –          |
| Amounts owed by subsidiary undertakings  | –            | –          | 2,917.8    | 2,220.9    |
| Other receivables                        | 286.7        | 330.8      | 17.8       | 65.0       |
| Cash held as collateral                  | 119.9        | –          | –          | –          |
| Prepayments and accrued income           | 1,422.9      | 1,405.6    | –          | –          |
|  | 5,174.6      | 5,068.1    | 2,935.6    | 2,285.9    |
| <b>Non-current assets</b>                |              |            |            |            |
| Amounts owed by subsidiary undertakings  | –            | –          | 3,790.6    | 3,661.2    |
|  | 5,174.6      | 5,068.1    | 6,726.2    | 5,947.1    |

Wholesale trade receivables includes a balance of £nil (2011 – £28.1m) in relation to contractual balances due from British Energy.

Other receivables includes financial assets totalling £21.8m (2011 – £93.4m). Cash held as collateral relates to amounts deposited on commodity trading exchanges.

Trade receivables and other financial assets are part of the Group's financial exposure to credit risk as explained in note 31.

## 19. CASH AND CASH EQUIVALENTS

|                           | Consolidated |            | Company    |            |
|---------------------------|--------------|------------|------------|------------|
|                           | 2012<br>£m   | 2011<br>£m | 2012<br>£m | 2011<br>£m |
| Bank balances             | 158.9        | 123.2      | 9.4        | 4.6        |
| Call deposits             | 30.3         | 353.7      | 4.9        | 314.5      |
| Cash and cash equivalents | 189.2        | 476.9      | 14.3       | 319.1      |

Cash and cash equivalents (which are presented as a single class of assets in the face of the balance sheet) comprise cash at bank and short term highly liquid investments with a maturity of three months or less.

|  | Consolidated |            | Company    |            |
|--|--------------|------------|------------|------------|
|  | 2012<br>£m   | 2011<br>£m | 2012<br>£m | 2011<br>£m |
| Cash and cash equivalents (from above)                   | 189.2        | 476.9      | 14.3       | 319.1      |
| Bank overdraft (note 23)                                 | (3.7)        | (5.3)      | –          | –          |
| Cash and cash equivalents in the statement of cash flows | 185.5        | 471.6      | 14.3       | 319.1      |

## 20. TRADE AND OTHER PAYABLES

|  | Consolidated |            | Company    |            |
|--|--------------|------------|------------|------------|
|  | 2012<br>£m   | 2011<br>£m | 2012<br>£m | 2011<br>£m |
| <b>Current liabilities</b>             |              |            |            |            |
| Amounts due to subsidiary undertakings | –            | –          | 2,463.2    | 2,757.0    |
| Trade payables                         | 3,212.5      | 3,197.2    | –          | –          |
| Other creditors                        | 1,344.6      | 1,227.8    | 51.7       | 35.3       |
| Accruals and deferred income (i)       | 625.6        | 653.0      | –          | –          |
|  | 5,182.7      | 5,078.0    | 2,514.9    | 2,792.3    |
| <b>Non-current liabilities</b>         |              |            |            |            |
| Accruals and deferred income (ii)      | 332.7        | 304.2      | –          | –          |
|  | 5,515.4      | 5,382.2    | 2,514.9    | 2,792.3    |

(i) Current accruals and deferred income includes customer contributions of £15.2m (2011 – £15.4m) and government grants of £0.6m (2011 – £0.6m).

(ii) Non-current accruals and deferred income includes customer contributions of £221.2m (2011 – £234.7m) and government grants of £5.0m (2011 – £5.6m).



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 21. CURRENT TAX LIABILITIES

|                 | Consolidated |            | Company     |            |
|-----------------|--------------|------------|-------------|------------|
|                 | 2012<br>£m   | 2011<br>£m | 2012<br>£m  | 2011<br>£m |
| Corporation tax | <b>231.8</b> | 268.2      | <b>10.7</b> | 22.9       |

#### 22. CONSTRUCTION CONTRACTS

|   | 2012<br>£m     | 2011<br>£m |
|---|----------------|------------|
| <b>Contracts in progress at balance sheet date:</b>                                   |                |            |
| Amounts due from contract customers included in trade and other receivables (note 18) | <b>29.3</b>    | 37.7       |
| Amounts due to contract customers included in trade and other payables (note 20)      | <b>(26.7)</b>  | (17.7)     |
| Contract costs incurred plus recognised profits less recognised losses to date        | <b>201.6</b>   | 196.2      |
| Less: Progress billings   | <b>(209.0)</b> | (200.0)    |
|   | <b>(7.4)</b>   | (3.8)      |

In the year to 31 March 2012, contract revenue of £462.9m (2011 – £468.9m) was recognised.

At 31 March 2012, retentions held by customers for contract work amounted to £1.8m (2011 – £1.3m). Advances received from customers for contract work amounted to £12.9m (2011 – £4.7m).

The Company does not hold any construction contracts.

#### 23. LOANS AND OTHER BORROWINGS

|   | Consolidated   |            | Company        |            |
|---|----------------|------------|----------------|------------|
|   | 2012<br>£m     | 2011<br>£m | 2012<br>£m     | 2011<br>£m |
| <b>Current</b>                          |                |            |                |            |
| Bank overdraft                          | <b>3.7</b>     | 5.3        | –              | –          |
| Other short-term loans                  | <b>693.1</b>   | 428.4      | <b>440.1</b>   | 106.8      |
| Obligations under finance leases        | <b>696.8</b>   | 433.7      | <b>440.1</b>   | 106.8      |
|   | <b>11.8</b>    | 12.8       | –              | –          |
|   | <b>708.6</b>   | 446.5      | <b>440.1</b>   | 106.8      |
| <b>Non-current</b>                      |                |            |                |            |
| Loans                                   | <b>5,206.7</b> | 4,800.5    | <b>3,955.2</b> | 3,499.5    |
| Obligations under finance leases        | <b>330.3</b>   | 359.4      | –              | –          |
| Amounts owed to subsidiary undertakings | –              | –          | <b>268.2</b>   | 257.4      |
|   | <b>5,537.0</b> | 5,159.9    | <b>4,223.4</b> | 3,756.9    |
| <b>Total loans and borrowings</b>       | <b>6,245.6</b> | 5,606.4    | <b>4,663.5</b> | 3,863.7    |
| Cash and cash equivalents (note 19)     | <b>(189.2)</b> | (476.9)    | <b>(14.3)</b>  | (319.1)    |
| <b>Net debt</b>                         | <b>6,056.4</b> | 5,129.5    | <b>4,649.2</b> | 3,544.6    |

**(i) Borrowings****Borrowing facilities**

The Group has an established €1.5bn Euro Commercial Paper programme. Paper can be issued in a range of currencies and is swapped back into Sterling. The Group has £1.0bn (2011 – £1.0bn) of committed credit facilities in place, maturing in August 2015. These provide back up to the commercial paper programme and at 31 March 2012 these facilities were undrawn.

In the year, the Group issued a new ten year £300m Sterling bond at a coupon of 4.25% and entered into a JP¥15bn (£126.7m) seven year loan at a fixed rate of 3.52% through a reverse enquiry on its EMTN programme.

**Analysis of borrowings****Loans and borrowings**

|  | 2012<br>Weighted<br>average interest<br>rate (vi) | 2012<br>Face value<br>£m | 2012<br>Fair value<br>£m | 2012<br>Carrying<br>amount<br>£m |
|--|---|--------------------------|--------------------------|----------------------------------|
| <b>Current</b>   |   |                          |                          |                                  |
| Bank overdrafts (i)                                    | 0.50%   | 3.7                      | 3.7                      | 3.7                              |
| Other short-term loans – amortising (ii)               | 6.04%   | 4.1                      | 4.3                      | 4.1                              |
| Other short-term loans – non-amortising (iii)          | 2.46%   | 676.1                    | 678.4                    | 675.2                            |
| Non-recourse funding (iv)                              | 5.73%   | 13.8                     | 13.8                     | 13.8                             |
| <b>Total current</b>                                   |   | <b>697.7</b>             | <b>700.2</b>             | <b>696.8</b>                     |
| <b>Non-current</b>                                     |   |                          |                          |                                  |
| Bank loans – amortising (ii)                           | 5.79%   | 1.4                      | 1.5                      | 1.4                              |
| Bank loans – non-amortising (v)                        | 4.92%   | 370.2                    | 382.2                    | 370.7                            |
| 6.125% Eurobond repayable on 29 July 2013              | 6.13%   | 500.3                    | 530.0                    | 499.6                            |
| 5.75% Eurobond repayable 5 February 2014               | 5.75%   | 700.0                    | 747.9                    | 698.2                            |
| Non-recourse funding (iv)                              | 5.88%   | 59.4                     | 59.4                     | 59.4                             |
| <b>Between two and five years</b>                      |   | <b>1,631.3</b>           | <b>1,721.0</b>           | <b>1,629.3</b>                   |
| Bank loans – non-amortising (v)                        | 2.61%   | 526.6                    | 552.2                    | 526.6                            |
| Non-recourse funding (iv)                              | 6.30%   | 188.7                    | 188.7                    | 188.7                            |
| 5.000% Eurobond repayable on 1 October 2018            | 5.00%   | 500.0                    | 553.2                    | 496.5                            |
| 4.25% Eurobond repayable 14 September 2021             | 4.25%   | 300.0                    | 307.7                    | 296.4                            |
| 5.875% Eurobond repayable on 26 September 2022         | 5.88%   | 300.0                    | 349.1                    | 297.1                            |
| 8.375% Eurobond repayable on 20 November 2028          | 8.38%   | 500.0                    | 709.6                    | 493.1                            |
| 5.50% Eurobond repayable on 19 June 2032               | 5.50%   | 350.0                    | 387.8                    | 350.2                            |
| 4.625% Eurobond repayable on 20 February 2037          | 4.63%   | 325.0                    | 315.3                    | 323.6                            |
| 6.25% Eurobond repayable on 27 August 2038             | 6.25%   | 350.0                    | 413.7                    | 345.8                            |
| 4.454% Index linked loan repayable on 27 February 2044 | 4.46%   | 110.4                    | 188.9                    | 110.4                            |
| 1.429% Index linked bond repayable on 20 October 2056  | 1.72%   | 118.4                    | 120.4                    | 117.8                            |
| <b>Over five years</b>                                 |   | <b>3,569.1</b>           | <b>4,086.6</b>           | <b>3,546.2</b>                   |
| Fair value adjustment (note 31)                        |   | –                        | –                        | 31.2                             |
| <b>Total non-current</b>                               |   | <b>5,200.4</b>           | <b>5,807.6</b>           | <b>5,206.7</b>                   |
| <b>Total</b>   |   | <b>5,898.1</b>           | <b>6,507.8</b>           | <b>5,903.5</b>                   |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 23. LOANS AND OTHER BORROWINGS (continued)

##### Loans and borrowings

|  | 2011<br>Weighted<br>average interest<br>rate (vi) | 2011<br>Face value<br>£m | 2011<br>Fair value<br>£m | 2011<br>Carrying<br>amount<br>£m |
|--|---|--------------------------|--------------------------|----------------------------------|
| <b>Current</b>   |   |                          |                          |                                  |
| Bank overdrafts (i)                                    | 0.50%   | 5.3                      | 5.3                      | 5.3                              |
| Other short-term loans – amortising (ii)               | 6.63%   | 8.2                      | 8.8                      | 8.2                              |
| Other short-term loans – non-amortising (iii)          | 2.73%   | 408.1                    | 408.4                    | 408.0                            |
| Non-recourse funding (iv)                              | 5.63%   | 12.2                     | 12.2                     | 12.2                             |
| <b>Total current</b>                                   |   | <b>433.8</b>             | <b>434.7</b>             | <b>433.7</b>                     |
| <b>Non-current</b>                                     |   |                          |                          |                                  |
| Bank loans – amortising (ii)                           | 5.98%   | 5.5                      | 6.0                      | 5.5                              |
| Bank loans – non-amortising (v)                        | 4.86%   | 470.2                    | 491.4                    | 471.0                            |
| 6.125% Eurobond repayable on 29 July 2013              | 6.13%   | 530.0                    | 557.0                    | 528.9                            |
| 5.75% Eurobond repayable 5 February 2014               | 5.75%   | 700.0                    | 749.4                    | 697.3                            |
| Non-recourse funding (iv)                              | 5.76%   | 54.7                     | 54.7                     | 54.7                             |
| <b>Between two and five years</b>                      |   | <b>1,760.4</b>           | <b>1,858.5</b>           | <b>1,757.4</b>                   |
| Bank loans – non-amortising (v)                        | 2.15%   | 400.0                    | 395.1                    | 400.0                            |
| Non-recourse funding (iv)                              | 5.95%   | 150.0                    | 150.0                    | 150.0                            |
| 5.000% Eurobond repayable on 1 October 2018            | 5.00%   | 500.0                    | 510.1                    | 495.9                            |
| 5.875% Eurobond repayable on 26 September 2022         | 5.88%   | 300.0                    | 318.7                    | 296.8                            |
| 8.375% Eurobond repayable on 20 November 2028          | 8.38%   | 500.0                    | 652.3                    | 492.6                            |
| 5.50% Eurobond repayable on 19 June 2032               | 5.50%   | 350.0                    | 351.5                    | 350.2                            |
| 4.625% Eurobond repayable on 20 February 2037          | 4.63%   | 325.0                    | 284.9                    | 323.5                            |
| 6.25% Eurobond repayable on 27 August 2038             | 6.25%   | 350.0                    | 379.7                    | 345.6                            |
| 4.454% Index linked loan repayable on 27 February 2044 | 4.46%   | 105.0                    | 137.1                    | 104.4                            |
| 1.429% Index linked bond repayable on 20 October 2056  | 1.66%   | 112.7                    | 115.8                    | 112.7                            |
| <b>Over five years</b>                                 |   | <b>3,092.7</b>           | <b>3,295.2</b>           | <b>3,071.7</b>                   |
| Fair value adjustment (note 31)                        |   | –                        | –                        | (28.6)                           |
| <b>Total non-current</b>                               |   | <b>4,853.1</b>           | <b>5,153.7</b>           | <b>4,800.5</b>                   |
| <b>Total</b>   |   | <b>5,286.9</b>           | <b>5,588.4</b>           | <b>5,234.2</b>                   |

(i) Bank overdrafts are repayable on demand.

(ii) Balances under amortising loans are adjusted for capital repayments or drawings in the financial year. These are held with the European Investment Bank (EIB) in a combination of fixed and floating rates.

(iii) Balances include commercial paper, term loans and EIB debt.

(iv) The Tay Valley Lighting companies formed under 50:50 partnership with Royal Bank Leasing Limited to provide streetlighting services are categorised as subsidiaries under SIC-12 (note 15). The debt held by these companies is included on consolidation but is non-recourse to the Group.

(v) The floating rate European Investment Bank advances are either reset quarterly or semi-annually. Other loans include a mixture of fixed and floating debt repayable between 2012 and 2015.

(vi) The weighted average interest rates are as noted. The weighted average interest rates for the Group (including swaps) for the year ended 31 March 2012 was 5.06% (2011 – 5.43%).

**(ii) Finance lease liabilities**

Future finance lease commitments are as follows:

|                                    | Minimum lease payments |            | Present value of minimum lease payments |            |
|------------------------------------|------------------------|------------|---|------------|
|                                    | 2012<br>£m             | 2011<br>£m | 2012<br>£m                              | 2011<br>£m |
| Amounts payable:                   |                        |            |   |            |
| Within one year                    | 48.8                   | 52.2       | 11.8                                    | 12.8       |
| Between one and five years         | 199.9                  | 202.5      | 66.5                                    | 61.1       |
| After five years                   | 423.2                  | 488.4      | 263.8                                   | 298.3      |
|                                    | <b>671.9</b>           | 743.1      | <b>342.1</b>                            | 372.2      |
| Less: future finance charge        | <b>(329.8)</b>         | (370.9)    |   |            |
| Present value of lease obligations | <b>342.1</b>           | 372.2      |   |            |

The Group has a power purchase agreement with Marchwood Power Ltd that is categorised as a finance lease. The lease is for use of their main asset, a 840MW Gas powered CCGT Electricity Generating Plant. The term of the lease is 15 years with the Group having the option for a further 5 years extension at the end of this period. £19.6m (2011 – £20.3m) of contingent rents under the lease were included within cost of sales for the period. Contingent rent consists of £/MWh charges for availability of the plant for energy production and a £/MWh charge for actual 'nominated' energy produced.

Of the remaining finance leases held by the Group, the average remaining term of the telecom leases is 7 years. No arrangements have been entered into for contingent rental payments for these leases.

The fair value of the Group's lease obligations approximates their carrying amount. The Group's obligations under finance leases are secured by the lessors' rights over the leased assets. The Company does not have any obligations under finance leases.

**24. DEFERRED TAXATION**

The following are the deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting periods:

|                                     | Accelerated capital allowances<br>£m | Fair value gains/(losses) on derivatives<br>£m | Retirement benefit obligations<br>£m | Share-based payments<br>£m | Other (i)<br>£m | Total<br>£m  |
|-------------------------------------|--------------------------------------|--|--------------------------------------|----------------------------|-----------------|--------------|
| <b>Consolidated</b>                 |                                      |  |                                      |                            |                 |              |
| At 1 April 2010                     | 904.7                                | (258.6)  | (201.7)                              | (1.9)                      | 24.4            | 466.9        |
| Acquisitions (note 16)              | (22.9)                               | –  | –                                    | –                          | 142.4           | 119.5        |
| Disposals (note 16)                 | (6.5)                                | –  | –                                    | –                          | (7.4)           | (13.9)       |
| Transfer to assets held for sale    | (23.3)                               | –  | –                                    | –                          | –               | (23.3)       |
| (Credit)/charge to income statement | (84.1)                               | 384.2  | 20.0                                 | –                          | 41.9            | 362.0        |
| Charge to equity                    | –                                    | 5.9  | 7.9                                  | 0.6                        | 1.2             | 15.6         |
| Exchange adjustments                | –                                    | –  | –                                    | –                          | (20.2)          | (20.2)       |
| At 31 March 2011                    | 767.9                                | 131.5  | (173.8)                              | (1.3)                      | 182.3           | 906.6        |
| Acquisitions (note 16)              | –                                    | –  | –                                    | –                          | 0.3             | 0.3          |
| (Credit)/charge to income statement | (64.9)                               | (131.0)  | 28.4                                 | (0.4)                      | (11.9)          | (179.8)      |
| Charge to equity                    | –                                    | (4.7)  | (30.3)                               | –                          | 8.4             | (26.6)       |
| Exchange adjustments                | –                                    | –  | –                                    | –                          | (0.8)           | (0.8)        |
| <b>At 31 March 2012</b>             | <b>703.0</b>                         | <b>(4.2)</b>                                   | <b>(175.7)</b>                       | <b>(1.7)</b>               | <b>178.3</b>    | <b>699.7</b> |

(i) Includes deferred tax on fair value items recognised in business combinations.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 24. DEFERRED TAXATION (continued)

|                                     | Fair value<br>gains/(losses)<br>on derivatives<br>£m | Retirement<br>benefit<br>obligations<br>£m | Share-based<br>payments<br>£m | Other<br>£m   | Total<br>£m    |
|-------------------------------------|--|--|-------------------------------|---------------|----------------|
| <b>Company</b>                      |  |  |                               |               |                |
| At 1 April 2010                     | 1.2  | (70.3)                                     | 0.5                           | (48.3)        | (116.9)        |
| (Credit)/charge to income statement | (10.7)   | 9.7  | –                             | (2.7)         | (3.7)          |
| (Credit)/charge to equity           | (0.4)  | (1.7)                                      | 0.6                           | –             | (1.5)          |
| At 31 March 2011                    | (9.9)  | (62.3)                                     | 1.1                           | (51.0)        | (122.1)        |
| (Credit)/charge to income statement | (16.4)   | 9.7  | (0.1)                         | 11.1          | 4.3            |
| (Credit)/charge to equity           | (3.6)  | 5.5  | –                             | –             | 1.9            |
| <b>At 31 March 2012</b>             | <b>(29.9)</b>  | <b>(47.1)</b>                              | <b>1.0</b>                    | <b>(39.9)</b> | <b>(115.9)</b> |

Certain deferred tax assets and liabilities have been offset, including the asset balances analysed in the tables above. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

|                                      | Consolidated   |            | Company        |            |
|--------------------------------------|----------------|------------|----------------|------------|
|                                      | 2012<br>£m     | 2011<br>£m | 2012<br>£m     | 2011<br>£m |
| Deferred tax liabilities             | <b>921.8</b>   | 1,068.3    | –              | –          |
| Deferred tax assets                  | <b>(222.1)</b> | (161.7)    | <b>(115.9)</b> | (122.1)    |
| Net deferred tax liabilities/(asset) | <b>699.7</b>   | 906.6      | <b>(115.9)</b> | (122.1)    |

The deferred tax assets disclosed include the deferred tax relating to the Group's pension scheme liabilities.

Temporary differences arising in connection with interests in associates and jointly controlled entities are recorded as part of the Group's share of investment in those entities. The aggregate amount of these is a charge, excluding exceptional items and remeasurements, of £33.4m (2011 – £35.2m charge).

A deferred tax asset has not been recognised on £56.3m of trading losses (2011 – £42.7m) due to uncertainty around the availability of future profits in the companies concerned.

#### 25. PROVISIONS

|                          | Decommissioning<br>(i)<br>£m | Contracting<br>provisions<br>(ii)<br>£m | Onerous<br>contracts<br>(iii)<br>£m | Other<br>(iv)<br>£m | Total<br>£m  |
|--------------------------|------------------------------|---|-------------------------------------|---------------------|--------------|
| <b>Consolidated</b>      |                              |   |                                     |                     |              |
| At 1 April 2011          | 148.8                        | 9.7                                     | 1.3                                 | 19.3                | 179.1        |
| Charged in the year      | –                            | 14.4                                    | 37.4                                | 12.1                | 63.9         |
| Unwind of discount       | 7.7                          | –                                       | –                                   | 0.1                 | 7.8          |
| Released during the year | (3.7)                        | –                                       | (1.3)                               | (2.3)               | (7.3)        |
| Utilised during the year | (0.9)                        | –                                       | –                                   | (5.0)               | (5.9)        |
| <b>At 31 March 2012</b>  | <b>151.9</b>                 | <b>24.1</b>                             | <b>37.4</b>                         | <b>24.2</b>         | <b>237.6</b> |
| <b>At 31 March 2012</b>  |                              |   |                                     |                     |              |
| Non-current              | 151.9                        | 13.0                                    | –                                   | 17.4                | 182.3        |
| Current                  | –                            | 11.1                                    | 37.4                                | 6.8                 | 55.3         |
|                          | <b>151.9</b>                 | <b>24.1</b>                             | <b>37.4</b>                         | <b>24.2</b>         | <b>237.6</b> |
| At 31 March 2011         |                              |   |                                     |                     |              |
| Non-current              | 148.8                        | 1.2                                     | –                                   | 19.2                | 169.2        |
| Current                  | –                            | 8.5                                     | 1.3                                 | 0.1                 | 9.9          |
|                          | 148.8                        | 9.7                                     | 1.3                                 | 19.3                | 179.1        |

- (i) Provision has been made for the estimated net present cost of decommissioning North Sea exploration and production assets and certain generation and gas storage assets. Estimates are based on forecast clean-up costs at the time of decommissioning discounted for the time value of money. The timing of costs provided is dependent on the lives of the facilities.
- (ii) The Group hold provisions in relation to long-term construction contracts including streetlighting PFIs. These relate to contract costs that are not guaranteed to being recovered under the respective contracts.
- (iii) The Group has recognised provisions of £37.4m in relation to onerous contracts in the year. These have been treated as exceptional charges (note 5). These contracts will be settled in the next year.
- (iv) Other provisions include balances held in relation to insurance and warranty claims. In addition, the Group has an employer financed retirement benefit provision for pensions for certain Directors and former Directors and employees, which is valued in accordance with IAS 19.

The Company does not hold provisions.

## 26. SHARE CAPITAL

|                                     | Number<br>(millions) | £m           |
|-------------------------------------|----------------------|--------------|
| Allotted, called up and fully paid: |                      |              |
| At 1 April 2011                     | 936.9                | 468.4        |
| Issue of shares (i)                 | 7.8                  | 3.9          |
| <b>At 31 March 2012</b>             | <b>944.7</b>         | <b>472.3</b> |

The Company has one class of Ordinary Share which carries no right to fixed income. The holders of Ordinary Shares are entitled to receive dividends as declared and are entitled to one vote per share at meetings of the Company.

- (i) Shareholders were able to elect to receive Ordinary Shares in place of the final dividend of 52.6p per Ordinary Share (in relation to year ended 31 March 2011) and the interim dividend of 24.0p (in relation to the current year) under the terms of the Company's scrip dividend scheme. This resulted in the issue of 907,008 and 6,273,193 new fully paid Ordinary Shares, respectively. In addition, the Company issued 0.6 million (2011 – 1.0 million) shares during the year under the savings-related share option schemes for a consideration of £6.1m (2011 – £9.2m).

During the year, on behalf of the Company, the employee share trust purchased 0.4 million shares for a total consideration of £4.9m (2011 – 0.8 million shares, consideration of £9.2m). At 31 March 2012, the trust held 3.6 million shares (2011 – 5.1 million) which had a market value of £48.0m (2011 – £64.4m).

## 27. RESERVES

The movement in reserves is reported in the Statement of Changes in Equity which is included as part of the primary statements (pages 94 to 95).

The capital redemption reserve comprises the value of shares redeemed or purchased by the Company from distributable profits.

The hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedge derivative instruments related to hedged transactions that have not yet occurred.

The translation reserve comprises exchange translation differences on foreign currency net investments offset by exchange translation differences on borrowings and derivatives classified as net investment hedges under IAS 39.

The profit for the year attributable to Ordinary Shareholders dealt with in the financial statements of the Company was £739.0m (2011 – £627.3m). As allowed by section 408 of the Companies Act 2006, the Company has not presented its own income statement.



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 28. HYBRID CAPITAL

|   | 2012<br>£m     | 2011<br>£m |
|---|----------------|------------|
| GBP 750m 5.453% perpetual subordinated capital securities | 744.5          | 744.5      |
| EUR 500m 5.025% perpetual subordinated capital securities | 416.9          | 416.9      |
|   | <b>1,161.4</b> | 1,161.4    |

On 20 September 2010 the Company issued €500m EUR and £750m Sterling bonds (hybrid capital). They have no fixed redemption date but the Group may, at its sole discretion, redeem all, but not part, of these bonds at their principal amount on 1 October 2015 or 1 October 2020 or any subsequent coupon payment date after this. In addition, under certain circumstances defined in the terms and conditions of the issue, the Group may at its sole discretion redeem all (but not part of) the bonds at their principal amount at any time prior to 1 October 2015.

The Company has the option to defer coupon payments on the bonds on any relevant payment date, as long as a dividend on the Ordinary Shares has not been declared. Deferred coupons shall be satisfied only in the following circumstances, all of which occur at the sole option of the Company:

- redemption; or
- dividend payment on Ordinary Shares.

Interest will accrue on any deferred coupon.

Coupon payments of £65.5m were made on 1 October 2011 and are expected to be made annually in arrears on 1 October in subsequent years. The purpose of the issue was to strengthen SSE's capital base and to fund the Group's ongoing capital investment and acquisitions.

#### 29. RETIREMENT BENEFIT OBLIGATIONS

##### Defined Benefit Schemes

The Group has two funded final salary pension schemes which provide defined benefits based on final pensionable pay. The schemes are subject to independent valuations at least every three years. The future benefit obligations are valued by actuarial methods on the basis of an appropriate assessment of the relevant parameters. The Company operates one of these schemes, being the Scottish Hydro-Electric scheme.

The Group also has an Employer Financed Retirement Benefit scheme and a Group Personal Pension Plan. The Group Personal Pension Plan operates on a Money purchase basis and has been arranged with Friends Provident. The Company matches employee contributions up to a specified limit, in most circumstances this is set at 6%. The Company may also provide additional contributions of 3% after five years and a further 3% after ten year's continuous Company service.

Pension summary:

|  | Scheme type     | Net actuarial (loss)/gain recognised<br>in respect of the pension asset in the<br>Statement of Comprehensive Income |            | Net pension (liability) |            |
|--|-----------------|---|------------|-------------------------|------------|
|  |                 | 2012<br>£m  | 2011<br>£m | 2012<br>£m              | 2011<br>£m |
| Scottish Hydro Electric                        | Defined benefit | (68.8)  | 92.3       | (196.2)                 | (239.8)    |
| Southern Electric                              | Defined benefit | (164.1)   | 16.8       | (535.7)                 | (428.8)    |
|  |                 | <b>(232.9)</b>  | 109.1      | <b>(731.9)</b>          | (668.6)    |
| IFRIC 14 movement                              |                 | <b>71.8</b>   | (117.9)    |                         |            |
| Net actuarial gain/loss and IFRIC 14 liability |                 | <b>(161.1)</b>  | (8.8)      |                         |            |

The Scottish Hydro-Electric Pension Scheme net liability of £196.2m (2011 – £239.8m) is presented after an IFRIC 14 minimum funding requirement of £302.4m (2011 – £374.2m).

The individual pension scheme details based on the latest formal actuarial valuations are as follows:

|   | Scottish Hydro Electric      | Southern Electric |
|---|------------------------------|-------------------|
| Latest formal actuarial valuation       | 31 March 2009                | 31 March 2010     |
| Valuation carried out by                | Hymans Robertson             | Aon Hewitt        |
| Value of assets based on valuation      | £860.0m                      | £1,183.5m         |
| Value of liabilities based on valuation | £1,189.3m                    | £1,666.6m         |
| Valuation method adopted                | Projected Unit               | Projected Unit    |
| Average salary increase                 | Inflation curve plus 2.3% pa | 5.2%              |
| Average pension increase                | 2.7%                         | 3.7%              |
| Value of fund assets/accrued benefits   | 72.3%                        | 71.0%             |

Both schemes have been updated to 31 March 2012 by qualified independent actuaries. The valuations have been prepared for the purposes of meeting the requirements of IAS 19. The major assumptions used by the actuaries in both schemes were:

|  | At 31 March 2012 | At 31 March 2011 |
|--|------------------|------------------|
| Rate of increase in pensionable salaries | 4.7%             | 5.0%             |
| Rate of increase in pension payments     | 3.2%             | 3.5%             |
| Discount rate                            | 4.6%             | 5.5%             |
| Inflation rate                           | 3.2%             | 3.5%             |

The assumptions relating to longevity underlying the pension liabilities at 31 March 2012 are based on standard actuarial mortality tables, and include an allowance for future improvements in longevity. The assumptions equivalent to future longevity for members in normal health at age 65 are as follows:

|                   | At 31 March 2012<br>Male | At 31 March 2012<br>Female | At 31 March 2011<br>Male | At 31 March 2011<br>Female |
|-------------------|--------------------------|----------------------------|--------------------------|----------------------------|
| Currently aged 65 | 24                       | 25                         | 24                       | 25                         |
| Currently aged 45 | 26                       | 28                         | 26                       | 28                         |

The impact on the schemes liabilities of changing certain of the major assumptions is as follows:

|               | At 31 March 2012                       |                                    | At 31 March 2011                       |                                    |
|---------------|--|------------------------------------|--|------------------------------------|
|               | Increase/<br>decrease in<br>assumption | Effect on<br>scheme<br>liabilities | Increase/<br>decrease in<br>assumption | Effect on<br>scheme<br>liabilities |
| Discount rate | 0.1%                                   | +/- 1.8%                           | 0.1%                                   | +/- 1.7%                           |
| Longevity     | 1 year                                 | +/- 2.9%                           | 1 year                                 | +/- 2.8%                           |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 29. RETIREMENT BENEFIT OBLIGATIONS (continued)

##### Valuation of combined Pension Schemes

|   | Consolidated   |                           |  |                           | Company  |                           |  |                           |
|---|--|---------------------------|--|---------------------------|--|---------------------------|--|---------------------------|
|   | Long-term rate of return expected at 31 March 2012 % | Value at 31 March 2012 £m | Long-term rate of return expected at 31 March 2011 % | Value at 31 March 2011 £m | Long-term rate of return expected at 31 March 2012 % | Value at 31 March 2012 £m | Long-term rate of return expected at 31 March 2011 % | Value at 31 March 2011 £m |
| Equities                                    | 7.0  | 1,040.3                   | 7.8  | 1,032.5                   | 7.0  | 406.6                     | 7.8  | 402.9                     |
| Government bonds                            | 3.3  | 939.4                     | 4.3  | 743.8                     | 3.3  | 636.9                     | 4.3  | 500.7                     |
| Corporate bonds                             | 4.6  | 481.2                     | 5.5  | 471.0                     | 4.6  | 189.7                     | 5.5  | 207.6                     |
| Other investments                           | 4.3  | 234.2                     | 4.4  | 216.3                     | 4.3  | 122.0                     | 4.5  | 109.9                     |
| Total fair value of plan assets             |  | 2,695.1                   |  | 2,463.6                   |  | 1,355.2                   |  | 1,221.1                   |
| Present value of defined benefit obligation |  | (3,124.6)                 |  | (2,758.0)                 |  | (1,249.0)                 |  | (1,086.7)                 |
| Pension (liability)/asset (pre IFRIC 14)    |  | (429.5)                   |  | (294.4)                   |  | 106.2                     |  | 134.4                     |
| IFRIC 14 liability (i)                      |  | (302.4)                   |  | (374.2)                   |  | (302.4)                   |  | (374.2)                   |
| <b>Deficit in the scheme</b>                |  | <b>(731.9)</b>            |  | <b>(668.6)</b>            |  | <b>(196.2)</b>            |  | <b>(239.8)</b>            |
| Deferred tax thereon                        |  | 175.7                     |  | 173.8                     |  | 47.1                      |  | 62.3                      |
| Net pension liability                       |  | <b>(556.2)</b>            |  | <b>(494.8)</b>            |  | <b>(149.1)</b>            |  | <b>(177.5)</b>            |

(i) The IFRIC 14 liability represents the deficit repair obligations required to ensure a minimum funding level together with a restriction on the surplus that can be recognised in the Scottish Hydro-Electric scheme.

##### Movements in the defined benefit obligation during the year:

|  | Consolidated     |                  | Company          |                  |
|--|------------------|------------------|------------------|------------------|
|  | 2012 £m          | 2011 £m          | 2012 £m          | 2011 £m          |
| At 1 April                             | (2,758.0)        | (2,762.3)        | (1,086.7)        | (1,113.6)        |
| Movements in the year:                 |                  |                  |                  |                  |
| Service costs                          | (37.8)           | (37.8)           | (17.7)           | (18.7)           |
| Member contributions                   | (7.8)            | (7.8)            | (3.3)            | (3.1)            |
| Benefits paid                          | 112.8            | 105.7            | 40.1             | 40.2             |
| Interest on pension scheme liabilities | (149.8)          | (150.2)          | (59.2)           | (60.7)           |
| Actuarial (losses)/gains               | (284.0)          | 94.4             | (122.2)          | 69.2             |
| At 31 March                            | <b>(3,124.6)</b> | <b>(2,758.0)</b> | <b>(1,249.0)</b> | <b>(1,086.7)</b> |

##### Movements in scheme assets during the year:

|  | Consolidated   |                | Company        |                |
|--|----------------|----------------|----------------|----------------|
|  | 2012 £m        | 2011 £m        | 2012 £m        | 2011 £m        |
| At 1 April                               | 2,463.6        | 2,298.3        | 1,221.1        | 1,118.8        |
| Movements in the year:                   |                |                |                |                |
| Expected return on pension scheme assets | 147.4          | 141.9          | 69.6           | 67.9           |
| Assets distributed on settlement         | (112.8)        | (105.7)        | (40.1)         | (40.3)         |
| Employer contributions                   | 138.0          | 106.6          | 47.9           | 48.5           |
| Member contributions                     | 7.8            | 7.8            | 3.3            | 3.1            |
| Actuarial gains                          | 51.1           | 14.7           | 53.4           | 23.1           |
| At 31 March                              | <b>2,695.1</b> | <b>2,463.6</b> | <b>1,355.2</b> | <b>1,221.1</b> |

**Charges/(credits) recognised:**

|  | Consolidated |            | Company    |            |
|--|--------------|------------|------------|------------|
|  | 2012<br>£m   | 2011<br>£m | 2012<br>£m | 2011<br>£m |
| Current service cost (charged to operating profit) | 37.8         | 37.8       | 17.7       | 18.7       |
|  | 37.8         | 37.8       | 17.7       | 18.7       |
| Charged/(credited) to finance costs:               |              |            |            |            |
| Expected return on pension scheme assets           | (147.4)      | (141.9)    | (69.6)     | (67.9)     |
| Interest on pension scheme liabilities             | 149.8        | 150.2      | 59.2       | 60.7       |
|  | 2.4          | 8.3        | (10.4)     | (7.2)      |

**History of (deficit)/surplus**

|   | Consolidated   |            |            |            |            | Company        |            |            |            |            |
|---|----------------|------------|------------|------------|------------|----------------|------------|------------|------------|------------|
|   | 2012<br>£m     | 2011<br>£m | 2010<br>£m | 2009<br>£m | 2008<br>£m | 2012<br>£m     | 2011<br>£m | 2010<br>£m | 2009<br>£m | 2008<br>£m |
| Total fair value of plan assets             | 2,695.1        | 2,463.6    | 2,298.3    | 1,786.8    | 2,081.0    | 1,355.2        | 1,221.1    | 1,118.8    | 860.0      | 1,005.6    |
| Present value of defined benefit obligation | (3,124.6)      | (2,758.0)  | (2,762.3)  | (1,929.8)  | (1,919.5)  | (1,249.0)      | (1,086.7)  | (1,113.6)  | (729.5)    | (709.2)    |
| IFRIC 14 Liability                          | (302.4)        | (374.2)    | (256.3)    | (130.5)    | (210.6)    | (302.4)        | (374.2)    | (256.3)    | (130.5)    | (210.6)    |
| <b>(Deficit)/surplus in the scheme</b>      | <b>(731.9)</b> | (668.6)    | (720.3)    | (273.5)    | (49.1)     | <b>(196.2)</b> | (239.8)    | (251.1)    | –          | 85.8       |

**Return on assets**

As required by IAS 19, the expected return on assets is based on the long-term expectation of returns for each asset class at the beginning of the year. The return on equities is 3.7% per annum in excess of the yield on government bonds. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation at 31 March 2012.

The actual return on Pension Scheme assets is as follows:

|  | Consolidated |            | Company    |            |
|--|--------------|------------|------------|------------|
|  | 2012<br>£m   | 2011<br>£m | 2012<br>£m | 2011<br>£m |
| Actual return on Pension Scheme assets | 198.5        | 156.6      | 123.0      | 91.0       |

**History of experience gains and losses**

|   | Consolidated |            |            |            |            | Company    |            |            |            |            |
|---|--------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
|   | 2012<br>£m   | 2011<br>£m | 2010<br>£m | 2009<br>£m | 2008<br>£m | 2012<br>£m | 2011<br>£m | 2010<br>£m | 2009<br>£m | 2008<br>£m |
| Total actuarial gains and (losses) and gains recognised in the Statement of Comprehensive Income before adjustment for taxation | (232.9)      | 109.1      | (383.0)    | (359.0)    | 185.0      | (68.8)     | 92.3       | (161.6)    | (188.4)    | 146.3      |
| Experience gains/(losses) on scheme liabilities   | 17.3         | 52.7       | (59.8)     | 0.8        | (50.6)     | 6.2        | 26.9       | (49.7)     | –          | –          |
| Experience gains/(losses) on scheme assets  | 51.1         | 14.7       | 394.1      | (412.2)    | (153.4)    | 53.4       | 23.1       | 200.4      | (190.0)    | (31.2)     |

The cumulative actuarial losses recognised in the Statement of Comprehensive Income before adjustment for taxation since the adoption of IAS 19 is £997.2m losses (2011 – £836.1m).

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 29. RETIREMENT BENEFIT OBLIGATIONS (continued)

##### Defined contribution scheme

The total contribution paid by the Group to defined contribution schemes was £19.1m (2011 – £16.8m).

##### Employer financed retirement benefit (EFRB) pension costs

The increase in the year in relation EFRB was £5.4m (2011 – £0.2m). This is included in other provisions (note 25).

##### Staff costs analysis

The pension costs in note 6 can be analysed thus:

|                                      | 2012<br>£m  | 2011<br>£m |
|--------------------------------------|-------------|------------|
| Service costs                        | 37.8        | 37.8       |
| Defined contribution scheme payments | 19.1        | 16.8       |
|                                      | <b>56.9</b> | 54.6       |

##### Expected contributions in the year to 31 March 2013

The Group currently expects to make contributions of £47.7m and £75.2m to the Scottish Hydro-Electric Pension Scheme and the Southern Electric Pension Scheme in the year to 31 March 2013, respectively. These include deficit repair contributions of £29.5m and £55.2m respectively.

#### 30. EMPLOYEE SHARE-BASED PAYMENTS

The Scottish and Southern Energy Group operates a number of share schemes for the benefit of its employees. Details of these schemes, all of which are equity-settled, are as follows:

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

This scheme gives employees the option to purchase shares in the Company at a discounted market price, subject to the employees remaining in employment for the term of the agreement. Employees may opt to save between £5 and £250 per month for a period of three and/or five years. At the end of these periods employees have six months to exercise their options by using the cash saved (including any bonus equivalent to interest). If the option is not exercised, the funds may be withdrawn by the employee and the option expires.

##### (ii) Share Incentive Plan (SIP)

This scheme allows employees the opportunity to purchase shares in the Company on a monthly basis. Employees may nominate an amount between £10 and £125 to be deducted from their gross salary. This is then used to purchase shares (Partnership shares) in the market each month. These shares are held in trust and become free of liability to income tax and national insurance on their fifth anniversary. These shares may be withdrawn at any point during the 5 years, but tax and national insurance would become payable on any shares withdrawn.

In addition to the shares purchased on behalf of the employee, the Company will also match the purchase up to a maximum of 6 (previously 5) shares ('Matching' shares) per month. These shares are also held in trust and become free of liability to income tax and national insurance on their fifth anniversary. If an employee leaves during the first three years, or removes his/her 'partnership' shares, these 'matching' shares are forfeited.

In addition to the above, the following special awards of free shares have been made:

|   |               |               |
|---|---------------|---------------|
| Award made  | 31 March 2007 | 31 March 2008 |
| Free shares per employee  | 20            | 10            |
| Date at which employee must still be employed to receive award<br>(in addition to 31 March) | 30 May 2007   | 1 August 2008 |

These awards were made to all employees in recognition of their contribution to the success of the Group. Under the arrangements for the awards, the shares are held in trust for five years and become free of liability to income tax and national insurance on their fifth anniversary. These shares may be withdrawn at any point during years four and five, but income tax and national insurance would become payable on any shares withdrawn.

**(iii) Deferred Annual Incentive Scheme**

This scheme (previously called deferred bonus scheme) applies to senior managers and Executive Directors. Under this scheme, 25% of all eligible employees' annual incentive is deferred into shares which only vest after three years, subject to continued service. The number of shares awarded is determined by dividing the relevant pre-tax incentive amount by the share price shortly after the announcement of the results for the financial year to which the incentive relates.

**(iv) Performance Share Plan**

This scheme applies to Executive Directors and senior executives. Shares granted under this arrangement vest subject to the attainment of performance conditions over the relevant three year performance period as set out below:

| Award made                                   | 2 June 2009                 | 2 June 2010                 | 2 June 2011                 |                             |
|--|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Maximum value of award as a % of base salary | 150                         | 150                         | 150                         |                             |
| <b>Performance conditions</b>                |                             |                             |                             |                             |
| Total shareholder return (i)                 | Full vesting<br>25% vesting | ≥ 75th percentile<br>median | ≥ 75th percentile<br>median | ≥ 75th percentile<br>median |
| Earnings per share (ii)                      | Full vesting<br>25% vesting | RPI + 9%<br>RPI + 3%        | RPI + 8%<br>RPI + 2%        | RPI + 8%<br>RPI + 2%        |
| Dividend per share growth (iii)              | Full vesting<br>25% vesting | –<br>–                      | RPI + 6%<br>RPI + 2%        | RPI + 6%<br>RPI + 2%        |

These awards will vest after three years to the extent that the relevant performance conditions are met.

- (i) Total Shareholder Return (TSR) target relative to other FTSE100 companies for the 2009 award and TSR target relative to other FTSE100 companies and MSCI Europe Utilities (a dedicated peer group of UK and other European utilities) Index for all other awards over the relevant performance period. Pro rata vesting will take place between the median and 75th percentile, with no vesting if the minimum target is not met.
- (ii) Under the EPS performance condition, pro rata vesting between the lower and upper level above RPI, with no vesting if the minimum EPS growth target is not achieved.
- (iii) Under the Dividend per share growth performance condition, pro rata vesting between 2% and 6% above RPI, with no vesting if the minimum dividend per share growth target is not achieved.

**(v) Long Term Incentive Plan (LTIP)**

This scheme applies to the Management Board (excluding Executive Directors). Shares granted under this arrangement vest subject to the attainment of performance conditions over the relevant performance period. The relevant performance period for this LTIP award is 1 April 2011 to 31 March 2016. The performance conditions are as set out below:

| Performance conditions          | Full vesting | RPI + 5% |
|---------------------------------|--------------|----------|
| Dividend per share growth (DPS) | 40% vesting  | RPI + 2% |

Where DPS growth is between 2 and 5% above RPI, vesting will be calculated on a straight-line basis. Where DPS growth is less than RPI + 2% no vesting will occur.

A charge of £13.5m (2011 – £9.9m) was recognised in the income statement in relation to these schemes, £1.4m (2011 – £3.1m) of this was in relation to the Directors of the Company.



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 30. EMPLOYEE SHARE-BASED PAYMENTS (continued)

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

##### (i) Savings-related share option scheme

The movement in savings related share option schemes in the year were as follows:

##### Consolidated

As at 31 March 2012

| Award date   | Option price (pence) | Outstanding at start of year | Granted   | Exercised | Lapsed    | Outstanding at end of year | Date from which exercisable | Expiry date (i) |
|--------------|----------------------|------------------------------|-----------|-----------|-----------|----------------------------|-----------------------------|-----------------|
| 14 July 2005 | 886                  | 26,554                       | –         | (3,318)   | (23,236)  | –                          | 1 October 2010              | 31 March 2011   |
| 11 July 2006 | 999                  | 517,837                      | –         | (485,772) | (5,293)   | 26,772                     | 1 October 2011              | 31 March 2012   |
| 10 July 2007 | 1,306                | 190,752                      | –         | (216)     | (190,536) | –                          | 1 October 2010              | 31 March 2011   |
| 10 July 2007 | 1,306                | 264,679                      | –         | (392)     | (16,676)  | 247,611                    | 1 October 2012              | 31 March 2013   |
| 17 July 2008 | 1,274                | 178,681                      | –         | (74,697)  | (11,497)  | 92,487                     | 1 October 2011              | 31 March 2012   |
| 17 July 2008 | 1,274                | 270,597                      | –         | (150)     | (24,775)  | 245,672                    | 1 October 2013              | 31 March 2014   |
| 30 June 2009 | 1,042                | 308,351                      | –         | (7,382)   | (24,123)  | 276,846                    | 1 October 2012              | 31 March 2013   |
| 30 June 2009 | 1,042                | 562,907                      | –         | (2,664)   | (46,839)  | 513,404                    | 1 October 2014              | 31 March 2015   |
| 30 June 2010 | 871                  | 771,919                      | –         | (4,320)   | (65,287)  | 702,312                    | 1 October 2013              | 31 March 2014   |
| 30 June 2010 | 871                  | 2,946,250                    | –         | (5,222)   | (178,675) | 2,762,353                  | 1 October 2015              | 31 March 2016   |
| 29 June 2011 | 1,105                | –                            | 426,347   | –         | (40,328)  | 386,019                    | 1 October 2014              | 31 March 2015   |
| 29 June 2011 | 1,105                | –                            | 765,339   | (45)      | (53,423)  | 711,871                    | 1 October 2016              | 31 March 2017   |
|              |                      | 6,038,527                    | 1,191,686 | (584,178) | (680,688) | 5,965,347                  |                             |                 |

As at 31 March 2011

| Award date   | Option price (pence) | Outstanding at start of year | Granted   | Exercised   | Lapsed      | Outstanding at end of year | Date from which exercisable | Expiry date (i) |
|--------------|----------------------|------------------------------|-----------|-------------|-------------|----------------------------|-----------------------------|-----------------|
| 16 July 2004 | 622                  | 1,890                        | –         | (315)       | (1,575)     | –                          | 1 October 2009              | 31 March 2010   |
| 14 July 2005 | 886                  | 1,066,454                    | –         | (1,031,131) | (8,769)     | 26,554                     | 1 October 2010              | 31 March 2011   |
| 11 July 2006 | 999                  | 16,155                       | –         | (1,066)     | (15,089)    | –                          | 1 October 2009              | 31 March 2010   |
| 11 July 2006 | 999                  | 563,277                      | –         | (3,247)     | (42,193)    | 517,837                    | 1 October 2011              | 31 March 2012   |
| 10 July 2007 | 1,306                | 214,493                      | –         | (476)       | (23,265)    | 190,752                    | 1 October 2010              | 31 March 2011   |
| 10 July 2007 | 1,306                | 400,684                      | –         | –           | (136,005)   | 264,679                    | 1 October 2012              | 31 March 2013   |
| 17 July 2008 | 1,274                | 252,498                      | –         | –           | (73,817)    | 178,681                    | 1 October 2011              | 31 March 2012   |
| 17 July 2008 | 1,274                | 439,226                      | –         | –           | (168,629)   | 270,597                    | 1 October 2013              | 31 March 2014   |
| 30 June 2009 | 1,042                | 539,099                      | –         | (2,102)     | (228,646)   | 308,351                    | 1 October 2012              | 31 March 2013   |
| 30 June 2009 | 1,042                | 1,109,927                    | –         | (494)       | (546,526)   | 562,907                    | 1 October 2014              | 31 March 2015   |
| 30 June 2010 | 871                  | –                            | 823,143   | –           | (51,224)    | 771,919                    | 1 October 2013              | 31 March 2014   |
| 30 June 2010 | 871                  | –                            | 3,073,329 | –           | (127,079)   | 2,946,250                  | 1 October 2015              | 31 March 2016   |
|              |                      | 4,603,703                    | 3,896,472 | (1,038,831) | (1,422,817) | 6,038,527                  |                             |                 |

(i) Options may remain exercisable beyond the published expiry date due to individuals taking advantage of the right to a payment holiday during the term of the scheme.

As share options are exercised continuously throughout the period from 1 October to 31 March, the weighted average share price during this period of 1,291p (2011 – 1,177p) is considered representative of the weighted average share price at the date of exercise. The weighted average share price of forfeitures is simply the option price to which the forfeit relates.

##### Company

As at 31 March 2012

| Award date   | Option price (pence) | Outstanding at start of year | Granted | Exercised | Outstanding at end of year | Date from which exercisable | Expiry date   |
|--------------|----------------------|------------------------------|---------|-----------|----------------------------|-----------------------------|---------------|
| 10 July 2007 | 1,306                | 144                          | –       | (144)     | –                          | 1 October 2010              | 31 March 2011 |
| 17 July 2008 | 1,274                | 442                          | –       | (442)     | –                          | 1 October 2011              | 31 March 2012 |
| 30 June 2009 | 1,042                | 1,253                        | –       | –         | 1,253                      | 1 October 2014              | 31 March 2015 |
| 30 June 2010 | 871                  | 413                          | –       | –         | 413                        | 1 October 2013              | 31 March 2014 |
| 30 June 2010 | 871                  | 283                          | –       | –         | 283                        | 1 October 2015              | 31 March 2016 |
|              |                      | 2,535                        | –       | (586)     | 1,949                      |                             |               |

As at 31 March 2011

| Award date   | Option price (pence) | Outstanding at start of year | Granted | Exercised | Outstanding at end of year | Date from which exercisable | Expiry date   |
|--------------|----------------------|------------------------------|---------|-----------|----------------------------|-----------------------------|---------------|
| 14 July 2005 | 886                  | 3,655                        | –       | (3,655)   | –                          | 1 October 2010              | 31 March 2011 |
| 10 July 2007 | 1,306                | 144                          | –       | –         | 144                        | 1 October 2010              | 31 March 2011 |
| 17 July 2008 | 1,274                | 442                          | –       | –         | 442                        | 1 October 2011              | 31 March 2012 |
| 30 June 2009 | 1,042                | 1,253                        | –       | –         | 1,253                      | 1 October 2014              | 31 March 2015 |
| 30 June 2010 | 871                  | –                            | 413     | –         | 413                        | 1 October 2013              | 31 March 2014 |
| 30 June 2010 | 871                  | –                            | 283     | –         | 283                        | 1 October 2015              | 31 March 2016 |
|              |                      | 5,494                        | 696     | (3,655)   | 2,535                      |                             |               |

No options were forfeited in the year.

The fair value of these share options at the measurement date, calculated using the Black-Scholes model, and the assumptions made in that model are as follows:

|                                | July 2005 |        | July 2006 |        | July 2007 |        | July 2008 |        | July 2009 |        | July 2010 |        | July 2011 |        |
|--------------------------------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|-----------|--------|
|                                | 3 Year    | 5 Year | 3 Year    | 5 Year | 3 Year    | 5 Year | 3 Year    | 5 Year | 3 Year    | 5 year | 3 year    | 5 Year | 3 year    | 5 Year |
| Fair value of option           | 126p      | 137p   | 217p      | 227p   | 287p      | 313p   | 304p      | 339p   | 244p      | 269p   | 231p      | 246p   | 171p      | 163p   |
| Expected volatility            | 15%       | 15%    | 19%       | 19%    | 25%       | 25%    | 28%       | 28%    | 35%       | 35%    | 19%       | 19%    | 18%       | 18%    |
| Risk free rate                 | 4.1%      | 4.2%   | 4.7%      | 4.7%   | 5.8%      | 5.7%   | 4.9%      | 5.0%   | 2.7%      | 2.9%   | 1.4%      | 2.2%   | 1.2%      | 2.1%   |
| Expected dividends             | 4.2%      | 4.2%   | 4.8%      | 4.8%   | 5.3%      | 5.2%   | 4.1%      | 4.2%   | 4.1%      | 4.2%   | 1.7%      | 2.2%   | 6.1%      | 6.1%   |
| Term of the option             | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  | 3 yrs     | 5 yrs  |
| Underlying price at grant date | 967p      | 967p   | 1,180p    | 1,180p | 1,460p    | 1,460p | 1,397p    | 1,397p | 1,139p    | 1,139p | 1,089p    | 1,089p | 1,393p    | 1,393p |
| Strike price                   | 886p      | 886p   | 999p      | 999p   | 1,306p    | 1,306p | 1,274p    | 1,274p | 1,042p    | 1,042p | 871p      | 871p   | 1,105p    | 1,105p |

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

## (ii) Share Incentive Plan

### Matching Shares

|                                  | Consolidated     |                                |           |                                | Company      |                                |        |                                |
|----------------------------------|------------------|--------------------------------|-----------|--------------------------------|--------------|--------------------------------|--------|--------------------------------|
|                                  | 2012             |                                | 2011      |                                | 2012         |                                | 2011   |                                |
|                                  | Shares           | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares       | Weighted average price (pence) | Shares | Weighted average price (pence) |
| Outstanding at start of year     | <b>1,752,503</b> | <b>1,205</b>                   | 1,745,224 | 1,215                          | <b>1,320</b> | <b>1,135</b>                   | 1,588  | 1,130                          |
| Granted during the year          | <b>522,744</b>   | <b>1,315</b>                   | 571,166   | 1,161                          | <b>240</b>   | <b>1,320</b>                   | 288    | 1,161                          |
| Forfeited during the year        | <b>(92,419)</b>  | <b>1,194</b>                   | (68,670)  | 1,215                          | –            | –                              | –      | –                              |
| Exercised during the year        | <b>(98,585)</b>  | <b>1,304</b>                   | (138,696) | 1,149                          | <b>(342)</b> | <b>1,287</b>                   | –      | –                              |
| Transfer to pool during the year | <b>(185,234)</b> | <b>1,328</b>                   | (356,521) | 1,149                          | <b>(210)</b> | <b>1,311</b>                   | (556)  | 1,149                          |
| Outstanding at end of year       | <b>1,899,009</b> | <b>1,219</b>                   | 1,752,503 | 1,205                          | <b>1,008</b> | <b>1,091</b>                   | 1,320  | 1,135                          |
| Exercisable at end of year       | <b>802,911</b>   | <b>1,581</b>                   | 781,271   | 1,396                          | <b>192</b>   | <b>1,260</b>                   | 1,040  | 1,096                          |

When shares have been held for 5 years they are transferred to a pooled share account. At this point the holder has an unconditional right to the share.

The fair value of shares in the share incentive plan is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price and is based on the price paid for the shares at the grant date as shares are acquired out of the market as at that date to satisfy awards made under the scheme.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 30. EMPLOYEE SHARE-BASED PAYMENTS (continued)

##### Free Shares

|                                  | Consolidated |                                |           |                                | Company |                                |        |                                |
|----------------------------------|--------------|--------------------------------|-----------|--------------------------------|---------|--------------------------------|--------|--------------------------------|
|                                  | 2012         |                                | 2011      |                                | 2012    |                                | 2011   |                                |
|                                  | Shares       | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares  | Weighted average price (pence) | Shares | Weighted average price (pence) |
| Outstanding at start of year     | 308,163      | 1,224                          | 673,999   | 1,210                          | 120     | 1,151                          | 320    | 1,151                          |
| Forfeited during the year        | (1,860)      | 1,225                          | (7,080)   | 1,210                          | –       | –                              | –      | –                              |
| Exercised during the year        | (43,976)     | 1,310                          | (126,298) | 1,149                          | (30)    | 1,310                          | –      | –                              |
| Transfer to pool during the year | (50)         | 1,000                          | (232,458) | 1,000                          | –       | –                              | (200)  | 1,000                          |
| Outstanding at end of year       | 262,277      | 1,187                          | 308,163   | 1,224                          | 90      | 1,098                          | 120    | 1,151                          |
| Exercisable at end of year       | 262,277      | 1,187                          | 308,163   | 1,076                          | 90      | 1,098                          | 120    | 1,113                          |

As shares are exercised continuously throughout the year, the weighted average share price during the period of 1,310p (2011 – 1,149p) is considered representative of the weighted average share price at the date of exercise.

The fair value of these shares is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price and is based on the price paid for the shares at the grant date as shares are acquired out of the market as at that date to satisfy awards made under the scheme.

##### (iii) Deferred Annual Incentive Scheme

|                              | Consolidated |                                |          |                                | Company  |                                |        |                                |
|------------------------------|--------------|--------------------------------|----------|--------------------------------|----------|--------------------------------|--------|--------------------------------|
|                              | 2012         |                                | 2011     |                                | 2012     |                                | 2011   |                                |
|                              | Shares       | Weighted average price (pence) | Shares   | Weighted average price (pence) | Shares   | Weighted average price (pence) | Shares | Weighted average price (pence) |
| Outstanding at start of year | 463,855      | 1,270                          | 322,905  | 1,367                          | 92,165   | 1,251                          | 58,867 | 1,349                          |
| Granted during the year      | 134,328      | 1,342                          | 166,426  | 1,079                          | 20,454   | 1,342                          | 33,298 | 1,079                          |
| Forfeited during the year    | (14,403)     | 1,144                          | (22,722) | 1,367                          | –        | –                              | –      | –                              |
| Exercised during the year    | (188,025)    | 1,484                          | (2,754)  | 1,054                          | (44,411) | 1,545                          | –      | –                              |
| Outstanding at end of year   | 395,755      | 1,198                          | 463,855  | 1,270                          | 68,208   | 1,177                          | 92,165 | 1,251                          |
| Exercisable at end of year   | 1,867        | 1,277                          | 868      | 1,072                          | –        | –                              | –      | –                              |

The fair value of the annual incentive scheme shares is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price and is based on the price paid for the shares at the grant date as shares are acquired out of the market as at that date to satisfy awards made under the scheme.

##### (iv) Performance Share Plan

|                              | Consolidated |                                |           |                                | Company   |                                |           |                                |
|------------------------------|--------------|--------------------------------|-----------|--------------------------------|-----------|--------------------------------|-----------|--------------------------------|
|                              | 2012         |                                | 2011      |                                | 2012      |                                | 2011      |                                |
|                              | Shares       | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares    | Weighted average price (pence) | Shares    | Weighted average price (pence) |
| Outstanding at start of year | 1,992,484    | 1,226                          | 1,592,479 | 1,353                          | 875,064   | 1,233                          | 752,945   | 1,360                          |
| Granted during the year      | 580,614      | 1,342                          | 840,095   | 1,079                          | 204,561   | 1,342                          | 338,645   | 1,079                          |
| Forfeited during the year    | (476,916)    | 1,505                          | (379,500) | 1,353                          | (225,245) | 1,545                          | (181,449) | 1,360                          |
| Exercised during the year    | (55,759)     | 1,545                          | (60,590)  | 1,076                          | –         | –                              | (35,077)  | 1,076                          |
| Outstanding at end of year   | 2,040,423    | 1,185                          | 1,992,484 | 1,226                          | 854,380   | 1,177                          | 875,064   | 1,233                          |

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

The fair value of the performance share plan shares is not subject to valuation using the Black-Scholes model. The fair value of shares granted in the year is equal to the closing market price on the date of grant.

**(v) Long Term Incentive Plan**

|                              | 2012    |                                |
|------------------------------|---------|--------------------------------|
|                              | Shares  | Weighted average price (pence) |
| Outstanding at start of year | –       | –                              |
| Granted during year          | 225,687 | 1,342                          |
| Outstanding at end of year   | 225,687 | 1,342                          |

Of the outstanding options at the end of the year, none were exercisable. The Company has no employees in the LTIP.

The fair value of the long term incentive plan shares is not subject to valuation using the Black-Scholes model. The fair value of shares granted in the year is equal to closing market price on the date of grant.

**31. FINANCIAL INSTRUMENTS AND RISK**

This note presents information about the fair value of the Group's financial instruments, the Group's exposure to the risks associated with those instruments, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further qualitative disclosures are included throughout these consolidated financial statements.

The Group has exposure to the following risks from its use of financial instruments:

- Credit risk
- Liquidity risk
- Commodity risk
- Currency risk
- Interest rate risk

The Board has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board established the Risk and Trading Committee, a standing committee of the Management Board comprising three Executive Directors and senior managers from the Energy Portfolio Management and Finance functions, to oversee the control of these activities. This committee is discussed further in the Directors Report.

The Group's policies for risk management are established to identify the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. These policies, and the systems used to monitor activities, are reviewed regularly by the Risk and Trading Committee.

Exposure to the commodity, currency and interest rate risks noted arise in the normal course of the Group's business and derivative financial instruments are entered into to hedge exposure to these risks. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained below.

The Company is required to disclose information on its financial instruments and has adopted policies identical to that of the Group, where applicable. Separate disclosure is provided where necessary.

Before detailing the relevant qualitative and quantitative disclosures in relation to the potential risks faced by the Group, details on the different categories of financial instrument and the carrying and fair values of each of those categories is provided below.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### A. CATEGORIES OF FINANCIAL INSTRUMENTS AND FAIR VALUES OF THOSE ASSETS AND LIABILITIES

The fair values of the primary financial assets and liabilities of the Group together with their carrying values are as follows:

|   | 2012<br>Amortised cost<br>or other (i)<br>£m | 2012<br>Classified as<br>trading (ii)<br>£m | 2012<br>Total<br>carrying<br>value<br>£m | 2012<br>Fair value<br>£m | 2011<br>Amortised cost<br>or other (i)<br>Restated<br>£m | 2011<br>Classified as<br>trading (ii)<br>£m | 2011<br>Total<br>carrying value<br>Restated<br>£m | 2011<br>Fair value<br>Restated<br>£m |
|---|--|---|--|--------------------------|--|---|---|--------------------------------------|
| <b>Financial assets</b>                             |  |   |  |                          |  |   |   |                                      |
| <b>Current</b>                                      |  |   |  |                          |  |   |   |                                      |
| Trade receivables                                   | 3,345.1                                      | –   | 3,345.1                                  | 3,345.1                  | 3,331.7  | –   | 3,331.7   | 3,331.7                              |
| Other receivables                                   | 21.8   | –   | 21.8                                     | 21.8                     | 93.4   | –   | 93.4  | 93.4                                 |
| Cash collateral                                     | 119.9  | –   | 119.9                                    | 119.9                    | –  | –   | –   | –                                    |
| Cash and cash equivalents                           | 189.2  | –   | 189.2                                    | 189.2                    | 476.9  | –   | 476.9   | 476.9                                |
| Derivative financial assets                         | –  | 851.2                                       | 851.2                                    | 851.2                    | –  | 2,525.5                                     | 2,525.5   | 2,525.5                              |
|   | <b>3,676.0</b>                               | <b>851.2</b>                                | <b>4,527.2</b>                           | <b>4,527.2</b>           | <b>3,902.0</b>   | <b>2,525.5</b>                              | <b>6,427.5</b>                                    | <b>6,427.5</b>                       |
| <b>Non-current</b>                                  |  |   |  |                          |  |   |   |                                      |
| Loans to associates and jointly controlled entities | 1,191.9                                      | –   | 1,191.9                                  | 1,191.9                  | 1,124.6  | –   | 1,124.6   | 1,124.6                              |
| Derivative financial assets                         | –  | 348.0                                       | 348.0                                    | 348.0                    | –  | 990.1                                       | 990.1   | 990.1                                |
|   | <b>1,191.9</b>                               | <b>348.0</b>                                | <b>1,539.9</b>                           | <b>1,539.9</b>           | <b>1,124.6</b>   | <b>990.1</b>                                | <b>2,114.7</b>                                    | <b>2,114.7</b>                       |
|   | <b>4,867.9</b>                               | <b>1,199.2</b>                              | <b>6,067.1</b>                           | <b>6,067.1</b>           | <b>5,026.2</b>   | <b>3,515.6</b>                              | <b>8,542.2</b>                                    | <b>8,542.2</b>                       |
| <b>Financial liabilities</b>                        |  |   |  |                          |  |   |   |                                      |
| <b>Current</b>                                      |  |   |  |                          |  |   |   |                                      |
| Trade payables                                      | (3,212.5)                                    | –   | (3,212.5)                                | (3,212.5)                | (3,197.2)  | –   | (3,197.2)   | (3,197.2)                            |
| Bank loans and overdrafts                           | (696.8)                                      | –   | (696.8)                                  | (700.2)                  | (433.7)  | –   | (433.7)   | (434.7)                              |
| Finance lease liabilities                           | (11.8)                                       | –   | (11.8)                                   | (11.8)                   | (12.8)   | –   | (12.8)  | (12.8)                               |
| Derivative financial liabilities                    | –  | (817.6)                                     | (817.6)                                  | (817.6)                  | –  | (2,307.5)                                   | (2,307.5)   | (2,307.5)                            |
|   | <b>(3,921.1)</b>                             | <b>(817.6)</b>                              | <b>(4,738.7)</b>                         | <b>(4,742.1)</b>         | <b>(3,643.7)</b>   | <b>(2,307.5)</b>                            | <b>(5,951.2)</b>                                  | <b>(5,952.2)</b>                     |
| <b>Non-current</b>                                  |  |   |  |                          |  |   |   |                                      |
| Loans and borrowings (iii)                          | (5,175.5)                                    | (31.2)                                      | (5,206.7)                                | (5,807.6)                | (4,829.1)  | 28.6  | (4,800.5)   | (5,153.7)                            |
| Finance lease liabilities                           | (330.3)                                      | –   | (330.3)                                  | (330.3)                  | (359.4)  | –   | (359.4)   | (359.4)                              |
| Derivative financial liabilities                    | –  | (399.2)                                     | (399.2)                                  | (399.2)                  | –  | (769.3)                                     | (769.3)   | (769.3)                              |
|   | <b>(5,505.8)</b>                             | <b>(430.4)</b>                              | <b>(5,936.2)</b>                         | <b>(6,537.1)</b>         | <b>(5,188.5)</b>   | <b>(740.7)</b>                              | <b>(5,929.2)</b>                                  | <b>(6,282.4)</b>                     |
|   | <b>(9,426.9)</b>                             | <b>(1,248.0)</b>                            | <b>(10,674.9)</b>                        | <b>(11,279.2)</b>        | <b>(8,832.2)</b>   | <b>(3,048.2)</b>                            | <b>(11,880.4)</b>                                 | <b>(12,234.6)</b>                    |
| <b>Net financial liabilities</b>                    | <b>(4,559.0)</b>                             | <b>(48.8)</b>                               | <b>(4,607.8)</b>                         | <b>(5,212.1)</b>         | <b>(3,806.0)</b>   | <b>467.4</b>                                | <b>(3,338.6)</b>                                  | <b>(3,692.4)</b>                     |

(i) Recorded at amortised cost or loans and receivables.

(ii) IAS 39 financial instruments.

(iii) Includes non-recourse borrowings.

The fair values of the primary financial assets and liabilities of the Company together with their carrying values are as follows:

|   | 2012<br>Amortised cost<br>or other (i)<br>£m | 2012<br>Classified as<br>trading (ii)<br>£m | 2012<br>Total<br>carrying<br>value<br>£m | 2012<br>Fair value<br>£m | 2011<br>Amortised cost<br>or other (i)<br>Restated<br>£m | 2011<br>Classified as<br>trading (ii)<br>£m | 2011<br>Total<br>carrying value<br>Restated<br>£m | 2011<br>Fair value<br>Restated<br>£m |
|---|--|---|--|--------------------------|--|---|---|--------------------------------------|
| <b>Financial assets</b>                             |  |   |  |                          |  |   |   |                                      |
| <b>Current</b>                                      |  |   |  |                          |  |   |   |                                      |
| Cash and cash equivalents                           | 14.3   | –   | 14.3                                     | 14.3                     | 319.1  | –   | 319.1   | 319.1                                |
| Amounts owed by subsidiary undertakings             | 2,917.8                                      | –   | 2,917.8                                  | 2,917.8                  | 2,220.9  | –   | 2,220.9   | 2,220.9                              |
| Derivative financial assets                         | –  | 12.2  | 12.2                                     | 12.2                     | –  | 30.0  | 30.0  | 30.0                                 |
|   | <b>2,932.1</b>                               | <b>12.2</b>                                 | <b>2,944.3</b>                           | <b>2,944.3</b>           | <b>2,540.0</b>   | <b>30.0</b>                                 | <b>2,570.0</b>                                    | <b>2,570.0</b>                       |
| <b>Non-current</b>                                  |  |   |  |                          |  |   |   |                                      |
| Amounts owed by subsidiary undertakings             | 3,790.6                                      | –   | 3,790.6                                  | 3,790.6                  | 3,661.2  | –   | 3,661.2   | 3,661.2                              |
| Loans to associates and jointly controlled entities | 1,140.0                                      | –   | 1,140.0                                  | 1,140.0                  | 1,029.5  | –   | 1,029.5   | 1,029.5                              |
| Derivative financial assets                         | –  | 94.7  | 94.7                                     | 94.7                     | –  | 48.0  | 48.0  | 48.0                                 |
|   | <b>4,930.6</b>                               | <b>94.7</b>                                 | <b>5,025.3</b>                           | <b>5,025.3</b>           | <b>4,690.7</b>   | <b>48.0</b>                                 | <b>4,738.7</b>                                    | <b>4,738.7</b>                       |
|   | <b>7,862.7</b>                               | <b>106.9</b>                                | <b>7,969.6</b>                           | <b>7,969.6</b>           | <b>7,230.7</b>   | <b>78.0</b>                                 | <b>7,308.7</b>                                    | <b>7,308.7</b>                       |
| <b>Financial liabilities</b>                        |  |   |  |                          |  |   |   |                                      |
| <b>Current</b>                                      |  |   |  |                          |  |   |   |                                      |
| Bank loans and overdrafts                           | (440.1)                                      | –   | (440.1)                                  | (391.7)                  | (106.8)  | –   | (106.8)   | (106.9)                              |
| Amounts owed to subsidiary undertakings             | (2,463.2)                                    | –   | (2,463.2)                                | (2,463.2)                | (2,757.0)  | –   | (2,757.0)   | (2,757.0)                            |
| Derivative financial liabilities                    | –  | (8.5)                                       | (8.5)                                    | (8.5)                    | –  | (15.5)                                      | (15.5)  | (15.5)                               |
|   | <b>(2,903.3)</b>                             | <b>(8.5)</b>                                | <b>(2,911.8)</b>                         | <b>(2,863.4)</b>         | <b>(2,863.8)</b>   | <b>(15.5)</b>                               | <b>(2,879.3)</b>                                  | <b>(2,879.4)</b>                     |
| <b>Non-current</b>                                  |  |   |  |                          |  |   |   |                                      |
| Eurobonds   | (3,126.7)                                    | –   | (3,126.7)                                | (3,611.1)                | (2,857.1)  | –   | (2,857.1)   | (3,167.2)                            |
| Bank loans  | (797.3)                                      | (31.2)                                      | (828.5)                                  | (861.9)                  | (671.0)  | 28.6  | (642.4)   | (676.9)                              |
| Amounts owed to subsidiary undertakings             | (268.2)                                      | –   | (268.2)                                  | (268.2)                  | (257.4)  | –   | (257.4)   | (257.4)                              |
| Derivative financial liabilities                    | –  | (206.3)                                     | (206.3)                                  | (206.3)                  | –  | (136.7)                                     | (136.7)   | (136.7)                              |
|   | <b>(4,192.2)</b>                             | <b>(237.5)</b>                              | <b>(4,429.7)</b>                         | <b>(4,947.5)</b>         | <b>(3,785.5)</b>   | <b>(108.1)</b>                              | <b>(3,893.6)</b>                                  | <b>(4,238.2)</b>                     |
|   | <b>(7,095.5)</b>                             | <b>(246.0)</b>                              | <b>(7,341.5)</b>                         | <b>(7,810.9)</b>         | <b>(6,649.3)</b>   | <b>(123.6)</b>                              | <b>(6,772.9)</b>                                  | <b>(7,117.6)</b>                     |
| <b>Net financial assets/(liabilities)</b>           | <b>767.2</b>                                 | <b>(139.1)</b>                              | <b>628.1</b>                             | <b>158.7</b>             | <b>(581.4)</b>   | <b>(45.6)</b>                               | <b>(535.8)</b>                                    | <b>191.1</b>                         |

(i) Recorded at amortised cost, available for sale, or loans and receivables.

(ii) IAS 39 financial instruments.

### Basis of determining fair value

Certain assets and liabilities designated and carried at amortised cost are loans and receivables. For certain current assets and liabilities their carrying value is equivalent to fair value due to short term maturity.

Assets and liabilities designated at fair value and the fair value of other financial assets and liabilities have been determined by reference to closing rate market values. This basis has been used in valuing interest rate instruments, foreign currency hedge contracts and denominated long-term fixed rate debt. Commodity contracts fair values are based on published price quotations.

The fair values are stated at a specific date and may be different from the amounts which will actually be paid or received on settlement of the instruments. The fair value of items such as property, plant and equipment, brands or the Group's customer base are not included as these are not financial instruments.



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS

###### (i) Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations.

Credit risk arising from the Group's normal commercial operations is controlled by individual business units operating in accordance with Group policies and procedures. Generally, for significant contracts, individual business units enter into contracts or agreements with counterparties having investment grade credit ratings only, or where suitable collateral or other security has been provided. Counterparty credit validation is undertaken prior to contractual commitment.

Credit risk management for the Group's Networks businesses is performed in accordance with industry standards as set out by the Regulator and is controlled by the individual business units. The Group's greatest credit risks lie with the operations of the Energy Supply business and the Energy Portfolio Management function and the activities carried out by the Group's Treasury function, for which specific credit risk controls that match the risk profile of those activities are applied.

Exposure to credit risk in the supply of electricity and gas arises from the potential of a customer defaulting on their invoiced payables. The financial strength and creditworthiness of business customers is assessed prior to commencing, and for the duration of, their contract of supply. Domestic customers' creditworthiness is reviewed from a variety of internal and external information.

Exposure to credit risk in the procurement of wholesale energy and fuel is managed by reference to agreed transaction credit limits which are determined by whether the counterparty:

- (i) holds an investment grade credit rating; or
- (ii) can be assessed as adequately creditworthy in accordance with internal credit rules using information from other external credit agencies; or
- (iii) can provide a guarantee from an investment grade-rated entity or post suitable collateral or provide other acceptable assurances in accordance with Group procedures where they have failed to meet the above conditions; or
- (iv) can be allocated a non-standard credit limit approved by the Risk Committee within its authorised limits as delegated by the Group Board.

Credit support clauses or side agreements are typically included or entered into to protect the Group against counterparty failure or non-delivery. Within the Energy Portfolio Management business, significantly increasing volumes of gas, electricity and other commodities products are now traded through cleared exchanges to further mitigate credit risk. Such exchanges are subject to strict regulation by the UK Financial Services Authority (FSA) and participants in these exchanges are obliged to meet rigorous capital adequacy requirements.

Individual counterparty credit exposures are monitored by category of credit risk and are subject to approved limits. At 31 March 2012, the Group's Energy Portfolio Management activities business had pledged £254.4m (2011 – £201.1m) of cash collateral and letters of credit and had received £54.3m (2011 – £38.7m) of cash collateral and letters of credit principally to reduce exposures on credit risk.

Bank credit exposures, which are monitored and reported on daily, are calculated on a mark-to-market basis and adjusted for future volatility and probability of default. Any issues relating to these credit exposures are presented for discussion and review by the Risk and Trading Committee.

Cash and cash equivalents comprise cash in hand and deposits which are readily convertible to cash. These are subject to insignificant risk of change in value or credit risk. Derivative financial instruments are entered into to cover the Group's market risks – commodity risk, interest rate risk, currency risk – and are consequently covered elsewhere in this note.

Trade receivables represent the most significant exposure to credit risk and are stated net of collateral held, letters of credit or other credit enhancements. The trade receivables total includes an allowance for impairment.

### Concentrations of risk

Trade receivables recorded by reported segment held at the 31 March were:

|  | 2012<br>£m     | 2011<br>£m |
|--|----------------|------------|
| <b>Networks</b>  |                |            |
| Electricity Distribution                               | 80.1           | 63.4       |
| Electricity Transmission                               | 0.8            | 0.2        |
| Other Networks   | 113.4          | 92.9       |
|  | <b>194.3</b>   | 156.5      |
| <b>Retail</b>  |                |            |
| Energy Supply  | 579.1          | 733.8      |
| Energy-related Services                                | 18.2           | 17.7       |
|  | <b>597.3</b>   | 751.5      |
| <b>Wholesale</b>                                       |                |            |
| Energy Portfolio Management and Electricity Generation | 2,551.0        | 2,410.8    |
| Gas Storage  | 2.3            | 12.3       |
| Gas Production   | -              | -          |
|  | <b>2,553.3</b> | 2,423.1    |
| Corporate unallocated                                  | 0.2            | 0.6        |
| <b>Total</b>   | <b>3,345.1</b> | 3,331.7    |

The Retail segment accounts for 17.8% (2011 – 22.6%) of the Group's trade receivables. Trade receivables associated with the Group's 9.55 million electricity and gas customers are recorded in this segment. The Group also has significant receivables associated with its Wholesale activities which are generally settled within 2 to 4 weeks from invoicing. The Group's exposure to credit risk is therefore subject to diversification with no exposure to individual customers totalling >10% of trade receivables. The biggest customer balance, due from a wholesale customer (also a wholesale supplier), is less than 9% (2011 – less than 10%) of the total trade receivables.

The ageing of trade receivables at the reporting date was:

|   | 2012<br>£m     | 2011<br>£m |
|---|----------------|------------|
| Not past due                            | 3,121.1        | 3,053.7    |
| Past due but not individually impaired: |                |            |
| 0 – 30 days                             | 140.5          | 181.7      |
| 31 – 90 days                            | 53.9           | 69.0       |
| Over 90 days                            | 166.9          | 171.5      |
|   | <b>3,482.4</b> | 3,475.9    |
| Less: allowance for impairment          | <b>(137.3)</b> | (144.2)    |
| Net trade receivables                   | <b>3,345.1</b> | 3,331.7    |

The Group has past due debt which has not had an impairment allowance set aside to cover potential credit losses. The Group has certain procedures to pursue customers in significant arrears and believes its impairment policy in relation to such balances is appropriate. Those debts which are neither past due nor impaired are considered to be good and are expected to be recoverable.

The Group has other receivables which are financial assets totalling £21.8m (2011 – £93.4m). The Company does not have trade receivables.

The movement in the allowance for impairment of trade receivables was:

|   | 2012<br>£m   | 2011<br>£m |
|---|--------------|------------|
| Balance at 1 April                                | 144.2        | 148.9      |
| Increase in allowance for impairment              | 46.7         | 50.7       |
| Impairment losses recognised                      | (57.0)       | (61.7)     |
| Recovery of impairment loss previously recognised | 4.2          | 6.3        |
| Foreign exchange movements                        | (0.8)        | -          |
| Balance at 31 March                               | <b>137.3</b> | 144.2      |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

At the end of each reporting period a review of the provision for bad and doubtful debts is performed. It is an assessment of the potential amount of trade receivables which will not be paid by customers after the balance sheet date. This amount is calculated by reference to the age, status and risk of each receivable.

##### (ii) Liquidity risk and Going Concern

Liquidity risk, the risk that the Group will have insufficient funds to meet its liabilities, is managed by the Group's Treasury department. The Group can have significant movements in its liquidity position due to movement in commodity price, working capital requirements, the seasonal nature of the business and phasing of its capital reduction programme.

Treasury is responsible for managing the banking and liquidity requirements of the Group, risk management relating to interest rate and foreign exchange exposures, and for managing the credit risk relating to the banking counterparties with which it transacts. Short term liquidity is reviewed daily by Treasury, while the longer term liquidity position is reviewed on a regular basis by the Board. The department's operations are governed by policies determined by the Board and any breaches of these policies are reported to the Risk and Trading Committee and Audit Committee.

In relation to the Group's liquidity risk, the Group's policy is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Company's reputation.

During the year, the Group's approach to managing liquidity was to seek to ensure that the Group has available committed borrowings and facilities equal to at least 105% of forecast borrowings over a rolling 12 month period. In May 2012, the Board revised this policy to cover at least 105% of forecast borrowings over a rolling 6 month period.

The Group uses a cash flow forecast to monitor its ongoing borrowing requirements. Typically, the Group will fund any short term borrowing positions by issuing commercial paper or borrowing from uncommitted bank lines and will invest in money market funds when it has a cash surplus. In addition to the borrowing facilities listed at note 23, the Group has £100m of uncommitted bank lines and a £15m overdraft facility.

During the year the Group (through SSE plc) successfully re-opened the European corporate bond market after the summer break by issuing a £300m ten year bond with a 4.25% coupon as well as managing to secure a JP¥15bn (equivalent to £126.7m) seven year loan with an effective interest rate of 3.52% through a reserve enquiry on its EMTN programme. In addition during February 2012 the Group also undertook a US private placement for a total consideration of \$700m (equivalent to £446.4m) with proceeds being received in April 2012. The senior notes were issued over four tranches at an average maturity of 10.3 years and an average all-in-cost of around 4.25%. This follows on from the previous year when the Group extended its existing £900m revolving credit facility and its £100m bilateral facility on reduced terms to August 2015, borrowed £400m from the European Investment Bank for a period of 10 years and issued hybrid capital of £1,161.4m.

Under the going concern principle, the Group does not need to issue medium to long term debt but does expect to do so during the year ended 31 March 2013. Taking this and the current liquidity in the commercial paper market and the availability of undrawn committed bank facilities into account, the Directors have concluded that the Group has sufficient headroom to continue as a going concern. In coming to this conclusion the Directors have taken into account the successful issuance of £5.0bn of medium to long term debt including hybrid capital since July 2008, the Group's credit rating, the successful renewal and increase of committed bank facilities and current market conditions. The statement of going concern is included in the Directors' Corporate Governance report on page 87.

Treasury also manage the Group's interaction with its relationship banks (defined as those banks that support the Company's financing activities through their ongoing participation in the committed lending facilities that are maintained by the Group). These are each allocated financial limits, subject to the maintenance of an investment grade credit rating allocated by a recognised major ratings group. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria.

As at 31 March 2012, the value of outstanding cash collateral in respect of mark-to-market related margin calls on exchange traded positions was £119.9m (2011 – £nil).

The contractual cash flows shown in the following tables are the contractual undiscounted cash flows under the relevant financial instruments. Where the contractual cash flows are variable based on a price, foreign exchange rate or index in the future, the contractual cash flows in the following tables have been determined with reference to the relevant price, foreign exchange rate, interest rate or index as at the balance sheet date. In determining the interest element of contractual cash flows in cases where the Group has a choice as to the length of interest calculation periods and the interest rate that applies varies with the period selected, the contractual cash flows have been calculated assuming the Group selects the shortest available interest calculation periods. Where the holder of an instrument has a choice of when to redeem, the amounts in the following tables are on the assumption the holder redeems at the earliest opportunity.

The numbers in the following tables have been included in the Group's cash flow forecasts for the purposes of considering Liquidity Risk as noted above.

The following are the undiscounted contractual maturities of financial liabilities, including interest and excluding the impact of netting agreements:

### Liquidity risk

|   | 2012<br>Carrying<br>value<br>£m | 2012<br>Contractual<br>cash flows<br>£m | 2012<br>0-12<br>months<br>£m | 2012<br>1-2<br>years<br>£m | 2012<br>2-5<br>years<br>£m | 2012<br>> 5<br>years<br>£m | 2011<br>Carrying<br>value<br>£m | 2011<br>Contractual<br>cash flows<br>£m | 2011<br>0-12<br>months<br>£m | 2011<br>1-2<br>years<br>£m | 2011<br>2-5<br>years<br>£m | 2011<br>> 5<br>years<br>£m |
|---|---------------------------------|---|------------------------------|----------------------------|----------------------------|----------------------------|---------------------------------|---|------------------------------|----------------------------|----------------------------|----------------------------|
| <b>Financial liabilities</b>                        |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| <b>Loans and borrowings</b>                         |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Bank overdrafts                                     | 3.7                             | (3.7)                                   | (3.7)                        | –                          | –                          | –                          | 5.3                             | (5.3)                                   | (5.3)                        | –                          | –                          | –                          |
| Commercial paper and cash advances                  | 440.1                           | (441.0)                                 | (441.0)                      | –                          | –                          | –                          | 106.7                           | (106.8)                                 | (106.8)                      | –                          | –                          | –                          |
| Bank loans – floating                               | 411.5                           | (457.4)                                 | (32.0)                       | (6.8)                      | (103.3)                    | (315.3)                    | 511.5                           | (564.5)                                 | (107.3)                      | (31.5)                     | (103.7)                    | (322.0)                    |
| Bank loans – fixed                                  | 836.8                           | (1,237.9)                               | (246.4)                      | (307.9)                    | (40.7)                     | (642.9)                    | 778.9                           | (1,189.5)                               | (239.9)                      | (106.8)                    | (322.9)                    | (519.9)                    |
| Unsecured bonds – fixed                             | 3,918.2                         | (7,036.6)                               | (226.0)                      | (1,426.3)                  | (465.8)                    | (4,918.5)                  | 3,643.5                         | (6,833.0)                               | (215.3)                      | (215.3)                    | (1,803.4)                  | (4,599.0)                  |
| Non-recourse funding                                | 262.0                           | (262.5)                                 | (14.0)                       | (14.0)                     | (45.6)                     | (188.9)                    | 216.9                           | (217.6)                                 | (12.5)                       | (11.9)                     | (43.3)                     | (149.9)                    |
| Fair value adjustment                               | 31.2                            | –                                       | –                            | –                          | –                          | –                          | (28.6)                          | –                                       | –                            | –                          | –                          | –                          |
|   | <b>5,903.5</b>                  | <b>(9,439.1)</b>                        | <b>(963.1)</b>               | <b>(1,755.0)</b>           | <b>(655.4)</b>             | <b>(6,065.6)</b>           | 5,234.2                         | (8,916.7)                               | (687.1)                      | (365.5)                    | (2,273.3)                  | (5,590.8)                  |
| Finance lease obligations                           | 342.1                           | (671.8)                                 | (48.8)                       | (51.2)                     | (148.7)                    | (423.1)                    | 372.2                           | (743.0)                                 | (52.1)                       | (50.2)                     | (152.4)                    | (488.4)                    |
|   | <b>6,245.6</b>                  | <b>(10,110.9)</b>                       | <b>(1,011.9)</b>             | <b>(1,806.2)</b>           | <b>(804.1)</b>             | <b>(6,488.7)</b>           | 5,606.4                         | (9,659.7)                               | (739.2)                      | (415.7)                    | (2,425.7)                  | (6,079.2)                  |
| <b>Derivative financial liabilities</b>             |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Operating derivatives designated at fair value      | 983.3                           | 1,974.3                                 | 1,489.6                      | 102.7                      | 393.3                      | (11.3)                     | 2,911.8                         | 12,623.3                                | 9,363.5                      | 2,413.4                    | 846.4                      | –                          |
| Interest rate swaps used for hedging                | 25.4                            | (25.4)                                  | (9.9)                        | (6.1)                      | (2.5)                      | (6.9)                      | 33.3                            | (33.2)                                  | (8.5)                        | (7.6)                      | (8.8)                      | (8.3)                      |
| Interest rate swaps designated at fair value        | 191.5                           | (191.5)                                 | (9.6)                        | (9.5)                      | (24.6)                     | (147.8)                    | 115.7                           | (115.6)                                 | (7.1)                        | (5.3)                      | (15.9)                     | (87.3)                     |
| Forward exchange contracts held for hedging         | 8.1                             | (620.6)                                 | (490.5)                      | (101.6)                    | (28.5)                     | –                          | 0.6                             | (10.2)                                  | (5.5)                        | (4.7)                      | –                          | –                          |
| Forward exchange contracts designated at fair value | 8.5                             | (866.6)                                 | (736.1)                      | (130.5)                    | –                          | –                          | 15.4                            | (960.5)                                 | (488.3)                      | (363.3)                    | (108.9)                    | –                          |
|   | <b>1,216.8</b>                  | <b>270.2</b>                            | <b>243.5</b>                 | <b>(145.0)</b>             | <b>337.7</b>               | <b>(166.0)</b>             | 3,076.8                         | 11,503.8                                | 8,854.1                      | 2,032.5                    | 712.8                      | (95.6)                     |
| <b>Other financial liabilities</b>                  |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Trade payables                                      | 3,212.5                         | (3,212.5)                               | (3,212.5)                    | –                          | –                          | –                          | 3,197.2                         | (3,197.2)                               | (3,197.2)                    | –                          | –                          | –                          |
|   | <b>3,212.5</b>                  | <b>(3,212.5)</b>                        | <b>(3,212.5)</b>             | <b>–</b>                   | <b>–</b>                   | <b>–</b>                   | 3,197.2                         | (3,197.2)                               | (3,197.2)                    | –                          | –                          | –                          |
| <b>Total</b>  | <b>10,674.9</b>                 | <b>(13,053.2)</b>                       | <b>(3,980.9)</b>             | <b>(1,951.2)</b>           | <b>(466.4)</b>             | <b>(6,654.7)</b>           | 11,880.4                        | (1,353.1)                               | 4,917.7                      | 1,616.8                    | (1,712.9)                  | (6,174.8)                  |
| <b>Derivative financial assets</b>                  |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Financing derivatives                               | (101.7)                         | (169.2)                                 | (50.9)                       | (41.2)                     | (55.5)                     | (21.6)                     | (81.9)                          | (777.2)                                 | (860.1)                      | 113.9                      | (10.7)                     | (20.3)                     |
| Operating derivatives designated at fair value      | (1,097.5)                       | (4,847.9)                               | (3,559.0)                    | (682.7)                    | (574.1)                    | (32.1)                     | (3,433.7)                       | (15,189.2)                              | (10,945.1)                   | (2,832.5)                  | (1,359.2)                  | (52.4)                     |
|   | <b>(1,199.2)</b>                | <b>(5,017.1)</b>                        | <b>(3,609.9)</b>             | <b>(723.9)</b>             | <b>(629.6)</b>             | <b>(53.7)</b>              | (3,515.6)                       | (15,966.4)                              | (11,805.2)                   | (2,718.6)                  | (1,369.9)                  | (72.7)                     |
| Net total (i)                                       | <b>9,475.7</b>                  | <b>(18,070.3)</b>                       | <b>(7,590.8)</b>             | <b>(2,675.1)</b>           | <b>(1,096.0)</b>           | <b>(6,708.4)</b>           | 8,364.8                         | (17,319.5)                              | (6,887.5)                    | (1,101.8)                  | (3,082.8)                  | (6,247.5)                  |

(i) The Group believes the liquidity risk associated with out-of-the-money operating derivative contracts needs to be considered in conjunction with the profile of payments or receipts arising from derivative financial assets. It should be noted that cash flows associated with future energy sales and commodity contracts which are not IAS 39 financial instruments are not included in this analysis, which is prepared in accordance with IFRS 7.

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

The Company has the following liquidity maturity profile:

##### Liquidity risk

|   | 2012<br>Carrying<br>value<br>£m | 2012<br>Contractual<br>cash flows<br>£m | 2012<br>0-12<br>months<br>£m | 2012<br>1-2<br>years<br>£m | 2012<br>2-5<br>years<br>£m | 2012<br>> 5<br>years<br>£m | 2011<br>Carrying<br>value<br>£m | 2011<br>Contractual<br>cash flows<br>£m | 2011<br>0-12<br>months<br>£m | 2011<br>1-2<br>years<br>£m | 2011<br>2-5<br>years<br>£m | 2011<br>> 5<br>years<br>£m |
|---|---------------------------------|---|------------------------------|----------------------------|----------------------------|----------------------------|---------------------------------|---|------------------------------|----------------------------|----------------------------|----------------------------|
| <b>Financial liabilities</b>                        |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| <b>Loans and borrowings</b>                         |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Commercial paper and cash advances                  | 440.1                           | (441.0)                                 | (441.0)                      | –                          | –                          | –                          | 106.8                           | (106.8)                                 | (106.8)                      | –                          | –                          | –                          |
| Bank loans – floating                               | 361.5                           | (406.3)                                 | (6.4)                        | (6.4)                      | (78.2)                     | (315.3)                    | 361.5                           | (412.3)                                 | (6.0)                        | (6.0)                      | (78.4)                     | (321.9)                    |
| Bank loans – fixed                                  | 435.8                           | (516.9)                                 | (20.7)                       | (223.1)                    | (24.6)                     | (248.5)                    | 309.5                           | (375.3)                                 | (16.2)                       | (16.2)                     | (226.1)                    | (116.8)                    |
| Unsecured bonds – fixed                             | 3,126.7                         | (5,172.3)                               | (190.0)                      | (1,390.3)                  | (357.4)                    | (3,234.6)                  | 2,857.1                         | (4,949.8)                               | (179.4)                      | (179.4)                    | (1,695.1)                  | (2,895.9)                  |
| Fair value adjustment                               | 31.2                            | –                                       | –                            | –                          | –                          | –                          | (28.6)                          | –                                       | –                            | –                          | –                          | –                          |
|   | <b>4,395.3</b>                  | <b>(6,536.5)</b>                        | <b>(658.1)</b>               | <b>(1,619.8)</b>           | <b>(460.2)</b>             | <b>(3,798.4)</b>           | 3,606.2                         | (5,844.2)                               | (308.4)                      | (201.6)                    | (1,999.6)                  | (3,334.6)                  |
| <b>Derivative financial liabilities</b>             |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Interest rate swaps used for hedging                | 25.2                            | (25.2)                                  | (8.4)                        | (5.5)                      | (2.5)                      | (8.8)                      | 29.1                            | (29.1)                                  | (6.3)                        | (6.3)                      | (8.2)                      | (8.3)                      |
| Interest rate swaps designated at fair value        | 173.0                           | (173.0)                                 | (8.7)                        | (8.7)                      | (22.1)                     | (133.5)                    | 106.8                           | (106.8)                                 | (5.8)                        | (4.8)                      | (15.4)                     | (80.8)                     |
| Forward exchange contracts held for hedging         | 8.1                             | (620.6)                                 | (490.5)                      | (101.6)                    | (28.5)                     | –                          | 0.6                             | (10.2)                                  | (5.5)                        | (4.7)                      | –                          | –                          |
| Forward exchange contracts designated at fair value | 8.5                             | (866.6)                                 | (736.1)                      | (130.5)                    | –                          | –                          | 15.7                            | (960.5)                                 | (488.3)                      | (363.3)                    | (108.9)                    | –                          |
|   | <b>214.8</b>                    | <b>(1,685.4)</b>                        | <b>(1,243.7)</b>             | <b>(246.3)</b>             | <b>(53.1)</b>              | <b>(142.3)</b>             | 152.2                           | (1,106.6)                               | (505.9)                      | (379.1)                    | (132.5)                    | (89.1)                     |
| <b>Other financial liabilities</b>                  |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Amounts due to subsidiary undertakings              | 2,731.4                         | (2,731.4)                               | (2,463.2)                    | (268.2)                    | –                          | –                          | 3,014.4                         | (3,014.4)                               | (2,757.0)                    | (257.4)                    | –                          | –                          |
|   | <b>2,731.4</b>                  | <b>(2,731.4)</b>                        | <b>(2,463.2)</b>             | <b>(268.2)</b>             | <b>–</b>                   | <b>–</b>                   | 3,014.4                         | (3,014.4)                               | (2,757.0)                    | (257.4)                    | –                          | –                          |
| <b>Total</b>  | <b>7,341.5</b>                  | <b>(10,953.3)</b>                       | <b>(4,365.0)</b>             | <b>(2,134.3)</b>           | <b>(513.3)</b>             | <b>(3,940.7)</b>           | 6,772.9                         | (9,965.2)                               | (3,571.3)                    | (838.1)                    | (2,132.1)                  | (3,423.7)                  |
| <b>Derivative financial assets</b>                  |                                 |   |                              |                            |                            |                            |                                 |   |                              |                            |                            |                            |
| Financing derivatives                               | (106.9)                         | (169.2)                                 | (50.9)                       | (41.2)                     | (55.5)                     | (21.6)                     | (78.0)                          | (777.3)                                 | (860.3)                      | 113.7                      | (10.4)                     | (20.3)                     |
| Net total   | <b>7,234.6</b>                  | <b>(11,122.5)</b>                       | <b>(4,415.9)</b>             | <b>(2,175.5)</b>           | <b>(568.8)</b>             | <b>(3,962.3)</b>           | (6,694.9)                       | (10,742.5)                              | (4,431.6)                    | (724.4)                    | (2,142.5)                  | (3,444.0)                  |

##### (iii) Commodity risk

The Group's Energy Portfolio Management function manages the Group's exposure to energy commodity price movements and also to physical commodity volume requirements as part of its normal course of business. This arises from the Group's requirement to source gas or electricity for the Energy Supply business, or to procure fuel to produce electricity from its generation assets. Insofar as the contracts relate to Energy Supply, the impact of delivered commodities will be passed through to the newly established segment.

The Group's strategy is to manage all exposures to commodity risk through volumetric limits and to measure the exposure by use of a Value at Risk (VaR) model. The exposure is subject to financial limits established by the Board and managed by the Risk and Trading Committee. The exposure is reported to the Committee on a monthly basis and to the Board when certain trigger levels are exceeded. Within this approach, only certain of the Group's energy commodity contracts are deemed to constitute financial instruments under IAS 39. As a result, while the Group manages the commodity price risk associated with both financial and non-financial commodity contracts, it is only the fair value of IAS 39 financial instruments which represents the exposure of the Group's commodity price risk under IFRS 7. This is a consequence of the accounting policy which requires that commodity contracts which are designated as financial instruments under IAS 39 should be accounted for on a fair value basis with changes in fair value reflected in profit or equity. Conversely, commodity contracts that are not financial instruments under IAS 39 are accounted for as 'own use' contracts. As fair value changes in own use contracts are not reflected through profit or equity, these do not represent the IFRS 7 commodity price risk. Therefore, as the overall Group VaR associated with the Energy Portfolio Management activity is monitored for internal risk management purposes and is outside the scope of IAS 39, these measures are not required to comply with IFRS 7.

Operationally, the economic risks associated with this exposure are managed through a selection of longer and shorter term contracts for commodities such as gas, electricity, coal and carbon emissions allowances, through the gas production assets and through flexibility from the Group's fleet of generation assets.

Short-term exposures arise from the requirement to match volumes of procured gas, electricity and power station fuel with demand for gas and electricity by the Energy Supply business customers or from Generation power plants, which can vary from expectations and result in a requirement to close the resulting positions at unfavourable prices. This aspect of commodity risk is managed through the ability to increase or decrease energy production either in the form of flexible purchase contracts or assets such as pumped storage generating plant, flexible hydro generating plant, standby oil plant and gas storage.

Longer-term exposures are managed through the Group's generation plant and longer term contracts (including forwards, futures contracts and other financial instruments). These, in turn, are used to reduce short-term market exposures.

Certain commodity contracts are entered into primarily for own use purposes to supply to customers or to provide fuel to power stations. However, as noted, a number of these contracts do not qualify for own use treatment under IAS 39 and are subject to fair value measurement through the income statement. In addition to this, the Group enters into certain contracts to manage commodity price and volume risk. These are also subject to fair value measurement through the income statement. Finally, other physical contracts can be treated as the hedging instrument in documented cash flow hedging relationships where the hedged item is the forecast future purchase requirement to meet production or customer demand. The accounting policies associated with such items are explained in note 1.

The consequential commodity risk which derives from these activities is quantified by the use of a Value at Risk (VaR) model which considers exposures in all commodities and provides an estimate of the potential change to the Groups forecast profits over a given period and to a given confidence level. The calculated financial risk is controlled through the imposition of a number of risk limits approved by the Board and monitored and managed by the Risk and Trading Committee. The Group's exposure to Commodity risk is subsequently reported to and monitored by the Risk and Trading Committee and to the Management Board by exception.

The Group's exposure to commodity price risk according to IFRS 7 is measured by reference to the Group's IAS 39 commodity contracts. IFRS 7 requires disclosure of a sensitivity analysis for market risks that is intended to illustrate the sensitivity of the Group's financial position and performance to changes in market variables impacting upon the fair value or cash flows associated with the Group's financial instruments.

Therefore, the sensitivity analysis provided discloses the effect on profit or loss and equity at the balance sheet date assuming that a reasonably possible change in the relevant commodity price had occurred, and been applied to the risk exposures in existence at that date. The reasonably possible changes in commodity prices used in the sensitivity analysis were determined based on calculated or implied volatilities where available, or historical data.

The sensitivity analysis has been calculated on the basis that the proportion of commodity contracts that are IAS 39 financial instruments remains consistent with those at that point. Excluded from this analysis are all commodity contracts that are not financial instruments under IAS 39.

|  | 2012           |   | 2011           |   |
|--|----------------|---|----------------|---|
|  | Base price (i) | Reasonably possible increase/decrease in variable | Base price (i) | Reasonably possible increase/decrease in variable |
| <b>Commodity prices</b>                  |                |   |                |   |
| UK gas (p/therm)                         | 69             | +/- 6   | 72             | +/- 10  |
| UK power (£/MWh)                         | 57             | +/- 6   | 63             | +/- 9   |
| UK coal (US\$/tonne)                     | 121            | +/- 7   | 132            | +/- 13  |
| UK carbon emissions allowances (€/tonne) | 8              | +/- 3   | 19             | +/- 3   |
| UK oil (US\$/bbl)                        | 105            | +/- 11  | 109            | +/- 12  |

(i) The base price represents the average forward market price over the duration of the active market curve used to calculate the sensitivity analysis.



## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

The impacts of reasonably possible changes in commodity prices on profit after taxation based on the rationale described are as follows:

|                                      | 2012                   |                        | 2011                   |                        |
|--------------------------------------|------------------------|------------------------|------------------------|------------------------|
|                                      | Impact on profit<br>£m | Impact on equity<br>£m | Impact on profit<br>£m | Impact on equity<br>£m |
| <b>Incremental profit/(loss)</b>     |                        |                        |                        |                        |
| Commodity prices combined – increase | <b>227.6</b>           | –                      | 257.3                  | –                      |
| Commodity prices combined – decrease | <b>(227.6)</b>         | –                      | (257.3)                | –                      |

The sensitivity analysis provided is hypothetical and is based on the Group's commodity contracts under IAS 39. This is analysis only and should be used with caution as the impacts disclosed are not necessarily indicative of the actual impacts that would be experienced. It should also be noted that these sensitivities impacts provided are indicative only and are based on calculations which do not consider all interrelationships, consequences and effects of such a change in those prices.

##### (iv) Currency risk

The Group publishes its consolidated financial statements in Sterling but also conducts business in foreign currencies. As a result, it is subject to foreign currency exchange risk arising from exchange rate movements which will be reflected in the Group's transaction costs or in the underlying foreign currency assets of its foreign operations.

The Group's policy is to use forward contracts, swaps and options to manage its exposures to foreign exchange risk. All such exposures are transactional in nature, and relate primarily to procurement contracts, commodity purchasing and related freight requirements, commodity hedging, long term plant servicing and maintenance agreements, and the purchase and sale of carbon emission allowances. The policy is to seek to hedge 100% of its currency requirements arising under all committed contracts excepting commodity hedge transactions, the requirements for which are significantly less predictable. The policy for these latter transactions is to assess the Group's requirements on a rolling basis and to enter into cover contracts as appropriate.

The Group has foreign subsidiary operations with significant Euro-denominated net assets. The Group's policy is to hedge its net investment in its foreign operations by ensuring the net assets whose functional currency cash flows are denominated in Euros are matched by borrowings in Euros.

Significant exposures are reported to, and discussed by, the Risk and Trading Committee on an ongoing basis and additionally form part of the bi-annual Treasury report to the Audit Committee.

At the balance sheet date, the total nominal value of outstanding forward foreign exchange contracts that the Group has committed to is:

|                                    | 2012<br>£m     | 2011<br>£m |
|------------------------------------|----------------|------------|
| Forward foreign exchange contracts | <b>2,119.5</b> | 2,074.4    |

The Group's exposure to foreign currency risk was as follows:

|   | 2012            |                  |                |                |                  | 2011     |                  |         |         |                  |
|---|-----------------|------------------|----------------|----------------|------------------|----------|------------------|---------|---------|------------------|
|   | JP¥m            | DKK<br>(million) | €m             | US\$m          | CHF<br>(million) | JP¥m     | DKK<br>(million) | €m      | US\$m   | CHF<br>(million) |
| Loans and borrowings                        | <b>46,000.0</b> | –                | <b>923.6</b>   | <b>248.3</b>   | <b>10.0</b>      | 28,000.0 | –                | 664.8   | 150.0   | 20.0             |
| Purchase and commodity contract commitments | –               | <b>106.7</b>     | <b>578.8</b>   | <b>2,019.1</b> | <b>44.8</b>      | –        | 1,036.8          | 415.0   | 1,859.7 | –                |
| Gross exposure                              | <b>46,000.0</b> | <b>106.7</b>     | <b>1,502.4</b> | <b>2,267.4</b> | <b>54.8</b>      | 28,000.0 | 1,036.8          | 1,079.8 | 2,009.7 | 20.0             |
| Forward exchange/swap contracts             | <b>46,000.0</b> | <b>106.7</b>     | <b>893.9</b>   | <b>1,559.1</b> | <b>54.8</b>      | 28,000.0 | 1,036.8          | 770.0   | 1,682.3 | 20.0             |
| Net exposure (in currency)                  | –               | –                | <b>608.5</b>   | <b>708.8</b>   | –                | –        | –                | 309.8   | 327.4   | –                |
| Net exposure (in £m)                        | –               | –                | <b>507.4</b>   | <b>442.9</b>   | –                | –        | –                | 273.7   | 203.8   | –                |

This represents the net exposure to foreign currencies, reported in pounds Sterling, and arising from all Group activities. All sensitivity analysis has been prepared on the basis of the relative proportions of instruments in foreign currencies being consistent as at the balance sheet date. This includes only monetary assets and liabilities denominated in a currency other than Sterling and excludes the translation of the net assets of foreign operations but not the corresponding impact of the net investment hedge.

The sensitivity analysis is indicative only and it should be noted that the Group's exposure to such market rate changes is continually changing. The calculations are based on linear extrapolations of rate changes which may not reflect the actual result which would impact upon the Group.

A 10% change in foreign currency exchange rates would have had the following impact on profit after taxation, based on the assumptions presented above:

|            | Equity                    |                           | Income statement          |                           |
|------------|---------------------------|---------------------------|---------------------------|---------------------------|
|            | At 31 March<br>2012<br>£m | At 31 March<br>2011<br>£m | At 31 March<br>2012<br>£m | At 31 March<br>2011<br>£m |
| US Dollars | -                         | -                         | 36.4                      | 16.5                      |
| Euro       | 41.1                      | 22.2                      | 0.6                       | -                         |
| DKK        | -                         | -                         | -                         | -                         |
| JP¥        | -                         | -                         | -                         | -                         |
| CHF        | -                         | -                         | -                         | -                         |
|            | <b>41.1</b>               | 22.2                      | <b>37.0</b>               | 16.5                      |

The impact of a decrease in rates would be an identical reduction in the annual charge.

#### (v) Interest rate risk

Interest rate risk derives from the Group's exposure to changes in the value of an asset or liability or future cash flows through changes in interest rates.

The Group's policy is to manage this risk by stipulating that a minimum of 50% of Group borrowings be subject to fixed rates of interest, either directly through the debt instruments themselves or through the use of derivative financial instruments. Such instruments include interest rate swaps and options, forward rate agreements and, in the case of debt raised in currencies other than Sterling, cross currency swaps. These practices serve to reduce the volatility of the Group's financial performance.

Although interest rate derivatives are primarily used to hedge risk relating to current borrowings, under certain circumstances they may also be used to hedge future borrowings. Any such pre-hedging is unwound at the time of pricing the underlying debt, either through cash settlement on a net present value basis or by transacting offsetting trades. The floating rate borrowings mainly comprise commercial paper issued at interest rates of LIBOR plus a variable margin and cash advances from the European Investment Bank (EIB).

The impact of a change in interest rates is dependent on the specific details of the financial asset or liability in question. Changes in fixed rate financial assets and liabilities, which account for the majority of cash, loans and borrowings, are not measured at fair value through the income statement. In addition to this, changes to fixed-to-floating hedging instruments which are recorded under cash flow hedge accounting also do not impact the income statement. Changes in variable rate instruments and hedging instruments and hedged items recorded under fair value hedge accounting are recorded through the income statement. The exposure measured is therefore based on variable rate debt and instruments.

The net exposure to interest rates at the balance sheet date can be summarised thus:

|  | 2012<br>Carrying<br>amount<br>£m | 2011<br>Carrying<br>amount<br>£m |
|--|----------------------------------|----------------------------------|
| Interest bearing/earning assets and liabilities: |                                  |                                  |
| – Fixed  | (4,815.8)                        | (4,258.4)                        |
| – Floating                                       | (1,336.7)                        | (1,016.2)                        |
|  | <b>(6,152.5)</b>                 | (5,274.6)                        |
| Represented by:                                  |                                  |                                  |
| Cash and cash equivalents                        | 189.2                            | 476.9                            |
| Derivative financial liabilities                 | (127.3)                          | (116.5)                          |
| Loans and borrowings                             | (5,872.3)                        | (5,262.8)                        |
| Finance lease obligations                        | (342.1)                          | (372.2)                          |
|  | <b>(6,152.5)</b>                 | (5,274.6)                        |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

Following from this, the table below represents the expected impact of an increase in 100 basis points in short term interest rates at the reporting date in relation to the income statement. There is no impact on equity as the analysis relates to the Group's net exposure at the balance sheet date. Contracts qualifying for hedge accounting are, by definition, part of the Group's covered position. The analysis assumes that all other variables, in particular foreign currency rates, remain constant. The assessment is based on a revision of the fair value assumptions included in the calculated exposures in the previous table.

All sensitivity analysis has been prepared on the basis of the proportion of fixed to floating instruments being consistent as at the balance sheet date and is stated after the effect of taxation.

The sensitivity analysis is indicative only and it should be noted that the Group's exposure to such market rate changes is continually changing. The calculations are based on linear extrapolations of rate changes which may not reflect the actual result which would impact upon the Group.

|                  | 2012<br>£m | 2011<br>£m |
|------------------|------------|------------|
| Income statement | 11.9       | 10.4       |
|                  | 11.9       | 10.4       |

The impact of an identified decrease in basis points would be an equal reduction in the annual charge.

##### (vi) Primary statement disclosures

For financial reporting purposes, the Group has classified derivative financial instruments into two categories, operating derivatives and financing derivatives. Operating derivatives include all qualifying commodity contracts including those for electricity, gas, oil, coal and carbon. Financing derivatives include all fair value and cash flow interest rate hedges, non-hedge accounted (mark-to-market) interest rate derivatives, cash flow foreign exchange hedges and non-hedge accounted foreign exchange contracts. Non-hedge accounted contracts are treated as held for trading.

The net movement reflected in the income statement can be summarised thus:

|   | 2012<br>£m     | 2011<br>£m     |
|---|----------------|----------------|
| <b>Operating derivatives</b>                    |                |                |
| Total result on operating derivatives (i)       | 142.0          | 887.9          |
| Less: Amounts settled (ii)                      | (575.7)        | 573.9          |
| Movement in unrealised derivatives              | (433.7)        | 1,461.8        |
| <b>Financing derivatives (and hedged items)</b> |                |                |
| Total result on financing derivatives (i)       | (1,288.7)      | (935.9)        |
| Less: Amounts settled (ii)                      | 1,199.2        | 891.5          |
| Movement in unrealised derivatives              | (89.5)         | (44.4)         |
| <b>Net income statement impact</b>              | <b>(523.2)</b> | <b>1,417.4</b> |

(i) Total result on derivatives in the income statement represents the total amounts (charged) or credited to the income statement in respect of operating and financial derivatives.

(ii) Amounts settled in the year represent the result on derivatives transacted which have matured or been delivered and have been included within the total result on derivatives.

The net derivative financial (liabilities) and assets are represented as follows:

|                                    | Consolidated     |            | Company        |            |
|------------------------------------|------------------|------------|----------------|------------|
|                                    | 2012<br>£m       | 2011<br>£m | 2012<br>£m     | 2011<br>£m |
| <b>Derivative financial assets</b> |                  |            |                |            |
| Non-current                        | 348.0            | 990.1      | 94.7           | 48.0       |
| Current                            | 851.2            | 2,525.5    | 12.2           | 30.0       |
|                                    | <b>1,199.2</b>   | 3,515.6    | <b>106.9</b>   | 78.0       |
| <b>Derivative liabilities</b>      |                  |            |                |            |
| Non-current                        | (399.2)          | (769.3)    | (206.3)        | (136.7)    |
| Current                            | (817.6)          | (2,307.5)  | (8.5)          | (15.5)     |
| Total derivative liabilities       | <b>(1,216.8)</b> | (3,076.8)  | <b>(214.8)</b> | (152.2)    |
| <b>Net liability</b>               | <b>(17.6)</b>    | 438.8      | <b>(107.9)</b> | (74.2)     |

### Fair Value Hierarchy

The following table provides an analysis of financial instruments that are measured subsequent to initial recognition at fair value, grouped into Levels 1 to 3 based on the degree to which the fair value is observable.

- Level 1 fair value measurements are those derived from unadjusted quoted market prices for identical assets or liabilities.
- Level 2 fair value measurements are those derived from inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices).
- Level 3 fair value measurements are those derived from valuation techniques that include inputs for the asset or liability that are not based on observable market data.

|                              | Level 1 | Level 2   | Level 3 | Total            |
|------------------------------|---------|-----------|---------|------------------|
| <b>Financial assets</b>      |         |           |         |                  |
| Energy derivatives           | 59.8    | 1,037.7   | –       | <b>1,097.5</b>   |
| Interest rate derivatives    | –       | 69.6      | –       | <b>69.6</b>      |
| Foreign exchange derivatives | –       | 32.1      | –       | <b>32.1</b>      |
|                              | 59.8    | 1,139.4   | –       | <b>1,199.2</b>   |
| <b>Financial liabilities</b> |         |           |         |                  |
| Energy derivatives           | (110.2) | (873.2)   | –       | <b>(983.4)</b>   |
| Interest rate derivatives    | –       | (196.8)   | –       | <b>(196.8)</b>   |
| Foreign exchange derivatives | –       | (36.6)    | –       | <b>(36.6)</b>    |
| Loans and borrowings         | –       | (31.2)    | –       | <b>(31.2)</b>    |
|                              | (110.2) | (1,137.8) | –       | <b>(1,248.0)</b> |

There were no significant transfers out of level 1 into level 2 and out of level 2 into level 1 during the year ended 31 March 2012.

### (vii) Cash flow hedges

The Group designates contracts which qualify as hedges for accounting purposes either as cash flow hedges or fair value hedges. Cash flow hedges are contracts entered into to hedge a forecast transaction or cash flow risk generally arising from a change in interest rates or foreign currency exchange rates and which meet the effectiveness criteria prescribed by IAS 39. The Group's accounting policy on cash flow hedges is explained in note 1.

The following table indicates the contractual maturities of the expected transactions and the qualifying cash flow hedges associated:

### Cash flow hedges

|                                    | 2012<br>Carrying<br>amount<br>£m | 2012<br>Expected<br>cash flows<br>£m | 2012<br>0-12<br>months<br>£m | 2012<br>1-2<br>years<br>£m | 2012<br>2-5<br>years<br>£m | 2012<br>> 5<br>years<br>£m | 2011<br>Carrying<br>amount<br>£m | 2011<br>Expected<br>cash flows<br>£m | 2011<br>0-12<br>months<br>£m | 2011<br>1-2<br>years<br>£m | 2011<br>2-5<br>years<br>£m | 2011<br>> 5<br>years<br>£m |
|------------------------------------|----------------------------------|--------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|----------------------------------|--------------------------------------|------------------------------|----------------------------|----------------------------|----------------------------|
| <b>Interest rate swaps:</b>        |                                  |                                      |                              |                            |                            |                            |                                  |                                      |                              |                            |                            |                            |
| Liabilities                        | (2.2)                            | (2.2)                                | (1.6)                        | (0.6)                      | –                          | –                          | (4.0)                            | (4.0)                                | (2.2)                        | (1.3)                      | (0.5)                      | –                          |
| <b>Forward exchange contracts:</b> |                                  |                                      |                              |                            |                            |                            |                                  |                                      |                              |                            |                            |                            |
| Assets                             | 9.0                              | (257.9)                              | (64.6)                       | (48.9)                     | (84.9)                     | (59.5)                     | 18.5                             | (237.8)                              | (186.2)                      | (11.8)                     | (19.5)                     | (20.3)                     |
| Liabilities                        | (8.1)                            | (620.6)                              | (490.5)                      | (101.6)                    | (28.5)                     | –                          | (0.6)                            | (10.2)                               | (5.5)                        | (4.7)                      | –                          | –                          |
|                                    | <b>0.9</b>                       | <b>(878.5)</b>                       | <b>(555.1)</b>               | <b>(150.5)</b>             | <b>(113.4)</b>             | <b>(59.5)</b>              | 17.9                             | (248.0)                              | (191.7)                      | (16.5)                     | (19.5)                     | (20.3)                     |

## Notes on the financial statements (continued)

### for the year ended 31 March

#### 31. FINANCIAL INSTRUMENTS AND RISK (continued)

##### B. RISKS FROM USE OF FINANCIAL INSTRUMENTS (continued)

###### Net investment hedge

The Group's net investment hedge covers debt issued in the same currency (€) as the net investment in foreign subsidiaries with € denominated functional currencies, these being the Airtricity Supply business and the Ireland and European wind farm portfolios. The hedge compares the element of the net assets whose functional cash flows are denominated in € to the matching portion of the € borrowings held by the Group. This provides protection against movements in foreign exchange rates.

Gains and losses in the hedge are recognised in equity and will be transferred to the income statement on disposal of the foreign operation (2012 – £29.8m gain, 2011 – £4.3m gain). Gains and losses on the ineffective portion of the hedge are recognised immediately in the income statement (2012 – £nil, 2011 – £nil).

###### (viii) Capital management

The Board's policy is to maintain a strong balance sheet and credit rating so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Group's credit ratings are also important in maintaining an efficient cost of capital and in limiting collateral requirements throughout the Group. As at 31 March 2012, the Group's long term credit rating was A3 stable outlook for Moody's and A- stable outlook for Standard & Poors. These remain unchanged in the year to 31 March 2012. Further detail of the capital management objectives, policies and procedures are included in the 'Financial management and balance sheet' section of the Financial Overview at pages 21 to 23 of this report.

The maintenance of a medium-term corporate model is a key control in monitoring the development of the Group's capital structure, and allows for detailed scenarios and sensitivity testing. Key ratios drawn from this analysis underpin regular updates to the Board and include the ratios used by the rating agencies in assessing the Group's credit ratings.

From time to time the Group purchases its own shares on the market. The timing of these purchases will depend on market prices and economic conditions. The use of share buy-backs is the Group's benchmark for investment decisions and is utilised at times when management believe the Group's shares are undervalued. No share buy-back was made during the year.

The Group's debt requirements are principally met through issuing bonds denominated in Sterling, US dollars and Euros as well as medium term bank loans predominately with the European Investment Bank. In addition the Group issued hybrid capital bonds which bring together features of both debt and equity, are perpetual and subordinate to all senior creditors. During February 2012 the Group also undertook a US private placement for a total consideration of \$700m (equivalent to £446.4m). The Group also maintains £1bn of committed bank facilities that act as a backstop to the Group's commercial paper programme and these remain undrawn for the majority of the time.

In summary, the Group's intent is to balance returns to shareholders between current returns through dividends and long-term capital investment for growth. In doing so, the Group will maintain its capital discipline and will continue to operate within the correct economic environment prudently. In these respects, there were no changes to the Group's capital management approach during the year.

## 32. RELATED PARTY TRANSACTIONS

The immediate parent and ultimate controlling party of the Group is SSE plc (incorporated in Scotland).

Balances and transactions between the Company and its subsidiaries, which are related parties of the Company, have been eliminated on consolidation and are not disclosed in this note. Details of transactions between the Group and other related parties are disclosed below.

### (i) Trading transactions

The following transactions took place during the year between the Group and entities which are related to the Group but which are not members of the Group. Related parties are defined as those in which the Group has control, joint control or significant influence.

|                                     | Sale of goods<br>and services<br>2012<br>£m | Purchase of<br>goods and<br>services<br>2012<br>£m | Amounts<br>owed from<br>2012<br>£m | Amounts<br>owed to<br>2012<br>£m | Sale of goods<br>and services<br>2011<br>£m | Purchase of<br>goods and<br>services<br>2011<br>£m | Amounts<br>owed from<br>2011<br>£m | Amounts<br>owed to<br>2011<br>£m |
|-------------------------------------|---|--|------------------------------------|----------------------------------|---|--|------------------------------------|----------------------------------|
| <b>Jointly controlled entities:</b> |   |  |                                    |                                  |   |  |                                    |                                  |
| Seabank Power Ltd                   | 34.7  | (94.8)   | 0.1                                | 9.1                              | 7.9   | (121.3)  | 0.3                                | 25.9                             |
| Marchwood Power Ltd                 | 46.8  | (80.5)   | 0.2                                | 4.0                              | –   | (82.7)   | 0.1                                | 7.3                              |
| Greater Gabbard Offshore Winds Ltd  | –   | (24.4)   | –                                  | 15.4                             | 6.3   | (0.2)  | –                                  | –                                |
| Scotia Gas Networks Ltd             | 59.2  | (154.3)  | 7.3                                | 13.9                             | 61.8  | (131.2)  | 15.7                               | 12.1                             |
| Other Joint Ventures                | 42.0  | –  | 0.2                                | 0.3                              | 39.7  | –  | 0.3                                | 0.6                              |
| <b>Associates</b>                   | <b>42.4</b>                                 | <b>(44.5)</b>                                      | <b>11.8</b>                        | <b>21.4</b>                      | 39.9  | (104.3)  | 8.3                                | 3.7                              |

The transactions with Seabank Power Limited, Marchwood Power Limited and Greater Gabbard Offshore Winds Limited relate to the contracts for the provision of energy or the tolling of energy under power purchase arrangements. Scotia Gas Networks Limited has operated the gas distribution networks in Scotland and the South of England from 1 June 2005. The Group's gas supply activity incurs gas distribution charges while the Group also provides services to Scotia Gas Networks in the form of a management service agreement for corporate services and stock procurement services. Other transactions include those with PriDE (SERP) Limited, which operates a long-term contract with Defence Estates for management of MoD facilities in the South East of England. All operational activities are sub-contracted to the ventures partners including SSE Contracting Limited.

The amounts outstanding are trading balances, are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties. Aggregate capital loans to jointly controlled entities and associates are shown in note 14.

### Remuneration of key management personnel

The remuneration of the key management personnel of the Group, is set out below in aggregate.

|  | 2012<br>£m | 2011<br>£m |
|--|------------|------------|
| <b>Short-term employment benefits</b>                |            |            |
| Executive Directors                                  | 2.8        | 3.7        |
| Other Management Board members (from 1 January 2011) | 2.0        | 0.3        |
|  | <b>4.8</b> | 4.0        |

Key management personnel are responsible for planning, directing and controlling the operations of the Group. From 1 January 2011 these personnel were identified as the Management Board, which is made up of the Executive Directors, seven (2011 – six) senior managers and the Chief Executive Officer of Scotia Gas Networks Limited (who is not remunerated by the Group).

In addition, the key management personnel receive share-based remuneration, details of which are found at note 30. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report. The Executive Directors are employed by the Company.

Information regarding transactions with post-retirement benefit plans is included in note 29.



## Notes on the financial statements (continued)

### for the year ended 31 March

### 33. COMMITMENTS AND CONTINGENCIES

#### (i) Capital commitments

|                                 | 2012<br>£m   | 2011<br>£m |
|---------------------------------|--------------|------------|
| Capital expenditure:            |              |            |
| Contracted for but not provided | <b>828.0</b> | 1,146.9    |

Contracted for but not provided capital commitments includes the fixed contracted costs of the Group's major capital projects. In practice contractual variations may arise on the final settlement of these contractual costs.

#### (ii) Operating lease commitments

##### (a) Leases as lessee:

|   | 2012<br>£m   | 2011<br>£m |
|---|--------------|------------|
| Amount included in the income statement relating to the current year leasing arrangements |              |            |
| Minimum lease payments – power purchase agreement   | <b>116.0</b> | 182.0      |
| Other lease payments  | <b>53.9</b>  | 53.3       |
|   | <b>169.9</b> | 235.3      |

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

|                                    | 2012<br>£m   | 2011<br>£m |
|------------------------------------|--------------|------------|
| <b>Power purchase agreements</b>   |              |            |
| Within one year                    | <b>134.2</b> | 120.8      |
| In second to fifth years inclusive | <b>336.4</b> | 358.0      |
| After five years                   | <b>82.2</b>  | 156.5      |
|                                    | <b>552.8</b> | 635.3      |
| <b>Other leases</b>                |              |            |
| Within one year                    | <b>55.3</b>  | 51.6       |
| In second to fifth years inclusive | <b>103.1</b> | 93.3       |
| After five years                   | <b>206.5</b> | 139.4      |
|                                    | <b>364.9</b> | 284.3      |
| <b>Total</b>                       |              |            |
| Within one year                    | <b>189.5</b> | 172.4      |
| In second to fifth years inclusive | <b>439.5</b> | 451.3      |
| After five years                   | <b>288.7</b> | 295.9      |
|                                    | <b>917.7</b> | 919.6      |

The average power purchase agreement lease term is 4 years (2011 – 5 years).

Certain obligations under power purchase agreements with various power generating companies are not deemed to qualify as finance leases as the lease term is not judged to be substantially all of the economic life of the power station and the present value of the minimum lease payments at the inception of the agreements did not amount to substantially all of the fair value of the power stations at that time.

The Company has no operating lease commitments as a lessee.

##### (b) Leases as lessor:

The Group and Company have no operating lease commitments as a lessor.

**(iii) Guarantees and indemnities**

SSE plc has provided guarantees on behalf of subsidiary, joint venture and associated undertakings as follows:

|                          | <b>2012</b><br><b>£m</b> | 2011<br>£m |
|--------------------------|--------------------------|------------|
| Bank borrowing           | <b>400.0</b>             | 400.0      |
| Performance of contracts | <b>1,127.4</b>           | 1,851.9    |
| Purchase of gas          | <b>40.5</b>              | 50.5       |

The Group has drawn down £400m from its European Investment Bank facility. SSE Renewables Holdings Limited and SSE Generation Limited, both wholly owned subsidiaries of the Company, have entered into guarantee and indemnity agreements with the European Investment Bank for the amounts drawn down.

The guarantees provided in respect of 50% of the major contracts for Greater Gabbard Offshore Winds joint venture project and certain other renewable capital developments reduced significantly during the year which is reflected in the above guarantees.

In addition, unlimited guarantees have been provided on behalf of subsidiary undertakings in relation to six contracts in respect of performance of work and any liabilities arising. Southern Electric Power Distribution plc and the Company have provided guarantees to the Southern Group of the ESPS in respect of the funding required by the scheme. Scottish Hydro Electric Power Distribution plc and the Company have provided guarantees to the Scottish Hydro-Electric Pension Scheme in respect of funding required by the scheme. SSE E&P (UK) Limited, a wholly-owned subsidiary of the Company, has provided a guarantee to Hess Limited in respect of decommissioning liabilities.

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

**34. POST BALANCE SHEET EVENTS**

On 16 April 2012, the Group received proceeds of US\$700.0m (£446.4m) from the US private placement undertaken in February 2012 (note 31).

## Shareholder information

### Shareholder enquiries

Share Registrar:  
Capita Registrars, The Registry,  
34 Beckenham Road, Beckenham,  
Kent BR3 4TU

Telephone: 0845 143 4005  
Email: [sse@capitaregistrars.com](mailto:sse@capitaregistrars.com)

### Financial calendar

Annual General Meeting/  
Interim Management Statement  
26 July 2012

Ex-dividend date  
25 July 2012

Record date  
27 July 2012

Final date for receipt of Scrip Elections  
(in respect of the 2011/12 final dividend)  
24 August 2012

Payment date  
21 September 2012

Half-year results announcement\*  
14 November 2012

### Website

The Company's website, [www.sse.com](http://www.sse.com), contains a wide range of information including a dedicated Investors section where you can find further information about shareholder services including:

- share price information;
- dividend history and trading graphs;
- the Scrip Dividend Scheme;
- telephone and internet share dealing; and
- downloadable shareholder forms.

### Twitter

We use popular social networking site Twitter to keep shareholders, investors, journalists, employees and other interested parties up-to-date with news from the Company. You can follow SSE on Twitter at [www.twitter.com/sse](http://www.twitter.com/sse).

### Mobile users

If you use a mobile phone with a barcode scanning application, you can scan the barcode below to access a copy of our website from your mobile device. If you don't have a mobile phone with a barcode scanning application you can still visit [www.sse.com/mobile](http://www.sse.com/mobile) for a mobile-friendly version of the Company's website.



\* Provisional date.

### eCommunications programme

Sign up to our eCommunications Programme at [www.sse.com/investors/ecommsprogramme](http://www.sse.com/investors/ecommsprogramme) and receive shareholder documentation via e-delivery. As a thank you we will donate £2 on your behalf to the World Wildlife Fund's (WWF) International Conservation Programmes. In 2011/12, SSE made a donation of over £6,000 on behalf of its shareholders.

### Keep us informed

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