

Answering the right questions

Scottish and Southern Energy plc
Annual Report 2008



Scottish and Southern
Energy

SSE's core purpose is to provide the energy people need in a reliable and sustainable way.



The right questions

SSE's strategy has been, and will continue to be, the delivery of sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of regulated and non-regulated energy and utility businesses. Over the next decade, many key questions will be asked of companies in the energy sector. SSE addresses these questions in this report.

How do we respond to rising global energy demand?

pg 6-7

SSE's priority is to maintain a diverse portfolio of efficient power stations and avoid dependency on any single primary fuel source. This diversity, with a growing emphasis on renewable energy, also enables SSE to manage the risks associated with primary fuel procurement at times of volatile and rising energy prices.

How do we help customers save energy?

pg 14-15

SSE encourages its customers to reduce their consumption of energy through initiatives including: the UK's first energy tariff designed to reward reduced energy consumption; and trials of smart meters and real-time displays which enable customers to track their energy use.

How do we ensure our networks are reliable?

pg 20-21

SSE targets investment to benefit the greatest number of customers through initiatives including: automating switching devices to help restore power more quickly when there are interruptions; and replacing open wire overhead conductors with covered wires that are more resilient to adverse weather conditions.

How do we secure energy supplies for customers?

pg 30-31

SSE recognises the UK's growing dependence on imports of gas – and the resulting risk to the security of energy supplies, given gas is used for generating electricity as well as heating homes, offices and businesses. To address this, SSE is investing further in developing large-scale gas storage facilities, which will be strategically important to the UK.

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Directors

Sir Robert Smith
Chairman
Ian Marchant
Chief Executive
Gregor Alexander
Finance Director
Nick Baldwin
Non-Executive Director
Richard Gillingwater
Non-Executive Director

Colin Hood
Chief Operating Officer
René Médori
Non-Executive Director
Alistair Phillips-Davies
Energy Supply Director
Susan Rice CBE
Non-Executive Director
Sir Kevin Smith CBE
Non-Executive Director

Financial Calendar

Annual General Meeting
24 July 2008
Ex dividend date
20 August 2008
Record date
22 August 2008
Final dividend payable
26 September 2008
Interim announcement
12 November 2008

*Unless otherwise stated, this Annual Report describes adjusted operating profit before exceptional items, the impact of IAS 32 and 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, the impact of IAS 32 and 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, the impact of IAS 32 and IAS 39 and deferred tax.



1. Energy Supply

SSE supplies electricity and gas to 8.45 million customers within the UK's competitive electricity and gas supply market, with growth continuing in the new financial year. This makes it the second largest supplier of energy in the UK.

2. Water Supply

SSE's subsidiary, SSE Water (SSEW), will become the first new company to offer both water and sewerage services since privatisation in 1989. This followed the granting of an 'inset' appointment to SSEW.

3. Home Services

SSE supplies a wide range of electrical and gas appliances and a range of maintenance and protection services for customers' gas and electrical systems and a full range of gas and electrical installation services. Its **shield** gas boiler, central heating and wiring protection service has 70,000 customers.

4. Energy Services

SSE provides bespoke energy solutions featuring on-site or off-site dedicated wind turbines, solar thermal systems, solar photovoltaic systems and ground-source heat pumps. Its Energy Services division operates and maintains site-wide energy infrastructures of this kind that improve environmental performance over conventional alternatives.

5. Electricity Networks Management

SSE's objective in electricity networks is to ensure that they are managed as efficiently as possible, including maintaining tight controls over operational expenditure and effectively delivering capital expenditure, so that the number and duration of power cuts experienced by customers is kept to a minimum.

6. Contracting

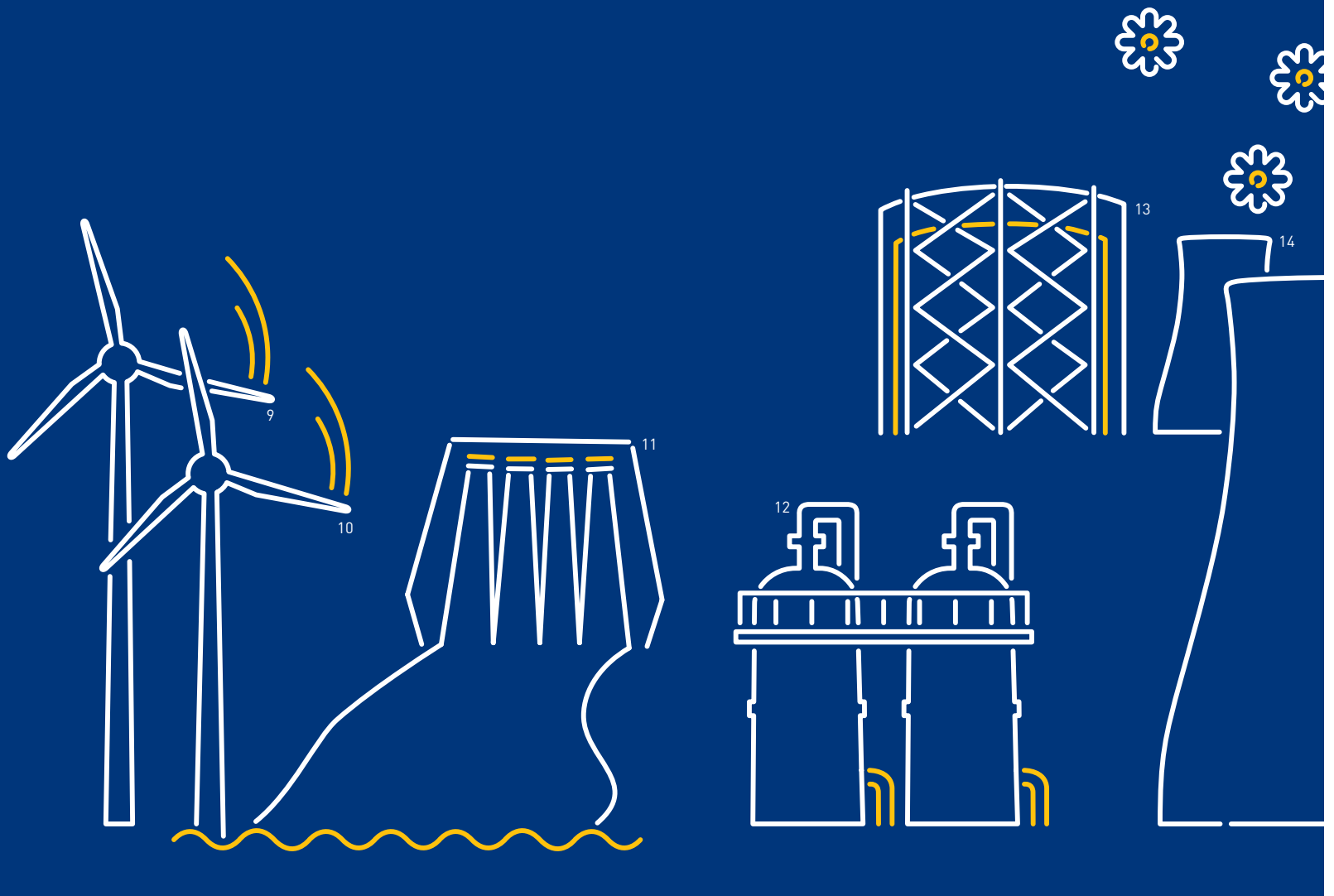
SSE's Contracting business has three main areas of activity: industrial, commercial and domestic mechanical and electrical contracting; electrical and instrumentation engineering; and public and highway lighting. It is one of the largest mechanical and electrical contracting businesses in the UK.

7. Telecoms

SSE Telecom and Neos Networks operate an 8,000km UK-wide telecoms network, providing services to other telecoms providers, companies and public sector organisations.

8. Electricity Networks Infrastructure

SSE is responsible for around 127,000km of overhead lines and underground cables, distributing electricity to 3.5 million homes, offices and businesses in the north of Scotland and central, southern England.



9. Onshore Wind

SSE owns and operates around 600MW of onshore wind farm capacity in Scotland, Northern Ireland and the Republic of Ireland and has consent to build another 400MW in various locations. Its Hadyard Hill wind farm in South Ayrshire was the first in the UK to generate over 100MW of electricity.

10. Offshore Wind

SSE has consent to build a 288 megawatt (MW) offshore wind farm in Germany and is to construct a 504MW offshore wind farm at Greater Gabbard in the outer Thames Estuary. On completion, it is expected to be the largest offshore wind farm in the world.

11. Hydro

SSE's total output from its hydro electric stations (excluding pumped storage) during 2007/08 was 3,518GWh. This compares with 3,767GWh in the previous year, which was the fourth highest on record. The construction of what will be SSE's second largest conventional hydro electric station at Glendoe, near Loch Ness, is now entering its final phase.

12. Gas Storage

SSE owns and operates the UK's largest onshore gas storage facility at Hornsea in East Yorkshire. Nine salt caverns have been leached into a salt layer 1.8km below the surface, creating 325 million cubic metres (mcm) of gas storage capacity.

13. Gas Networks

SSE holds 50% of the equity of Scotia Gas Networks plc, which owns and operates the Scotland and the Southern gas distribution networks. The networks comprise some 74,000km of gas mains, delivering gas to around 5.7 million industrial, commercial and domestic customers.

14. Generation Portfolio

SSE owns around 10,500MW of electricity generation capacity, including its share of joint ventures and associates. This makes it the second largest electricity generator across the UK and Ireland. The capacity comprises 4,500MW of gas- and oil-fired capacity, 4,000MW of coal-fired capacity (with biomass 'co-firing' capability), and over 2,000MW of renewable capacity.

SSE's core purpose is to provide the energy people need in a reliable and sustainable way.



Sir Robert Smith Chairman

Scottish and Southern Energy delivered very good operational and financial results in 2007/08, a challenging year for the sector in which many key questions were asked about the sustainability, reliability and affordability of energy. The maintenance of our policy of responsible pricing helped us to gain 700,000 additional electricity and gas customers, making us the UK's second largest energy supplier. Our power stations performed well, as did our electricity networks, enabling us to contribute significantly to the security and reliability of the UK's energy supplies.

Investment

Securing future supplies and tackling climate change are the twin goals of energy policy in the UK, Ireland and throughout the European Union, and our expanding programme of investment reflects this. It should enable us to create value for shareholders to complement the value enhancement which flows from continually improving our day-to-day operations. We will continue to focus on our energy and infrastructure related businesses in the UK and, following the recent acquisition of Airtricity, in Ireland. That acquisition also provides us with the scope to build on our UK-leading position in renewable energy to develop an international business in this increasingly critical area.

Customers

SSE's core purpose is to provide the energy people need in a reliable and sustainable way, and I am pleased that our energy distribution businesses and our energy supply business, on which millions of households up and down the country rely, performed well. Clearly, as global demand for energy soars, the price paid by customers is higher than anyone

would like. Nevertheless, customers to whom SSE supplies energy have the assurance of our responsible pricing policy: we will continue to seek to be the last, or one of the last, of the major suppliers to put up prices if we have to and the first, or one of the first, to bring them down if we can.

Responsibility

Shareholders expect companies not simply to be profitable, but to be responsible in how those profits are made. SSE's core activities clearly have an environmental impact, but it is one which we are working to reduce significantly. I am therefore pleased that we have set ourselves a new and more challenging target of reducing the carbon intensity of electricity generated at power stations in which we have an ownership or contractual interest, by 50% by 2020. We will report on progress against this new target in next year's Annual Report.

People

Responsible companies are the ones which prosper in the long-term, and SSE is a company that is built to last. It is staffed by an exceptional team of people, who have discernible pride in and passion for their organisation. This pride and passion strikes me and the non-Executive Directors whenever we meet anyone from the company and is something with which we, in turn, are very proud to be associated.

One of those Directors, Sir Kevin Smith, has decided to step down from the Board after four years of service and so will not be seeking re-election at the Annual General Meeting in July. Sir Kevin's long experience in industry has given him an excellent insight into the issues facing SSE and the company

has benefited greatly from his outstanding contribution to the work of the Board.

Dividend

We are also proud to be associated with SSE's track record of dividend growth. The Board is recommending a final dividend of 42.4p, making a full-year dividend of 60.5p, an increase of 10.0% on last year. The quality of the SSE team, the extensive investment opportunities (added to by the acquisition of Airtricity) and the ongoing scope for continuing improvement in operational performance give us the means to maintain our track record of dividend growth in the next decade. Delivering that dividend growth, delivering our investment programme and delivering excellent service to customers are our key priorities in 2008/09 and will remain so in the years ahead.

Challenges

The years ahead will be challenging, and ones in which energy companies will have to demonstrate that they have the right answers to the key questions about the reliability and sustainability of energy supplies. SSE long ago recognised that the production and consumption of energy would change, and has taken steps in anticipation of that. It is, therefore, very well placed to meet the challenges of the next decade. 🌸



Ian Marchant Chief Executive

SSE's values are:
safety, service, efficiency,
sustainability, excellence
and teamwork.

Purpose and Strategy

SSE's core purpose is to provide the energy people need in a reliable and sustainable way. In line with this, its strategy has been and will continue to be the delivery of sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of regulated and non-regulated energy and utility businesses.

Within this strategic framework, SSE will continue to focus on enhancing and creating value for shareholders from its energy and infrastructure-related activities in the UK and Ireland and from the development of an international renewable energy business.

Implementation of the strategy will continue to be founded on SSE's well-established financial principles. These principles are: delivery of sustained real dividend growth; effective management of core businesses; rigorous analysis to ensure investments are well-founded and, where appropriate, innovative; maintenance of a strong balance sheet; deployment of a selective and disciplined approach to acquisitions; and use of purchase in the market of the company's own shares as the benchmark against which financial decisions are taken.

Future Environment

This strategy and these principles have been shown to be robust in a wide variety of financial and operational conditions and have led to SSE becoming the UK's broadest-based energy company. SSE will continue to adhere to them in the future.

That future will be different. Over the next decade, key questions will be asked of

companies in the energy sector. How are they responding to climate change? How are they responding to rising global demand for energy as supplies of oil and gas deplete? How are they helping to secure energy supplies and make them more reliable? How are they helping customers to use less energy? SSE believes these are the right questions and that its strategy and priorities are delivering the right answers.

The days of meeting an unchecked demand for energy through monolithic carbon-intensive power stations are coming to an end. Increasingly the emphasis will be on energy efficiency, renewables, cleaned up fossil fuel plant and micro generation. SSE is active in all of these areas and preparing for this profound change.

SSE's primary focus for shareholders will be on delivering sustained real growth in the dividend, and the changing nature of energy production is why the acquisition of Airtricity should help to maintain its track record of growth during the second decade of this century. So, too, should the scale of the investment opportunities which that acquisition and SSE's established businesses and new ventures have created.

Priorities for 2008/09 and Beyond

For this reason, SSE's continuing focus during 2008/09 will be on the efficient and timely delivery of investments in renewable energy, other electricity generation, electricity and gas networks and gas storage. The value created from these investments will be complemented by the identification and delivery of enhanced operational performance in the management of power

stations and the operation of electricity and gas networks and in SSE's other energy-related services.

As SSE's investment programme, expected to be around £1.3bn in 2008/09, gathers pace, the growth in its modern and diverse asset base should continue, reinforcing its position as the UK's broadest-based energy company. This, in turn, should enable SSE to maintain its track record of dividend growth in the second decade of this century as should continuing profit growth based on continuous improvements in operations from which customers will benefit. Through ongoing responsible pricing and sector-leading service delivery, SSE expects its number of customers to continue to grow.

In uncertain financial times, there is one question being posed by many investors: which companies provide an unambiguous commitment to, and focus on, sustained real dividend growth, backed up by a track record of having delivered it in the past and the means to deliver it in the future? SSE believes that is the right question, and that, with its commitment to sustained real dividend growth, it is one of those companies. In line with that, its priority for 2008/09 is to deliver its target of at least 4% real growth in the dividend payable to shareholders. 🌸

The right question

The International Energy Agency (IEA) said in November 2007 that it believed that by 2030 global demand for energy could be more than 50% above current levels. At the same time, those resources are limited: known reserves of oil are expected to last only to around the middle of this century; and the amount of gas is also finite. Reserves of coal, the most carbon-intensive of the main fossil fuels, are believed to last for at least another two centuries. The right question for SSE is – how is it responding to rising global demand for energy so it is able to provide the energy people need in a sustainable way?

HOW DO WE RESPOND TO RISING GLOBAL ENERGY DEMAND?

SSE's priority as an electricity generator is to maintain a diverse portfolio of efficient power stations and avoid dependency on any single primary fuel source. This diversity also enables SSE to manage the risks associated with primary fuel procurement at times of volatile and rising energy prices.

In May 2007, the Energy White Paper pointed out that the UK will need substantial investment in new generation capacity over the next two decades. It also pointed out that the UK's diverse generation mix avoids exposure to the risks associated with heavy dependency on a single fuel or technology type, helps to maintain secure supplies of energy and provides the country's electricity system with the flexibility to accommodate variations in demand and to respond to changes in fossil fuel prices.

To meet these objectives, SSE is investing in a number of fossil-fuelled, renewable and energy-technology projects including: constructing a new 840 megawatt (MW) CCGT power station at Marchwood near Southampton; proposing a 470MW extension to the existing CCGT Barking power station near Dagenham; planning an additional CCGT power station; extending the life of Fiddler's Ferry and Ferrybridge coal-fired power stations by fitting flue gas desulphurisation (FGD) equipment; building a new 100MW hydro station at Glendoe near Loch Ness; acquiring Airtricity and Slough Heat and Power, the UK's largest dedicated biomass facility; and investing in a range of emerging technologies.

Key to responding to rising global energy demand is renewable energy. As the EU Commissioner for Energy stated 'In a time of growing oil prices and climate change concerns, renewable energy sources is an opportunity that we cannot miss. This will help to reduce our carbon dioxide emissions and strengthen our security of supply'. Against this background, SSE is seeking to enhance and create value for shareholders from the development of an international business focusing on renewable energy.

£3.0bn investment in onshore wind, offshore wind and hydro electric schemes in the UK and Ireland, and in renewable energy in new markets and technologies over the next five years.

3.0

Highlight Airtricity

In addition to its obvious environmental credentials, renewable energy also significantly reduces SSE's exposure to escalating prices for fossil fuels for the straightforward reason that – in the case of hydro and wind – the fuel used to generate electricity is indigenous and free.

Following the acquisition of Airtricity in February 2008, and a review of its renewable generation projects, SSE now expects to have around 4,000MW of renewable generation capacity in the UK and Ireland in 2013, doubling in five years its renewable capacity in those countries. SSE expects its portfolio in 2013 will comprise: 1,500MW of hydro electric schemes; around 2,000MW of onshore wind farms; over 250MW of offshore wind farms; and around 250MW of waste-to-energy and biomass developments.

10.5

10.5 gigawatts (GW) of electricity generation capacity, including its share of joint ventures, making SSE the second largest electricity generator in the UK.

Financial Results for 2007/08

These results for the year to 31 March 2008 are reported under International Financial Reporting Standards, as adopted by the EU. SSE's focus is on profit before tax before exceptional items, the impact of International Accounting Standards IAS 32 and IAS 39 and after the removal of taxation on profits from jointly-controlled entities and associates (adjusted profit before tax*). The following table reconciles SSE's reported profit before tax and its adjusted profit before tax.

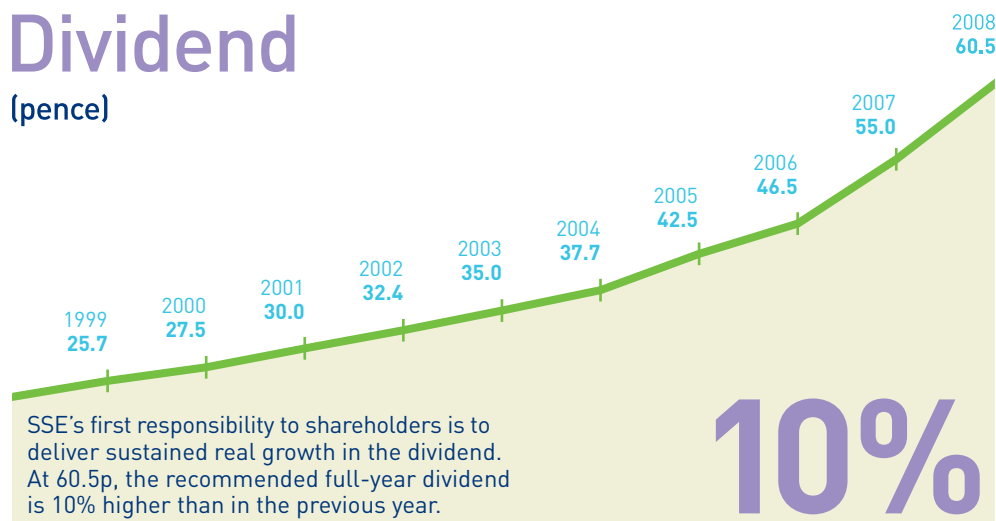
	March 08 £m	March 07 £m
Reported Profit before Tax	1,083.8	1,132.0
Movement on derivatives (IAS 39)	164.1	(54.5)
Exceptional items	(65.2)	(33.6)
Tax on JVs and Associates	41.9	31.8
Interest on convertible debt	4.6	3.6
Adjusted Profit before Tax*	1,229.2	1,079.3
Adjusted current tax charge	(317.2)	(282.6)
Adjusted Profit after Tax*	912.0	796.7
Reported Profit after Tax	873.2	830.5
Number of shares for basic and adjusted EPS (million)	863.2	860.9
Adjusted EPS*	105.6	92.5
Basic EPS	101.1	96.5

Adjusted Profit Before Tax*

Adjusted profit before tax* grew by 13.9%, from £1,079.3m to £1,229.2m. While there was increased profitability in all parts of SSE, the most significant growth continues to be achieved in Generation and Supply. This reflects the successful development and deployment of SSE's diverse and flexible electricity generation portfolio, which now comprises around 10,500MW of capacity, and the sustained increase in the number of energy supply customers, which totalled 8.45 million on 31 March 2008. Significant

Dividend

(pence)



growth was also achieved in Scotia Gas Networks, thereby helping SSE to maintain the balance in profitability between its regulated and non-regulated activities.

As previously stated, SSE's emphasis is on adjusted profit before tax* on a full-year, as opposed to six-monthly, basis and its interim results in any financial year should always be viewed in light of that. This is because interim results are more likely to fluctuate, with unusual variations or exceptional circumstances. The majority of SSE's adjusted profit before tax in 2007/08 was delivered in the first six months; in 2008/09, SSE expects the reverse to be the case.

Exceptional Items

There were three exceptional items. First, in Budget 2007, the UK government announced a reduction in the main Corporation Tax rate from 1 April 2008, from 30% to 28%, and accordingly SSE has restated its deferred tax provisions. A £32.4m credit has been

recognised in relation to SSE's share of joint ventures and associates and is therefore reported in profit before tax, which is adjusted accordingly. A further £55.4m has been released by SSE, which is included in the headline tax charge. The second exceptional item was a foreign exchange loss of £22.2m on the unhedged proportion of Euro debt raised for the acquisition of Airtricity. The third exceptional item was a £55.0m gain before tax on the disposal of SSE's telecoms sites assets in August 2007.

Adjusted Earnings Per Share*

To monitor financial performance over the medium-term, SSE continues to focus on adjusted earnings per share*, which increased by 14.2%, from 92.5p to 105.6p.

Final Dividend

SSE's first responsibility to shareholders is to deliver sustained real growth in the dividend. The Board is recommending a final dividend of 42.4p, compared with 39.9p in the previous year, an increase of 6.3%. This will make a full-year dividend of 60.5p, compared with 55p last year, an increase of 10.0%.

The expected full-year dividend in respect of 2007/08, of 60.5p, compares with 35.0p for 2002/03, an increase of 72.9% in five years. This represents a compound annual growth rate during that period of 11.6%.

The full-year dividend payment to shareholders for 2007/08 is covered 1.73 times by SSE's adjusted profit after tax*, compared with 1.68 times in the previous year.

Future Dividend

SSE's target remains the delivery of at least 4% annual real growth in the dividend paid to shareholders in respect of 2008/09 and 2009/10. The acquisition of Airtricity in February 2008, and the investment opportunities it yields, are expected to help SSE maintain this track record of dividend growth well into the second decade of this century. 🌱

What are Values?

During 2006/07, Scottish and Southern Energy adopted the 'SSE SET' of values: **safety; service; efficiency; sustainability; excellence; and teamwork.** These values are in support of SSE's core purpose, which is to provide the energy people need in a reliable and sustainable way.

As Jim Collins and Jerry Porras put it in their book, *Built to Last: Successful Habits of Visionary Companies*, values should be 'an organisation's essential and ensuring tenets, not to be compromised for financial gain or short-term expediency'.

SSE believes that the only sustainable competitive advantage which any company has is its reputation. By adhering to these values, SSE believes it will maintain trust, goodwill and respect among customers, shareholders and employees and so they are central to its long-term ambitions and success.



02 Business Statement Generation and Supply

1. Overview 2. Generation

OVERVIEW

→ **Operating profit* up 12.7% to £724.2m**

Introduction

SSE owns around 10,500 megawatts (MW) of electricity generation capacity, including its share of joint ventures and associates. This makes it the second largest electricity generator across the UK and Ireland. The capacity comprises almost 4,500MW of gas- and oil-fired capacity, 4,000MW of coal-fired capacity (with biomass 'co-firing' capability), and over 2,000MW of renewable (hydro, wind and dedicated biomass) capacity. This gives SSE diversity in fuels and, as a result, greater optionality in the overall management of its power stations.

As at 31 March 2008, SSE supplied energy to 8.45 million customers within Great Britain's competitive electricity and gas supply market, with growth continuing in the new financial year. This makes it the second largest supplier of energy in the UK, and the fastest growing. Its responsibility to those customers is to procure the electricity and gas they need and to arrange for it to be distributed to them through the relevant networks. Under the British Electricity Trading and Transmission Arrangements (BETTA) wholesale gas and wholesale electricity are transacted like any other commodity in a fully-competitive market. SSE purchases gas and, where appropriate, some electricity via bilateral contracts and through the wholesale market – the latter complementing the electricity produced from its own generation portfolio.

Under its integrated Generation and Supply business model, SSE's power stations and fuel supply contracts are used to support performance in electricity supply, mainly through using flexibility and optionality to respond to customer demand and market conditions. Generation and Supply is, therefore, assessed as a single value chain and this approach means, amongst other things, that more sustained value can be created from SSE's balanced portfolio of assets, contracts and customers than would be the case on a stand-alone basis.

In January 2008, Ofgem 'confirmed that Britain's competitive market in energy is working'. A month later, however, it launched an investigation into the markets in electricity and gas for households and small businesses, using its powers under the Enterprise Act 2002. While it has stated it has 'no clear evidence' of failure of the market, it is carrying out the investigation in response to 'public concern'. Ofgem expects to reach initial conclusions by September 2008. In SSE's view, Ofgem's original belief that there is no clear evidence of failure of the market is correct; indeed, the market is very competitive and provides customers with an excellent degree of choice across all aspects of electricity and gas supply.

In April 2008, Ofgem launched another investigation, into SSE and Scottish Power Limited, under section 18 of the Competition Act 1998 and Article 82 of the EC Treaty. It said its decision was based on a formal complaint alleging abuse of an alleged dominant position in the electricity generation sector at times of constraint on the Great Britain transmission system, as well as informal enquiries. SSE is co-operating fully with Ofgem. It remains confident that its actions in electricity generation have always been consistent with the operation of a competitive market and believes that this process can be brought to a speedy conclusion.

Performance Overview

Operating profit* in Generation and Supply rose by 12.7%, from £642.6m to £724.2m, contributing 52.3% of SSE's total operating profit during the year. Total revenue for Generation and Supply was £14.26bn, which accounted for 89% of SSE's total revenue in 2007/08, of which £5.61bn was in relation to sales of electricity and gas to industrial, commercial and domestic customers. The financial performance of Generation and Supply has been reported excluding the impact of IAS 39 re-measurements because SSE does not believe this represents underlying business performance.

During 2007/08, SSE generated 45.8 terrawatt-hours (TWh) of electricity, including power stations in which it has ownership or contractual interest. In addition, Airtricity's wind farms produced 0.8TWh of electricity during 2007/08, including 0.15TWh after its acquisition by SSE in February 2008. SSE also purchased 9.9TWh of electricity via long-term contracts with other generators, including British Energy. In the year, it supplied 28.2TWh of electricity to its domestic and small business customers and 27.5TWh was supplied under contract to industrial and commercial customers. Any net balances were traded in the wholesale electricity market.

The continuing growth achieved by SSE's integrated Generation and Supply business is the outcome of the company's investment in and acquisition of a diverse range of electricity generating assets and a growth of almost four million in the number of energy supply customers over the past six years, following its sustained policy of responsible pricing.

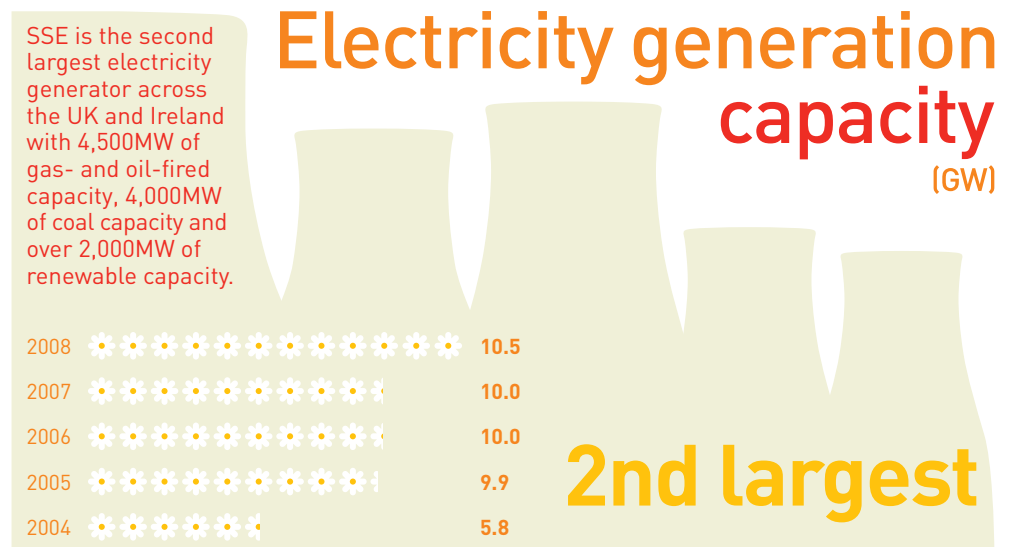
GENERATION

- **Gas-fired power station availability 95%; coal station availability 91%**
- **Acquisition of Airtricity Holdings Ltd**
- **Acquisition of Slough Heat and Power Ltd**
- **Operating/consented onshore wind farm capacity passed 1,000MW mark, with increase of 150MW since January 2008**
- **Operating renewable energy capacity passed 2,000MW mark**
- **Operating/consented renewable energy capacity passed 3,000MW mark**
- **New target for operating renewable energy capacity of 4,000MW by 2013**
- **Consent granted for extension to Barking Power Ltd**
- **New target adopted to reduce carbon intensity of power generated by 50% by 2020**

Generation Objectives

In May 2007, the Energy White Paper pointed out that the UK will need substantial investment in new generation capacity over the next two decades. It also pointed out that the UK's diverse generation mix avoids exposure to the risks associated with heavy dependency on a single fuel or technology type, helps to maintain secure supplies of energy and provides the country's electricity system with the flexibility to accommodate variations in demand and to respond to changes in fossil fuel prices.

The same points apply to SSE's portfolio. Its key objectives in Generation are to ensure that it has a diverse portfolio of power stations, available to generate electricity and support



2. Generation (continued)

security of supply, with the maximum possible efficiency, in response to customer demand and market conditions, while complying fully with all safety standards and environmental regulations. It is this diversity which enables SSE to manage the risks associated with primary fuel procurement at a time of volatile and rising prices.

In support of these objectives, SSE completed the acquisition of Airtricity in February 2008 for a final enterprise value of £1,349.1m. The acquisition was the largest completed by SSE since its formation in 1998. It is designed, amongst other things, to further balance SSE's electricity generation portfolio, reduce its exposure to volatile commodity prices for fossil fuels and provide a major new range of investment opportunities from which to secure growth over the next decade.

At the same time, SSE's investment in Generation will go beyond renewable energy. It will continue to examine opportunities across all aspects of Generation to ensure it has optionality in plant technology, timing of investment and construction and scale of development.

To support future and current assets, SSE has also established an Engineering Centre to provide both an effective long-term asset management and investment planning capability across its Generation portfolio and a platform for the future growth of the portfolio.

Gas-fired Generation – Operations

Good performance in BETTA is dependent on plant availability to generate electricity. During 2007/08, SSE's principal wholly-owned gas-fired power stations (Fife, Keadby, Medway and Peterhead) achieved an average of 95% of their maximum availability to generate electricity, excluding planned outages, the same as in the previous year.

During 2007/08, SSE extended its power purchase agreements with Seabank Power Limited, in which it also has a 50% stake. The agreements were due to expire in 2009 and 2011, but have now been extended to 2018, with the option of a further extension to 2023. The new contracts represent a significant milestone in the long-term development of SSE's portfolio.

Gas-fired Generation – Investment

With its high thermal efficiency, relatively low cost and short construction times, combined cycle gas turbine (CCGT) technology is set to remain the benchmark technology for some years to come. Work on the construction of Marchwood Power Ltd's new 840MW CCGT plant in Southampton is now well under way. Marchwood Power is a joint venture between SSE and ESBI International, in which SSE will have 50% of the equity (£43m) and 50% of the debt (£160m) – of which £55m was invested by 31 March 2008. All of the station's output, however, will be contracted to SSE. With a net thermal efficiency in excess of 58%, it will be one of the most efficient in the UK. As it was procured before the upsurge in capital costs seen in the electricity generation sector over the past two years, it will also be one of the best value new power station developments under way in the UK.

The 22km high pressure gas pipeline between Lockerley and Marchwood has now been installed, and the next key milestone will be the installation of the first gas turbine generator, which is expected to take place shortly. The plant therefore remains on course to be completed and in commercial operation in time for the winter of 2009/10.

In December 2007, consent was given under Section 36 of the Electricity Act 1989 to Barking Power Ltd for the extension of the existing CCGT power station at Dagenham.

The proposed extension will provide a further 470MW to the existing 1,000MW capacity. SSE has a 30.4% stake in Barking Power Ltd and so the extension would effectively add around 140MW to its portfolio of generation assets. A decision on whether to proceed with the extension is likely to be made during 2009, following a tender for the plant and construction work and final agreement on offtake arrangements and financing.

SSE had identified the potential to substitute existing plant at its Peterhead power station with new state-of-the-art equipment, increasing the modern CCGT capacity at Peterhead to the station's effective grid limit of 1,520MW. The front-end engineering design (FEED) study is now completed and SSE has decided not to proceed with this particular project at this time, partly because of the onerous nature of the transmission charges that would apply to it.

Nevertheless, SSE is actively seeking to identify an option for an additional CCGT plant, either at one of its existing power station sites or an alternative 'brown field' site. Future investment decisions of this kind will have to reflect the likely impact of the EU's legally-binding target of 20% for the proportion of all energy to be derived from renewable sources by 2020. As the amount of electricity generated from renewable sources increases, gas-fired and coal-fired power stations are likely to run at lower load factors than has historically been the case and will have to be increasingly flexible. At the same time, the value inherent in the flexibility of SSE's power stations should increase. These factors will have to be considered when investment decisions are made.

Coal and Biomass Generation – Operations

The Ferrybridge and Fiddler's Ferry power stations, each with a capacity of almost 2,000MW, achieved 91% of their maximum availability to generate electricity, excluding planned outages, during 2007/08, compared with 92% in the previous year. This slight reduction reflects an increase in two-shift operation of the plant and integration work with the Flue Gas Desulphurisation (FDG) projects currently running at both stations.

The stations can also 'co-fire' fuels from renewable sources (biomass), thus displacing fossil fuels and reducing the impact of carbon emissions resulting from their operation, using direct injection technology. The resulting electricity output qualifies for Renewable Obligation Certificates (ROCs). During the year, their output qualifying for ROCs was 368GWh, compared with 741GWh in the previous year. This reflects outages relating to the installation of FGD equipment and difficulties relating to the 'bioswirl' facility at Ferrybridge.

There have been issues with respect to these co-firing facilities, including the fact that the

What is Safety?

We believe that all accidents are preventable, so we aim to do everything safely and responsibly, or not at all. This means we believe all of our work can and should be carried out without any harm to employees, contractors, customers or any other people.

Moreover, we recognise that achieving high standards of health and safety helps achieve high standards of business performance and supports our other values, such as service, efficiency and teamwork.

During 2007/08, the number of lost time and reportable accidents within SSE was 0.04 per 100,000 hours worked and the number of serious, or potentially serious, road traffic accidents involving employees driving company vehicles was 0.18 per 100 vehicles. This is too many accidents and our ultimate goal continues to be injury-free working.



availability of the biomass fuel (principally by-products from other processes) has proved to be lower than expected, so SSE recognised an impairment charge of £12.2m in respect of the original expenditure on the co-firing facilities.

At the same time, however, the new facilities mean that SSE is now the UK's leading user of biomass co-firing. In January 2008, the UK government announced decisions to 'band' the Renewables Obligation, so that, from 1 April 2009, electricity output resulting from co-firing will receive 0.5 ROCs per MWh. This compares with the 0.25 ROCs originally proposed. The cap on such co-firing will be retained, so that electricity suppliers can only meet up to 10% of their Renewables Obligation from this technology.

Coal and Biomass Generation – Investment

Although CCGT will be the benchmark technology in the coming years, it is clear that coal-fired electricity generation will remain a key part of the UK's energy mix for many years to come, albeit within appropriate environmental constraints. As the UK Secretary of State for Business put it in March 2008, fossil fuels will continue to play an important role in ensuring the flexibility of the electricity generation system, 'with coal a key source of that flexibility as we increase the proportion of renewable energy in our electricity mix'.

The Large Combustion Plant Directive (LCPD) aims to reduce acidification, ground level ozone and particles to below the Emission Limit Value thresholds for sulphur dioxide, nitrogen oxides and dust from plants including power stations. In line with that, SSE has opted in to the Directive all of the capacity at Fiddler's Ferry and half of the capacity at Ferrybridge and so is installing FGD equipment at the stations in an investment expected to total around £225m. By making them compliant with the LCPD emissions levels, the stations' contribution to the security of the UK's energy supplies is being extended and SSE will continue to have the country's most diverse electricity generation portfolio.

Although progress in recent months has been slower than expected, the installation of FGD at both stations is expected to be completed, as originally envisaged, during this year. To achieve that, SSE is working very closely with the main contractor to improve performance through to the end of the project. In line with that, construction activities are now well-advanced and the first units at both sites are now scheduled to begin hot commissioning in late summer.

The LCPD actually came into effect on 1 January 2008 and, in the meantime, SSE has an agreement with the Environment Agency to enable it to operate Fiddler's Ferry for 1,270 hours to 15 September 2008 and also Ferrybridge for 1,270 hours to 15 September

2008, under a derogation from Article 5 of the LCPD. As a result, the stations operated with a lower than usual load factor in the early months of 2008.

In order to comply with the LCPD after 2015, SSE will have to install advanced nitrogen oxide abatement equipment at Fiddler's Ferry and at the capacity at Ferrybridge fitted with FGD. This will require a substantial investment, but it is unlikely to commence before 2011/12 and the first stage is included in SSE's expected capital expenditure for the next five years.

In view of the ongoing role for coal-fired electricity generation in the UK, SSE believes that there may be a need to replace the capacity (1,000MW) at Ferrybridge which is scheduled to close in 2015. Having discounted 'retrofit' options in the autumn of 2007, it is currently developing options for a new 800MW unit at the site using the Supercritical Boiler technology. The high temperatures and pressures which feature in this technology deliver a significant increase in thermal efficiency, from a typical 35% for existing plant to around 45%, thereby delivering a significant reduction in the carbon dioxide emissions per kilowatt-hour of electricity produced.

Any plant would be made 'capture ready', enabling it to be fitted with carbon capture and storage (CCS) equipment. SSE has a long-standing and active interest in developments in CCS and, following the launch of the UK government's CCS competition in November 2007, submitted in March 2008 an outline project proposal to operate by 2012 a post-combustion plant fitted to 50-100MW of an existing sub-critical coal unit at Ferrybridge power station. This would allow the necessary design and operational knowledge to be developed to enable commercial-sized units (300-400MW of flue gas treatment) to be offered on a commercial basis on an earlier timetable than proposals based on installation to new Supercritical plant which is unlikely to be available before 2015. SSE believes its proposal provides an achievable and important step in the technological development of CCS.

Plant construction lead times for coal-fired (and gas-fired) generation are lengthening as the global demand for power generation equipment continues to heighten, and that global demand could have a significant impact on the price of such equipment. This, allied to the volatile nature of commodity prices for coal and gas, makes investment decisions in these areas increasingly complex. At the same time, it supports the value of existing assets and assets already under development, including those which rely on renewable sources to produce energy.

Coal and Biomass Generation – Sustainability

The overall sustainability of SSE's coal-fired power stations will be further enhanced upon

the completion of the plasterboard factory being developed at Ferrybridge by Lafarge Plasterboard Ltd and the ash separation plant being developed at Fiddler's Ferry by RockTron Limited.

Creating around 70 new jobs, the Lafarge factory at Ferrybridge will use the source of gypsum produced as a result of FGD, process it and despatch it from the site as plasterboard. The factory is expected to be operational later this year.

Over a period of up to 25 years, the RockTron plant at Fiddler's Ferry will remove and process all fresh ash produced by the power station, and much of that currently stored in lagoons at the site, up to a total of around 800,000 tonnes per annum. The ash will be processed into its constituent parts which become marketable products, with the largest volume being used as cement substitutes. Without processing, ash disposal would begin to attract landfill duty and associated environmental liabilities. The plant is expected to be operational before the end of 2008.

EU Emissions Trading Scheme

Phase II of the EU Emissions Trading Scheme (EU ETS) started on 1 January 2008. Across its electricity generation portfolio (taking account of contractual shares), SSE received an allocation of 16.3 million tonnes per annum. This can be compared with its Phase I allocation of 19.6 million tonnes per annum. SSE's Phase II allocation as a percentage of its Phase I allocation is around 83%, compared with around 80% across the electricity sector as a whole. In addition, the Environment Agency has confirmed that Marchwood Power Ltd has an allocation of five million tonnes reserved to it from when it is commissioned to the end of Phase II.

SSE does not believe such allocations represent any kind of 'windfall'. Before the introduction of EU ETS on 1 January 2005, power stations could emit carbon dioxide free of charge. After that date, they had to operate within tighter emissions limits. Where those limits have had to be breached – often to ensure the stability of the country's electricity system – electricity generators, including SSE, have had to purchase permits to emit carbon dioxide.

In other words, EU ETS represents an additional – and, over the long-term, growing – cost for electricity generators, and is not a 'windfall'. It is expected to grow on the basis that the UK government and the EU remain convinced that a price for carbon that reflects the environmental costs of electricity production and consumption is the best means of encouraging investment in low- and zero-carbon technologies.

In line with this, in January 2008, the EU set out proposals for the EU ETS after 2012.

2. Generation (continued)

It is suggested that all of the carbon dioxide emissions allowances for electricity producers should be auctioned. The proposals are subject to approval by the EU Council of Ministers and the European Parliament and so they have some way to go before they are adopted policy for implementation.

In 2007/08, emissions of carbon dioxide from SSE's power stations and from the contracted output share of emissions from power stations in which it has a contractual relationship totalled 22.7 million tonnes, compared with 25.8 million tonnes in the previous year. It purchased carbon dioxide emissions allowances totalling 6.7 million tonnes in 2007/08, beyond that provided under the National Allocation Plan.

Under the Clean Development Mechanism (CDM) established under Article 12 of the Kyoto Protocol, companies can meet their carbon emissions reduction targets by purchasing Carbon Emissions Reduction Certificates (CERs) from CDM-approved carbon reduction projects in the developing world.

During 2007/08, SSE entered into agreements with companies in China and Brazil to purchase around three million CERs over a period of up to five years. The CERs relate to wind farms and hydro schemes and therefore mirror SSE's strategy in the UK. While the large majority of SSE's investment in reducing carbon emissions will continue to be in the UK, it will continue to seek opportunities to expand its activities in this area.

Renewable Energy – Overview

Tackling climate change and securing future supplies are the twin goals of energy policy in the UK, Ireland and throughout the European Union (EU). In line with that, the EU's adoption of a legally-binding target of 20% for the proportion of all energy to be derived from renewable sources by 2020, supported by a draft Directive, will clearly lead to a dramatic increase in the amount of renewable energy that will be required by that date. The EU targets currently mean the UK will have to increase its renewable energy proportion of all energy demand from 1.3% to 15%. For Ireland, the increase is from 3.1% to 16%. In practice, this is likely to mean that around 40% of the countries' electricity requirements will have to be met from renewable sources.

As the EU Energy Commissioner stated in January 2008 'In a time of growing oil prices and climate change concerns, renewable energy sources is an opportunity that we cannot miss. They will help us to reduce our carbon dioxide emissions and strengthen our security of supply'. Against this background, SSE will seek to enhance and create value for shareholders from the development of an international business focusing on renewable energy. An international business will provide SSE with the opportunity to gain

experience of operating in a number of countries, as well as providing greater diversity within its renewable energy portfolio.

Following the acquisition of Airtricity, and the ongoing development of its own portfolio of projects, SSE now owns and operates over 2,000MW of capacity for generating electricity from renewable sources, comprising: over 1,350MW of capacity in hydro electric schemes (including pumped storage); around 600MW of wind farms; and the UK's largest dedicated biomass energy facility at Slough (80MW). Of this capacity, 260MW is in the Republic of Ireland, with the remainder being in the United Kingdom.

Looking ahead, the expected completion of onshore and offshore wind farm developments and the Glendoe hydro electric scheme should increase SSE's renewable energy capacity in the UK and Ireland to over 2,500MW by the end of 2010 and to 4,000MW by the end of 2013.

As well as its obvious environmental credentials, renewable energy also significantly reduces SSE's exposure to escalating prices for fossil fuels for the straightforward reason that – in the case of hydro and wind – the fuel used to generate electricity is indigenous and free.

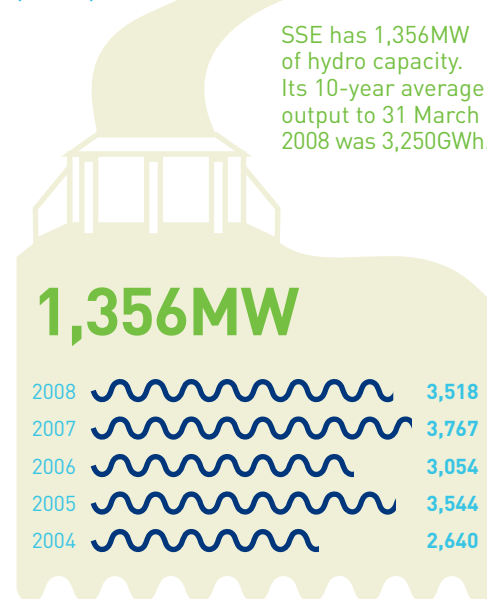
Hydro Generation – Operations

Total output from SSE's hydro electric stations (excluding pumped storage) during 2007/08 was 3,518GWh. This compares with 3,767GWh in the previous year, which was the fourth highest on record, and with the 10-year average of 3,250GWh. As at 31 March 2008, the amount of water held in SSE's reservoirs which could be used to generate electricity was 73% of the maximum, compared with 75% on the same date last year, enough to generate 655GWh of electricity.

The output of refurbished hydro electric stations with capacity of up to 20MW, and of all new stations commissioned after 2002, qualifies for ROCs and SSE has just over 400MW of capacity in this category. Of the total hydro output in 2007/08, just over 1,700GWh qualified for ROCs. Assuming average 'run off' of water into SSE's reservoirs during the year, the ROC-qualifying output from hydro generation is expected to be around 1,600GWh in 2008/09.

In October 2007, and following discussions with SSE and others, the Scottish Environment Protection Agency published the Significant Water Management Issues consultation report, an intermediate step in the preparation of the river basin management plan for Scotland under the Water Framework Directive. The outcome of this consultation will help shape the way the water environment is regulated, and SSE believes that, ultimately, the Directive can be implemented without reducing the output of renewable energy.

Hydro generation output (GWh)



Hydro Generation – Investment

The construction of what will be SSE's second largest conventional hydro electric station at Glendoe, near Loch Ness, is now entering its final phase. The 960 metre-long dam is expected to be completed in the autumn and commissioning of the single 100MW turbine is expected to take place early in the New Year. It therefore remains on course for electricity to be generated by the end of this financial year. At that point, SSE's hydro electric capacity, including pumped storage will reach over 1,450MW.

With an installed capacity of 100MW, Glendoe will produce around 180GWh of electricity qualifying for ROCs in an average year. When synchronised, it will be able to start generating 100MW of electricity in 30 seconds. The final investment at Glendoe is likely to be over £140m, of which £128m has been incurred by the end of March 2008.

In addition to Glendoe, SSE has applied for consent to build new 'run-of-river' hydro electric schemes near Crianlarich (2.5MW) and Wester Ross (3.5MW). SSE continues to believe there is potential to develop a small number of new, larger hydro electric schemes in the Highlands, and given the significance of the recently-adopted EU targets it is exploring again the scope to develop at least one of these potential sites and is currently identifying the site most likely to overcome the various planning obstacles and secure consent.

The vast majority of SSE's hydro electric stations were built in the 1950s and early 1960s and are the subject of a rolling programme of investment to prolong their working life and improve their operational efficiency, with a total value of around £15m per annum.

Wind Generation – Operations

SSE's wind farms at Tangy (now 19MW following its extension), Spurness (currently 8MW), Artfield Fell (20MW) and Hadyard Hill (120MW) produced 350GWh of ROC-qualifying output in 2007/08, compared with 384GWh in 2006/07.

These wind farms are all in Scotland and, following its acquisition of Airtricity, SSE now owns capacity at two other Scottish wind farms which produced electricity during 2007/08: Ardrossan (12MW); and Braes of Doune (36MW). It also now owns and operates two wind farms in Northern Ireland which produced electricity during the year: Bin Mountain (9MW); and Tappaghan (19MW). The total ROC-qualifying output from this capacity in 2007/08 as a whole was 189GWh, of which 39GWh was attributable to SSE following the acquisition of Airtricity.

In addition, SSE's 10 wind farms in the Republic of Ireland produced 645GWh of electricity during 2007/08, of which 110GWh was attributable to SSE following the acquisition of Airtricity.

The output from SSE's wind farms in the UK and the Republic of Ireland is expected to be significantly greater in 2008/09 than in the preceding year based on recently-constructed wind farms such as Dalswinton and Drumderg producing power and new plant currently in construction being commissioned.

Wind Generation – Investment Overview

Airtricity is now SSE's renewable energy development division, and has been combined with SSE's existing wind and hydro development team to provide a significantly enhanced capability in this vital area.

When it entered into the agreement to acquire Airtricity in January 2008, the combined business had 875MW of onshore wind farm capacity in operation, in construction or with consent for development. Since then, consent has been granted for a number of developments and construction work has been completed at some others. As a result, SSE now has almost 1,030MW of onshore wind farm capacity in these categories, an addition of more than 150MW since January 2008. This means the pipeline of opportunities in renewable energy which the acquisition highlighted is being realised. It also means that SSE now has over 3,000MW of renewable energy capacity in operation, under construction or with consent.

SSE said, when it acquired Airtricity, that it expected to have over 3,500MW of operating renewable capacity in the UK and Ireland in 2013. Following a comprehensive review of its renewable energy projects, SSE now expects this to be around 4,000MW. On this basis, it will double in five years its renewable energy capacity in the UK and Ireland. During 2008/09 alone, it will start construction work at a number of wind farms in Scotland and elsewhere.

The achievement of this new target is subject to projects securing all of the necessary approvals in a timely manner, adequate electricity network capacity and to the maintenance of a stable public policy framework which encourages investment in renewable energy. Subject to that, SSE expects its portfolio in 2013 will comprise, in addition to almost 1,500MW of hydro electric schemes: around 2,000MW of onshore wind farms; over 250MW of offshore wind farms; and around 250MW of waste-to-energy and biomass developments.

In addition to the above, SSE is now pursuing onshore and offshore wind farm developments in Europe and onshore developments in China which could add well over 500MW to its renewable energy portfolio by 2013.

Wind Generation – Investment in the UK and Ireland

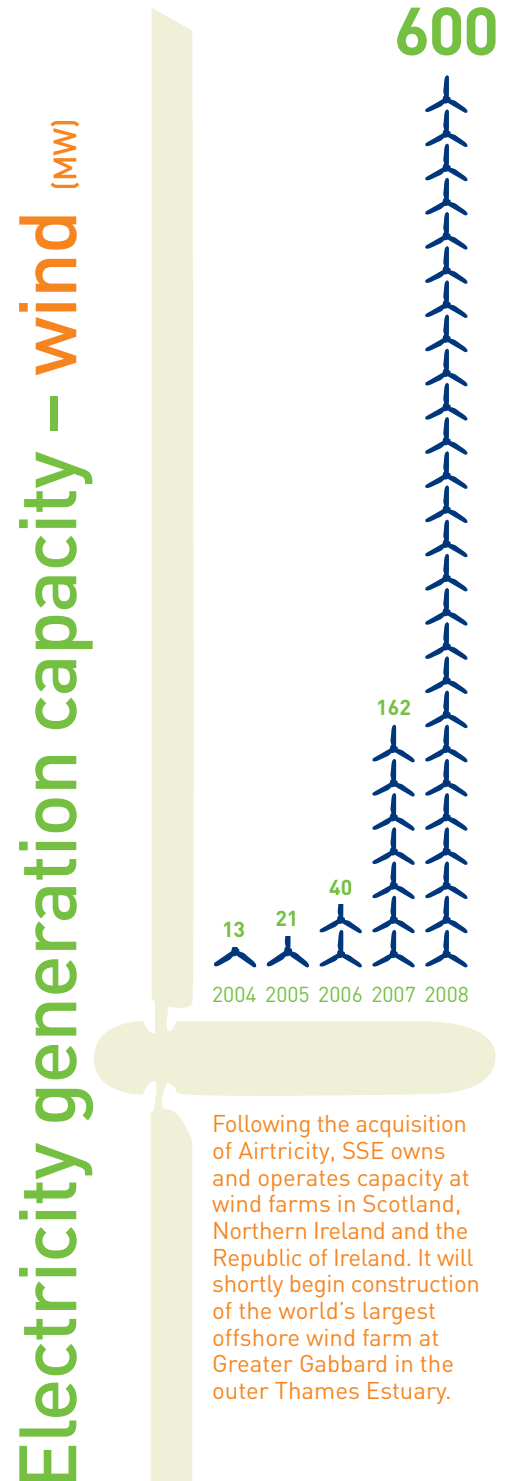
The delivery of an additional 2,000MW of renewable capacity in the UK and Ireland by 2013 is likely to require capital investment of over £2.5bn in onshore wind, offshore wind and hydro electric schemes over the next five financial years, with investment currently expected to peak in 2010/11.

This investment programme includes the 504MW Greater Gabbard offshore wind farm. Construction work will begin shortly and on completion it will be the world's largest offshore wind farm.

The development of the wind farm was carried out by Greater Gabbard Offshore Wind Ltd, a 50:50 joint venture between Airtricity and Fluor. Having secured the construction contract, Fluor agreed to sell its 50% stake in the joint venture to SSE for £40m in cash in May 2008. SSE intends to sell 50% of the project equity later this year.

A turbine reservation agreement with Siemens Wind Power A/S for the supply of 140 3.6MW turbines was secured in 2007 and both parties subsequently agreed the turbine supply contract and the five-year service and warranty contract for the development.

The wind farm will be commissioned in two phases, with the entire construction scheduled to be completed in 2011. It is expected to have a load factor of over 40%, based on site-specific data collected since 2005.



Following the acquisition of Airtricity, SSE owns and operates capacity at wind farms in Scotland, Northern Ireland and the Republic of Ireland. It will shortly begin construction of the world's largest offshore wind farm at Greater Gabbard in the outer Thames Estuary.

The development, excluding the connection, is expected to require investment of around £1.3bn. SSE will fund its 50% share from either its balance sheet or through non-recourse project finance. It also expects to take 50% of the output of Greater Gabbard, with the remainder being the subject of a separate agreement with another power purchaser.

A major construction project of this kind, in potentially challenging conditions, is not without risks but these have been

The right question

13

13 terrawatt-hours (TWh) of energy-saving measures provided to SSE customers as a result of measures introduced under the Energy Efficiency Commitment during 2007/08.

Highlight better plan

The structure of energy consumption is going to change significantly and SSE believes that customers' greater awareness of the need for energy efficiency represents an opportunity. SSE has launched the **better plan** – a unique energy programme which enables and encourages customers to commit to using less energy – and financially rewards them for doing so with: vouchers enabling them to get money off their energy bills; A-rated electrical and gas appliances; and energy efficiency measures including a monitor that measures customers' real-time energy consumption.

The UK government's White Paper published in May 2007 stated that 'Improving the energy efficiency of homes can reduce energy bills and help ensure that the most vulnerable can afford to heat their homes'. Against this background, where everyone has a part to play in reducing CO₂ emissions, the right question is – how does SSE help customers save energy and reduce their energy bills?

HOW DO WE HELP CUSTOMERS SAVE ENERGY?

SSE supplies electricity and gas to 8.45 million customers in the UK and Ireland. Growth during 2007/08 enabled it to overtake E.ON UK to become the UK's second largest supplier.

One of the key elements of SSE's Environment Policy is to 'focus on encouraging its customers to consider and implement ways of reducing their consumption of energy'. This is consistent with the government's White Paper which said 'the starting point for our energy policy is to save energy'. SSE does this through a number of initiatives including: introducing of the UK's first energy tariff designed to financially reward reduced energy consumption; and participating in trials of smart meters and real-time displays which enable customers to track their energy use.

Under the Energy Efficiency Commitment (EEC), SSE helps its customers to reduce the energy they use by: providing subsidised A-rated domestic appliances; supplying low energy lamps (Compact Fluorescent Lamps); and promoting A-rated gas condensing boilers and home insulation measures. At least 50% of these energy-saving measures are focused on a priority group of low-income customers in receipt of certain benefits, so it is expected that EEC will also contribute to the eradication of fuel poverty.

SSE is recruiting qualified Domestic Energy Assessors so it can participate in the UK government's Energy Performance Certificates scheme for house sales and commercial and rented properties. Under the scheme, certificates are commissioned by the seller or their agent from an accredited energy assessor, who visits the property to collect the relevant data and who creates the certificate which shows potential buyers or tenants the energy efficiency of the premises.

One of the challenges faced by SSE, indeed by us all, is persuading people that we can all make a difference to climate change and energy security through our collective efforts to reduce energy consumption.

2. Generation (continued)

managed through the procurement and project management strategies which have been adopted.

The overall investment profile for the next five years is subject to a number of factors, including constraints on the supply of wind turbines and the impact of those constraints on their procurement. Nevertheless, the turbine supply position is expected to improve over the next few years, and SSE's enhanced significance as a wind farm developer following the acquisition of Airtricity should enable it to secure good value from suppliers. It is also exploring new sources for wind turbines, including China. In line with that, it is working with a Chinese manufacturer on the introduction of its turbines into the European market next year.

The target for 2013 does not include the proposal by SSE and Viking Energy Ltd, the company established to represent Shetland Islands Council's interests in wind farm development, to develop on Shetland's Central Mainland a wind farm with around 600MW of capacity. An application for consent to build the wind farm is now expected to be submitted to Scottish Ministers later this year. It also does not include the proposal by SSE for a 94MW wind farm on the Isle of Lewis, which, if consented, is not expected to be operational before the end of 2013.

Biomass

In December 2007, SSE completed the acquisition of Slough Heat and Power from SEGRO plc for a total cash consideration of £49.5m. Slough Heat and Power is an integrated energy business, which includes a combined heat and power (CHP) plant with current generating capacity of 80MW. The CHP plant is the UK's largest dedicated biomass energy facility and its main fuel

sources are wood chips, biomass and waste paper. The site has its own fuel processing plant, which takes delivery of waste paper products and converts them into useable fuel.

Part of the plant is contracted under the Non Fossil Fuel Obligation. It produced 144GWh of output qualifying for ROCs during 2007/08, of which 19GWh was attributable to SSE. The acquisition gives SSE a platform from which to build up its interest in biomass and waste-to-energy, which it believes will become increasingly important over the next decade.

Investment in New Markets

In addition to its wind and hydro investments in the UK and Ireland, SSE is also expecting to invest around £500m in renewable energy in new markets: onshore and offshore wind farms in Europe (principally Portugal, Sweden, Italy and Germany where there are particular opportunities for growth in renewables); onshore wind farms in China; waste-to-energy (principally in the UK); and emerging technologies. This investment will largely be on an equity basis, with non-recourse debt expected to account for around 75% of the total cost of the investment.

For example, in April 2008, SSE – through Airtricity – entered into a 50:50 joint venture with Gothia Vind which is expected to lead to the development of new wind farms in western Sweden. Based near Gothenburg, Gothia Vind is a specialist wind energy developer. The joint venture is aiming to develop around 200MW of wind farm capacity in western Sweden, with the first wind farm scheduled to be in operation around 2011. The development of this capacity is expected to require equity investment by Airtricity and Gothia Vind of around €30m each over the next few years, with non-recourse debt in this instance expected to account for around 80% of the total cost of the investment.

While the acquisition of Airtricity has extended the scope of SSE's renewable energy interests to continental Europe and to China, thereby giving it development and operational activity in new geographical locations, that activity will remain very focused and disciplined. SSE will be specific about the new markets which it is tackling and longer-term developments will depend upon clearly demonstrated success in attaining shorter-term goals, such as those set for 2013.

Investment in Emerging Technologies

As well as investing in technologies which already have the scale to make a substantial contribution to meeting energy needs in the near future, SSE has a range of investments in emerging technologies. The development of secure, reliable and cost-effective low carbon energy technologies towards commercial deployment is a key priority for the UK government and is part of SSE's strategy to remain the UK's leading generator of electricity from renewable sources. Participation in emerging technology developments helps SSE to be at the forefront of, and to adapt to, the changes in energy production and consumption that are likely to occur over the next decade.

Of the emerging technologies, solar is likely to be critical and SSE has a 12.3% stake in Solarcentury, the UK's leading independent solar photovoltaics company. SSE is Solarcentury's preferred installer and the two companies have been appointed by the UK Department of Business to supply and install solar panels on Britain's public buildings as part of its £50m Low Carbon Buildings Programme.

SSE also has a 50% stake in Aquamarine, the marine energy company which is developing wave power and tidal power devices for comprehensive testing at the European Marine Energy Centre in Orkney.

In March 2008, SSE and Intelligent Energy announced the formation of a joint venture company which will develop clean and reliable fuel cell-based CHP systems for the light industrial, commercial and residential markets in the UK and Ireland. In addition, in April 2008, SSE acquired a 21% stake in Logan Energy Limited, in return for £375,000 and goodwill brought to the new business, which will focus on fuel cell installation and maintenance.

This was followed in April 2008 by an agreement to invest up to £15m in cash for a 20% stake in Geothermal International, the UK's leading supplier of ground-source heating and cooling systems, from existing shareholders. From being established in 2000, it has installed over 1,300 ground-source heat pump systems, amounting to over 90MW of installed capacity.

What is Service?

We give our customers service we are proud of and make commitments that we deliver.

Our belief is that customers will continue to acquire products and services from companies that they trust. In other words, it is not simply the product itself which matters, but also all of the services relating to it.

That is why we are introducing a new Customer Charter, featuring a series of commitments on quality service, fair pricing and the environment. The Charter sets out in straightforward language what our customers can expect of us and what we aim to deliver every day.



3. Energy Supply

Since the start of 2007/08, through equity and loans, SSE has committed to investing over £60m in a variety of emerging technologies designed to deliver secure, reliable and cost-effective low carbon energy systems, of which £13.8m was invested by the end of March 2008.

Review of Carbon Intensity Target

In the light of its enhanced renewable energy capability, SSE has reviewed its target of reducing the amount of carbon dioxide per kilowatt-hour of electricity, produced at power stations in which it has an ownership or contractual interest, by 20% over the ten years to 2016. The base year for SSE's carbon intensity target is 2005/06, because it was the first full year after it acquired coal-fired power stations at Fiddler's Ferry and Ferrybridge.

SSE is now targeting a reduction in carbon intensity of 50%, to around 300g/kWh, over the period from 2005/06 to 2020. As with the previous target, SSE will report on its progress against the 50% target each year, and in 2007/08 carbon intensity on this basis was just under 500g/kWh. The decisions SSE takes and the investments it makes will be guided by its new target. Like most long-term targets, achievement will be influenced to some extent by circumstances outside its control.

Nuclear Power

SSE's first responsibility to its customers is to maintain supplies of energy, in a way that is compatible with wider climate change and energy security issues. Of the total electricity supplied by SSE during 2007/08, around 15% was derived from nuclear power stations, which are owned and operated by other generators.

In its submission to the UK government consultation on the future of nuclear power in 2007, SSE said there is value in the UK making available the nuclear option, along with a diverse range of other generation options, provided there is a stable framework in place for investors and an appropriate degree of public confidence in all aspects of nuclear power is maintained. In other words, it believes that one more tranche of nuclear power stations will be necessary, but that the deployment of such power stations should be minimised through the maximum exploitation of renewable sources of energy.

Against this background, SSE may work with other parties to help secure the development of new nuclear power stations, through appropriate contractual support or investment. In practice, however, any investment is unlikely to be made before the next decade – and any new nuclear power stations are unlikely to be commissioned before the start of the decade after that.

Generation Priorities for 2008/09 and Beyond

During 2008/09, and beyond, SSE's key objectives in Generation will be to ensure that its diverse portfolio of power stations

is available to generate electricity, with the maximum possible efficiency, in response to customer demand and market conditions, while complying fully with all safety standards and environmental regulations.

The achievement of these objectives is now supported by an SSE-wide Engineering Centre, which has been established to provide an effective long-term asset management, engineering strategy and investment planning capability across SSE's growing range of electricity generation and gas storage assets.

SSE will also be working to ensure that all generation plant is well-maintained, with timely investment in asset replacement and refurbishment projects and that the new generation projects proceed on time and on budget. As is the case throughout the generation sector, these projects and plans may be subject to the impact of increasing capital costs and skills shortages as worldwide demand for electricity infrastructure continues to rise.

During 2008/09, major questions will continue to be asked about the sustainability of electricity production in the UK, Ireland, the EU and elsewhere. SSE is a major investor in minimising the environmental impact of gas- and coal-fired generation and in renewable energy (especially following the acquisition of Airtricity) and emerging technologies and making progress with these investments will be a central priority for SSE in 2008/09 and beyond.

Over the five years to 2013, it expects to invest over £4bn across its entire generation portfolio, including investment in existing assets. This investment will be designed to abate the environmental impact of existing assets and extend their lives and to deliver new assets, principally in renewable energy but also – as in the case of Marchwood – thermal generation.

As a result, SSE will have a growing, but balanced, portfolio of electricity generation assets, with a diminishing environmental impact and with relatively less exposure to fossil fuel price volatility.

ENERGY SUPPLY

- Net gain of 700,000 energy supply customers, to 8.45 million following responsible pricing policy
- Grown to become UK's second largest supplier of electricity and gas
- Only supplier to defer electricity and gas price rises to end of winter period
- Further reduction, of 27%, in complaints to energywatch
- Ranked first in uSwitch.com Customer Satisfaction Report
- Top-ranked supplier of electricity and gas in JD Power Customer Satisfaction Study
- 'better plan' energy efficiency reward

- programme for customers launched
- Sector-leading Customer Charter and new Vulnerable Customers Code of Practice
- Establishment of presence in the Irish all-island market, with 38,000 mainly commercial customers
- Launch of new Energy Performance Certificates business

Energy Supply Objectives

Energy supply in the UK is changing dramatically, with companies having to operate in volatile markets, which reflect depletion of North Sea oil and gas fields, soaring global demand and competition for all types of energy and, during 2007/08, the passing of the \$100 per barrel oil price milestone. All of this culminated in persistently high wholesale prices for electricity and gas during 2007/08. These pressures are compounded by the rising transmission, distribution and environmental costs which suppliers have to meet.

The UK's energy market remains the most competitive in the EU and G7, according to a report by the Oxford Economic Research Associates (OXERA) published in January 2008 which monitored the competitiveness of the energy market by assessing a range of factors. In welcoming the report, the UK Secretary of State for Business said 'Creating an open and competitive energy market has meant that UK consumers have consistently benefited from amongst the lowest energy prices in Europe'.

Figures from Ofgem show that the switching rate for gas and electricity suppliers reached more than five million in 2007. This was the highest level of switching for five years. As the Ofgem Chief Executive stated 'Suppliers who don't offer competitive prices and good service will lose customers'.

In an industry where switching is commonplace and the cost of regaining customers is significant, SSE's objective is to grow its Energy Supply business by offering consistently competitive prices and providing sector-leading service so that it is able to retain and gain customers. It also aims to broaden its relationship with those customers through the provision of added value products and services relevant to them and their needs.

Pricing Policy for Domestic Electricity and Gas Customers

Over the past few years, SSE has adopted a responsible pricing policy. The policy means that SSE seeks to be the last, or one of the last, of the major suppliers to increase prices if it has to and the first, or one of the first, to reduce prices if it can. The consistent application of this policy means that SSE's customers have paid an average total of around £430 less for their electricity and gas during the last four years than have customers of the UK's largest supplier,

3. Energy Supply (continued)

British Gas. SSE was the only major supplier not to introduce a price increase during 2007/08, although price rises were implemented on 1 April 2008. It intends to maintain its responsible pricing policy going forward.

Customer Numbers

The implementation of its responsible pricing policy helped SSE achieve a net gain of 700,000 energy customers during 2007/08, taking the total to 8.45 million as at 31 March 2008, comprising 5.28 million electricity customers and 3.17 million gas customers. Within the total, SSE's business customers now cover over 400,000 sites throughout Great Britain and 1.8 million customers have 'loyalty' products such as **energypus Argos**, which rewards customers with money-off discount vouchers.

The growth secured during the year enabled SSE to overtake E.ON UK to become the UK's second largest supplier according to the Datamonitor Market Share Monitor. SSE has gained almost four million energy supply customers since the start of 2002, when it was the UK's fifth largest supplier.

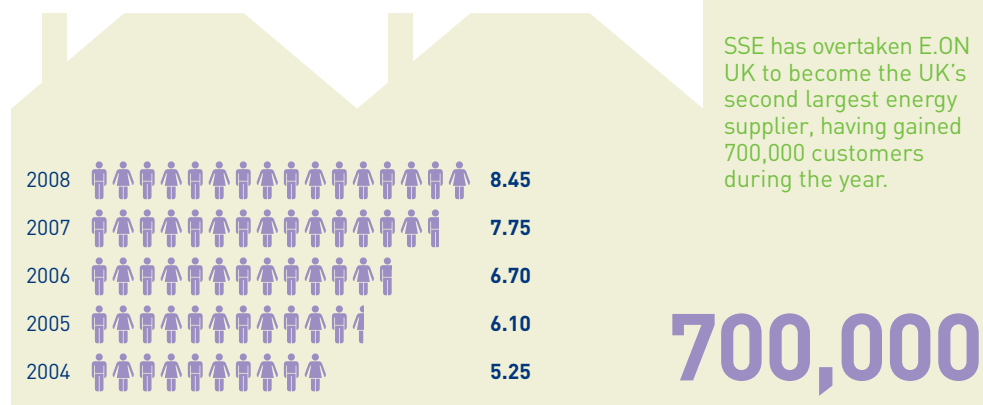
In addition to electricity and gas customers, SSE now has 165,000 **talk with** telecoms customers and 70,000 **shield** gas boiler maintenance customers. This means its total customer base in Great Britain was almost 8.7 million as at 31 March 2008. It also has 38,000 mainly commercial electricity customers in the Irish all-island market.

In July 2007, Ofgem published its Domestic Retail Market Report, which confirmed that SSE is the UK's most successful supplier in terms of the share of the electricity supply market held by 'incumbent' suppliers in the 14 regions of Great Britain. It stated that SSE had 80% of the electricity customers in the Scottish Hydro Electric area, 70% of the customers in the SWALEC area and 62% of the customers in the Southern Electric area. The next highest share held by an incumbent supplier was 61%. This has again confirmed the value of SSE's three regional energy supply brands.

Customer Service Performance

Central to success in a highly-competitive market such as Energy Supply is maintaining the highest possible standards of customer service. Despite the significant growth in customer numbers, SSE secured during 2007/08 another reduction, of 27% to 615, in the number of customer complaints sent to energypus for resolution. This compares with 3,400 five years ago in 2002/03. SSE continues to have the lowest number of complaints sent to energypus for resolution and, in September 2007, it was announced that it had come top in an energypus survey of small business customers' satisfaction with their energy suppliers.

Customer numbers
(million)



In October 2007, uSwitch.com reported that SSE was ranked top for customer satisfaction for the fourth time in a row in its latest independent Customer Satisfaction Report and it described SSE as 'simply the best'.

In the result of the JD Power 2007 UK Electricity and Gas Customer Satisfaction Study announced in November 2007, SSE was ranked the top-performing supplier in both electricity and gas. This was the first time one supplier had achieved the top ranking in both sectors. In electricity, it was the only supplier to achieve overall customer satisfaction which was 'significantly better' than average; and in gas it was one of just two suppliers to deliver 'significantly better' than average customer satisfaction.

Customer Service Developments

SSE's objective is to build on its position as the UK's leading energy supplier for customer service, and thereby be in a strong position to retain and gain customers. In line with that, it is introducing a new Domestic Energy Customer Charter, building on the original Charter which it launched in 2006.

The new Charter maintains the 'commitment-based' approach to general customer enquiries which was central to the approach contained in the first Charter, with the emphasis on ensuring that as many customers as possible have their issues resolved at the first point of contact. It also sets out improved standards for responding to customers' enquiries and also confirms SSE's responsible pricing policy.

Customer service performance is now supported by the combination, from September 2007, of telephony and billing systems so that they now recognise a customer's phone number and bring up their details on the screen in front of the customer service adviser. This saves an average of 30 seconds per call and adds the equivalent of around 100 extra people to take calls.

It is in line with research which has confirmed that the key frustrations for customers are the length of time they spend on hold when seeking help over the telephone and being passed to more than one company representative. In other words, while technology has its part to play in supporting service delivery, customers like to interact directly with company representatives. SSE has, therefore, broadened the role of its advisers and actively extended call times to ensure there is a full understanding of customers' requirements.

Vulnerable Customers

The single biggest contribution which energy suppliers can make to helping vulnerable customers is to keep prices as low as possible for as long as possible, and this principle is one of the reasons for SSE's responsible pricing policy.

SSE also believes that any 'social' tariff offered by suppliers is only meaningful if it is clearly the lowest-cost tariff that they make available to any type of customer on any type of payment plan or sign-up method. Its **energypus care** tariff and package of services means eligible customers receive at least a 20% discount from their energy tariff in addition to other help including benefit entitlement checks, free energy efficient appliances and home insulation, where appropriate. SSE is aiming to make the tariff available on 100,000 customer accounts by the end of March 2009.

In April 2008, SSE and the other major energy suppliers entered into a three-year agreement with the UK government to offer increased assistance to the fuel poor and groups vulnerable to fuel poverty. Under the agreement, SSE will operate existing and new schemes with a total value of around £16m in the first phase, up to 31 March 2009. The UK government has stated that given the substantial commitment that an agreement of this kind represents, it will

not expect or ask companies to do more on social assistance over the period 2008-11.

These schemes will be designed to assist the fuel poor and those vulnerable to fuel poverty. They will feature a variety of approaches such as 'social' tariffs, including **energyplus care**, charitable donations, bespoke services for vulnerable customers, work with advocate organisations and community-based programmes. In support of this agreement, SSE has published a Code of Practice for Vulnerable Customers, following consultation with consumer and voluntary organisations.

Renewable Energy

In common with all other electricity suppliers, SSE provides information to its customers on the fuel mix of their electricity supply. The intention is that the provision of this information should enable customers to make informed choices about the environmental impact of the electricity they buy. Based on the latest information available at 31 March 2008, SSE's customers were supplied by a higher proportion of renewable energy (10.2%) than customers of any other major supplier. The average proportion of renewable energy supplied by the other major suppliers was 4.5%.

Product Marketing

Energy supply remains intensely competitive and, in addition to responsible pricing and best-in-sector customer service, product development and marketing – sometimes working with other organisations – has an important part to play in gaining and retaining customers' loyalty.

SSE has a suite of energyplus 'loyalty' products, ranging from **energyplus Argos**, which rewards customers with money-off discount vouchers, to **energyplus Pulse**, which supports the British Heart Foundation. Of SSE's 8.45 million energy supply customers, around 1.8 million now have 'loyalty' products – an increase of around one-third during the year.

The Energy White Paper said 'the starting point for our energy policy is to save energy'. It said the government would 'empower consumers to make more informed energy choices' and it also referred to trials of smart meters and real-time displays which enable people to track their energy use, and in which SSE has been selected to participate.

In short, the structure of energy consumption is going to change significantly and SSE believes that customers' greater awareness of the need for energy efficiency represents an opportunity. Against this background, it has launched the **better plan** – a unique energy programme which enables and encourages customers to commit to using less energy, supported by the provision of a real-time unit displaying electricity consumption. The **better plan** rewards them for doing so with vouchers

enabling them to get money off their energy bills, A-rated electrical and gas appliances and energy efficiency measures. Around 40,000 customers have already joined the **better plan**.

Energy Performance Certificates

The UK government is progressively introducing Energy Performance Certificates (EPCs) for house sales and commercial and rented properties. The certificates are commissioned by the seller or their agent from an accredited energy assessor, who visits the property to collect the relevant data and who creates the certificate. Ultimately, there could be a requirement for up to 7.5 million surveys each year.

SSE is recruiting qualified Domestic Energy Assessors to develop a new nationwide business to provide customers with EPCs and other related services which will complement its activities in energy supply, energy efficiency and energy services. The launch of the new business is another part of SSE's strategy to work with customers to actively manage their energy consumption.

Ireland

The all-island electricity market comprises 2.6 million customers. There are also around 750,000 gas customers. Following the acquisitions of Airtricity and also CHP Supply Ltd, SSE had just over 38,000 mainly commercial electricity customers at 31 March 2008. SSE will build on this customer base to expand its presence in the commercial sector, begin supplying electricity to domestic customers and, in due course, begin supplying gas. With its experience of competing successfully in the energy supply market in Great Britain, SSE believes it is well-placed to make an impact on the all-island market also.

Energy Supply Priorities in 2008/09 and Beyond

During 2008/09, and beyond, SSE will seek to capitalise further on its strong regional

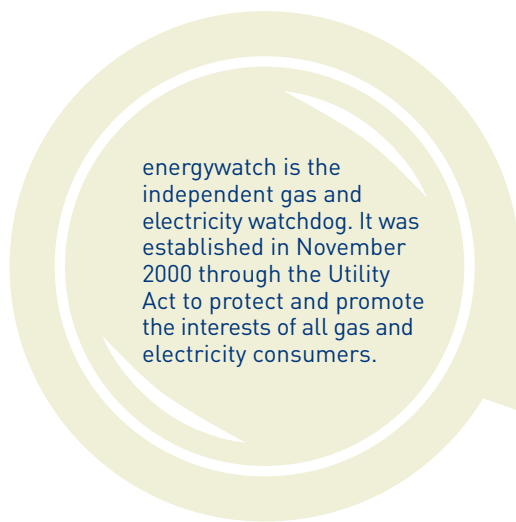
brands, best-in-sector customer service, responsible pricing policy and range of value-adding offers to increase further its number of energy supply customers in Great Britain.

Central to this will be the development and deployment of further improvements to the level of service offered to customers, leading to higher standards and fewer complaints. This will include improvements in SSE's ability to communicate electronically with customers. The successful launch of new products, sometimes in partnership with other organisations, will be a key priority. There will also be a focus on providing enhanced support for vulnerable customers.

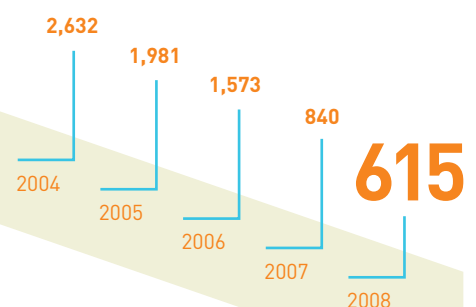
SSE's priority in the Irish all-island market will be to consolidate and integrate its recently-acquired supply businesses, thereby providing the basis from which to grow customer numbers significantly in the future.

During 2008/09, significant questions will continue to be asked about the affordability of electricity and gas, in the context of intense global competition for energy. SSE's response will be to maintain its policy of responsible pricing, promote energy efficiency, reinforce the standard of its customer service and enhance its support for its most vulnerable customers.

Longer-term, continuing trends in technology, and customers' use of it, are likely to lead to a material change in the number of energy supply customers who wish to deal with their supplier online. This, in turn, means that suppliers will be required to have the optimum range of products and tariff structures and, perhaps, affinity arrangements. Over the next few years, SSE expects to make significant investment and progress in each of these areas which, allied to its long-standing focus on responsible pricing and customer service, is designed to deliver continuing long-term growth in its energy supply business. 🌱



Complaints to energywatch



The right question

Once produced and gathered, electricity and gas are delivered via overhead lines, underground cables and pipelines to people who rely on this energy in homes, offices, businesses, schools and hospitals. Any interruption to the energy supply, no matter how brief, is considered by many as unacceptable. The right question is – how does SSE make sure its networks are reliable so that the number and duration of power cuts experienced by customers is kept to a minimum?

HOW DO WE ENSURE OUR NETWORKS ARE RELIABLE?

SSE distributes electricity to over 3.5 million customers in central southern England, and in the north of Scotland through one transmission and two distribution networks. The key responsibility of SSE's electricity networks businesses is to maintain safe and reliable supplies of electricity. This means networks which do not succumb to random failures, are able to withstand unusual conditions such as storms and are resilient in the face of rapid variations in demand for power. In addition, SSE must be able to restore supplies as quickly as possible in the event of interruptions.

Ofgem's Distribution Price Control Review for 2005-10 resulted in substantially increased allowances for capital expenditure to maintain and improve the networks' performance. The challenge for SSE is to target this investment so as to benefit the greatest number of customers through initiatives including: automating switching devices to help restore power more quickly when there are interruptions; and replacing open wire overhead conductors with 'BLX' and 'ABC' covered wires that are more resilient to adverse weather conditions. During the year, SSE's capital expenditure on electricity networks was £264.4m, compared with £204.5m in the previous year.

The other priority for SSE is to ensure that it delivers high levels of service to customers whose supplies of electricity are interrupted. The quality of service received by customers from electricity distribution companies is monitored by Ofgem. It focuses on two main types of quality of service measure: guaranteed standards of performance and output measures for specific service areas such as the number and duration of power supply interruptions. In 2007/08, the average SSE distribution customer in the south of England was without power for a total of 67 minutes; in the north of Scotland, it was 72 minutes.

Looking ahead, Ofgem is undertaking a two-year review of the regulatory regime governing electricity networks to examine whether the current approach will deliver customers reliable and well-run networks, with good service at reasonable prices. Reliability, therefore, will remain the key issue in electricity networks for years to come.

Highlight

Island supplies

SSE is responsible for distributing electricity to the Scottish Highlands and Islands. With the exception of Shetland, the Islands rely on subsea cable connections to the mainland electricity network. In all, SSE operates over 450km of subsea cables. This year has seen the replacement of three of these cables reinforcing the electricity supply to islands. In all, over 15km of subsea cable were replaced at a cost of £4.5m. In addition, a new 10km subsea cable has been laid to reinforce the supply to the island of Mull at a cost of £2m.

2.7

£2.7bn is SSE's estimate of Ofgem's valuation of the assets in its electricity distribution and transmission businesses.

127,000km of overhead and underground cables make SSE the UK's second largest electricity network company.

127

OVERVIEW

- **Energy Networks operating profit* of £544.4m, compared with £471.1m in the previous year**

Networks Introduction

SSE owns Southern Electric Power Distribution, Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission. Under the current arrangements, these companies are the subject of incentive-based regulation by the Office of Gas and Electricity Markets (Ofgem), which sets for periods of five years the index-linked prices they can charge for the use of their electricity networks, their capital expenditure and their allowed operating expenditure, within a framework known as the Price Control. Ofgem also places specific incentives on companies to improve their efficiency and quality of service.

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. In electricity, the current Distribution Price Control runs until 31 March 2010 and the current Transmission Price Control runs until 31 March 2012.

As at 31 March 2008, SSE estimates that Ofgem's valuation of the assets of its electricity distribution and transmission businesses, the Regulated Asset Value (RAV), was £2.7bn, based on Ofgem's methodology, including just over £300m for transmission. On this basis, SSE is the UK's third largest electricity distribution company.

SSE also has an equity interest of 50% in, and provides corporate and management services to, Scotia Gas Networks (SGN), which owns Southern Gas Networks and Scotland Gas Networks. These companies own and operate the medium and low pressure gas distribution networks in their areas of the UK. They are the subject of incentive-based regulation similar to that which applies in electricity. A new Price Control for the five years to 31 March 2013 came into effect on 1 April 2008.

SGN estimates that the RAV of the networks it owns was around £3.5bn, based on Ofgem's methodology, as at 31 March 2008. This makes it the UK's second largest gas distribution company. SSE's share of this RAV is £1.75bn which, when added to its electricity network businesses, gives SSE a total RAV of £4.45bn.

In March 2008, Ofgem announced plans to review the 20-year old regime governing the regulation of electricity and gas networks. The review will examine whether the 'current approach will continue to deliver customers

reliable, well-run networks with good service at reasonable prices amid growing investment challenges faced by the energy networks in the future'. Ofgem has stated that the range of possible recommendations emerging from the review runs from no change to substantial change, and that where change is recommended, there will be full consultation. Because the review will not report until 2010, and because any proposed changes will be subject to consultation, work on the Distribution Price Control Review for 2010-15 is expected to be unaffected.

After electricity and gas, Telecoms is SSE's third networks business; unlike the other two, it is not the subject of economic regulation. It operates a national telecoms network for commercial and public sector customers which extends to around 8,000km throughout Great Britain.

Energy Systems Performance Overview

Operating profit* in Energy Systems, including gas distribution, increased from £471.1m to £544.4m, contributing 39.4% of SSE's total operating profit.

The amount of electricity transmitted and distributed through SSE's networks and the amount of gas distributed through SGN's networks is determined by the weather, by customers' demand for energy and by the availability of the networks themselves. Variations in the volume of energy distributed have an impact on the income earned by SSE's energy systems businesses.

During 2007/08, Southern Electric Power Distribution, Scottish Hydro Electric Power Distribution, Scottish Hydro Electric Transmission and SGN all distributed more units of energy than in the previous year, which was marked by unusually high temperatures.

If, in any year, regulated energy networks companies' revenue is greater (over recovery) or lower (under recovery) than is allowed under the relevant Price Control, the difference is carried forward and the subsequent prices the companies may charge are adjusted.

Power Systems Objectives

SSE's objective in power systems is to ensure that they are managed as efficiently as possible, including maintaining tight controls over operational expenditure and delivering effective capital expenditure, so that the number and duration of power cuts experienced by customers is kept to a minimum.

Through good performance in areas such as customer service and innovation, SSE seeks to earn additional incentive-based revenue under the various Ofgem-sponsored schemes. Over time, its objective is to grow the RAV of the networks businesses and

secure increased revenue from them. Constructive engagement with the regulator, Ofgem, during the various Price Control Reviews, is central to this objective.

ELECTRICITY NETWORKS

- **Power Systems operating profit* of £382.9m, up from £368.0m in the previous year**
- **Investment in electricity networks up 29% to £264.4m**
- **Additional revenue of £16m earned under Ofgem's Quality of Service and other incentive schemes**
- **Beaulieu-Denny Public Inquiry completed in February 2008**

Southern Electric Power Distribution

Southern Electric Power Distribution's operating profit* increased by 3.9%, from £224.0m to £232.7m. During the year, it distributed 34.2 terrawatt-hours (TWh) of electricity, compared with 33.9TWh in the previous year. The positive impact on profitability of this increase in the number of units distributed was supplemented by changes in their price.

Ensuring the reliability of the electricity networks it owns and operates is one of SSE's main priorities and the key measures of reliability are customer minutes lost and customer interruptions. The average number of minutes that customers in the Southern Electric Power Distribution area were without supply during the year was 67, compared with 72 in the previous year; and the number of supply interruptions per 100 customers was 66, compared with 75 in the previous year.

Performance in respect of both minutes lost and interruptions was ahead of the targets set by Ofgem under its Quality of Service Incentive Scheme (QSIS), which gives financial benefits to distribution network operators that deliver good performance for customers. This, together with income earned during 2007/08 under other incentive arrangements, is expected to lead to SSE receiving additional revenue totalling £10.5m during the next two financial years.

Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission

Operating profit* for Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission increased by 4.3%, from £144.0m to £150.2m. In the Scottish Hydro Electric area, 8.8TWh of electricity were distributed during the year, compared with 8.5TWh distributed in the previous year. As in the Southern Electric area, the positive impact on profitability of this increase in the number of units distributed was supplemented by changes in their price.

The average number of minutes that customers were without supply during the

year was 72, compared with 77 in the previous year. The number of supply interruptions per 100 customers was 69, compared with 79 in the previous year. Performance in respect of both minutes lost and interruptions was ahead of Ofgem's QGIS targets. This, together with income earned in 2007/08 under other incentive arrangements is expected to lead to SSE receiving additional revenue of £5.5m during the next two financial years.

Electricity Network Investment and RAV Growth

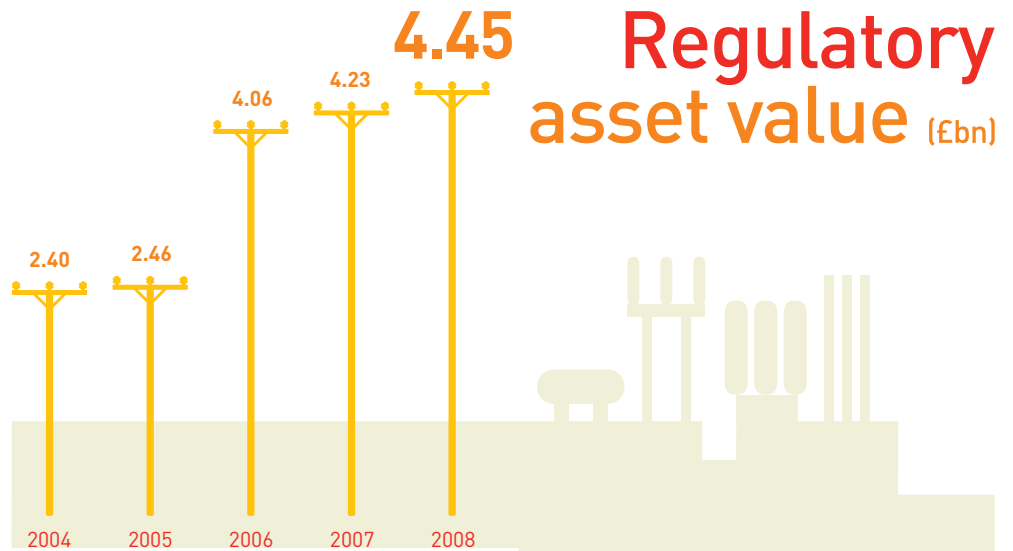
The key responsibility of SSE's electricity networks businesses is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions. The Distribution Price Control Review for 2005-10 resulted in substantially increased allowances for capital expenditure to maintain and improve the networks' performance. This will enable SSE to increase its revenue from its networks, and the efficient delivery of this enhanced investment programme was one of SSE's priorities for 2007/08.

During the year, SSE's capital expenditure on electricity networks was £264.4m, compared with £204.5m in the previous year.

The most significant electricity distribution project being undertaken by SSE is the construction of two new underground cable 132kV circuits from Bramley to Basingstoke in Hampshire, designed to ensure the electricity network can meet maximum demand for 650,000 customers served by the Bramley and Fleet grid supply points. The 10km route includes 4km of urban roads, directional drills under rural water courses and large open cut crossings through the main railway line cutting in Basingstoke. It also requires development work at two substations. The total cost of the project is over £16m and it is on course for completion before the end of this year.

The most significant electricity transmission project on which work is actually getting under way is the Inverarnan substation, which will provide 200MW additional export capacity for electricity generated from renewable sources in Argyll. This is a joint project with Scottish Power Transmission. SSE's investment is around £12m.

Since the start of the current Distribution Price Control in April 2005, SSE has invested £556m in its distribution networks (which excludes metering) and a further £88m in its transmission network. It estimates that the RAV of its distribution and transmission businesses is now £2.7bn. The expected total growth in the RAV over the whole of the 2005-10 Distribution Price Control period, based on Ofgem's methodology, is forecast to be almost £500m, taking it to around £3bn in 2010. This excludes any major transmission



investment. In line with this, SSE expects to invest almost £300m in its electricity networks in 2008/09.

Future Transmission Developments

As the licensed transmission company for the north of Scotland, SSE is required to ensure there is sufficient network capacity for those seeking to generate electricity from renewable sources. In January 2008, the Scottish Government designated electricity network reinforcement to support renewable energy development as one of nine proposed 'National Developments' in the draft second National Planning Framework. Designation as National Developments in the Framework establishes these projects as being in the national interest.

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

As the UK Business Council for Sustainable Energy said in its paper on implementing the EU renewable energy target in the UK, the consenting and completion of the Beaulieu-Denny rebuild is essential to releasing the upgrade potential of the existing Scottish transmission system. By rebuilding the weakest part of a north of Scotland transmission ring, it will allow the other elements to that ring to be re-conducted and re-insulated (avoiding

Regulatory asset value (£bn)

The Regulated Asset Value is Ofgem's valuation of SSE's electricity and gas network assets (equity share).

£4.45bn

any need for new overhead line routes) to increase the capability for renewable energy capacity in the north of Scotland to over 6 gigawatts (GW), compared with around 2.2GW currently connected.

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

The Scottish Government is exploring subsea electricity network options through two offshore transmission studies: the Irish Scottish Links on Energy Study and the North Sea Energy Grid. Before its acquisition by SSE, Airtricity was an early advocate of proposals to develop a European offshore grid to facilitate the export of renewable energy. SSE is well-placed to contribute to the development of new grid options and will continue to work on them with Scottish Ministers and officials and other stakeholders.

In September 2007, the European Commission published its third package of proposals to further liberalise the EU's energy market. The package includes options for electricity and gas transmission

networks: the full ownership unbundling of transmission from production and supply in both electricity and gas; or the designation of an independent system operator (ISO) that would operate, maintain and develop the networks, which would make it possible for existing vertically-integrated companies to retain network ownership. SSE believes that the ISO model in Great Britain has worked well and could be successfully replicated elsewhere in the EU. Discussions on this issue are continuing, with a view to EU governments reaching agreement on a way forward later this year.

Electricity Distribution and Transmission Priorities in 2008/09 and Beyond

During 2008/09, and beyond, SSE's first objective in electricity distribution and transmission will be to maintain safe and reliable supplies of power and to restore supplies as quickly as possible in the event of interruptions, so performance in terms of customer minutes lost and customer interruptions will continue to be critical.

This will be supported by delivery of continuous improvement initiatives, following the implementation of a review of internal processes and customer-facing operations that took place during 2007/08. Ofgem has already stated that encouraging electricity distribution companies to be 'more responsive to the needs of customers' will be amongst its key priorities for the forthcoming Distribution Price Control Review for 2010-15.

Over the next year, detailed work will begin on the Review, where Ofgem's other key priorities include giving companies 'strong incentives to help tackle climate change' and 'delivering good value for consumers by ensuring that companies provide secure and more sustainable networks'. Ofgem also pointed out that it is likely that there

will be growth in renewable and small-scale 'distributed' generation, which could see much more generation connecting directly to the distribution, as opposed to the transmission, network.

During 2008/09, important questions will be asked about the reliability of the UK's electricity networks and their fitness for purpose in the context of the need to accommodate output from renewable energy schemes. Key priorities for SSE during the year will include the efficient delivery of the next phase of the major programme of investment in the networks. This will be targeted at upgrading them so as to benefit the greatest number of customers. It will also undertake work in advance of what is hoped to be a successful outcome from the Public Inquiry into the Beaulieu-Denny transmission line proposal. In total, SSE currently expects to invest around £1.75bn in its electricity networks over the next five years.

Longer-term, Ofgem's review of the regulatory regime for energy networks, with its focus on the growing investment challenges, the implications of greater distributed generation, customer service and cutting the regulatory burden represent an opportunity to build on the strengths of the existing system which SSE, operating at the efficiency frontier in electricity networks, should be able to influence and capitalise on.

GAS NETWORKS

- **Share of SGN's adjusted operating profit* up from £103.1m to £161.5m**
- **SGN capital expenditure up 49% to £179.8m and replacement expenditure up 14% to £199.2m**
- **Improved efficiency ranking**
- **Agreement on Gas Distribution Price Control 2008-13**

Scotia Gas Networks – Financial

SGN, in which SSE holds 50% of the equity, owns and operates the Scotland and the Southern gas distribution networks. The networks comprise around 74,000km of gas mains, delivering gas to around 5.7 million industrial, commercial and domestic customers. SSE receives 50% of the distributable earnings from SGN, in line with its equity holding, and also provides it with corporate and management services.

SSE's share of SGN's adjusted operating profit* was £161.5m during 2007/08, compared with £103.1m in the previous year. This reflects an increase in the volume of gas transported, changes in prices for transporting gas (following the under-recovery of revenue in 2006/07) and greater efficiencies yielding a reduction in operating costs.

Around 23% of SGN's operating profit was derived from the non-regulated activities of its contracting, connections and commercial services divisions, and these continued to perform well.

Scotia Gas Networks – Operational

During 2007/08, the gas transportation volume for SGN's network in Scotland was 59.5TWh and for its Southern network the volume was 110TWh. This compares with 57TWh and 105TWh respectively in the previous year.

SGN's objective is to be at the frontier of safety, customer service and efficiency in gas distribution. In September 2007, Ofgem published a comparison of efficiency rankings in which Scotland Gas Networks was ranked the second most efficient of the eight distribution networks and Southern Gas Networks the third. This compares with seventh and sixth respectively when the two networks were acquired by SGN in 2005.

In March 2008, the number of lost-time injuries in SGN fell to 0.15 per 100,000 hours worked, compared with 0.21 in March 2007. The focus on customer service helped SGN deliver a reduction in the number of complaints about it sent to energywatch for resolution of 67%, to 25. The introduction of new front office management systems, reducing the total number of systems from over 50 to 11, has been successfully completed. This means SGN now has free-standing systems which are capable of supporting more efficient deployment of resources. When SGN acquired its networks in June 2005, National Grid was contracted to provide it with services with a total value of over £40m. Over the last three years, many of these services have been brought within SGN and another major contract will end when SGN's gas network 'System Control' goes live in two phases, starting later this year.

What is Efficiency?

We keep things simple, do the work that adds value and avoid wasting money, materials, energy or time. This is vital when it comes to delivering electricity to people's homes, offices and businesses. We must maintain reliable power supplies in the most efficient way possible.



That means keeping the number and length of power cuts to a minimum. During 2007/08 the number of power cuts per 100 customers was 66 in southern England and 69 in northern Scotland. The average number of minutes of lost electricity supply per customer was 67 in southern England and 72 in northern Scotland.

Our regulator, Ofgem, will be reviewing the price framework for electricity distribution between 2010 and 2015. The priority will continue to be efficiency: delivering good value for customers by ensuring we provide secure networks demonstrating efficiency day-in, day-out.

7. Telecoms Networks

SGN also owns and operates SGN Connections and SGN Contracting. Amongst other things, these businesses carry out work previously done by contractors and give SGN greater scope to improve the efficiency, and reduce the cost, of the work it carries out.

It has also established SGN Metering, which is an Ofgem-accredited Meter Asset Manager. SGN Metering now owns and manages a portfolio of around 46,000 gas meters which it has installed in the Southern and Scotland network areas and it will own and manage all new meters fitted. In February 2008, SGN Metering secured a £15m per annum contract from National Grid Metering to deliver domestic metering work in the Scotland and Southern areas for up to three years. This was followed by a £3m, two-year contract to deliver metering work in the industrial and commercial sector. These contracts provide streams of work which can be carried out during the down-time associated with SGN's emergency work.

SGN's approach of in-sourcing work and the expansion of its gas network and other activities means it now directly employs 3,750 people, compared with 2,000 when it acquired its two distribution networks in June 2005. Its three-year pay and productivity deal for employees, which was agreed during 2006/07, has allowed the introduction of more flexible working patterns and associated efficiency gains. These include the removal of restrictive practices and their replacement by a consistent framework for terms and conditions. Work pattern rotas can now be determined by local management, and site start and finish provisions have been introduced to enhance productivity.

Scotia Gas Networks – Investment

During the year, SGN invested £179.8m in capital expenditure projects, compared with £120.4m in the previous year. It also invested £199.2m in mains and services replacement expenditure works, compared with £174.8m in the previous year, 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, and in 2007/08, SGN replaced just over 900km of its metallic gas mains with modern polyethylene pipes.

Following this investment, SGN estimates that the RAV of the networks it owns was around £3.5bn as at 31 March 2008 – which is significantly above their enterprise value when they were acquired in June 2005.

The Gas Distribution Price Control for 2008-13 provides the opportunity for SGN to increase significantly investment in its Scottish and Southern gas distribution networks, thereby reinforcing their safety and reliability and securing another significant increase in their

RAV. By 2013, SGN estimates its RAV will be around £4.8bn. In line with that, it expects to invest around £170m in capital expenditure projects and around £210m in replacement expenditure works during 2008/09.

Scotia Gas Networks Priorities in 2008/09 and Beyond

SSE's priority in gas distribution will continue to be to provide SGN with the corporate and management services to support its ongoing reform of procedures, processes and practices which are designed to improve performance and effectiveness. The successful delivery of SGN's gas network 'System Control' is a key priority over the next two years.

TELECOMS NETWORKS

- **Operating profit* up 2.9% to £14.3m (on continuing businesses up 28.4% to £13.1m)**
- **Sale of sites assets for £79m total consideration**
- **Acquisition of additional fibre optic and telecom duct network**

Introduction to Telecoms

After electricity and gas, Telecoms is SSE's third networks business. It combines SSE Telecom and Neos Networks and operates an 8,000km UK-wide telecoms network, providing services to other telecoms providers, companies and public sector organisations. This includes 3,240km of fibre optic cabling which SSE owns; the remainder is leased fibre and microwave radio.

The business offers customers a national telecoms network, and has a UK-wide sales force and a competitive range of products targeted at commercial and public sector customers. As a subsidiary of SSE, it is also able to position itself as one of the UK's most financially secure telecoms network operators, which gives an important competitive advantage.

Telecoms Operations

SSE's combined Telecoms business achieved an operating profit* of £14.3m during 2007/08, an increase of 2.9% (excluding the telecoms site assets disposed of in August 2007, operating profit was £13.1m, an underlying increase of 28.4%).

The improvement in performance during 2007/08 was mainly the result of higher sales achieved by Neos, and important contracts were signed with a diverse range of major organisations, such as AT&T and Carphone Warehouse. In January 2008, a significant order was received from Zen Internet, one of the leading UK internet service providers.

Telecoms Investment

In July 2007, SSE entered into an agreement with The Wireless Infrastructure Company Limited, under which it sold its telecoms sites assets, involving over 220 tower sites,

for a total consideration of £79m, excluding working capital, at a gain before tax of £55m. The assets disposed of contributed approximately 0.3% of SSE's profit in 2006/07. The disposal reflected SSE's commitment to complete the refocusing of its telecoms business on network-related, as opposed to site-related, services.

In line with this, in October 2007, SSE acquired a 1,100km fibre optic network from TeliaSonera International Carrier UK Ltd for a total consideration of £12.5m. The asset acquired by SSE comprises a duct containing fibre running between London, Bristol, Manchester and Leeds plus ten operational repeater sites. Included in the acquisition are extensions in seven cities around England. It provides SSE with owned fibre capacity throughout the UK, together with local connectivity that could be integrated into its existing network. In December 2007, SSE supplemented this with the acquisition of 160km of telecom duct network within London. The acquisitions have provided Neos Networks with one of the most extensive wholly-owned telecom duct fibre footprints in the UK.

Neos has upgraded its optical core network to enable point-to-point services at up to 40 Gigabits per second and has also started to upgrade its ethernet platform (a frame-based technology connecting computer systems to form a network) to provide customers with high speed, scalable and flexible connectivity – committing a total investment of over £8m to be made over five years. This will support future new business growth.

Telecoms Priorities in 2008/09 and Beyond

SSE's priority in Telecoms in 2008/09 is to complete the integration of assets acquired during 2007/08 and to continue to grow its sales, using its already-established nationwide network, with its competitive range of products targeted at commercial and public sector customers. Longer-term, its ambition is to become the UK's leading alternative telecoms network company. 🌱

OVERVIEW

In addition to being involved in Generation, Supply and Networks, SSE also provides an additional range of other energy-related services which complement its other businesses: Contracting, Connections and Metering; Energy and Home Services; and Gas Storage. These are important services, on which customers depend, so that their increasingly complex energy requirements can be met.

CONTRACTING, CONNECTIONS AND METERING

- **Operating profit* up 7.8% to £55.6m**
- **Coverage of Contracting business extended, now with 64 branches nationwide**
- **Acquisition of three additional street lighting PFI contracts**
- **Further expansion of out-of-area electricity networks, with 45 in operation or under construction**
- **Premises connected to SSE gas pipelines now above 50,000**
- **First new water and sewerage company since privatisation**
- **Completion of in-sourcing of Metering work in three areas of the UK**
- **Installation of smart meters under way via Energy Demand Reduction Trial**

Overview

Contracting, Connections and Metering delivered operating profit* of £55.6m during 2007/08, compared with £51.6m in the previous year.

Introduction to Contracting

SSE's Contracting business, Southern Electric Contracting (SEC), has three main areas of activity: industrial, commercial and domestic mechanical and electrical contracting; electrical and instrumentation

engineering; and public and highway lighting. Now employing over 4,000 people, it is one of the largest mechanical and electrical contracting businesses in the UK. It operates from 64 regional offices throughout Great Britain and also trades as SWALEC Contracting in Wales and Scottish Hydro Contracting in Scotland.

Contracting Performance During 2007/08

SEC made significant progress against its key priorities for the year of broadening further its geographical presence and ensuring there continues to be good performance in the long-term contracts which are central to its ongoing business development.

For a nominal consideration, it acquired Hills Electrical and Mechanical plc, a business with an annual turnover of £45m operating in all parts of the UK. The acquisition complements SEC's existing businesses whilst strengthening its position as a leading mechanical and electrical contractor. It expands SEC's number of branch offices from 57 to 64, and provides it with a national business supporting the retail sector.

SEC also acquired Seeboard Trading Limited, which finances and operates street lighting maintenance and replacement projects for three local authorities under the Private Finance Initiative (PFI). The three local authorities are the London Borough of Islington, the London Borough of Ealing and Dorset County Council. The projects cover around 90,000 street lighting columns and they all have at least 20 years to run.

In partnership with the asset finance division of The Royal Bank of Scotland, SEC already has PFI contracts to replace and maintain around 210,000 street lighting columns for four local authorities in England: Stoke on Trent City Council; Leeds City Council; and

Newcastle City and North Tyneside Councils. These contracts all have over 20 years to run and, when combined with the contracts acquired via Seeboard Trading Limited, mean SSE's interests in PFI contracts extends to 300,000 lighting columns.

In addition to the PFI replacement and maintenance contracts, SSE has contracts with 22 local authorities in England, Wales and Scotland to maintain over one million street lights. It is the largest street lighting contractor in the UK, and in 2007/08 secured its first-ever contract in north-west England, with St Helens Council.

During 2007/08 SEC's order book exceeded £100m for the first time. The order book has been supported by significant contract wins with a number of leading organisations such as National Air Traffic Service (NATS) and the VT Group. To support future growth, SEC is developing the services it offers to customers, and during 2007/08 it launched a new business area for solar and photovoltaic products. It also recruited almost 200 apprentice electricians during the year and expects to recruit more apprentices during 2008/09.

Contracting Priorities in 2008/09 and Beyond

The first priority for SEC in 2008/09 is to ensure that it delivers a high standard of service to all customers in all of the sectors in which it operates, given such a major proportion of its business is 'repeat'. It will also seek to complete the integration of businesses acquired during 2007/08 and secure further increases in its order book, with a growing focus on emerging technologies and renewable energy installation capability. In line with this, a trial will be launched to promote the installation of solar and photovoltaic products on to domestic rooftops. To position itself for long-term growth, it expects to recruit more apprentices. That long-term growth should result, over the next few years, in SEC's operations being further extended throughout Great Britain and, over time, Ireland.

Introduction to Connections

SSE's national Connections business provides electricity, gas and water connections and designs, finances, builds, owns and operates gas, electricity and telecommunications networks throughout the country.

Connections Performance During 2007/08 – Electricity

Continued expansion of its Connections business was among SSE's priorities for 2007/08. During the year it completed 42,800 electrical connections, compared with 44,600 in the previous year.

In addition, it has continued to develop its portfolio of electricity networks outside the Southern Electric and Scottish Hydro Electric Power Distribution areas. It now owns and

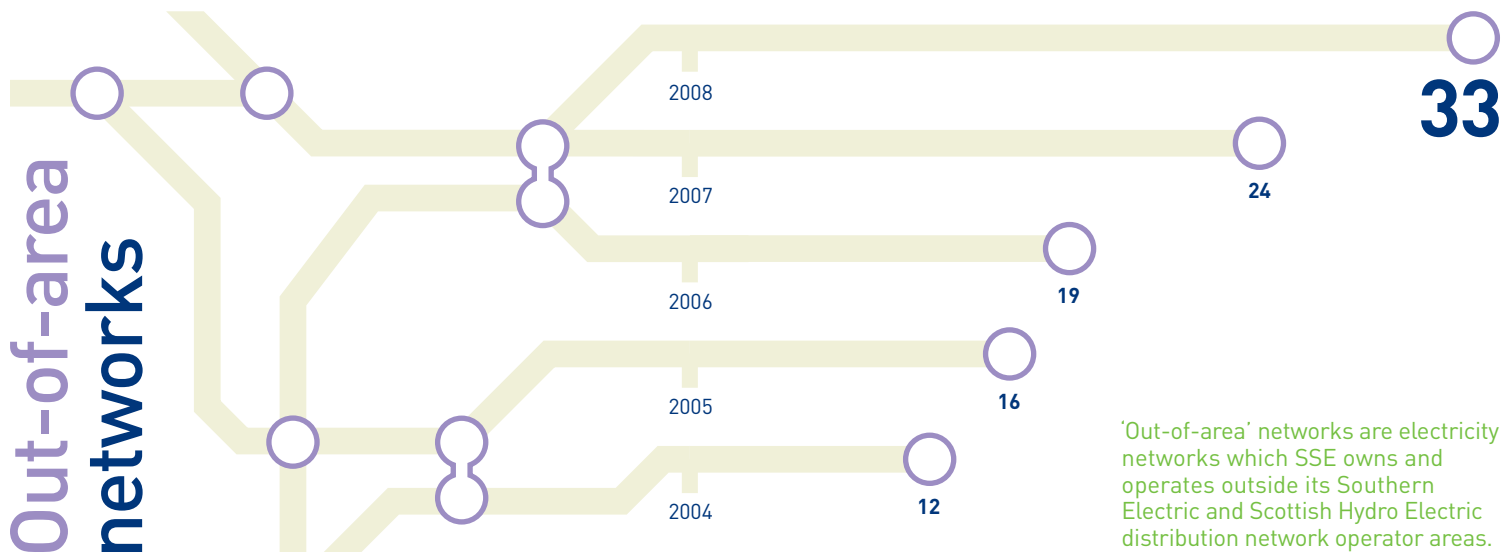
What is Sustainability?

We aim to operate ethically, taking the long-term view to achieve growth while safeguarding the environment. That is why we actively support ways of changing the way in which energy is produced and consumed.

As fossil fuels deplete and as the evidence about their impact on the earth's climate grows, the need to generate more electricity from renewable sources is going to become even stronger. The days of meeting an unchecked demand for energy through monolithic carbon-intensive power stations are coming to an end.

We own and operate over 2,000MW of renewable electricity generation capacity and aim to double this over the next five years through a major investment programme. We believe this major commitment is right for shareholders, customers and the environment.





manages 33 energised electricity networks outside these two areas, with development work ongoing at a number of these, and a further 12 are under construction, including Eurocentral and West Prestonpans in Glasgow, Valleywood and St Davids in Wales and Castlewood in Nottingham. In total, SSE has just over 400MW of energised networks capacity, including 180MW currently under construction. Key clients are from the UK land development sector and currently include the London Development Agency, Laing O'Rourke, Persimmon and Hammersons. This remains a relatively new business for SSE, but it became profitable during 2007/08.

Connections Performance During 2007/08 – Gas

SSE's Connections business is also a licensed gas transporter. Trading as SSE Pipelines, it installs, owns and operates gas mains and services on new housing and commercial developments throughout the UK. The number of new premises connected to its gas networks has continued to grow, and during the year, it connected a further 8,000 premises, taking the total number of connections to over 53,000. During 2007/08, it began construction of its biggest pipeline project to date – to supply up to 1,000 new-build residential properties at a development in Bedford.

Water

In October 2007, Ofwat announced that SSE's subsidiary, SSE Water (SSEW), will become the first new company to offer both water and sewerage services since privatisation in 1989. This followed the granting of an 'inset' appointment to SSEW, which allows for one supplier of water and sewerage services to be replaced by another for a defined geographical area, in this case a housing development near Salisbury. Ofwat said 'SSE has a proven track record for its high levels of customer service. Ofwat expects SSEW to set a benchmark in the water industry for similar high levels of customer service'.

SSE is already experienced in designing, installing and operating multi-utility infrastructures. The granting of inset appointments will enable it to provide a more comprehensive multi-utility solution to customers in the property development and house-building sectors, through being able to install, own, operate and supply water and sewerage services alongside SSE's existing electricity and gas services.

Construction work at the development near Salisbury began in December, and the early evidence suggests that the 'one-stop' approach to infrastructure installation on larger sites is a very good way forward for developers. Once the water infrastructure is completed, SSE will own and operate the network, having the same responsibilities as any other water company: issuing bills; reading meters; testing water quality and cleaning blocked sewers.

SSE expects to make further applications for inset appointments in other areas, and made a second one – in respect of a development at Llanilid Park (Valleywood) in Wales – in February 2008.

Connections Priorities for 2008/09 and Beyond

The Connections business' focus will be on the successful delivery of a growing number of utility connections and on continuing to expand its range of electricity networks outside the Southern Electric and Scottish Hydro Electric Power Distribution areas, reinforcing its position as a leading provider of utility infrastructure solutions to the UK land development sector. Another key priority will be the successful completion of the water installation at Salisbury, securing other inset appointments and building up the one-stop approach to infrastructure provision.

Introduction to Metering

SSE's Metering business provides services to most electricity suppliers with customers

in central southern England and the north of Scotland and has undertaken a programme of in-sourcing of meter reading operations and meter operator work in other parts of the UK. 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.

Metering Performance During 2007/08

In total, SSE owns 3.7 million meters and changes around 250,000 meters each year as they reach the end of their useful life or to meet customer requests for changed functionality. During 2007/08, it collected around 5.8 million electricity readings and 2.3 million gas readings, up from 4.3 million and 1.4 million respectively in the previous year.

SSE's Metering activities expanded significantly during 2007/08, with the in-sourcing of meter reading operations in south-west England and central and southern Scotland and meter operator work in south Wales, resulting in the transfer of 200 employees to SSE. This will take the total in the Metering business to over 800, and double its geographic coverage.

During 2008/09, SSE will in-source meter reading and meter operations work in south-east England and also meter operator work in south-west England and central and southern Scotland. This will result in the transfer of almost 150 employees to SSE via a mixture of TUPE transfer and new recruitment.

The ongoing development of SSE's Metering business is designed to achieve both efficiency gains and high standards of service for SSE's customers and to support the energy supply business.

SSE is the leading participant in the UK-government sponsored two-year Energy

Demand Reduction Project, under which almost 30,000 SSE customers will be taking part in energy-saving trials. These include around 8,000 customers receiving state-of-the-art smart meters. Ultimately, smart meters will allow energy suppliers to communicate directly with their customers, remove the need for meter readings and ensure entirely accurate bills with no estimates, helping customers to reduce their consumption of energy. The results of the trials will provide evidence to support the future roll-out of smart electricity and gas meters.

The first smart meters were installed in Perthshire in February 2008. Although some other high volume roll-outs have occurred elsewhere in the world, none has attempted such a level of complexity, using this level of leading-edge technology. Customers involved in this trial will be able to manage gas and electricity usage through a mixture of in-home remote displays, graphs on bills and website information.

In March 2008, SSE invested £1m in Onzo Limited, in return for a 24.5% share of the business. Onzo is a newly-established data systems development business, with specific intellectual property relating to the development of display devices that support smart metering systems. The devices provide real-time information about energy consumption and have the potential to provide data down to the individual appliance level.

In this context, SSE welcomed the decision by the UK government to include within the Energy Bill broad enabling powers to support a national roll-out of smart meters. These powers should allow a detailed framework for a roll-out to be developed and implemented over the next decade.

Metering Priorities in 2008/09 and Beyond

For Metering, the key priority is the successful completion of the 'in-sourcing' of work in south-east and south-west England and central and southern Scotland. This will be another key milestone in SSE's long-term objective of building a national metering business. It is also important that SSE's participation in the Energy Demand Research Project, with its focus on smart metering technologies, is successful, and during 2008/09 SSE expects to install around 8,000 smart meters as part of it.

ENERGY AND HOME SERVICES

- **115,000 new gas boiler and telecoms customers, taking total to 235,000**
- **Product portfolio enhanced with electrical wiring service**

Introduction to Energy and Home Services

The UK energy market is still focused on the delivery of units of energy but a market is beginning to emerge for the supply of energy services – warmth, light and power. SSE's goal is to deliver products and services which go beyond the meter, helping it to gain, retain and develop long-term relationships with customers.

More fundamentally, over time, a new model is likely to be created whereby homes and other buildings are developed and designed so they need as little energy as possible. Energy services and SSE's related investments in emerging technologies are about preparing for that new model.

Energy Services Performance During 2007/08

Customers are increasingly interested in managing their own energy use and SSE provides bespoke energy solutions featuring on-site or off-site dedicated wind turbines,

solar thermal systems, solar photovoltaic systems and ground-source heat pumps. SSE's Energy Services division operates and maintains site-wide energy infrastructures of this kind that improve environmental performance over conventional alternatives.

In addition, business customers of SSE now have over 50MW of on-site installed Combined Heat and Power (CHP) generation capacity, generating heat and power in a single process. Current developments include The Warren, in south-east London, where Berkeley Homes Group is building 460 apartments, a nursery unit, primary care trust and commercial units. Under the Energy Services Company (ESCO) Agreement, SSE is responsible for designing and installing an energy centre, including a CHP plant. SSE will also undertake all associated heat, electricity and gas infrastructure, metering and billing customer services, long-term operations and maintenance services and all fuel procurement requirements.

SSE's main contractor on this development is Vital Energi Utilities Ltd, and in October 2007 SSE entered into an agreement to invest £6m for a 30% share of the business. Vital Energi specialises in the design, supply and installation of CHP and District Heating systems in the commercial, industrial and residential sectors.

SSE's home services team offers a range of maintenance and protection services for customers' gas and electrical systems and a full range of gas and electrical installation services. Its **shield** gas boiler, central heating and wiring protection service is now almost two years old and had already attracted 70,000 customers by the end of March 2008.

This growth is expected to continue and the number of postcode areas covered by the service has now reached 43, with a further five postcode areas due to be added in 2008/09.

The home services offered by SSE also include the **talk with** telecoms service, which now has 165,000 customers and is profitable. SSE and BT have entered into a partnership that sees BT become the provider of integrated voice and broadband services to SSE for resale to its UK customers. Under the terms of the three-year agreement, BT Wholesale will support SSE's plans to become a high quality, national provider of integrated communications services. The service is expected to launch this summer.

Energy Services Priorities in 2008/09 and Beyond

The market for these home and other energy services is evolving, but it is one in which rapid change is likely as – for example – demand for low- and zero-carbon homes grows. As the needs of customers become

What is Excellence?

We strive to get better and smarter and more innovative because we want to be the best in everything we do. That means constantly looking for new ideas to improve products, processes and services and finding better ways of working – all for the benefit of customers.

One leading industry commentator recently told a group of SSE people that innovation is 'a great opportunity, a great challenge and great fun'. To encourage it, we have a Licence to Innovate (LTI) scheme, whereby people are able to research, review, trial and explore their ideas knowing they have the full support of the Chief Executive.

During 2007/08, 24 LTIs were successfully completed – each improving a product, process or service. These innovations, and improvements delivered throughout the organisation every day, all contribute to the culture of innovation and excellence which we believe to be a hallmark of SSE.



11. Gas Storage

more complex, SSE's approach is to provide a growing range of dependable services and thereby position itself to be a successful – and national – provider as the production and consumption of energy changes over the next decade.

GAS STORAGE

- **Operating profit* of £50.9m compared with £55.9m in previous year**
- **First caverns at Aldbrough scheduled for commercial operation in autumn**
- **Planning permission secured to double the size of Aldbrough development to over 800mcm**

Introduction to Gas Storage

It is generally recognised that the UK has insufficient gas storage. This under capacity reflects the reliance it was able to place in past years on gas production from the North Sea. As North Sea gas declines, UK imports will continue to increase and this means there will be a growing reliance on gas storage facilities to help provide security of supply. Such facilities therefore have a long-term value.

SSE owns and operates the UK's largest onshore gas storage facility at Hornsea in East Yorkshire. Nine salt caverns have been leached into a salt layer 1.8km below the surface, creating 325 million cubic metres (mcm) of gas storage capacity. Gas can be injected at a rate of 2mcm per day and withdrawn at a rate of 18mcm per day, which is equivalent to the requirements of around four million homes.

The services offered at Hornsea provide customers with a reliable source of flexibility with which to manage their gas supply/demand balance and respond to market opportunities. Capacity is sold in Standard Bundled Units (SBU), of which Hornsea has 195 million available in total, and each SBU provides capacity to inject gas into the facility, store gas there and withdraw gas from it.

Gas Storage – Operations

Gas Storage delivered an operating profit* of £50.9m, compared with £55.9m in the previous year (which SSE said in its Annual Report 2007 was a high point in gas storage profitability). The value of, and demand for, gas storage facilities in the UK has, however, continued to be high and incidents at the Bacton gas terminal and the Grangemouth oil refinery again demonstrated the importance of gas storage in securing UK energy supplies.

One of SSE's priorities for 2007/08 was to ensure that Hornsea maintained its excellent record of dependability, and during the year it was 100% available to customers, except in instances of planned maintenance. This enabled customers to manage their gas market risks and respond to gas trading opportunities.

Gas Storage – Investment

The joint venture with Statoil (UK) Ltd to develop, at Aldbrough, near Hornsea, what will become the UK's largest onshore gas storage facility is continuing to make progress, albeit at a slower rate than expected when the development work started in 2004 and also when the project was reviewed at the start of 2007/08.

SSE's investment in Aldbrough, is now expected to total around £175m, reflecting the increased length of time required to complete the development and the significant inflationary pressures seen throughout the UK construction industry. With a total new capacity of around 420mcm, of which SSE will have ownership interest in 280mcm, Aldbrough will provide valuable gas storage for the UK. Its flexibility is demonstrated by the fact that it will enable gas to be injected at a rate of up to 30mcm per day and withdrawn at a rate of 40mcm.

The first three of the nine caverns at Aldbrough are scheduled to enter commercial operation in the autumn. The first gas has been introduced to site and dewatering of the first caverns will commence shortly.

SSE and Statoil (UK) Ltd have secured consent from East Riding of Yorkshire Council to increase the storage capacity at the Aldbrough site beyond that currently under development. They are now able to develop a further nine gas storage caverns, taking the total to 18. If developed in full, this would approximately double the amount of gas that can be stored, to over 800mcm. Construction of the extension would, therefore, help to ensure that the UK can meet gas demand during periods of high energy usage.

SSE would contribute 50% of the cost of the extension in return for ownership of 50% of

the capacity. On completion of the extension, SSE would have effective ownership of over 800mcm of gas storage capacity, including Hornsea. Site preparation work has been completed and a final decision on whether to proceed with this development is expected to be taken during 2008/09.

Gas Storage Priorities in 2008/09 and Beyond

SSE's priorities in Gas Storage during 2008/09 are to: maintain its excellent record of reliability at Hornsea; ensure that the first of the new caverns at Aldbrough are available for commercial storage; and make a decision on whether to proceed with the Aldbrough extension. Longer-term, SSE will also continue to look for other opportunities to add to its gas storage capability. 🌱

What is Teamwork?

We support and value our colleagues and enjoy working together as a team in an open and honest way. Our team includes over 16,000 people working from more than almost 200 power stations, depots, customer service centres, shops and offices in every part of the UK and, now, overseas as well.

Working as a team gives us a common sense of purpose and creates a climate in which everyone is very open to ideas and very honest with each other. It encourages excellence in everything we do on behalf of our shareholders and our customers. Teamwork is a key way of assessing performance within SSE.

With employees becoming shareholders and customers themselves, we believe there is a real commonality of interest between the SSE team, our customers and our shareholders – on which we'll build on in the years ahead.



The right question

9

Nine underground caverns at Aldbrough, the first three of which are expected to be available for full commercial service in 2008/09.

Highlight Aldbrough

In a joint venture with Statoil (UK) Ltd, SSE is developing what will become the UK's largest onshore gas storage facility, at Aldbrough in Yorkshire. The new facility will have a total new capacity of 420mcm, of which SSE will have an ownership interest in 280mcm, bringing the company's total gas storage capacity to 605mcm. Aldbrough will provide valuable gas storage for the UK energy industry. Its flexibility is demonstrated by the fact that it will enable gas to be injected at a rate of up to 30mcm per day and withdrawn at a rate of 40mcm.

420

420mcm is the total capacity of the new gas storage facility at Aldbrough in Yorkshire.

The UK relies on gas to provide energy for heating and electricity more than any other primary source of energy. The Energy White Paper 'The Energy Challenge' said that gas-fired power plants are a key method of electricity generation, generating over one-third of the UK's electricity requirement. By 2010, it is estimated that the UK will be 50% dependent on imported gas, rising to 80% by 2020. The right question is – how is SSE investing to help secure energy supplies for customers?

HOW DO WE SECURE ENERGY SUPPLIES FOR CUSTOMERS?

In an environment where the UK is becoming increasingly dependent in imported gas, there is clear benefit in reducing that dependency. SSE is doing this by continuing to expand its diverse portfolio of power stations which, in addition to gas, use coal, biomass, hydro and wind as their primary sources of energy.

SSE's newly established Engineering Centre will provide an effective long-term asset management and investment planning capability across its generation portfolio to provide a platform to support this growth. For example, SSE is now the UK's leading user of biomass co-firing following the completion of enhanced facilities at its Fiddlers' Ferry and Ferrybridge power stations. The installation of FGD equipment at these stations will extend their contribution to the security of the UK's energy supplies.

In addition to reducing the dependency on gas overall, reducing the risk of short-term disruption to energy supplies due to supply problems can be limited by large-scale storage of gas. The UK has a total storage capacity of 3.3 billion cubic metres (bcm), equivalent to 14 days' supply at average winter gas demand rates.

SSE owns and operates the UK's largest onshore gas storage facility at Hornsea in East Yorkshire. Nine salt caverns have been leached into a salt layer 1.8km below the surface, creating 325 million cubic metres (mcm) of gas storage capacity. Gas can be injected at a rate of 2mcm per day and withdrawn at a rate of 18mcm per day, which is equivalent to the requirements of around four million homes.

SSE faces the challenge of continuing to secure gas supplies as the UK becomes increasingly dependent on imports. To address this, it is currently developing additional capacity at nearby Aldbrough and has secured consent for further capacity at the site beyond that currently under development.

INVESTMENT AND CAPITAL EXPENDITURE

Introduction

SSE has a substantial capital and investment programme, with the objective of upgrading existing assets and developing new assets and thereby continuing the ongoing expansion of the scale and the scope of its activities. It is a key means by which SSE seeks to generate future cash flows and enhance and create value for shareholders. All investments are expected to achieve returns which are greater than the cost of capital and are expected to enhance earnings.

Investment in 2007/08

Capital and investment expenditure (excluding SGN) totalled £810.3m during 2007/08, including £28.1m in respect of Marchwood Power Ltd, compared with £663.4m in the previous year. Including SSE's share of SGN's capital and replacement expenditure, the total was £1.0bn.

Within its overall total, capital and investment expenditure of £16.9m was incurred by SSE through Airtricity after it was acquired in February 2008. Over 2007/08 as a whole, Airtricity's capital and investment expenditure was around €240m.

Capital expenditure in Power Systems was £264.4m, compared with £204.5m in the previous year, in line with the investment focus described under 'Electricity Network Investment'. In addition, there was investment of £276.5m for growth in Generation during the year, with the progress of the Marchwood development, construction work being carried out at Glendoe hydro electric scheme and Drumderg wind farm and the installation of FGD equipment and other work at Fiddler's Ferry and Ferrybridge.

As well as Power Systems and Generation, £40.9m was invested in the ongoing development of the new gas storage facility at Aldbrough. Of its expected total investment of around £175m, SSE has so far invested £140m at Aldbrough.

Within the total, capital expenditure for growth, including Marchwood, was £537.2m during 2007/08. This mainly comprised electricity generation and gas storage.

Future Investment Priorities in 2008/09 and Beyond

In the five years from April 2003, SSE's capital and investment expenditure totalled £2.65bn, and in the period since its investment in gas distribution in June 2005, SSE's share of SGN's capital and replacement expenditure was £453.5m.

SSE's capital and investment expenditure will continue to be substantial during 2008/09, at around £1.3bn, and subsequently. Over the five years to 2013, it is projected to total around £6.7bn and will be focused on

projects in line with SSE's core purpose of providing energy in a reliable and sustainable way.

Around 45% of this investment is expected to be directed towards renewable energy developments. In addition, SSE expects to invest around £1.2bn in gas- and coal-fired generation, around £1.75bn in electricity networks and around £600m in a number of other areas, such as gas storage. The result of this will be a significantly enhanced asset base and additional cash flows, which will support future dividend growth.

FINANCIAL MANAGEMENT AND BALANCE SHEET

- Net debt up £1.433bn to £3.666bn
- Average debt maturity 8.6 years
- Underlying interest cover of 11.7 times
- Purchase of 16.66 million shares (1.9% of called-up share capital) for £238.2m
- 24.5 million new shares issued under 3.75% Convertible Bond
- 870.1 million shares in issue

Treasury Policy

SSE's operations are 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 2008, after taking account of interest rate swaps, 65.7% of SSE's borrowings were at fixed or inflation-linked interest rates. This fixed-rate component was unusually low due to the high amount of short-term debt on the balance sheet, arising primarily from the acquisition of Airtricity. In the medium-term, SSE targets a fixed rate component of around 80-85%.

Borrowings are made in both Sterling and Euro to reflect the underlying currency

denomination of assets and cashflows within SSE. All other foreign currency borrowings are swapped back to Sterling.

The United Kingdom remains SSE's main area of operation, although business activities in overseas markets – most notably in the Republic of Ireland – have grown during the year. 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. Its policy is to hedge all material transactional foreign exchange exposures through the use of forward currency purchases and/or derivative instruments. Indirect exposures created by SSE's gas purchasing are similarly hedged on an ongoing basis.

Translational foreign exchange risk arises in respect of overseas investments and hedging in respect of such exposures is determined as appropriate to the circumstances on a case-by-case basis.

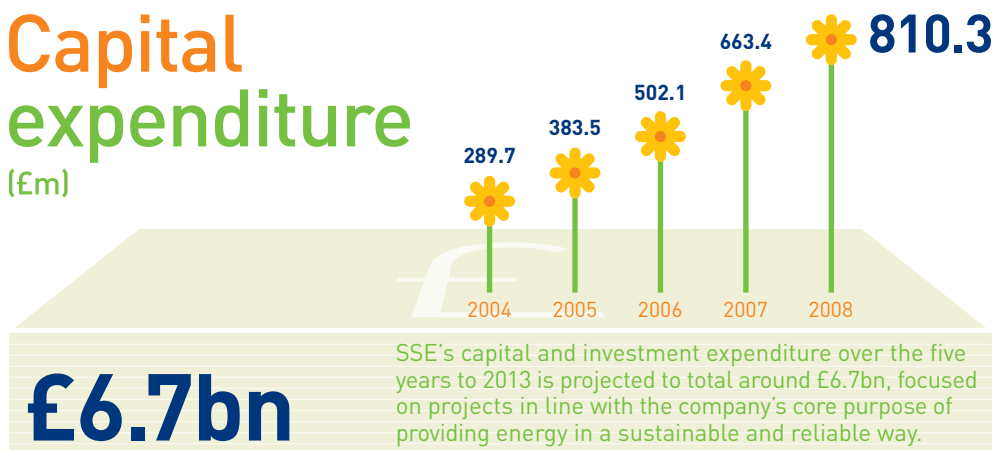
Net Debt and Cash Flow

As at 31 March 2008, SSE's net debt was £3.666bn, compared with £2.233bn at 31 March 2007, an increase of £1.433bn. This largely reflects the £1.349bn acquisition of Airtricity, together with other capital and investment expenditure undertaken during the year. Cash generated from operating activities was over 30% higher than in the previous year, reflecting increased profitability and improvement in working capital.

Borrowings and Facilities

SSE's liquidity policy is to ensure that it has committed borrowings and facilities equal to at least 105% of forecast debt over a rolling 12 month period. On 31 March 2008 it had available undrawn committed bank borrowing facilities of £1.1bn which mature in June and November 2009.

The objective for SSE is to maintain a balance between continuity of funding and flexibility, with debt maturities staggered across a broad range of dates. Its average age of debt as at 31 March 2008 was



8.6 years, compared with 13.8 years as at 31 March 2007. This year-on-year reduction in term reflects the unusually high amount of short-term debt on the balance sheet at 31 March 2008, arising primarily from the acquisition of Airtricity.

SSE's debt structure continues to be strong, with around £2.1bn of medium- to long-term borrowings in the form of issued bonds, European Investment Bank debt and long-term project finance and other loans relating to Airtricity. A total of 47.1% of SSE's borrowings will mature in the 12 months to March 2009, the majority of which relates to bank borrowings raised to finance the acquisition of Airtricity. It is expected that this debt will be re-financed in the capital markets during the course of this year.

Net Finance Costs

The table below reconciles reported net finance costs to adjusted net finance costs, which SSE believes is a more meaningful measure. In line with this, SSE's adjusted net finance costs during 2007/08 were £154.3m, compared with £151.8m in the previous year.

	March 08 £m	March 07 £m
Reported net finance costs (note 6) add/(less)	32.8	48.1
Share of JCE*/		
Associate interest	127.6	117.9
Interest on convertible debt	(4.6)	(3.6)
Exceptional foreign exchange loss	(22.2)	-
Movement on derivatives	20.7	(10.6)
Adjusted net finance costs	154.3	151.8
Return on pension scheme assets	141.4	130.1
Interest on pension scheme liabilities	(117.4)	(107.2)
Notional interest arising on discounted provisions	(3.6)	(1.4)
Adjusted interest costs**	174.7	173.3

* Jointly Controlled Entities

** Adjusted finance income and costs for interest cover calculation

The average interest rate for SSE, excluding JCE/Associate interest, during the year was 5.23%, compared with 5.31% in the previous year. Based on adjusted interest costs, underlying interest cover was 11.7 times, compared with 11.0 times the previous year, and including interest related to SGN it was 7.9 times (7.1 times in the previous year).

Within the adjusted net finance costs of £154.3m, the element relating to SGN's net finance costs was £82.7m (compared with £70.6m in the previous year), after netting loan stock interest payable to SSE. Its contribution to SSE's profit before tax was,

therefore, £78.8m, compared with £32.5m in the previous year.

Tax

To assist the understanding of SSE's tax position, the adjusted current tax charge is calculated as follows:

	March 08 £m	March 07 £m
Reported tax charge	210.6	301.5
add back:		
Share of JCE/Associate tax	10.7	33.8
less:		
Deferred tax	(31.5)	(25.6)
Exceptional tax	127.4	(27.1)
Adjusted current tax charge	317.2	282.6

The effective adjusted current tax rate, based on adjusted profit before tax, was 25.8%, compared with 26.2% in the previous year, on the same basis. The impact of SSE's higher capital expenditure programme and the changes introduced in Budget 2007 are likely to have a positive effect on the effective current tax rate in the coming years.

The reported tax charge was 19.4%, compared with 26.6% in the previous year. This reflects the restatement of the deferred tax position following the Corporation Tax rate change introduced in Budget 2007.

SSE's contribution to government revenues, including Corporation Tax, Employers' National Insurance Contributions and Business Rates totalled £517.1m during 2007/08, compared with £459.5m in the previous year, an increase of 12.5%. This includes joint ventures and associates and compares with dividends paid to shareholders during the year of £502.8m.

Balance Sheet

In line with its core financial principles, SSE continues to maintain one of the strongest balance sheets in the global utility sector. This gives it significant competitive advantages, allowing it to pay interest at lower rates than would otherwise be the case and also enables it to respond speedily to opportunities which emerge to invest in, or acquire, assets. The tumultuous events witnessed in global financial markets during 2007/08 have again demonstrated the risks associated with inappropriately large levels of debt and have underlined the importance of maintaining a strong financial profile.

In line with the IAS 19 treatment of pension scheme assets, liabilities and costs, pension scheme liabilities of £134.9m and a pension scheme asset of £85.8m are recognised in the balance sheet at 31 March 2008, gross of deferred tax. This means there was a reduction of £42.8m in net liabilities compared with the position at March 2007, from £91.9m to £49.1m.

During 2007/08, employer cash contributions to the Scottish Hydro Electric scheme amounted to £13.4m. Contributions to the Southern Electric scheme, including deficit repair contributions of £35.5m, amounted to £60.2m. As part of the Distribution Price Control for 2005-2010, it was agreed that allowances for 76% of deficit repair contributions should be recoverable via price-controlled revenue.

At 31 March 2008, there was a net liability arising from IAS 39 of £117.3m, before tax, compared with a net asset of £45.0m, before tax, at 1 April 2007.

Purchase of Own Shares and Convertible Bond Maturity

During 2007/08, SSE purchased 16.66 million of its own shares for cancellation, which contributed to the enhanced earnings per share delivered during the year. The weighted average price per share (before costs) was £14.30, with the purchase price ranging from £13.87 to £14.74. The aggregate consideration was £238.2m (excluding fees) and the purchases represented 1.9% of the called-up share capital of the company.

The Directors of SSE are seeking at the Annual General Meeting on 24 July 2008 renewal of their authority to purchase, in the market, the company's own shares should it result in an increase in SSE's earnings per share and be in the best interests of shareholders generally. Any shares repurchased under this authority may be cancelled or retained as treasury shares to accommodate requirements for shares under SSE's incentive schemes. SSE does not currently hold any treasury shares. SSE also has an outstanding 3.75% convertible bond which matures on 29 October 2009, which had an initial nominal value of £300m. To date, holders have exercised their option to exchange their bonds for ordinary shares in the company at £9 per share, in respect of bonds totalling £220.7m of nominal value. New shares issued as a consequence of these conversions total 24.5 million. A nominal value of £79.3m or 26.4% of the original bond issue, remains outstanding. The total number of shares in issue at 31 March 2008 was 870.1 million.

Financial Management and Balance Sheet Priorities in 2008/09 and Beyond

SSE's financial management and balance sheet priorities in 2008/09 and beyond are to adhere to its six key financial principles: delivery of sustained real dividend growth; effective management of core businesses; rigorous analysis to ensure investments are well-founded and, where appropriate, innovative; maintenance of a strong balance sheet; deployment of a selective and disciplined approach to acquisitions; and use of purchase in the market of the company's own shares as the benchmark against which financial decisions are taken. 🌱

Introduction

Shareholders expect companies not simply to be profitable, but to be responsible in how those profits are made. For SSE, this means that its Generation activities should be as sustainable as possible and that the energy it supplies should be as affordable as possible. In addition, its networks should be reliable and its energy-related services dependable.

Principal Risks

The principal risk factors to which SSE is potentially exposed were reviewed by the Board in March 2008. They are: the operation of assets, equipment and processes; capital investment risks, in respect of major projects; financial risks, such as interest rate and commodity exposure, including a lack of liquidity in traded markets; the impact of public policy or regulatory developments in the areas of energy and the environment; resource shortages, in terms of people with the relevant skills and in terms of equipment and materials, including fossil fuels; the impact of the weather on SSE's interests in the generation of electricity from renewable sources, in energy supply and in energy distribution; and an economic slowdown. The latter risk potentially affects both the level of business activity and bad debt write-offs.

At a corporate level, SSE seeks to address these risks by: maintaining the strongest possible focus on the consistent delivery of excellence across all aspects of its operations; rigorous management and scrutiny of major projects; adhering to the series of well-defined and established financial principles set out under 'Financial Overview'; strong oversight by a Risk Committee; full and transparent engagement with Ministers, elected members and officials in the relevant executives and legislatures; upgrading its human resources and procurement functions to ensure SSE has access to the best possible people and equipment; maintaining a variety of energy production, distribution and supply businesses, with actively-managed fuel procurement where appropriate; and effective credit management.

In summary, SSE's principal risk management approach is its fundamental strategy: operating and investing in a balanced range of regulated and non-regulated energy and utility businesses. This limits both the extent of any single risk and the value associated with it and the need to limit the value at risk is at the heart of SSE's decision-making processes.

The investigations and reviews being undertaken by Ofgem, and a number of UK government policy developments, could reinforce some perceptions of the extent of the risk associated with the impact of public policy or regulatory developments. SSE is fully engaged with all key stakeholders and believes that Ofgem and the UK government

fully understand the need for a clear and stable policy and regulatory framework. It also believes that, fundamentally, the framework in the UK is supportive of SSE's core purpose of providing energy in a reliable and sustainable way.

At an operational level, comprehensive procedures for internal control and risk management are in place throughout SSE. These procedures are actively maintained and regularly reviewed through an audit programme which addresses the full spectrum of SSE's potential risks. This is complemented by an ongoing programme of business improvement initiatives designed to secure continuous progress in processes and procedures and further improve the overall management and performance of SSE, avoiding undue business concentration.

Safety and the Environment

SSE aims to create value for shareholders by running the business with a strong emphasis on safety and on sustainability – achieving growth while safeguarding the environment. During 2007/08, the number of lost time and reportable accidents within the company was 11, or 0.04 per 100,000 hours worked, compared with 0.05 in 2006/07 and with 0.17 five years ago, in 2002/03. The number of serious, or potentially serious, road traffic accidents involving employees driving company vehicles was 0.18 per 100 vehicles, compared with 0.29 in 2006/07.

In 2008/09, SSE will report its safety performance on the basis of the Total Recordable Injury Rate, as its central workplace safety indicator.

A significant issue for SSE is process safety – the engineering and management skills focused on preventing major incidents arising from the use of, amongst other things, fossil fuels. Its approach in this area has been comprehensively reviewed in the light of the report of the Baker Panel into the BP incident at Texas City published in early 2007.

SSE's target for any given year is zero reportable environmental incidents. There was one such incident during 2007/08. In January 2008, the Environment Agency served an enforcement action on SSE for failure to make sufficient progress on an agreed programme of improvements at its Smurfit Townsend Hook CHP plant in Kent.

Corporate Responsibility Index and Business in the Environment Index

Business in the Community's Corporate Responsibility Index provides an authoritative benchmark for companies to evaluate their management practice in four key areas of corporate responsibility (community, environment, marketplace and workplace) and performance in a range of environmental and social impact areas material to their business.

The results of the Index for 2007, in which 111 companies participated, and which was the most challenging yet, were published in May 2008. SSE's score was 98.0%, compared with 98.5% in the previous year, putting the company in the highest possible performance band of 'Platinum'. Within the main Index is the Business in the Environment Index, SSE's score was 99.0%, compared with 99.5% in the previous year.

Teamwork

On 31 March 2008, SSE employed 16,892 people, an increase of 3,465 on the previous year. The progress made by SSE is due to the professionalism, commitment and teamwork of its employees. For that reason, and to mark the tenth anniversary of SSE's formation in 1998, every person who was employed by SSE on 31 March 2008, and who is still in employment on 1 August 2008, will receive a special award comprising: an offer, free of charge, of 10 shares in the company; an online voucher worth £200 for SSE's retail business; and an additional day's holiday.

The acquisitions of Airtricity and Slough Heat and Power brought to SSE talented teams of people with skills and knowledge which are already complementing the well-established capabilities of the people already in SSE.

Board

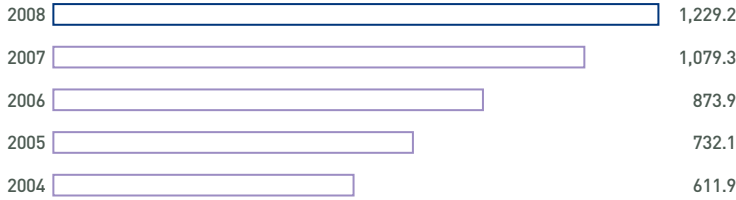
Sir Kevin Smith, who joined SSE as a non-Executive Director in 2004, has decided not to seek re-election to the Board at this year's Annual General Meeting and will step down from it at the conclusion of the Meeting. At that point, the Board of SSE will comprise four Executive Directors and four non-Executive Directors, plus the Chairman.

Corporate Responsibility Priorities in 2008/09 and Beyond

SSE's priorities in 2008/09, and beyond, are to: manage its principal risks effectively; make further progress towards its ultimate goal of injury-free working; avoid environmental incidents; and make progress towards securing a reduction in the carbon dioxide intensity of electricity produced at power stations in which it has an ownership or contractual interest; and maintain SSE as a fulfilling place to work. 🌱

02 Key Performance Indicators

Adjusted Profit Before Tax* – £m



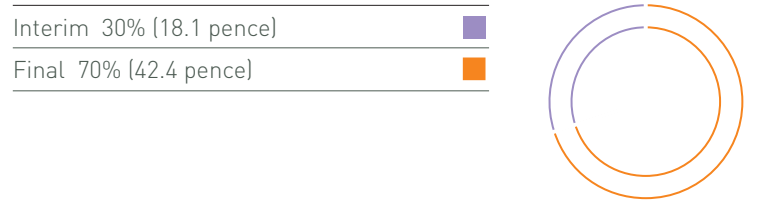
Operating Profit* – £m

	2006	2007	2008
Generation and Supply	444.8	642.6	724.2
Energy Systems	470.6	471.1	544.4
Gas Storage	27.3	55.9	50.9
Telecoms	13.2	13.9	14.3
Contracting, Connections and Metering	50.4	51.6	55.6

Dividend – pence



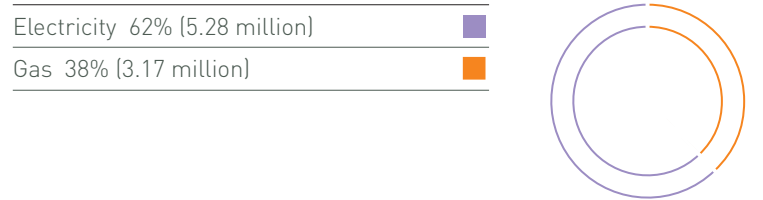
Dividend – composition



Energy Customer Numbers – million



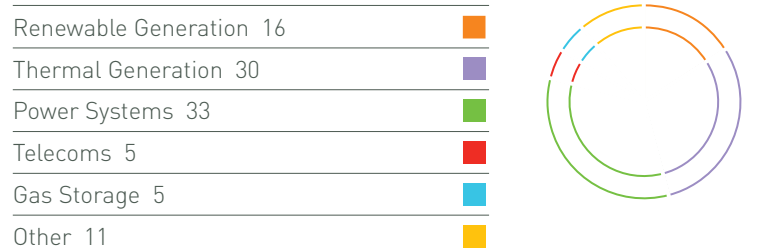
Energy Customer Numbers – composition



Capital Expenditure – £m

Renewable Generation	132.8
Thermal Generation	246.2
Power Systems	264.4
Telecoms	37.9
Gas Storage	40.9
Other	88.1
Total	810.3

Capital Expenditure – %



Corporate Responsibility

	2004	2005	2006	2007	2008
Lost Time and Reportable Accidents	27	17	17	11	11
Complaints to energywatch	2,632	1,981	1,573	840	615
Customer Minutes Lost – SEPD	81	84	71	72	67
Customer Minutes Lost – SHEPD	83	82	65	77	72

	2006	2007	2008	change	
FINANCIAL OVERVIEW					
Adjusted profit before tax* – £m	873.9	1,079.3	1,229.2	+13.9%	●
Adjusted earnings per share* – pence	74.7	92.5	105.6	+14.2%	●
Dividend per share – pence	46.5	55.0	60.5	+10.0%	●
Capital expenditure – £m	502.1	663.4	810.3	+22.1%	●
Net debt – £bn	2.17	2.23	3.67	+64.6%	●
Underlying interest cover – times	9.2	11.0	11.7	+6.4%	●
Dividend cover – times	1.61	1.68	1.73	+3.0%	●
GENERATION AND SUPPLY					
Generation and Supply operating profit* – £m	444.8	642.6	724.2	+12.7%	●
Electricity generation capacity – MW	10,015	10,017	10,542	+5.2%	●
Electricity generated – TWh	44.0	51.6	45.8	-11.2%	●
Energy generation capacity – renewable – MW	1,516	1,518	2,036	+34.1%	●
Electricity generation capacity qualifying for ROCs – hydro and wind – MW	566	568	748	+31.7%	●
Hydro storage – % of maximum water for generation	61	75	73	-2.7%	●
Power station availability – hydro output – GWh	3,054	3,767	3,518	-6.6%	●
Gas-fired power station availability – %	87	95	95	0.0%	●
Gas-fired power station thermal efficiency – %	50.4	49.5	49.2	-0.6%	●
Coal and biomass-fired power station availability – %	92	92	91	-1.1%	●
Coal and biomass-fired power station thermal efficiency – %	36.2	36.1	35.9	-0.6%	●
Power station water consumption – million cubic metres	3.49	3.18	4.12	+29.6%	●
Power station CO ₂ emissions – million metric tonnes	25.21	25.88	22.72	-20.3%	●
Power station CO ₂ emissions – kilograms per kWh	0.620	0.555	0.496	-10.1%	●
Power station SO ₂ emissions – metric tonnes	64,967	50,776	37,125	-26.9%	●
Power station SO ₂ emissions – grams per kWh	1.596	1.086	0.903	-16.9%	●
Power station NO _x emissions – metric tonnes	49,180	44,120	39,643	-10.1%	●
Power station NO _x emissions – grams per kWh	1.208	0.944	0.964	+2.1%	●
Electricity supplied – TWh	49.9	50.9	55.7	+9.4%	●
Energy customer numbers – millions	6.70	7.75	8.45	+9.0%	●
Electricity customers – millions	4.47	4.95	5.28	+6.7%	●
Gas customers – millions	2.23	2.80	3.17	+13.2%	●
Talk customers – thousands	30	97	165	+70.1%	●
Gas boiler customers – thousands	N/A	22	70	+218.2%	●
Complaints to energywatch	1,573	840	615	-26.8%	●
Electricity disconnections per 1,000 customers	0.02	0.03	0.03	+0.0%	●
Gas disconnections per 1,000 customers	0.20	0.22	0.22	+0.0%	●
ENERGY SYSTEMS					
Power Systems operating profit* – £m	367.9	368.0	382.9	+4.0%	●
Power Systems capital expenditure – £m	172.1	204.5	264.4	+29.3%	●
Regulatory Asset Value – £bn	2.5	2.6	2.7	+3.1%	●
Southern Electric Power Distribution operating profit* – £m	226.1	224.0	232.7	+3.9%	●
Scottish Hydro Electric Power Distribution and Transmission operating profit* – £m	141.8	144.0	150.2	+4.3%	●
Electricity distributed – TWh	43.8	42.4	43.0	+1.4%	●
Southern Electric Power Distribution customer minutes lost	71	72	67	-6.9%	●
Southern Electric Power Distribution interruptions – per 100 customers	78	75	66	-12.0%	●
Southern Electric Power Distribution mains in commission – km	74,300	74,832	75,747	+1.2%	●
Scottish Hydro Electric Power Distribution customer minutes lost	65	77	72	-6.5%	●

● = Positive ● = Neutral or Not Applicable ● = Negative

	2006	2007	2008	change	
Scottish Hydro Electric Power Distribution interruptions – per 100 customers	78	79	69	-12.7%	●
Scottish Hydro Electric Power Distribution mains in commission – km	45,586	46,221	46,454	+0.5%	●
Scottish Hydro Electric Power Distribution transmission mains in commission – km	4,913	4,913	4,913	+0.0%	●
Scotia Gas Networks operating profit* (SSE share) – £m	102.7	103.1	161.5	+56.6%	●
Scotia Gas Networks capital expenditure – £m	109.2	120.4	179.8	+49.3%	●
Scotia Gas Networks repair expenditure – £m	123.6	174.8	199.2	+14.0%	●
Scotia Gas Networks mains in commission – km	73,617	73,661	73,705	+0.1%	●
Scotia Gas Networks units distributed – TWh	185.3	162.3	169.5	+4.4%	●
Scotia Gas Networks Regulatory Asset Value – £bn	2.9	3.2	3.5	+9.4%	●
GAS STORAGE					
Gas Storage operating profit* – £m	27.3	55.9	50.9	-8.9%	●
Customer nominations met – %	100	100	100	+0.0%	●
TELECOMS					
Telecoms operating profit* – £m	13.2	13.9	14.3	+2.9%	●
Operational faults fixed within Service Level Agreements – %	90	94	98	+4.3%	●
Project delivery on standard projects – %	89	98	96	-2.0%	●
CONTRACTING, METERING AND CONNECTIONS					
Contracting, Connections and Metering operating profit* – £m	50.4	51.6	55.6	+7.8%	●
New electrical connections – thousands	42.9	44.6	42.8	-4.0%	●
New gas connections – thousands	7.9	9.2	8.2	-10.9%	●
Out-of-area networks in operation	19	24	33	+37.5%	●
Contracting order book peak – £m	87.2	95.4	107.2	+12.4%	●
Meters read once a year – %	N/A	95.1	95.4	+0.4%	●
Meters read twice a year – %	N/A	78.7	80.8	+2.6%	●
SAFETY					
Lost time and reportable accidents	17	11	11	0.0%	●
Lost time and reportable accidents – per 100,000 hours worked	0.08	0.05	0.04	-20.0%	●
Serious or potentially serious road traffic accidents	17	19	13	-31.6%	●
Serious or potentially serious road traffic accidents – per 100 vehicles	0.28	0.29	0.18	-37.9%	●
Injury-free business units	50	66	72	+9.1%	●
Scotia Gas Networks lost time accidents	20	21	13	-38.1%	●
Scotia Gas Networks lost time accidents – per 100,000 hours worked	0.28	0.21	0.15	-28.6%	●
ENVIRONMENT					
Non-power station CO ₂ emissions – tonnes	17,019	16,687	16,534	-0.9%	●
Breaches of IPC/IPPC	6	2	2	0.0%	●
Oil leaked – litres	27,941	31,761	42,189	+32.8%	●
Waste produced – offices and depots – tonnes	28,380	25,052	30,299	+20.9%	●
Waste sent to landfill – offices and depots – tonnes	10,217	7,787	8,282	+6.4%	●
Water consumption in principal offices – cubic metres	135,421	133,822	109,167	-18.4%	●
Water consumption in principal offices – cubic metres per whole time equivalent (WTE)	11.0	10.4	7.4	-28.9%	●
Energy Consumption in operational buildings – GWh	34.8	34.2	27.7	-18.9%	●
Energy consumption in principal offices – GWh	28.3	31.1	32.6	+4.9%	●
Energy consumption in principal offices – MWh per WTE	5.1	4.9	4.6	-6.1%	●
Distance travelled on SSE business – million km	194.49	198.51	212.63	+7.1%	●
Distance travelled on SSE business – km per WTE	15,855	15,416	13,864	-10.1%	●
Business flights	8,079	9,311	7,897	-15.2%	●
Business flights – per 1,000 employees	659	693	467	-32.6%	●

	2006	2007	2008	change	
Business flights – million km	6.97	9.22	7.36	-20.2%	●
Business rail journeys	1,511	2,545	9,706	+281.4%	●
Business rail journeys – per 1,000 employees	123	189	633	+234.9%	●
Business rail journeys – million km	0.56	0.86	2.83	+229.1%	●
Operational vehicles business travel – million km	153.80	156.90	168.91	+7.7%	●
Company cars business travel – million km	33.18	31.52	31.38	-0.04%	●
MARKETPLACE					
EEC energy savings – GWh	4,891	7,125	13,789	+93.5%	●
Homes insulated – thousands	200	229	201	-12.2%	●
Low energy lamps subsidised – thousands	410	560	9,100	+1,525.0%	●
Energy efficient appliances subsidised – thousands	24.8	23.4	19.8	-15.4%	●
Customers registered for Priority Services Register – thousands	219.9	297.8	367.1	+23.3%	●
Customers with tailor made payment plans – thousands	235.6	229.0	200.0	-12.7%	●
Customers on loyalty plans – millions	0.84	1.34	1.86	+38.8%	●
New suppliers	1,085	1,112	1,024	-7.9%	●
Suppliers for more than three years	N/A	5,626	4,270	-24.1%	●
WORKPLACE					
Employees – headcount	12,287	13,427	16,892	+25.8%	●
Employees – monthly average	12,124	13,053	15,777	+20.9%	●
Average age of employees – years	39	40	41	+2.5%	●
Absence from work per employee – days	6.37	6.01	6.03	+0.3%	●
Turnover of employees – annual %	13.3	13.8	11.9	-13.8%	●
Gender split – all employees – male/female	76/24	75/25	74/26	N/A	●
Gender split – managers – male/female	90/10	89/11	84/16	N/A	●
Employees in Share Incentive Plan – %	48	44	38	-13.6%	●
COMMUNITY					
Employees in receipt of Into Action	303	278	502	+80.6%	●
Employees participating in Quids In	892	943	1,375	+45.8%	●
Community benefit paid – £thousands	349	292	906	+210.1%	●
Charitable donations – £thousands	507	685	873	+27.4%	●
Research and development – £m	1.4	6.3	3.7	-41.3%	●

Principal Activities

Scottish and Southern Energy plc is a holding company. Its subsidiaries are organised into the main businesses of: generation, transmission, distribution and supply of electricity; storage, distribution and supply of gas; electrical and utility contracting; domestic appliance retailing; and telecoms. A review of the year's operations and future developments is contained in the Business Statement on pages 8 to 34 and the Corporate Governance Report on pages 41 to 47 which form part of this report.

Business Review

The business review has been divided into three areas and dealt with in the Annual Report as follows:

- Principal risks and uncertainties – pages 45 and 46 of the Corporate Governance Report;
- Review of the development and performance of the business – included in the Business Statement on pages 8 to 34; and
- Performance indicators – pages 35 to 38.

Directors

The Directors at the date of this report are:

Executive

Gregor Alexander
Colin Hood
Ian Marchant
Alistair Phillips-Davies

Non-Executive

Sir Robert Smith (Chairman)
Nick Baldwin
Richard Gillingwater
René Médori
Susan Rice
Sir Kevin Smith

Richard Gillingwater was appointed as a non-Executive Director on 25 May 2007 and David Payne retired on 26 July 2007.

Colin Hood, Ian Marchant, René Médori and Sir Robert Smith retire by rotation at the Annual General Meeting and, being eligible and in accordance with the Articles of Association, all offer themselves for re-election. Sir Kevin Smith will also retire as a non-Executive Director on 24 July 2008.

Biographical details for all Directors are set out on pages 48 and 49. Details of the service contracts for Colin Hood and Ian Marchant, and the letters of appointment for René Médori and Sir Robert Smith, all of whom are standing for re-election are set out in the Remuneration Report on pages 52 and 53 respectively. The interests of the Directors in the ordinary shares of the company at 31 March 2008 are set out in the Remuneration Report on page 54.

Resolution 2 to be proposed at the Annual General Meeting seeks shareholders' approval of the Remuneration Report.

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 is currently in force. The company also purchased and maintained throughout the financial year directors' and officers' liability insurance in respect of itself and for its Directors and Officers.

Results and Dividends

The Group profit attributable to shareholders for the financial year amounted to £872.9m. The Directors recommend a final dividend of 42.4p per ordinary share which, subject to approval at the Annual General Meeting, will be payable on 26 September 2008 to shareholders on the register at close of business on 22 August 2008. With the interim dividend of 18.1p per ordinary share paid on 25 March 2008, this makes a total dividend of 60.5p per ordinary share.

Share Capital

Details of the company's authorised and issued share capital at 31 March 2008, which includes options granted under the Group's employee share option schemes, are detailed in notes 24 and 27 to the Financial Statements. Each ordinary share of the company carries one vote at general meetings of the company.

Annual General Meeting

The 19th Annual General Meeting of the company will be held on 24 July 2008 at 12 noon at the Bournemouth International Centre, Exeter Road, Bournemouth BH2 5BH. The Notice of Annual General Meeting together with full explanations of business to be conducted is set out in the separate shareholder circular.

Substantial Shareholdings

As at the date of this report the company had received the following notifications of beneficial interests of three per cent or more in the company's issued share capital:

	Number of shares	Percentage
Barclays	43,048,546	4.95
Legal & General Group plc	39,198,734	4.50

Research and Development

Research and development is fundamental to the company's ability to change and adapt to the challenges of the future, and in 2007/08 a number of strategic parts of SSE's R&D programme were successfully implemented. These included the appointment of R&D Coordinators in each of the main business areas, improved R&D governance, identification of key R&D funding sources, and the development of strategic research partnerships with leading UK research institutes. The company has also continued to take an active role in the UK Energy Research Partnership, as well as building relationships with UK and EU Research Councils.

During 2007/08 the company invested £3.7m in a number of innovative research and demonstration projects including clean coal technologies, carbon capture and storage, and novel fuel processing techniques. Other projects have focused on climate change, energy efficiency, energy storage and advanced renewable energy technologies. One of the largest R&D projects commissioned in 2007 was the Energy Demand Research Project which is jointly funded by SSE and the government, to enhance the understanding of how customers react to improved information on energy consumption.

SSE Power Distribution has continued to take an active role in the Ofgem Innovation Funding Incentive for both distribution and transmission and has commissioned R&D projects addressing asset management, security of supply and active network management.

Employees

The number of staff directly employed by the Group at 31 March 2008 was 16,892.

Employees are encouraged to participate in the business of the company in a variety of ways. In support of the Board's commitment to providing opportunities for employees to become shareholders, the company offers a Share Incentive Plan and a Sharesave Scheme which is open to all eligible employees. Employee participation in these schemes is around 38% and 37% respectively. The company recognises that its continuing success is closely linked to the performance, skills and individual commitment of its employees. As part of the 2007 employee award, all eligible employees were awarded 20 free shares.

The company places a strong emphasis on employee communication and involvement. An employee newspaper is published and distributed to employees. Participation and engagement is encouraged through team meetings, briefings and the intranet where employees are informed of the latest company news from recent media coverage and about developments within the business.

The Chief Executive regularly communicates with employees through his blog and receives feedback, in addition to live on-screen question and answer style 'webchats'. During the year, the senior management held a series of roadshows around the Group to present and discuss the Group's vision, values and strategy.

The company has in place an extensive range of policies to safeguard the interests of its employees and potential employees. In particular, its equal opportunities policy aims to ensure that all employees and job applicants are no less fairly treated due to age, gender, sexual orientation, race, disability or other reasons not justified in law or relevant to performing their job. The company also aims to ensure that employees have the right skills to deliver the high standards of performance that are necessary to achieve its objectives. Detailed information about the company's approach to these and related matters is set out in its Corporate Responsibility Report 2008 (see www.scottish-southern.co.uk).

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 numbers of suppliers' days represented by trade creditors was 42 days at 31 March 2008.

Donations

Charitable donations amounted to £873,000 (2007 – £685,000). There were no payments for political purposes.

Financing Policy and Derivatives

The Group's policies together with details of financial instruments and derivatives are set out in notes 1 and 28 to the Financial Statements.

Additional Information

Where not provided elsewhere in the Directors' Report, the following provides the additional information required to be disclosed by Part 7 of the Companies Act 1985 as amended.

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 scheme's trust give directions to the trustees to vote on their behalf by way of a Form of Direction.

The company is not aware of any agreements between shareholders that may result in restrictions on the transfer of securities and/or voting rights.

The rules governing the appointment of Directors is set out in the Corporate Governance Report on pages 41 to 47. 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.

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 Annual General Meeting.

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 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
28 May 2008

03 Corporate Governance Report

1. Organisation and Structure

Dear Shareholder

The Board's principal objective is to ensure that the Group delivers its strategy whilst ensuring that this is carried out within a sound framework of corporate governance. The Board believes that strong corporate governance enhances shareholder value and this report sets out how the governance framework is implemented across the Group.

David Payne retired at the 2007 Annual General Meeting after nine years of service on the Board. David's background in energy and perceptive understanding of complex issues made him an outstanding Director.

I am pleased that we were able to appoint Richard Gillingwater as a non-Executive Director in May 2007. Richard has brought a wealth of experience and knowledge to the Board having held a number of appointments in the City of London. His appointment complements very well the contributions of the other Directors. After these changes, the Board continued to have four Executive Directors and five independent non-Executive Directors in addition to myself as Chairman.

Sir Kevin Smith, who joined SSE as a non-Executive Director in 2004, has decided not to seek re-election to the Board at this year's Annual General Meeting and will step down from it at the conclusion of the Meeting. During his time with us, Kevin has made an invaluable contribution, not least in supporting the work of the Health, Safety and Environmental Advisory Committee of the Board. After Kevin steps down, the Board of SSE will comprise four Executive Directors and four non-Executive Directors, in addition to myself as Chairman.

During the year the Board continued to visit new and existing operational sites. These visits took in the length and breadth of the country from Glendoe in the North of Scotland, which will be the first large-scale hydro electric power station in 50 years, to new facilities on the South coast of England. The Directors also met a wide range of stakeholders as well as investors and analysts at the annual and interim results presentations.

We have just completed our Board and committee performance evaluation. The evaluation process highlighted some areas where improvements could be made but overall the conclusion was that the Board continues to function well.

Sir Robert Smith
Chairman
28 May 2008

The Framework of Corporate Governance

The Board is accountable to the company's shareholders for the good conduct of the company's affairs. The following information sets out how the principles contained in the Financial Reporting Council's Combined Code on Corporate Governance (the Code) are applied by the company.

Throughout the year the company monitors developments in corporate governance best practice. Due regard is also given to the policy guidelines of organisations representing major institutional investors. In addition, internal procedures are regularly reviewed and updated by the Board and the various Board committees.

Combined Code Compliance

The Board continues to be committed to ensuring that the highest standards of corporate governance are maintained. The Board confirms that the company has, throughout the period under review, complied with all provisions set out in Section 1 of the Code.

ORGANISATION AND STRUCTURE

Role of the Board

The Board is collectively responsible for creating and sustaining shareholder value through the overall management of the Group whilst ensuring that a sound system of internal control and risk management is in place.

The Directors are fully briefed in advance of Board meetings on all matters to be discussed, including regular business and financial reports, and they also receive copies of analysts' and brokers' reports on the company.

The Board receives detailed financial and operational information to allow it to monitor effectively the performance of the key areas of the business. It also receives regular updates on the progress and performance of investments and other major decisions made by it, together with business reports and presentations from senior management.

Board Decisions

A formal schedule of matters is specifically reserved to the Board for its decision, including:

- Group strategy;
- annual budget;
- approval of interim and final financial statements;
- significant changes in accounting policy and practice;
- Board and committee appointments and related governance matters;
- major acquisitions, mergers, disposals and capital expenditure;

- changes to the Group's capital structure; and
- key policies.

The schedule is reviewed regularly by the Board and is published on the company's website (www.scottish-southern.co.uk).

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 it operates effectively whilst providing appropriate challenge to management.

During the year, the Chairman met regularly with senior managers. Although not a member, he regularly attends the Audit Committee meetings. External engagements included meetings with analysts and other representatives of institutional investors, and he participated in both the interim and annual results presentations. Biographical information on the Chairman is set out on page 48.

The Chief Executive is responsible for the day to day management of Group business and the implementation of strategy and policy as agreed by the Board. In discharging his responsibilities, the Chief Executive is advised and assisted by senior management and a number of specific management committees from throughout the Group's businesses. Biographical information on the Chief Executive is set out on page 48.

Balance of the Board

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

Non-Executive Directors

The responsibilities of the non-Executive Directors include to:

- scrutinise, measure and review the performance of management;
- assist in the development of strategy;
- review the financial information;
- ensure systems of internal control and risk management are appropriate and effective;
- manage the relationship with the external Auditor; and
- review the remuneration of and succession planning for the Board.

Independence and Experience of Non-Executive Directors

The Board has assessed the independence of the non-Executive Directors against the criteria set out in the Code and has concluded that they are all independent in character and judgement. In line with the recommendations of the Code, at least half the Board, excluding the Chairman, are independent non-Executive Directors. Sir Robert Smith was also independent when appointed Chairman.

The non-Executive Directors are chosen for their wide range of skills and experience. Their continuing independence of judgement is confirmed in the annual Board performance evaluation process. Non-Executive Directors serve on the Board committees of Audit, Nomination and Remuneration, and one serves on the Health, Safety and Environmental Advisory Committee. Further details on the membership and operation of these committees are set out on pages 43 to 46.

The Chairman and non-Executive Directors met during the year without the Executive Directors being present. The non-Executive Directors met without the Chairman present.

All of the non-Executive Directors have been appointed for fixed terms of three years. Appointment letters are available on the company's website (www.scottish-southern.co.uk).

Senior Independent Director

Susan Rice was appointed Senior Independent Director on 26 July 2007 on the retirement of David Payne. She is available to meet with major shareholders on request and she attended the city presentation of the Group's half-year results. In January 2008 she carried out the Chairman's performance evaluation, together with the other non-Executive Directors.

Director Elections

The company requires all Directors to stand for election by shareholders at the first Annual General Meeting (AGM) following appointment. In addition, all Directors are required to retire by rotation and stand for re-election at least every three years. Colin Hood, Ian Marchant, René Médori and Sir Robert Smith will stand for re-election at this year's AGM. Sir Kevin Smith intends to retire from the Board at the AGM this year. The Board evaluation process confirmed that the performance of the Directors standing for re-election continue to be effective and that they continued to demonstrate commitment in their respective roles. In addition, Sir Robert Smith as Chairman and René Médori as a non-Executive Director, have the appropriate experience, knowledge and independence to scrutinise effectively the performance of management. Biographical details for all the Directors are set out on pages 48 and 49.

Attendance at Board and Board Committee Meetings

Non-attendance at Board and committee meetings is rare, although may arise due to unforeseen circumstances or prior commitments which could not be rearranged, as in the case of Sir Kevin Smith during 2007/08. Where a Director is unable to attend a meeting he or she provides comments and feedback to either the Chairman, Committee Chairman or Company Secretary, who ensure that the comments received are raised at the meeting.

The attendance of Directors at Board meetings and at meetings of the six principal committees during 2007/08 is set out in Table A below.

BOARD EFFECTIVENESS

Information and Professional Development

The Directors receive accurate, timely and

clear information, with all committee and Board papers being issued in advance of meetings. On joining the Board, Directors receive a comprehensive induction course tailored to their individual requirements which includes meetings with the Executive Directors and the senior management team, visits to key sites, and meeting 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 the Group.

During the year, the Board and Board committees are kept up-to-date with developments. This generally follows a forward programme where briefings are given by Executive Directors and the senior management team on developments in their business area. Additional specialist briefings were given on areas such as Directors' duties, corporate governance, regulation, health and safety, and financial reporting standards. Separate more informal meetings were also held with the senior management team. The non-Executive Directors have individual meetings, briefings and site visits. The briefs focus on subjects where they have specific knowledge or expertise, such as energy trading, operational matters and customer service.

The Board believes that given the experience and skills of the Directors and the briefings referred to above, any further personal training needs should be left to the discretion of the individual. The company makes the necessary resources available should any Director request training.

There is an agreed procedure for Directors to be able to take independent professional advice, if necessary, at the Group's expense. The prior approval of the Chairman is required where such advice is likely to exceed £10,000. Any advice obtained shall be made available

Table A – Attendance at Meetings

	Board 8 meetings	Audit Committee 3 meetings	Nomination Committee 2 meetings	Remuneration Committee 5 meetings	Executive Committee 12 meetings	Risk Committee 13 meetings	Health, Safety and Environmental Advisory Committee 3 meetings
Sir Robert Smith	8	–	2	5	–	–	–
Gregor Alexander	8	–	–	–	12	13	–
Nick Baldwin	8	3	–	–	–	–	–
Richard Gillingwater*	8	3	–	3	–	–	–
Colin Hood	8	–	–	–	12	–	3
Ian Marchant	8	–	2	–	12	12	–
René Médori	8	3	2	–	–	–	–
David Payne**	3	1	1	1	–	–	–
Alistair Phillips-Davies	8	–	–	–	12	13	–
Susan Rice	8	–	1	5	–	–	–
Sir Kevin Smith	6	–	2	4	–	–	3

* Richard Gillingwater was appointed to the Remuneration Committee on 26 July 2007.

** David Payne retired as a non-Executive Director on 26 July 2007 and attended all relevant meetings up to his retirement.

3. Board Committees 4. Audit Committee

to the other members of the Board, if the Board so requests.

All Directors have access to the advice and services of the Company Secretary.

The company continues to operate advanced performance coaching for some of the Executive Directors and for members of the senior management team which is designed to develop and enhance individual and Group performance.

Performance Evaluation

The Board, the Board committees and the individual Directors undergo an annual process of performance evaluation. The senior management team also participates in a performance evaluation programme.

During the year the Chairman conducted the performance evaluation of the Board. Each Director completed detailed questionnaires which had been developed since the previous year's evaluation. The questionnaires covered the Board and committee processes, their effectiveness and where improvements could be made. Reports were produced on the key findings and the Chairman of the Board and the committee Chairmen reported these findings to the Board meeting in March 2008 for discussion. Directors also completed detailed questionnaires on individual performance which formed the basis of the one-to-one meetings with the Chairman. The process for evaluating the Chairman was managed by the Senior Independent Director which involved a separate meeting of the non-Executive Directors chaired by the Senior Independent Director.

Following the review, the Directors have concluded that the Board and its committees operate effectively, continued to set clear objectives and focussed on the correct areas. Each of the Directors continued to make an effective contribution to the work of the Board and was well informed and demonstrated full commitment to his or her duties. Some areas for improvement were identified and these will be taken forward in 2008.

The Board was satisfied that the review of its performance was a worthwhile exercise and the Directors had participated in an open and frank basis.

BOARD COMMITTEES

During the year, the Board had six principal committees. The terms of reference for all committees are reviewed regularly and are available for inspection on the company's website (www.scottish-southern.co.uk).

AUDIT COMMITTEE

The Audit Committee assists the Board in the effective discharge of its responsibilities for financial reporting and internal control. It acts independently of the Executive Directors.

In the discharge of its duties the Committee:

- ensures that the company's financial reports represent an accurate, clear and balanced assessment of the company's position and prospects;
- ensures the efficiency and monitors the effectiveness of the company's operations and internal control and risk management functions; and
- reviews 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.

The Committee has unrestricted access to company documents and information as well as to employees of the company and the external Auditors. The Audit Committee Chairman reports the outcome of meetings to the Board.

Membership and Meetings

The members of the Audit Committee during the year and at the date of this report are set out in Table B below.

The Deputy Company Secretary is Secretary of the Audit Committee.

All members of the Committee are independent non-Executive Directors. Membership is determined by the Board, on the recommendation of the Nomination Committee and in consultation with the Audit Committee Chairman. Its terms of reference are set by the Board and are reviewed regularly.

In terms of the Code, at least one member of the Committee must have recent and

relevant financial experience and all Committee members are expected to be financially aware. René Médori has recent and relevant financial experience through his position as Finance Director of a major international listed company.

The Committee normally asks the Finance Director, Head of Group Audit and the external Auditors to attend its meetings. Senior management including the Group Treasurer, Group Financial Controller, Head of Energy Trading and Head of Portfolio Support may also attend to present reports.

The Audit Committee had three meetings during the year.

Activities in 2007/08

During the year the Audit Committee undertook the following in order to discharge its responsibilities:

Financial Statements

- reviewed the financial statements in the 2007 report and accounts and the interim results. As part of this review the Committee received from the Auditor KPMG Audit Plc a report on their audit of the annual report and accounts and their review of the interim results; and
- reviewed the annual and interim results announcements.

Control Environment and Risk Management

- received six-monthly reviews by Group 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 Audit Plan for the year ending 31 March 2008;
- 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 Audit on the Internal Control Risk Assessment setting out the Group Risk Map and Residual Risk Map both of which had been reviewed by the Executive Committee; and
- received the annual Post-Investment Appraisal Report and Independent Project Review.

Table B – Members of the Audit Committee

Name	Role	Date of appointment/resignation
René Médori	Committee Chairman and non-Executive Director	Appointed June 2003
Nick Baldwin	Non-Executive Director	Appointed November 2006
Richard Gillingwater	Non-Executive Director	Appointed May 2007
David Payne	Non-Executive Director	Retired July 2007

External Audit Process

- reviewed the effectiveness of the overall audit process for 2007/08, meeting with the Auditor and management separately to identify any areas of concern in the preparation of the financial statements;
- reviewed 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 key accounting and audit issues; and
- reviewed recommendations made by the Auditor in its management letter and the adequacy of management's response.

Independence of Auditor

- reviewed the extent of non-audit services provided by the Auditor in accordance with the established policy where:
 - a competitive tender process is required where non-audit fees exceed a threshold of £30,000 for general advice and £75,000 for tax-related advice;
 - the Committee must be satisfied that the work was best handled by the Auditors because of their knowledge of the Group; and
 - the Committee must be satisfied that the objectivity and independence of the Auditors was not affected by the work
- reviewed changes in the Audit team; and
- recommend to the Board that the Auditor be reappointed.

Full disclosure of the non-audit fees paid during the year is made in note 3 to the Financial Statements.

Evaluation

The annual evaluation was conducted by the Committee of its composition, role and

responsibilities, operation and effectiveness, the conclusions of which were agreed and reported to the Board at its meeting in March 2008.

REMUNERATION COMMITTEE**Role**

The principal responsibilities of the Remuneration Committee are:

- formulation of remuneration policy and approval of all aspects of the Executive Directors' remuneration, including bonuses and the granting of incentives under the company's schemes;
- ensuring that an appropriate proportion of pay is linked to corporate and individual performance; and
- review and approval of the Chairman's fees.

Membership

The members of the Remuneration Committee who held office during the year and at the date of this report are set out in Table C below.

Activities in 2007/08

During the year the Remuneration Committee met five times.

Full details of Directors' remuneration, general policy and developments during the year are given in the Remuneration Report set out on pages 50 to 56. The Company Secretary is Secretary to the Remuneration Committee.

Evaluation

The annual evaluation was conducted by the Committee of its composition, role and responsibilities, operation and effectiveness, the conclusions of which were agreed and reported to the Board at its meeting in March 2008.

NOMINATION COMMITTEE**Role**

The Nomination Committee reviews the structure, composition and balance of the Board and leads the process for Board appointments. Before an appointment is made the Committee evaluates the skills, knowledge and experience of the Board to ensure that any new appointment complements these qualities. Candidates from a wide range of backgrounds are considered and as part of the process for identifying suitable candidates, the Committee utilises the assistance of a professional search firm. The Committee reviews membership of all Board committees.

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.

Membership

The members of the Nomination Committee who held office during the year and at the date of this report are set out in Table D below.

The Company Secretary is Secretary to the Nomination Committee.

Members do not take part in discussions about their own appointment. The Board Chairman would not chair the meeting when it is dealing with the appointment of his successor. In this case the meeting would be chaired by a non-Executive Director elected by the remaining members.

Activities in 2007/08

During the year the Nomination Committee met twice.

Table C – Members of the Remuneration Committee

Name	Role	Date of appointment/resignation
Susan Rice	Committee Chairman and non-Executive Director	Appointed November 2006
Richard Gillingwater	Non-Executive Director	Appointed July 2007
Sir Robert Smith	Board Chairman	Appointed November 2006
Sir Kevin Smith	Non-Executive Director	Appointed November 2004
David Payne	Non-Executive Director	Retired July 2007

Table D – Members of the Nomination Committee

Name	Role	Date of appointment/resignation
Sir Robert Smith	Committee and Board Chairman	Appointed January 2005
René Médori	Non-Executive Director	Appointed November 2006
Susan Rice	Non-Executive Director	Appointed November 2007
Sir Kevin Smith	Non-Executive Director	Appointed November 2004
Ian Marchant	Chief Executive	Appointed October 2002
David Payne	Non-Executive Director	Retired July 2007

7. Risk Committee 8. Executive Committee 9. Health, Safety and Environmental Advisory Committee
10. Accountability, Risk Management and Internal Control

Following the retirement of David Payne, the committee recommended the appointment of Susan Rice as the Senior Independent Director. This appointment was made on 26 July 2007. The committee also reviewed the membership of Board committees, and succession planning.

Evaluation

The annual evaluation was conducted by the Committee of its composition, role and responsibilities, operation and effectiveness, the conclusions of which were agreed and reported to the Board at its meeting in March 2008.

RISK COMMITTEE

The Risk Committee comprises Alistair Phillips-Davies (Chairman), Ian Marchant, Gregor Alexander and senior managers from Energy Trading, Electricity Generation and Finance. It met 13 times during the year to review and manage the operational and financial risks and exposures in Energy Trading, Generation, and Treasury. A member of the company secretariat team is Secretary to the Risk Committee.

EXECUTIVE COMMITTEE

The Executive Committee comprised all the Executive Directors and other senior managers. The Chairman was Ian Marchant. It met 12 times during the year and was responsible for all key management issues arising from the business of the Group; the implementation of the Group strategy; and monitoring the operational and financial performance and assessing and reviewing risks arising from the Group's business. The Company Secretary was a member of and Secretary to the Executive Committee.

Since the year end, the Executive Committee has been replaced by several more business specific leadership teams.

HEALTH, SAFETY AND ENVIRONMENTAL ADVISORY COMMITTEE

The Health, Safety and Environmental Advisory Committee met three times during the year and was responsible for ensuring that health, safety and environmental policies had been implemented, setting targets and monitoring performance, and promoting awareness of these issues throughout the Group.

The Committee members are Colin Hood (Chairman), the Director of Human Resources, the Group Safety and Environmental Manager and non-Executive Director, Sir Kevin Smith, with Ian Marchant attending as appropriate. The Deputy Company Secretary is Secretary to the Committee.

ACCOUNTABILITY, RISK MANAGEMENT AND INTERNAL CONTROL

The Board considers risk management and the system of internal control to be fundamental to achieving the Group's strategy.

The system of internal control is the Board's overall responsibility. Reviewing the system and monitoring its effectiveness is delegated to the Audit Committee and is reviewed at least annually by the Board.

The system of internal control is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement and loss.

The Board and the Audit Committee have reviewed the effectiveness of the internal control system in accordance with the Code for the period from 1 April 2007 to the date of approval of this Annual Report. No significant failings or weaknesses have been identified. However, had there been, the Board confirms that appropriate action would have been taken.

Internal control is maintained through an organisation structure with clearly defined responsibilities, authority levels and lines of reporting. The key elements of the Group's internal control process are summarised below:

The Board, which:

- 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 by the Audit Committee and other Board committees, management and internal audit;
 - the provision of quality reporting from the external Auditors;
 - 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 after review by the Audit Committee;
- approves and regularly reviews and updates the Group's strategy and business development;
- reviews performance through a system of reporting based on annual operating and capital expenditure budgets; monthly reviews against actual results, analysis of variances and evaluation of key performance indicators;
- receives regular reports from the Chief Executive, the Finance Director and the Executive Directors; and
- undertakes an annual evaluation of the Board, its committees and individual Directors.

The Audit Committee, which:

- assists the Board in the effective discharge of the responsibilities for financial reporting and internal control, acting independently of management;
- ensures financial reports and formal announcements represent an accurate, clear and balanced assessment of the Group's position and prospects;
- reviews and ensures the effectiveness of operational and internal controls, the reliability of the information and accounting systems, and the implementation of established policies and procedures;
- monitors and reviews the effectiveness of the internal audit function through regular reports from the internal audit department;
- reviews the significant risks identified by each business unit as well as the mitigating action against those risks;
- maintains a close relationship with the external Auditors; and
- reviews the arrangements by which employees can in confidence raise concerns about any possible improprieties in financial and other matters.

The Executive Directors, who:

- monitor operational and financial performance of the Group;
- develop and implement Group strategy, operational plans, policies, procedures and budgets;
- assess and control all Group risk; and
- monitor competitive forces in each areas of operation.

The Risk Committee, which:

- supports the Audit Committee and management in managing risks and exposure in Energy Trading and Treasury;
- ensures that risk exposure is managed appropriately;
- sets and approves risk management policies and trading strategies;
- ensures the effectiveness of operations and internal controls; and
- ensures risks inherent in business activities are understood and managed.

The Health, Safety and Environmental Advisory Committee, which:

- together with the Audit Committee and management, ensures that the health, safety and environmental policy statements are being adhered to;
- sets health, safety and environmental targets for the Group; and
- monitors the performance of the Group against these targets.

The Internal Audit Department, which:

- 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 the Group's system of internal control through the distribution of reports and, where appropriate, action plans to senior managers, Directors, the Audit Committee and external Auditors;
- monitors adherence to the Group's key policies and principles; and
- provides the Audit Committee and Board with objective assurance on the Group's control environment.

KEY RISKS AND THE CONTROL ENVIRONMENT

The Business Statement considers risk in the context of the current business environment. The key risks and the control environment which generally apply are considered below.

Treasury Risk

The Board reviews and agrees policies for addressing risks in respect of interest rates, foreign exchange, liquidity and credit. If either fuel or plant are contracted in foreign currency, it is the Group's policy to hedge material purchases through foreign currency swaps and forward rate contracts.

Energy Trading Risk

The risk of exposure to energy prices and volumes is addressed by the Risk Committee and is further explained in note 28 to the Financial Statements.

Operational Risk

Mechanical or process failure in the licensed operations could be significant. Operating risk is addressed through the identification of key operational risks and the development of mitigation plans by each business unit. The Group also focuses on seeking operational excellence and on maintaining the highest standards of safety and quality.

Regulatory and Governmental Risk

The Group is exposed to economic regulation and Government policy. The Executive Directors and management respond to developments and where appropriate engage with the industry regulators, government ministers and officials and other key bodies to ensure any risks are mitigated.

Financial Risk

The Group's performance is reviewed by the Board and the Executive Committee. There is a comprehensive financial review cycle, which includes an annual budget approved by the Board, review of monthly variances against budget and regular review of forward looking and historic key performance indicators. Clear authorisation levels also exist and there is proper segregation of accounting duties.

Investment Risk

There is a formal authorisation procedure for all investments with clear guidelines on appraisal techniques and success criteria. The Audit Committee reviews investments through the Post-Investment Appraisal process.

GOING CONCERN

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

COMMUNICATION WITH SHAREHOLDERS AND MAJOR STAKEHOLDERS

Institutional Shareholders

The Board encourages and seeks to build up a mutual understanding of objectives between the Group and institutional shareholders, fund managers and analysts. It believes that this is fundamental to ensuring that the Group's strategy is understood and that any questions or issues are dealt with in a constructive way.

The Executive Directors follow an ongoing programme of dialogue, meetings, presentations and site visits. The Investor Relations team has day-to-day responsibility for managing communications with institutional shareholders.

The Board receives reports on significant discussions with shareholders allowing Directors to form a view of the priorities and concerns of the company's stakeholders. Brokers' reports and analysts' briefings are distributed to Directors.

An internal Disclosure Group ensures all appropriate communications are made to the London Stock Exchange and shareholders. Copies of all announcements can be accessed from the company's website (www.scottish-southern.co.uk).

The Chairman attended the company's interim and preliminary results presentations in May 2007 and November 2007. Susan Rice who was appointed Senior Independent Director in July 2007 also attended the interim results presentation in November.

As part of the induction programme, arrangements are made for major shareholders to meet with newly appointed Directors.

Private Shareholders

The Board is equally interested in the concerns of private shareholders and, on its behalf the Company Secretary oversees communication with these investors.

Annual General Meeting

The company's Annual General Meeting (AGM) gives an opportunity for the Board to communicate with shareholders. It gives shareholders the opportunity to be briefed by management on the performance of the Group. All Directors attend the AGM and shareholders are invited to ask questions and to meet with the Directors and senior managers both before the meeting and following the conclusion of the formal part of the meeting.

At the AGM, shareholders are advised of the proxy votes cast for each resolution and a report is placed on the company's website following the meeting, in addition to being announced to the London Stock Exchange.

Company Communications

Following the introduction of the Companies Act 2006 shareholders now have a choice on how to receive their company communications such as the annual report. A letter from the Chairman was sent to shareholders as part of the dividend mailing in March 2008 asking shareholders to elect:

- to receive email notification of company communications, view documentation online and lodge their proxy over the internet;
- to receive written notification of the availability of company communications on the website; or
- to continue to receive paper copies of company communications.

Following this programme, an additional 10,000 shareholders chose to receive all their communications electronically. As recognition of the reduced environmental impact that this form of communication entails the company, on behalf of shareholders, will make a donation of £20,000 to the World Wildlife Fund's (WWF's) International Forest Programme. The company now communicates with 41,000 shareholders electronically. In addition, over 260,000 shareholders chose to receive written notification of the electronic availability of future communications and the company will make a further donation in excess of £65,000 to WWF's International Forest Programme.

The previous electronic communications and shareholding merger programmes resulted in over 39,000 native species trees being planted in SSE woodlands.

Dividend Reinvestment Plan

The company runs a dividend reinvestment plan which allows shareholders to reinvest cash dividends in further shares to build up their stake in the company. Details can be obtained from the company's website or by calling the shareholder helpline number.

Investor Centre

Shareholders can also access Investor Centre, a free internet-based service provided through the company's registrar allowing shareholders online access to:

- view their shareholdings;
- update their details;
- manage their share portfolio; and
- make use of the registrar's share dealing service.

Company's Website –

www.scottish-southern.co.uk

To ensure that shareholders have access to as much information as possible, the company's website contains a wide range of information about the Group, including:

- Media centre contains a financial overview of the Group, press releases and project news.
- Investor centre contains annual and interim reports, shareholder presentations, regulatory and news announcements; share price information.
- Corporate Responsibility contains the Governance section, including the Articles of Association, Schedule of Matters Reserved to the Board, committee terms of reference and the letters of appointment of the non-Executive Directors.

Shareholder Helpline Number –

0845 143 4005

A telephone helpline is available that provides a point of contact directly to the company's registrars for shareholders on issues such as dividends, change of details and duplicate share certificates.

Other Stakeholders

In November 2007, the Board met with a range of external stakeholders representing the public sector, investment community, environmental affairs, and consumer interests. The purpose was to hear their views, suggestions and any concerns, and also to explain the Group's position on a range of business, policy and public interest issues.

More generally, working with public policy makers is a vital area for SSE, given the high profile of energy- and environment-related issues in the UK and elsewhere.

SSE engages with stakeholders in seven main ways:

- constructive engagement with Ofgem, which is responsible for promoting competition, wherever appropriate, and regulating the monopoly companies which run the gas and electricity networks;
- ongoing dialogue with Ministers and officials in government, including the devolved administrations in the UK;

- submissions to government and Parliamentary consultations and inquiries (which are generally publicly available);
- meetings with, and briefings of, elected members of all parties in legislatures;
- engagement with local authority elected members and officials;
- active participation in relevant trade associations and bodies; and
- discussions and work with non-governmental organisations and other relevant organisations such as charities.

SSE'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 policy and regulatory framework which is compatible with the delivery of the legally-binding EU targets for renewable energy in 2020.

**1. Nick Baldwin (55)****Non-Executive Director**

Nick joined the Board of Scottish and Southern Energy as a non-Executive Director in September 2006. Previously he worked in electricity, gas and water utilities, culminating in being the Chief Executive of Powergen plc. He is a non-Executive Director of the Nuclear Decommissioning Authority, a non-Executive Director of the Forensic Science Service and Chair of the Public Weather Service Customer Group. He also serves on the Advisory Board of Climate Change Capital Limited and is Chairman of Worcester Community Housing Limited. He is a member of the Audit Committee.

2. René Médori (50)**Audit Committee Chairman**

René joined the Board as a non-Executive Director in June 2003. He is Finance Director of Anglo American plc and is a non-Executive Director of Anglo Platinum and DB (De Beers) Investments. He is a former Finance Director of the BOC Group plc, and previously worked for Accenture and Schlumberger Limited. He is Chairman of the Audit Committee and a member of the Nomination Committee.

3. Gregor Alexander (45)**Finance Director**

Gregor joined the Board of Scottish and Southern Energy as Finance Director in October 2002. He was appointed Group Treasurer and Tax Manager in 1998 having held a number of senior positions within the Finance team. He worked for Arthur Andersen for five years before joining Scottish Hydro Electric in 1990, six months before privatisation. Gregor is a Director of Scotia Gas Networks plc and Chairman of The Group of Scottish Finance Directors. He is a member of the Risk Committee.

4. Susan Rice CBE (62)**Non-Executive Director**

Susan joined the Board as a non-Executive Director in July 2003. She is Chairman and Chief Executive of Lloyds TSB Scotland plc, having previously been Managing Director, Personal Banking, for the Bank of Scotland. Susan is a non-Executive Director to the Court of the Bank of England and chairs the Board of the Edinburgh International Book Festival along with several other organisations. Susan chairs the Remuneration Committee and is a member of the Nomination Committee.

5. Alistair Phillips-Davies (40)**Energy Supply Director**

Alistair joined the Board in January 2002, having previously held various positions in the finance and commercial operations areas of the company. He joined Southern Electric in February 1997 having previously worked for HSBC and the National Westminster Bank in corporate finance and business development roles. He is a Chartered Accountant and a Director of the Energy Retail Association. Alistair is Chairman of the Risk Committee and has Board level responsibility for Energy Trading, Electricity and Gas Supply, Sales, Marketing and Energy Services.

6. Ian Marchant (47)**Chief Executive**

Ian was appointed Chief Executive in October 2002 having been Finance Director since 1998. He joined Southern Electric in 1992 and joined the Board on becoming Finance Director in 1996. Previously he worked for Coopers & Lybrand (now PwC), including a two-year secondment to the Department of Energy working on electricity privatisation. Ian is a member and former Chairman of the United Kingdom Business Council for Sustainable

Energy, Chairman of the Scottish Climate Change Business Delivery Group, and a member of Ofgem's Environmental Advisory Group, the Coal Forum and of the Energy Research Partnership. Ian is a non-Executive Director of Maggie's Cancer Centres and a non-Executive Director of John Wood Group PLC. He is a member of the Risk and the Nomination committees and is lead Director for the Environment and Corporate Responsibility.

7. Richard Gillingwater (51)**Non-Executive Director**

Richard joined the Board as a non-Executive Director in May 2007. He is Dean of Cass Business School and is a non-Executive Director of Debenhams plc and Tomkins plc. He has held senior appointments in the City, including at Kleinwort Benson, BZW and Credit Suisse. He has advised HM Government and most recently was Chief Executive then Chairman of the government's Shareholder Executive. He is a member of the Audit and the Remuneration committees.

8. Sir Robert Smith (63)**Chairman**

Sir Robert joined the Board as a non-Executive Director in June 2003, was appointed Deputy Chairman in November 2003 and became Chairman in January 2005. He is Chairman of The Weir Group plc and a non-Executive Director of 3i Group plc, Standard Bank Group Limited, and Aegon UK plc. Sir Robert was formerly Chief Executive of Morgan Grenfell Asset Management Limited, a member of the Financial Services Authority and the Financial Reporting Council, a Governor of the BBC, a Board Trustee of the British Council, Chairman of Stakis plc and a Past President of the Institute of Chartered Accountants of Scotland. He is Chairman of the Nomination Committee and a member of the Remuneration Committee.



**9. Colin Hood (53)
Chief Operating Officer**

Colin joined the Board of Scottish and Southern Energy as Power Systems Director in January 2001, and became Chief Operating Officer in October 2002. Previously he was Director of Distribution for Southern Electric, having joined the industry with the North of Scotland Hydro Electric Board in 1977. He was Chairman of Scotia Gas Networks plc during 2007/08, and a member of the Forum for Renewable Energy Developments in Scotland. Colin is Chairman of the Health, Safety and Environmental Advisory Committee and is the lead Director for Health and Safety matters. He has Board level responsibility for Generation, Power Systems, Customer Service, People, IT and Contracting.

**10. Sir Kevin Smith CBE (53)
Non-Executive Director**

Sir Kevin joined the Board as a non-Executive Director in June 2004. He is Chief Executive of GKN having previously been Managing Director, Aerospace. Prior to GKN, he held various positions in BAE Systems over a 20-year period, latterly as Group Managing Director – New Business. Sir Kevin is a Fellow of the Royal Aeronautical Society, a Companion of the Chartered Management Institute and a past President of The Society of British Aerospace Companies Ltd. He is a member of the Health, Safety and Environmental Advisory Committee, the Nomination and the Remuneration committees.

**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 IFRS as adopted by the EU and have elected to prepare the parent company financial statements on the same basis.

The Group and parent company financial statements are required by law and IFRS as adopted by the EU to present fairly the financial position of the Group and the parent company and the performance for that period; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of the Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

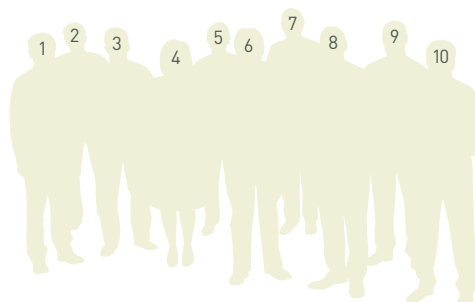
In preparing each of the Group and parent company financial statements, the Directors are required to:

- 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 proper accounting records which 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 1985. They have a 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 regulation, the Directors are also responsible for preparing a Directors' Report, Directors' Remuneration Report and the Corporate Governance Statement that comply 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.



Dear Shareholder

I am pleased to introduce the Remuneration Report for this year, 2007/08.

This is my first full year as Chairman of the Remuneration Committee, and we have taken the opportunity to review the approach to reporting. So that it is easier to understand, the report has a new layout which gives more detail on the operation of the Committee and the structure of the remuneration package. I hope you will find these changes helpful.

Following the introduction of the new Performance Share Plan in 2006 and an amendment last year, the Committee is satisfied that the remuneration package for our Directors and senior Executives is appropriate. Therefore no significant changes are proposed this year. The Committee is aware of the need to keep a watching brief on the market trends for remuneration. The Executive Directors are a strong team who have performed well, and potentially this could make them attractive to other organisations. Managing their reward structure effectively is an important part of managing the company's assets and shareholders' interests.

This Remuneration Report – like that of all other quoted companies – will rightly attract a great deal of scrutiny. To be balanced and objective, however, that scrutiny must take account of three key factors.

First, the remuneration of Executive Directors in quoted companies is effectively subject to shareholder approval by a resolution at the Annual General Meeting. There is, therefore, a transparency and accountability that is absent in other types of company.

Second, the responsibilities of Executive Directors and other senior managers in SSE are increasingly wide ranging and complex. SSE has, and must retain, an excellent leadership team which is fully capable of discharging those responsibilities for the benefit of shareholders and customers. This is in keeping with the sound approach to talent management which SSE seeks to adopt throughout its operations.

Third, SSE's policy on remuneration is responsible: it is clearly related to the delivery of a high standard of performance in critical areas such as safety, the environment and customer service.

As part of the Board evaluation process, the effectiveness of the Remuneration Committee was reviewed. The results of this review indicate that the Committee continues to operate effectively.

Susan Rice
Chairman, Remuneration Committee
28 May 2008

The following is the report of the Board of Directors in compliance with the Directors' Remuneration Report Regulations 2002. The report sets out the company's policy on Executive Directors' remuneration for the year ended 31 March 2008 and, so far as is reasonable, for subsequent years. Any changes in policy for years after 2008 will be described in future Remuneration Reports which will continue to be subject to shareholder approval.

The Role of the Remuneration Committee

The Remuneration Committee's members are Susan Rice, who chairs the Committee, Richard Gillingwater, Sir Robert Smith and Sir Kevin Smith. Biographical details of the current Committee members are given on pages 48 and 49. Richard Gillingwater joined the Committee on 26 July 2007, and David Payne stepped down from the Committee on that date on his retirement from the Board. The Committee met on five occasions.

Under its Terms of Reference (published in the Corporate Governance section of the SSE website at www.scottish-southern.co.uk) the Committee is responsible for:

- setting the overall remuneration policy on behalf of the Board;
- approving the detailed remuneration terms of the Executive Directors including their service contracts;
- approving the remuneration of the Chairman;
- approving the design and performance targets of incentive schemes; and
- granting awards under the company's Long Term Incentive Plans.

The Remuneration Committee regularly consults the Chief Executive, Ian Marchant, who attends and assists the Committee in respect of those Directors reporting to him, although he is not present when his own remuneration is under discussion.

In addition, the Director of Human Resources, Graham Juggins, and SSE's Senior Executive Remuneration Adviser, Jane Williams, provided information and advice on the Directors' remuneration, including comparative data drawn from published remuneration and benefit surveys, and advice on appropriate awards of bonuses and long-term incentives. The Company Secretary, Vincent Donnelly, provided information to the Committee on developments in corporate governance guidelines as they affect the Remuneration Committee. During the year the Committee received advice and views from Towers Perrin and from its brokers Merrill Lynch, as part of a general review of remuneration policy. Both Towers Perrin and Merrill Lynch were appointed by the company on behalf of the Committee.

During the year, the Committee meetings covered the following topics:

- Executive Directors' and Chairman's salary review;
- bonus target setting and awards;
- awards under the Performance Share Plan;
- review of the Remuneration Report; and
- review of overall remuneration policy, including the operation of the Performance Share Plan and its performance criteria.

The Board as a whole reviews the fees of the non-Executive Directors, whilst ensuring that no Director is involved in decisions on their own pay.

The Remuneration Committee's composition, responsibilities and operation comply with Section B of the Corporate Governance Code. In forming remuneration policy, the Committee has given full consideration to the best practice provisions set out in the Code.

The Principles of the Remuneration Policy

The company's remuneration policy is to:

- retain and attract Executive Directors who are able to run the company effectively for the benefit of shareholders and customers; and
- adopt a competitive and practical approach to overall remuneration which meets the expectations of shareholders.

This has been achieved by providing remuneration consisting of basic salary and benefits, together with an Annual Bonus Scheme and a Performance Share Plan both of which require the achievement of demanding performance targets against the company's core values of safety, service, efficiency, sustainability, excellence and teamwork.

Given the nature of the company's business, the Committee believes that around half of the total remuneration should be performance-related, with up to two-thirds where performance is exceptional. The Committee is satisfied that the overall remuneration structure is set at levels which are reasonable and appropriate to reward performance sufficiently.

Other Senior Executives

There are a number of Senior Executives below Board level who have a significant influence on the performance of the Group. The Committee remains fully aware of the need to ensure there is an appropriate relationship between Executive Director remuneration, and the levels of remuneration of other Senior Executives within the Group. The Committee considers remuneration levels of Senior Executives when reviewing remuneration of the Executive Directors

and is satisfied that an appropriate remuneration and benefits structure exists to recognise and retain its key executives.

Outside Appointments

Executive Directors are entitled to accept a non-Executive appointment outside the company with the consent of the Board, as such appointments can enhance Directors' experience and value to the company. Any fees received can be retained by the Director. In 2007/08 Ian Marchant held a non-Executive Director position with John Wood Group plc, and received £40,000 in fees.

Share Ownership Policy

Share ownership is encouraged throughout the Group. In addition the Committee believes that the interests of the Executive Directors and other Senior Executives should be closely aligned with those of shareholders. The Share Option schemes and Incentive Plans provide considerable alignment. The company has also adopted a policy that the Executive Directors and certain other Senior Executives should acquire and maintain a level of shareholding approximately equivalent to one year's salary, to be attained within a reasonable timescale. Consent to sell shares under the company's Share Dealing Code 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. Table C on page 54 contains the current shareholdings of the Directors.

Current Salaries

In addition to individual performance, the Committee takes account of pay levels in companies that are in related business sectors, of similar size principally in the FT-SE100, some specific comparisons in the utilities sector, and also general survey data. The Committee acknowledges that SSE operates predominantly in the UK with a growing portfolio of overseas renewable development opportunities which increased in the current year with the acquisition of Airtricity.

The Committee decided that salaries should increase for three key reasons. First, in line with the retention objective, it is important to recognise consistent high achievement over the past few years. This, in turn, means considering what it would cost to attract other Executive Directors of similar calibre. Second, while the remuneration of Executive Directors of SSE should generally be below the median for FT-SE100 companies, it should not be allowed to fall too far below that median. Third, SSE has increased significantly in scale, scope and complexity in each of the past five years, including 2007/08. The growing demands on Executive Directors and other senior members of

the company's management team need to be prudently recognised through the remuneration package.

In line with this, the Executive Directors' salary increases with effect from 1 January 2008 was in the range 11%-14%. The current base salary levels for the Executive Directors are as follows: Ian Marchant £800,000; Gregor Alexander £460,000; Colin Hood £600,000; and Alistair Phillips-Davies £460,000.

Current Incentive Arrangements Annual Bonus Scheme

The maximum bonus level is 100% of base salary and for 2007/08 comprised 60% for corporate financial performance, 20% for personal objectives and 20% for teamwork. Of the bonus awarded, 75% is paid in cash, and the remainder is compulsorily deferred into shares which only vest, subject to continued service, after three years. The number of shares under an award is determined by dividing the relevant pre-tax amount of bonus by the share price shortly after announcement of results for the financial year to which the bonus relates. The share award is satisfied by a transfer of shares from the Employee Share Ownership Trust together with shares representing dividends during the period the shares have been held in trust.

The maximum corporate financial element is payable if performance exceeds by 10% or more the budgeted profit before tax target, but no corporate element is payable if performance falls below 95% of this target. The personal objectives are based on a wide range of specific business activities. The specific standards of performance set are commercially confidential but they include objectively measurable improvements in areas such as:

- Group safety performance;
- customer service;
- delivery of investment opportunities;
- generation plant availability;
- innovation and sustainable development;
- achievement of customer growth targets;
- financial and working capital management; and
- development and delivery of new market opportunities.

The teamwork targets are designed to deliver overall objectives for the Group in areas such as:

- Group-wide performance on safety;
- business development;
- customer growth; and
- effective leadership and commitment to company values.

The company's performance in all these areas is described in the Chief Executive's Statement and the Business Statement on pages 8 to 34 of this Annual Report. The majority of personal targets are operational in

nature, set against measurable and verifiable data either within the Group or more generally within the energy sector. However, some targets are set which require some subjective assessment. This is done by the Chief Executive and reported by the Director of Human Resources to the Committee for consideration, except in the case of targets for the Chief Executive himself, where they are assessed by the Committee, with assistance from the Director of Human Resources and the company Chairman.

The bonus for 2007/08 was based on performance relative to measures and targets set at the beginning of the year, including teamwork targets as described above.

The corporate financial performance of profit before tax outturned at just over 104% of budget, and the bonus paid for this element 44%. The personal objectives and teamwork objectives were assessed by the Committee. Whilst the majority of individual targets were met, such as customer growth and complaint reduction there was still scope for improvement in areas such as renewable consents and lost time and reportable accidents. The range of payments for the personal element was therefore 14%-16%, against a maximum possible of 20%. The teamwork element of the bonus was 15% out of a maximum possible of 20%.

For 2008/09, the bonus remains 60% for corporate financial performance, 20% based on teamwork within the Executive team including performance in Service and Safety, and 20% for individual objectives. The bonuses are non-pensionable.

Long Term Incentives Performance Share Plan (PSP)

Under the PSP, the maximum value of share awards made to Executive Directors each year is 150% of base salary. Awards will be released after three years to the extent that performance conditions are met. One-half of the award is subject to total shareholder return (TSR) performance relative to other FT-SE100 companies. For full vesting, the company's TSR must be at or above the 75th percentile over the three-year performance period. 25% of the award will vest if the company's TSR is at the median. Awards will vest on a straight-line pro rata basis between median and 75th percentile. Awards based on TSR will only vest if the Committee is satisfied with the underlying financial performance of the company over the performance period. The remaining one-half of the award will be subject to an adjusted earnings per share (EPS) growth target. For the three-year period commencing in 2007/08, full vesting will occur if the annual growth in adjusted EPS is equivalent to 9% above RPI per annum. If the annual growth in adjusted EPS is equivalent to 3% above RPI per annum, 25% of the shares will vest

with vesting on a straight-line basis between 3% and 9% above RPI. There will be no vesting of the appropriate portion of award if the TSR minimum target of median is not achieved, or if the minimum real annual growth of EPS is not achieved.

The Committee considers the use of these two measures, in these proportions, to be appropriate. The relative TSR performance measure is dependent on the company's relative long-term share price performance, and therefore brings a market perspective to the PSP. Further vesting of this element requires the Committee to be satisfied with the underlying financial performance of the company. The TSR measure is balanced by a key internal measure, adjusted EPS growth, which is critical to the company's long-term success and ties in with the Group's strategic goals. The Committee considered that the achievement of real annual adjusted EPS growth of 9% above RPI per annum was a suitably demanding target for maximum vesting in light of the regulatory regime in which the company operates and on the basis of independent advice. The target range was set in the light of consensus expectations and the company's own forecasts. The Committee believed that for 2007/08 this target range struck the right balance between being stretching at the top end, and being achievable and motivational at the lower end. Different vesting levels may be set in future years for the TSR or EPS elements in order to ensure that the target remains sufficiently stretching. There will be no retesting of either the TSR or EPS performance measures.

For awards under the PSP granted in 2006, the maximum value of awards was 100% of salary, with full vesting after three years for EPS growth of RPI plus 8% and TSR at or above 75th percentile, and 30% of the award vesting for median performance for TSR and EPS growth of RPI plus 3%.

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:

- (a) The Sharesave Scheme, a savings-related share option scheme available to all employees. This scheme operates within specific tax legislation (including a requirement to finance exercise of the option using the proceeds of a monthly savings contract of up to £250 per month), and, in common with all such schemes, exercise of the option is not subject to satisfaction of a performance target. The option price is set at a discount of 10% to market value.
- (b) The Share Incentive Plan (SIP), also available to all employees, under which employees allocate part of their pre-tax salary to purchase shares up to a maximum of £125 per month. The SIP operates within specific tax legislation. During the year, the company matched the first five shares purchased by the participating employees each month as part of a company-wide agreement.
- (c) The company is also offering 10 free shares to all eligible employees under the SIP, with no performance conditions attached, in recognition of the overall staff contribution to the performance of the Group in 2007/08.
- (d) There is a long service award scheme whereby 10, 20, 30, 40 or 50 shares are purchased on behalf of an employee on the occasion of the employee reaching 10, 20, 30, 40 or 50 years' service respectively with the Group.

Previous Long-Term Incentive Scheme

The Deferred Bonus Scheme, which applied to Executive Directors and a selection of senior

managers, was designed to contribute to increasing shareholder return and motivation of senior management over the longer-term. It also facilitated the building of share ownership in the company.

If a participant resigns voluntarily in the three years following award, all outstanding awards lapse. The shares under award can normally vest after three years, but can vest earlier in certain exceptional circumstances such as retirement or redundancy.

The Deferred Bonus Scheme has been superseded by the PSP which was approved at the Annual General Meeting in July 2006.

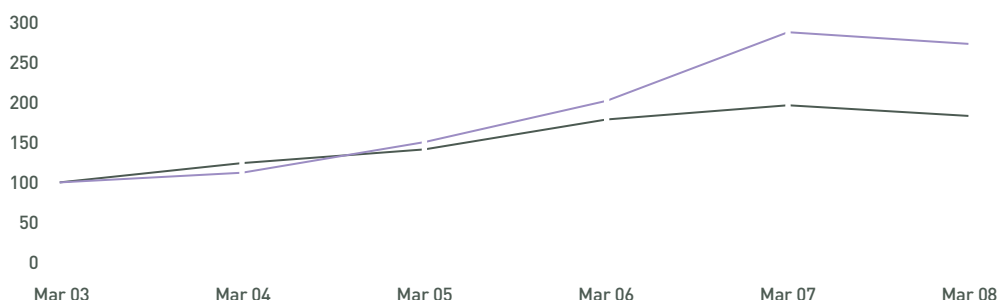
Service Contracts

It is the company's policy that Executive Directors should have service contracts with the company which are terminable on 12 months' notice given by either party. The key aspects of each contract are as follows:

- the Executive Directors are employed under service contracts with the company each dated 11 March 2005;
- they are eligible under the contracts to participate in the company's Executive Directors' bonus scheme, the company's Sharesave or other employee share schemes and incentive plans;
- they are each entitled to a company car or a cash allowance, membership of the company's pension scheme including life assurance cover equal to four times salary, and private health insurance which also covers dependants; and
- the contracts are each for an indefinite term ending automatically on retirement date (age 60), but may be terminated by 12 months' notice given by the company or by 12 months' notice given by the Director.

The company may at its discretion elect to terminate any Executive Director's contract

Total Shareholder Return



TSR Performance Graph

The graph to the left charts the cumulative TSR of the company since 1 April 2003 compared to the FT-SE100 Index over the same period. The company is a member of the FT-SE100 index, and this was considered to be the most relevant index for comparative purposes.

SSE ■
 FT-SE100 ■

by making a payment in lieu of notice equal to the basic salary which would have been received during the notice period (excluding any bonus and any other emolument referable to the employment). Payments in lieu of notice will be made in staged payments, and such payments will either reduce or cease completely in circumstances where the departing Executive Director gains new employment. There is also a specific provision obliging the departing Executive to mitigate his/her loss in these circumstances. There are no special provisions applying in the event of change of control.

Pensions

All the Executive Directors are members of either the Southern Electric Pension Scheme or the Scottish Hydro Electric Pension Scheme, which are funded final salary pension schemes. The Directors' service contracts provide for a possible maximum pension of two-thirds final salary at age 60. In relation to Executive Directors who are subject to the scheme specific salary cap (which mirrors the provisions of the previous HM Revenue & Customs cap arrangements) the company provides top-up (unfunded) arrangements which are designed to provide an equivalent pension on retirement at age 60 to that which they would have earned if they had not been subject to the salary cap. The Executive Directors have no right to any special or preferential pension benefit terms upon leaving. However, in

common with all members of the pension schemes who joined at the time the Directors joined the schemes, in the case of retirement through ill-health an unreduced pension based on service to expected retirement is paid. In the case of reorganisation or redundancy an unreduced accrued pension is paid to a member who has reached the age of 50 or above, with at least five years' service, or for a member who has not yet reached that age, it is payable with effect from 50.

Following legislative changes, from April 2006, existing HM Revenue & Customs limits ceased to apply to benefits provided by the pension schemes. If a member's accrued fund exceeds the new lifetime allowance (LTA), the benefits payable by the scheme from that excess will be subject to a higher rate of income tax. The company is maximising the use of the new allowance thereby providing Executive Directors with more of their existing benefits through registered schemes. In the case of Colin Hood, who was not subject to the previous earnings cap but is now limited by the LTA, further accrual is via an unfunded arrangement. There are no arrangements to compensate members for any change in their personal tax liability.

Non-Executive Directors

The remuneration of non-Executive Directors, apart from the company Chairman, is agreed by the Board annually, with the non-Executive

Directors concerned not participating in this process. The fees are reviewed against companies of similar size and complexity. The non-Executive Directors do not have service contracts but instead have letters of appointment. They are appointed for fixed terms of three years, subject to retirement by rotation and re-election at AGMs in terms of the company's Articles of Association. They do not participate in the Bonus Scheme, any of the share option schemes, or contribute to any Group pension scheme. The standard fee during the year was £45,000. The Chairman of the Audit Committee received an additional fee of £12,000, the Chairman of the Remuneration Committee received an additional fee of £10,000, and the Senior Independent Director received an additional fee of £10,000.

Remuneration in Detail

The Auditors are required to report on the information contained in tables A, B and D.

Table A – Directors' Emoluments

The emoluments of each of the Directors were as follows:

	Salary/fee £000	Bonuses £000	Benefits £000	Total 2008 £000	Total 2007 £000
Executive Directors					
Ian Marchant	740	450	18	1,208	1,210
Gregor Alexander	419	255	15	689	656
Colin Hood	555	328	16	899	894
Alistair Phillips-Davies	419	253	15	687	659
Non-Executive Directors					
Nick Baldwin	45	–	–	45	24
René Médori	57	–	–	57	47
Richard Gillingwater ⁽¹⁾	38	–	–	38	0
David Payne ⁽²⁾	24	–	–	24	69
Susan Rice	62	–	–	62	42
Sir Kevin Smith	45	–	–	45	42
Sir Robert Smith (Chairman)	293	–	–	293	266
	2,697	1,286	64	4,047	3,909

(1) Appointed to the Board on 25 May 2007.

(2) Retired from the Board 26 July 2007.

In addition to the annual cash bonus amount for this year, Ian Marchant, Gregor Alexander, Colin Hood and Alistair Phillips-Davies will be awarded £150k, £85k, £110k and £84k respectively in the form of deferred shares in respect of the bonus due to them for 2007/08. These share awards will not be made until June 2008 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.

Table B – Retirement Benefits

Details of Directors' retirement benefits are as follows:

	Years of industry service	Accrued benefit			Transfer value of accrued benefit			
		At 31 March 2008 £000	Increase in year including inflation £000	Increase in year excluding inflation £000	At 31 March 2008 £000	At 31 March 2007 £000	Increase less Directors' contributions £000	Increase in year excluding inflation £000
Ian Marchant	16	273	39	30	3,503	3,356	130	446
Gregor Alexander	17	155	29	24	1,799	1,548	234	287
Colin Hood	30	271	34	25	5,181	3,999	1,165	401
Alistair Phillips-Davies	11	110	23	20	1,253	1,002	234	280

Members of the scheme have the option to pay additional voluntary contributions; neither the contributions nor the resulting benefits are included in the above table. The retirement age of Executive Directors is 60.

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) All benefit payments are guaranteed to increase annually by the same percentage as state pensions, which are currently linked to movements in the UK RPI.

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. 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.
- (ii) 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' Interests

The interests of the Directors, all of which are beneficial, in the ordinary shares of the company on the dates shown were as follows:

	31 March 2008		1 April 2007	
	Shares held	Shares under option	Shares held	Shares under option
Gregor Alexander	32,630	120,508	21,589	87,837
Nick Baldwin	2,024	0	2,000	0
Richard Gillingwater	2,000	0	0	0
Colin Hood	27,967	227,324	26,710	162,097
Ian Marchant	119,178	223,656	94,785	172,266
René Médori	2,000	0	2,000	0
Alistair Phillips-Davies	31,353	136,026	31,116	87,074
Susan Rice	4,423	0	4,254	0
Sir Kevin Smith	2,000	0	2,000	0
Sir Robert Smith	22,600	0	15,800	0

From 31 March 2008 to 28 May 2008, the following changes to the interests of Directors took place:

- Under the Share Incentive Plan, on 30 April 2008, Ian Marchant, Colin Hood, Gregor Alexander and Alistair Phillips-Davies each acquired 14 shares.
- Under a standing order for reinvestment of a PEP, Ian Marchant acquired one share on 2 April 2008.

A further analysis of the Directors' shares under option as at 31 March 2008, and options granted and exercised during the year, is set out below.

The Register of Directors' Interests (which is open to shareholder inspection) contains full details of Directors' shareholdings and options to subscribe for shares.

Table D – Directors' Share Options

Option scheme	Options at 1 April 2007	Awarded during year	Options exercised	Market price at time of exercise (pence)	Options at 31 March 2008	Weighted average option price per share (pence)	Normally exercisable
Ian Marchant							
Savings-related	1,657	–	606	–	1,051	622	10/09-03/10
Deferred Bonus	116,467	11,962	39,937	14.30	93,150	#	07/08-06/17
Performance Share Plan	54,142	75,313	–	–	129,455		07/09-07/10
Colin Hood							
Savings-related	1,492	144	–	–	1,636	923	10/10-03/11
Deferred Bonus	119,998	8,598	–	–	128,596	#	07/06-06/17
Performance Share Plan	40,607	56,485	–	–	97,092		07/09-07/10
Gregor Alexander							
Savings-related	2,628	–	–	–	2,628	613	10/08-03/11
Deferred Bonus	56,908	6,518	18,350	14.30	47,215	#	07/08-06/17
Performance Share Plan	28,301	42,364	–	–	70,665		07/09-07/10
Alistair Phillips-Davies							
Savings-related	1,865	–	–	–	1,865	886	10/10-03/11
Deferred Bonus	56,908	6,588	–	–	63,496	#	07/07-06/17
Performance Share Plan	28,301	42,364	–	–	70,665		07/09-07/10

£1 per grant. No price was paid for the award of any option.

Shares exercised under the Deferred Bonus Scheme included the following arising from dividend reinvestment: Ian Marchant – 4,658 shares, Gregor Alexander – 2,139 shares.

The closing market price of the shares at 31 March 2008 was 1403.5p and range for the year was 1679.5p to 1378.5p. The options granted during the year were granted under either the Deferred Bonus Scheme, the Savings-related Scheme, or the PSP.

The aggregate amount of gains made by Directors on the exercise of share options during the year was £838,837 (2007 – £777,337). Under the Deferred Bonus Scheme, the aggregate value of the shares placed in trust for Directors in the year to 31 March 2008 was £486,305 (2007 – £1,433,053). Under the PSP, the aggregate value of the shares placed in trust for Directors in the year to 31 March 2008 was £3,104,983 (2007 – £1,844,969). The aggregate amount of gains made by the highest-paid Director, Ian Marchant was £576,432 (2007 – £408,876).

This report was approved by the Board and signed on its behalf by:

Susan Rice
Remuneration Committee Chairman
28 May 2008

05 Independent Auditors' Report to the members of Scottish and Southern Energy plc 56

We have audited the Group and parent company financial statements (the 'financial statements') of Scottish and Southern Energy plc for the year ended 31 March 2008 which comprise the Consolidated Income Statement, the Consolidated and Parent Company Balance Sheets, the Consolidated and Parent Company Cash Flow Statements, the Consolidated and Parent Company Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 Auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 49.

Our responsibility is to audit the financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the financial statements, Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements. The information given in the Director's Report includes that specific information presented in the Chief Executive's Statement that is cross referenced from the Business Review section of the Directors' Report. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of Audit Opinion

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

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' Remuneration Report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 March 2008 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 March 2008;
- the financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the financial statements, Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

Chartered Accountants
Registered Auditor
Edinburgh
28 May 2008

05 Consolidated Income Statement for the year ended 31 March

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	Note	2008			2007		
		Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements (note 4) £m	Total £m	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements (note 4) £m	Total £m
Revenue	2	15,256.3	–	15,256.3	11,867.1	–	11,867.1
Cost of sales		(13,509.8)	(187.8)	(13,697.6)	(10,247.7)	61.3	(10,186.4)
Gross profit		1,746.5	(187.8)	1,558.7	1,619.4	61.3	1,680.7
Operating costs	3	(605.7)	–	(605.7)	(557.5)	–	(557.5)
Other operating income		0.1	55.0	55.1	–	33.0	33.0
Operating profit before jointly controlled entities and associates		1,140.9	(132.8)	1,008.1	1,061.9	94.3	1,156.2
Jointly controlled entities and associates:							
Share of operating profit		242.6	–	242.6	169.2	0.9	170.1
Share of interest		(127.6)	–	(127.6)	(117.9)	–	(117.9)
Share of movement on derivatives		–	4.2	4.2	–	5.5	5.5
Share of tax		(41.9)	31.2	(10.7)	(31.8)	(2.0)	(33.8)
Share of profit on jointly controlled entities and associates	12	73.1	35.4	108.5	19.5	4.4	23.9
Operating profit	2	1,214.0	(97.4)	1,116.6	1,081.4	98.7	1,180.1
Finance income	6	202.6	–	202.6	193.4	–	193.4
Finance costs	6	(233.9)	(1.5)	(235.4)	(230.9)	(10.6)	(241.5)
Profit before taxation		1,182.7	(98.9)	1,083.8	1,043.9	88.1	1,132.0
Taxation	7	(306.8)	96.2	(210.6)	(276.4)	(25.1)	(301.5)
Profit for the year		875.9	(2.7)	873.2	767.5	63.0	830.5
Attributable to:							
Equity holders of the parent		875.6	(2.7)	872.9	767.5	63.0	830.5
Minority interest		0.3	–	0.3	–	–	–
Basic earnings per share (pence)	9			101.1p			96.5p
Diluted earnings per share (pence)	9			101.0p			93.9p
Adjusted earnings per share (pence)	9			105.6p			92.5p
Dividends paid in the year (£m)	8			£502.8m			£411.3m

The accompanying notes are an integral part of these financial statements.

	Note	Consolidated		Company	
		2008 £m	2007 £m	2008 £m	2007 £m
Assets					
Property, plant and equipment	11	6,334.3	5,042.1	–	–
Intangible assets:					
Goodwill	10	659.0	293.2	–	–
Other intangible assets	10	256.9	12.9	–	–
Investments in associates and jointly controlled entities	12	917.8	702.3	516.9	516.9
Other investments	12	6.0	4.1	–	–
Investments in subsidiaries	13	–	–	2,137.8	777.9
Trade and other receivables	16	–	–	1,772.7	1,783.5
Retirement benefit assets	26	85.8	128.1	85.8	128.1
Deferred tax assets	22	43.1	66.0	–	–
Derivative financial assets	28	318.9	54.5	–	–
Non-current assets		8,621.8	6,303.2	4,513.2	3,206.4
Intangible assets	10	340.9	177.7	–	–
Inventories	15	251.2	214.1	–	–
Trade and other receivables	16	3,400.3	2,266.7	2,429.2	1,754.3
Cash and cash equivalents	17	255.3	56.1	104.2	5.8
Derivative financial assets	28	1,106.5	452.9	1.1	–
Current assets		5,354.2	3,167.5	2,534.5	1,760.1
Total assets		13,976.0	9,470.7	7,047.7	4,966.5
Liabilities					
Loans and other borrowings	21	1,847.6	474.8	1,696.3	349.5
Trade and other payables	18	3,601.9	2,340.4	3,580.2	2,573.9
Current tax liabilities	19	220.8	199.2	9.0	10.1
Provisions	23	9.5	8.0	–	–
Derivative financial liabilities	28	1,229.4	351.9	–	–
Current liabilities		6,909.2	3,374.3	5,285.5	2,933.5
Loans and other borrowings	21	2,073.6	1,803.8	612.6	820.8
Deferred tax liabilities	22	967.3	923.7	9.6	27.9
Trade and other payables	18	490.1	327.7	–	–
Provisions	23	107.3	104.4	–	–
Retirement benefit obligations	26	134.9	220.0	–	–
Derivative financial liabilities	28	313.3	120.9	–	44.9
Non-current liabilities		4,086.5	3,500.5	622.2	893.6
Total liabilities		10,995.7	6,874.8	5,907.7	3,827.1
Net assets		2,980.3	2,595.9	1,140.0	1,139.4
Equity:					
Share capital	24	435.1	431.0	435.1	431.0
Share premium	25	315.7	99.1	315.7	99.1
Capital redemption reserve	25	22.0	13.7	22.0	13.7
Equity reserve	25	3.9	14.6	3.9	14.6
Hedge reserve	25	2.3	(10.5)	7.1	(10.9)
Translation reserve	25	25.4	–	(21.1)	–
Retained earnings	25	2,175.6	2,048.0	377.3	591.9
Total equity attributable to equity holders of the parent		2,980.0	2,595.9	1,140.0	1,139.4
Minority interest	25	0.3	–	–	–
Total equity		2,980.3	2,595.9	1,140.0	1,139.4

These financial statements were approved by the Board of Directors on 28 May 2008 and signed on their behalf by:

Gregor Alexander
Finance Director

Sir Robert Smith
Chairman

05 Statements of Recognised Income and Expense for the year ended 31 March 59

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Gains/(losses) on effective portion of cash flow hedges (net of tax)	11.6	(22.6)	18.0	(14.0)
Transferred to income statement on cash flow hedges (net of tax)	8.0	-	-	-
Losses on net investment hedge (net of tax)	(21.1)	-	(21.1)	-
Actuarial (loss)/gain on retirement benefit schemes (net of tax)	(18.7)	33.2	(43.3)	12.3
Exchange difference on translation of foreign operations	46.5	-	-	-
Jointly controlled entities and associates:				
Share of (losses)/gains on effective portion of cash flow hedges (net of tax)	(6.8)	5.5	-	-
Share of actuarial gain/(loss) on retirement benefit schemes (net of tax)	16.4	(1.4)	-	-
Net income/(expense) recognised directly in equity	35.9	14.7	(46.4)	(1.7)
Profit for the year	873.2	830.5	571.7	415.8
Total recognised income and expense for the year	909.1	845.2	525.3	414.1
Attributable to:				
Equity holders of the parent	908.8	845.2	525.3	414.1
Minority interests	0.3	-	-	-
	909.1	845.2	525.3	414.1

05 Cash Flow Statements for the year ended 31 March

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Cash flows from operating activities				
Profit for the year after tax	873.2	830.5	571.7	415.8
Taxation	210.6	301.5	(2.4)	(5.0)
Movement on financing and operating derivatives	167.1	(50.7)	1.6	4.0
Exchange loss in relation to foreign investment	22.2	–	22.2	–
Finance costs	233.9	230.9	207.9	201.0
Finance income	(202.6)	(193.4)	(191.7)	(212.0)
Share of jointly controlled entities and associates	(108.5)	(23.9)	–	–
Income from investments in subsidiaries	–	–	(609.3)	(403.8)
Pension service charges less contributions paid	(44.4)	(31.6)	(13.4)	(11.6)
Depreciation and impairment of assets	267.8	239.1	–	–
Amortisation and impairment of intangible assets	32.5	57.2	–	–
Deferred income released	(15.1)	(15.1)	–	–
(Increase) in inventories	(25.9)	(48.7)	–	–
(Increase) in receivables	(616.0)	(225.0)	(779.0)	(442.9)
Increase in payables	725.5	40.4	990.1	645.6
(Decrease) in provisions	(6.4)	25.7	–	–
Charge in respect of employee share awards (before tax)	10.8	6.8	–	–
Profit on disposal of property, plant and equipment	(65.3)	(5.0)	–	–
Loss on disposal of replaced assets	0.4	1.7	–	–
Cash generated from operations	1,459.8	1,140.4	197.7	191.1
Dividends received from jointly controlled entities	35.1	22.7	–	–
Dividends received from subsidiaries	–	–	979.3	216.8
Finance income	61.2	63.4	124.9	148.6
Finance costs	(108.6)	(118.8)	(201.3)	(157.2)
Income taxes paid	(283.6)	(212.2)	(289.3)	(4.8)
Payment for consortium relief	(7.6)	(26.6)	(7.6)	–
Net cash from operating activities	1,156.3	868.9	803.7	394.5
Cash flows from investing activities				
Purchase of property, plant and equipment	(798.8)	(564.1)	–	–
Purchase of software and other intangibles	(16.9)	(3.7)	–	–
Deferred income received	8.9	12.4	–	–
Proceeds from sale of property, plant and equipment	100.6	13.0	–	–
Loans to jointly controlled entities	(5.6)	(5.5)	–	–
Purchase of Airtricity (note 14)	(1,302.2)	–	(1,302.2)	–
Purchase of Slough Heat and Power (note 14)	(49.5)	–	–	–
Purchase of businesses and subsidiaries (note 14)	(16.2)	–	–	–
Cash acquired in purchases	597.3	–	–	–
Investment in Marchwood Power (note 12)	–	(5.0)	–	–
Loans repaid by jointly controlled entities	10.8	33.8	–	23.0
Loans repaid by associates	–	0.8	–	–
Increase in other investments	(14.5)	(2.8)	–	–
Net cash from investing activities	(1,486.1)	(521.1)	(1,302.2)	23.0
Cash flows from financing activities				
Proceeds from issue of share capital	2.2	9.2	2.2	9.2
Repurchase of ordinary share capital for cancellation	(237.0)	–	(237.0)	–
Dividends paid to Company's equity holders	(502.8)	(411.3)	(502.8)	(411.3)
Employee share awards share purchase	(12.4)	(8.2)	(12.4)	–
New borrowings	2,275.1	236.5	1,696.4	114.7
Borrowings acquired in purchases	(543.0)	–	–	–
Repayment of borrowings	(466.6)	(169.4)	(349.5)	(150.0)
Net cash from financing activities	515.5	(343.2)	596.9	(437.4)
Net increase/(decrease) in cash and cash equivalents	185.7	4.6	98.4	(19.9)
Cash and cash equivalents at the start of year (note 17)	48.4	43.8	5.8	25.7
Net increase/(decrease) in cash and cash equivalents	185.7	4.6	98.4	(19.9)
Effect of foreign exchange rate changes	9.0	–	–	–
Cash and cash equivalents at the end of year (note 17)	243.1	48.4	104.2	5.8

1. SIGNIFICANT ACCOUNTING POLICIES**General information**

Scottish and Southern Energy plc (the Company) is a company domiciled in Scotland. The address of the registered office is given on the back cover. The Group's operations and its principal activities are set out in the Business Statement at pages 8 to 34. The consolidated financial statements for the year ended 31 March 2008 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 230(4) of the Companies Act 1985 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 28 May 2008. The financial statements have been prepared in accordance with International Financial Reporting Standards and its interpretations as adopted by the European Union (adopted IFRS).

Basis of measurement

The financial statements of the Group and the Company are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: certain derivative financial instruments, financial instruments classified as available for sale and the assets and liabilities of the Group pension scheme. 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 included on page 63.

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 68.

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 re-measurements 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 re-measurements are re-measurements 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 which are held for the Group's own use requirement.

The following accounting standards and interpretations have been adopted by Group from 1 April 2007:

- IFRS 7 Financial Instruments: Disclosures
- IFRIC 8 Scope of IFRS 2 Share Based Payments
- IFRIC 9 Reassessment of Embedded Derivatives
- Amendment to IAS 1 Presentation of Financial Statements – Capital Disclosures
- IFRIC 10 Interim Financial Reporting and Impairment
- IFRIC 11/IFRS 2 Share Based Payments – Group and Treasury Transactions

There was no significant impact on the financial statements arising from the adoption of these standards.

The following published standards and interpretations are not yet effective and have not been early adopted by the Group:

- IFRIC 12 Service Concession Arrangements
- IFRIC 13 Customer Loyalty Programmes
- IFRIC 14/IAS 19 The Limit on a Defined Benefit Assets, Minimum Funding Requirements and their Interaction
- IFRS 8 Operating Segments
- Amendment to IAS 1 Presentation of Financial Statements – A Revised Presentation
- Amendments to IAS 23 Borrowing Costs
- Amendments to IAS 27 Consolidation and Separate Financial Statements
- Amendments to IFRS 3 Business Combinations

The impact of these new standards has not been fully analysed and this will be assessed in future accounting periods.

Restated amounts

Certain balance sheet items have been reclassified as current and non-current assets or liabilities to enhance understanding of the prior year results and to aid comparability with the current year presentation. No revision of carrying values has been made.

1. Significant Accounting Policies (continued)

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 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. Pre-acquisition dividends are accounted for as a reduction in the cost of investment in the subsidiary.

Associates

Associates are those entities in which the Group has significant influence but not control over the financial and operating policies, namely where the Group has a shareholding of between 20% and 50% of the voting rights. The consolidated financial statements include the Group's share of the total recognised gains and losses of associates on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases.

Joint ventures

Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement. In the consolidated financial statements, investments are accounted for under the equity method of accounting. Jointly controlled operations are businesses which use assets and liabilities that are separable from the rest of the Group. In these arrangements, the Group accounts for its own share of property, plant and equipment, carries its own inventories, incurs its own expenses and liabilities and raises its own finance.

In the Company, investments in jointly controlled entities are carried at cost less any impairment charges.

Transactions eliminated on consolidation

Intra-Group balances and any unrealised gains and losses or income and expenses arising from Intra-Group transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains and losses arising from transactions with associates and jointly controlled entities are eliminated to the extent of the Group's interest in the entity.

Accounting policies**Revenue recognition: energy, services and goods relating to the sale of energy**

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and that the revenue can be reliably measured. Revenue comprises sales of energy, use of system income, gas storage facility revenue, the value of services and facilities provided and goods sold during the year in the normal course of business.

Revenue on energy sales, including monies received from the electricity and gas balancing markets in the UK and wholesale market energy sales, includes an estimate of the value of electricity and gas supplied to customers between the date of the last meter reading and the year end. Unread energy sales are estimated using historical consumption patterns taking account of industry volume reconciliation processes.

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.

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 one-off services, such as connections, revenue is recognised at the date of service. 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.

Government grants and customer contributions

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. Customer contributions and capital grants have been recorded as deferred income and released to the income statement over the estimated life of the related assets.

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 64.

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. These are taken against the hedge reserve to the extent that 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, a separate component of equity, and are reported in the statement of recognised income and expense.

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, 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.

Accounting policies continued**Property, plant and equipment****(i) Owned assets**

Items of property, plant and equipment are stated at cost less accumulated depreciation and impairments. The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads. All items of property, plant and equipment are accounted for under the cost model within IAS 16.

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 the estimated useful life of the asset. 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. The estimated useful lives are as follows:

	Years
Hydro civil assets	100
Wind generation assets	25
Power stations	20 to 60
Overhead lines, underground 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
Shop refurbishment, fixtures, equipment, vehicles and mobile plant	3 to 10

Heritable and freehold land is not depreciated.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets or, where shorter, over the term of the relevant lease.

(v) Subsequent expenditure

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.

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. 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.

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* excluding non-current assets (or disposal groups) that are classified as held-for-sale, which are recognised and measured at fair value less costs to sell. The excess of the cost of acquisition over the fair value of the acquired business is represented as goodwill.

Intangible assets

(i) Goodwill

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 and liabilities of a subsidiary, associate or jointly controlled entity at the date of acquisition.

Goodwill is recognised as an asset and is reviewed for impairment at least on an annual basis. Any impairment is recognised immediately as a charge in the income statement and is not subsequently reversed.

From 1 April 1998 to 31 March 2004, any purchased goodwill was capitalised and amortised on a straight-line basis to the income statement. This was normally over a period of up to 20 years from the date of acquisition, with the exception of goodwill relating to the acquisitions of the Hornsea and Neos businesses, which were amortised over a period of 30 years and 10 years respectively. Goodwill arising on acquisitions purchased prior to 1 April 1998 was written-off to reserves in accordance with the accounting standard then in force. In respect of acquisitions prior to 1 April 2004, goodwill is included on the basis of deemed cost which represents the carrying amount at 1 April 2004. The goodwill amortised between 1 April 2004 and 31 March 2005 was reinstated. On disposal or closure of a previously acquired business, any attributable goodwill will be included in determining the profit or loss on disposal, with the exception of any goodwill written off prior to 1 April 1998.

(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 carbon emissions trading. The Group recognises carbon allowances granted as a current intangible asset at fair value at the date of grant and as deferred income and does not subsequently re-value the intangible asset. Carbon emissions liabilities incurred are recorded as a current liability. Carbon allowances purchased are recorded at cost. Up to the level of allowances held the liability is measured at the cost of purchased or granted allowances held. When carbon emissions liabilities exceed the carbon allowances held, the net liability is measured at the market price of allowances. Forward carbon contracts are measured at fair value with gains or losses arising on re-measurement 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 de-recognised at its original value. As a result, no amortisation is booked but an impairment charge may be recognised should the carrying value exceed market value.

The Renewable Obligations Certificates (ROCs) scheme is administered and accounted for in a similar but not identical manner to the European Emissions trading scheme. ROCs obtained from own generation are awarded by Ofgem. Self-generated ROCs are recorded at market value and purchased ROCs 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.

(iv) Development wind assets

Costs capitalised as development wind intangibles represent the costs incurred in bringing individual wind farm projects to the consented stage. 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 as part of the fair value exercise on acquisition of a controlling interest in a project. Development wind assets are not amortised until the asset is substantially complete and ready for its intended use. The asset is subject to impairment testing on an annual basis until this time. At the time the project is confirmed, the carrying value of the project is transferred to property, plant and equipment as assets under construction. Amortisation is 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 the Atlantic brand, 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

Accounting policies continued**Impairment testing**

The carrying amounts of the Group's assets, other than inventories or deferred tax assets, are reviewed each financial year to determine whether there is any indication of impairment. If there is evidence of impairment, the recoverable amount of the asset is estimated to determine the extent of any such impairment. For goodwill and other intangible assets with an indefinite life or not ready for use, the test for impairment is carried out annually.

The recoverable amount is the higher of fair value less costs to sell and value in use. Value in use is based on projected cash flows which are discounted for risks and the time value of money. Where the cash flows of the asset under review cannot be assessed independently from other assets, the Group estimates to which cash-generating unit (CGU) the asset belongs. Once established, the discounted projected cash flows of the asset or CGU are calculated and measured against the carrying amount of the asset or CGU. Where the recoverable amount is lower than the carrying amount an impairment charge is 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 appropriate overheads.

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 recognised income and expense. 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

Following the transitional provisions of IFRS 1, the requirements of IFRS 2 *Share-based Payments* have been applied to all grants of equity instruments after 7 November 2002 that had not vested as at 1 January 2005.

The Group operates a number of employee share schemes as described in the Remuneration Report and note 27. 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 change 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 in 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 28.

Accounting policies under IAS 32 and 39

(i) Interest rate and foreign exchange derivatives

Financial derivative instruments are used by the Group to hedge interest rate and currency exposures. All such derivatives are recognised at fair value and are re-measured to fair value each reporting period. Certain derivative financial instruments are designated as being held for hedging purposes. The designation of the hedge relationship is established at the inception of the contract and procedures are applied to ensure the derivative is highly effective in achieving its objective and that the effectiveness of the hedge can be reliably measured. The treatment of gains and losses on re-measurement is dependent on the classification of the hedge and whether the hedge relationship is designated as either a 'fair value' or 'cash flow' hedge. Derivatives that are not designated as hedges are treated as if held for trading, with all fair value movements attributable to the risk being hedged being recorded through the income statement.

A derivative classified as a 'fair value' hedge recognises gains and losses from re-measurement 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 Income Statement. The gains or losses that are recognised directly in equity are transferred to the income statement in the same period in which the forecast transaction affects profit or loss.

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 re-measurement being recognised in the income statement in cost of sales.

(iii) Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives where the characteristics of the derivatives are not closely related to those of the host contracts.

(iv) Net investment hedges

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the effective portion of the hedge is recognised in equity, 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) Convertible bond

The Group has issued a convertible bond which represents debt that can be converted to share capital at the option of the holder, where the number of shares issued does not vary with changes in their fair value. This is accounted for as a compound financial instrument, net of transaction costs. The equity component of the convertible bond is calculated as the excess of the issue proceeds over the present value of the future interest and principal payments, discounted at the market rate of interest applicable to similar liabilities that do not have a conversion option. The interest expense recognised in the income statement is calculated using the effective interest method.

(vi) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

(vii) Trade receivables

Trade receivables do not carry any interest and are measured at cost less an appropriate allowance for irrecoverable receivables.

(viii) Interest-bearing loans and borrowings

All such loans and borrowings are initially recognised at fair value including transaction costs and are subsequently measured at amortised cost, except where the loan or borrowing is the hedged item in an effective fair value hedge relationship.

(ix) Share capital

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

Accounting policies continued**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 estimated cost of decommissioning. Decommissioning dates are uncertain but are expected to be between 2008 and 2035. A corresponding decommissioning asset is recognised and is included within property, plant and equipment. Changes in these provisions are recognised prospectively. 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.

Critical accounting judgements and key sources of estimation uncertainty

In the process of applying the Group's accounting policies, management necessarily makes judgements and estimates that have a significant effect on the amounts recognised in the financial statements. Changes in the assumptions underlying the estimates could result in a significant impact to the financial statements. The most critical of these accounting judgement and estimation areas are noted.

(i) Revenue recognition

Revenue on energy sales includes an estimate of the value of electricity or gas supplied to customers between the date of the last meter reading and the year end. This will have been estimated by using historical consumption patterns and takes into consideration industry reconciliation processes for total consumption by supplier. At the balance sheet date, the estimated consumption by customers will either have been billed (estimated billed revenue) or accrued (unbilled revenue). Management apply judgement to the measurement of the quantum of the estimated consumption and to the valuation of that consumption. The judgements applied, and the assumptions underpinning these judgements are considered to be appropriate. However, a change in these assumptions would impact upon the amount of revenue recognised.

(ii) Retirement benefits

The assumptions in relation to the cost of providing post-retirement benefits during the period are set after consultation with qualified actuaries. While these assumptions are believed to be appropriate, a change in these assumptions would impact the earnings of the Group. The value of scheme assets is impacted by the asset ceiling test which restricts the surplus that can be recognised to assets that can be recovered fully through refunds or reductions in future contributions.

(iii) Impairment testing

The Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that the value of those assets is impaired. In assessing for impairment, assets that do not generate independent cash flows are allocated to an appropriate cash generating unit (CGU). The recoverable amount of the assets, or the appropriate CGU, is measured as the higher of their fair value less costs to sell and value in use.

Management necessarily apply judgement in allocating assets that do not generate independent cash flows to appropriate CGUs. The value in use calculation also requires estimation of the timing and value of underlying projected cash flows. Subsequent changes to these estimates or judgements may impact the carrying value of the assets within the respective CGUs.

(iv) Provisions and contingencies

The assessments undertaken in recognising provisions and contingencies have been made in accordance with IAS 37. The evaluation of the likelihood of the contingent events has required best judgement by management regarding the probability of exposure to potential loss. Should circumstances change following unforeseeable developments, this likelihood could alter.

(v) Financial instruments – fair values

The valuation of the financial instruments reported in note 28 is based upon published price quotations in active markets and valuation techniques where such information is not available. Energy commodity contracts are classified as either derivative contracts under IAS 39 or as contracts for the Group's own use requirements. Only IAS 39 derivatives are accounted for on a fair value basis. More detail on this is included in note 28.

(vi) Exceptional and re-measurements

The criteria for identifying what constitutes an exceptional item are outlined in note 1 Use of estimates and judgements.

2. SEGMENTAL INFORMATION**Primary reporting format – business segments**

The primary segments are as reported for management purposes and reflect the day-to-day management of the business. The Group's primary segments are the distribution and transmission of electricity in the North of Scotland, the distribution of electricity in the South of England (together referred to as Power Systems) and the generation and supply of electricity and sale of gas in Great Britain and Ireland (Generation and Supply). The Group's 50% equity share in Scotia Gas Networks plc, a business which distributes gas in Scotland and the South of England is included as a separate business segment where appropriate due to its significance.

Analysis of revenue, operating profit, assets, liabilities and other items by segment is provided overleaf. All revenue and profit before taxation arise from operations within Great Britain and Ireland.

(a) Revenue by segment

	Total revenue		Intra-segment revenue (i)		External revenue	
	2008 £m	2007 £m	2008 £m	2007 £m	2008 £m	2007 £m
Power Systems						
Scotland	283.6	270.4	108.4	99.1	175.2	171.3
England	434.0	407.4	194.6	189.6	239.4	217.8
	717.6	677.8	303.0	288.7	414.6	389.1
Generation and Supply	14,263.0	10,977.9	13.1	15.4	14,249.9	10,962.5
Other businesses	1,017.8	859.4	426.0	343.9	591.8	515.5
	15,998.4	12,515.1	742.1	648.0	15,256.3	11,867.1

(i) Intra-segment revenue is derived from use of system income received by the Power Systems businesses from Generation and Supply, provision of Contracting, Metering and Connections services, use of Gas Storage facilities, Telecoms infrastructure charges, internal heat and light charges and other Corporate services. All are provided at arm's length.

Revenue from the Group's investment in Scotia Gas Networks (SSE share being 2008 – £361.2m; 2007 – £297.3m) is not recorded in the revenue line in the income statement.

(b) Operating profit by segment

	Adjusted £m	JCE/Associate share of interest and tax (i) £m	2008		Total £m
			Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	
Power Systems					
Scotland	150.2	–	150.2	–	150.2
England	232.7	–	232.7	–	232.7
	382.9	–	382.9	–	382.9
Scotia Gas Networks	161.5	(139.3)	22.2	30.3	52.5
Energy Systems	544.4	(139.3)	405.1	30.3	435.4
Generation and Supply	724.2	(29.9)	694.3	(182.7)	511.6
Other businesses	124.7	(0.3)	124.4	55.0	179.4
	1,393.3	(169.5)	1,223.8	(97.4)	1,126.4
Unallocated expenses (ii)	(9.8)	–	(9.8)	–	(9.8)
	1,383.5	(169.5)	1,214.0	(97.4)	1,116.6
			2007		
	Adjusted £m	JCE/Associate share of interest and tax (i) £m	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Total £m
Power Systems					
Scotland	144.0	–	144.0	–	144.0
England	224.0	–	224.0	–	224.0
	368.0	–	368.0	–	368.0
Scotia Gas Networks	103.1	(122.2)	(19.1)	3.8	(15.3)
Energy Systems	471.1	(122.2)	348.9	3.8	352.7
Generation and Supply	642.6	(27.1)	615.5	94.9	710.4
Other businesses	125.2	(0.4)	124.8	–	124.8
	1,238.9	(149.7)	1,089.2	98.7	1,187.9
Unallocated expenses (ii)	(7.8)	–	(7.8)	–	(7.8)
	1,231.1	(149.7)	1,081.4	98.7	1,180.1

(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 plc interest includes loan stock interest payable to the consortium shareholders. The Group has accounted for its 50% share of this, £35.4m (2007 – £35.8m), as finance income (note 6).

(ii) Unallocated expenses comprise corporate office costs which are not directly allocable to particular segments.

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 70

2. Segmental Information (continued)

Primary reporting format – business segments *continued***(b) Operating profit by segment** *continued*

The Group's share of operating profit from jointly controlled entities and associates has been recognised in the Generation and Supply segment other than that for Scotia Gas Networks plc, which is recorded in a separate segment, and PriDE (South East Regional Prime), which is recognised in Other businesses (£1.0m before tax; 2007 – £1.4m before tax).

(c) Assets and liabilities

	Segment assets (i)		Segment liabilities (ii)	
	2008 £m	2007 £m	2008 £m	2007 £m
Power Systems				
Scotland	1,495.2	1,363.8	931.8	898.4
England	2,335.4	2,202.9	1,461.2	1,446.0
	3,830.6	3,566.7	2,393.0	2,344.4
Scotia Gas Networks (iii)	501.1	438.8	–	–
Energy Systems	4,331.7	4,005.5	2,393.0	2,344.4
Generation and Supply	12,514.7	9,398.2	11,624.1	7,996.1
Other businesses	1,843.9	1,203.7	1,429.5	742.5
Corporate and unallocated	9,910.7	6,907.5	10,174.1	7,836.0
	28,601.0	21,514.9	25,620.7	18,919.0
Less: inter-segment	(14,625.0)	(12,044.2)	(14,625.0)	(12,044.2)
	13,976.0	9,470.7	10,995.7	6,874.8

(i) Segment assets consist of property, plant and equipment, goodwill, other intangible assets, inventories, financial assets (operating derivatives) and receivables. Unallocated assets include pension assets, deferred tax assets, financial assets (financing derivatives), investments in joint ventures and associates, investments in subsidiaries and cash and cash equivalents.

(ii) Segment liabilities consist of operating liabilities. Unallocated liabilities include taxation, corporate borrowings, pension liabilities and deferred taxation.

(iii) The asset balance represents the Group's net investment in Scotia Gas Networks plc.

(d) Capital expenditure

	Capital additions to intangible assets (note 10)		Capital additions to property, plant and equipment (note 11)	
	2008 £m	2007 £m	2008 £m	2007 £m
Power Systems				
Scotland	–	–	100.0	73.9
England	–	–	164.4	130.6
	–	–	264.4	204.5
Scotia Gas Networks (i)	–	–	–	–
Energy Systems	–	–	264.4	204.5
Generation and Supply	218.5	349.3	351.9	299.6
Other businesses	3.4	–	165.9	126.8
Corporate and unallocated	10.7	3.7	–	–
	232.6	353.0	782.2	630.9
Less: inter-segment	–	–	–	–
	232.6	353.0	782.2	630.9

(i) The Group's share of the capital additions in Scotia Gas Networks plc is not included within Property, Plant and Equipment.

Capital additions does not include assets acquired in acquisitions.

(e) Included within operating profit

	Depreciation/ impairment on property, plant and equipment (note 11)		Amortisation/impairment of intangible assets (note 10)	
	2008 £m	2007 £m	2008 £m	2007 £m
Power Systems				
Scotland	40.5	38.3	-	-
England	68.8	63.8	-	-
	109.3	102.1	-	-
Generation and Supply	118.2	99.1	28.5	54.8
Other businesses	40.3	36.5	-	-
Corporate and unallocated	-	-	4.0	2.4
	267.8	237.7	32.5	57.2
Less: inter-segment	-	-	-	-
	267.8	237.7	32.5	57.2

The Group's share of Scotia Gas Networks plc depreciation (2008 – £46.0m; 2007 – £39.9m) and amortisation (2008 – nil; 2007 – nil) is not included within operating costs. Property, plant and equipment impairment charges of £12.2m (2007 – £13.9m) are included within Generation and Supply. The impairment charge relating to granted carbon allowances of £25.2m (2007 – £53.9m) has nil impact on the income statement (note 10).

Secondary reporting format – geographical segments

The Group operates in two main geographical areas:

	2008			2007		
	UK £m	Europe £m	Total £m	UK £m	Europe £m	Total £m
Revenue – external	15,183.4	72.9	15,256.3	11,867.1	-	11,867.1
Total assets (i)	12,785.6	1,190.4	13,976.0	9,470.7	-	9,470.7
Capital expenditure (ii)	778.1	4.1	782.2	630.9	-	630.9
Expenditure on intangible assets (iii)	230.1	2.5	232.6	353.0	-	353.0

(i) Based on location of assets.

(ii) Capital Expenditure on property, plant and equipment (note 11) based on location of assets.

(iii) Capital Expenditure on other intangible assets (note 10) based on location of assets.

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 72

3. Other Operating Income and Expense 4. Exceptional Items and Certain Re-measurements

3. OTHER OPERATING INCOME AND EXPENSE

Group operating costs can be analysed thus:

	2008 £m	2007 £m
Distribution costs	214.6	203.6
Administration costs	391.1	353.9
	605.7	557.5

Group operating profit is stated after charging (or crediting) the following items:

	2008 £m	2007 £m
Depreciation and impairment of property, plant and equipment (note 11)	267.8	237.7
Impairment of investment	–	1.4
Research and development costs	3.7	6.3
Operating lease rentals (note 30)	268.9	235.8
Release of deferred income in relation to customer contributions and capital grants	(15.1)	(15.1)
Gain on disposal of property, plant and equipment	(65.3)	(5.0)
Loss on disposal of replaced assets	0.4	1.7
Impairment of wind development asset (note 10)	2.0	–
Amortisation of brand costs (note 10)	1.1	0.9
Amortisation of intangible assets (note 10)	4.2	2.4

No charge has been recognised in respect of the impairment of granted carbon allowances as this has been offset by an equal reduction in the related carbon emissions liability (note 10).

Auditor's remuneration

	2008 £m	2007 £m
Statutory audit services – audit of the Group's accounts	0.2	0.2
Statutory audit of subsidiary accounts	0.4	0.2
Audit of parent and subsidiary entities	0.6	0.4
Tax services	0.1	–
Other services	0.9	0.2

Tax service fees incurred in the year were £0.1m (2007 – £0.03m). In addition to the amounts shown above, the auditors received fees of £0.03m (2007 – £0.03m) for the audit of the Scottish Hydro-Electric Pension Scheme. Statutory audit of subsidiary accounts includes £0.2m in relation to Airtricity. Other service fees include fees incurred in relation to the disposal of the telecoms sites assets and work in relation to regulatory accounts and returns required by Ofgem. The majority of the fee related to the disposal of the telecoms sites assets and in accordance with policy this was the result of a competitive tender. This fee also included an element related to the success, in proceeds terms, of the transaction. Proceeds totalled £79m including a profit of £55m. A description of the work of the Audit Committee is set out on page 45 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.

4. EXCEPTIONAL ITEMS AND CERTAIN RE-MEASUREMENTS

(i) Exceptional items

During the year, the Group disposed of telecoms sites assets to the Wireless Infrastructure Company Limited, for a total potential consideration of £79.0m. The gain recognised on this disposal is £55.0m. This gain has been disclosed separately in the income statement.

The Group incurred an unhedged translation loss of £22.2m on Euro-denominated debt held in relation to the acquisition of Airtricity Holdings Limited (see note 14). This has been recognised as exceptional following the Group's decision to restructure the borrowings associated with this element of the acquisition in order to match Sterling exposures with Sterling funding. As a consequence this translation loss is a non-recurring item.

In previous years, the Group financial statements included net dividends received in relation to the administration of TXU Europe Energy Trading Limited which had been placed into administration in 2002 (2007 – £33.0m). In addition to this, in previous years, the Group recognised its share of the net dividend from the administration of TXU Europe Energy Trading Limited received by an associate company, Barking Power Limited, separately within share of operating profit from jointly controlled entities and associates (2007 – £0.9m before tax).

(ii) Certain re-measurements

Certain re-measurements arising from IAS 39 are disclosed separately to aid understanding of the underlying performance of the Group.

5. Directors and Employees

(iii) Taxation

The Group has separately recognised the tax effect of the exceptional items and certain re-measurements summarised above. In addition to this, the Group has also separately disclosed the effect of the announced change in the base corporation tax rate of 30% to 28%, which is effective from 1 April 2008. This has an impact on any temporary differences which exist at 1 April 2008 (note 7).

These transactions can be summarised thus:

	2008 £m	2007 £m
Exceptional items		
Distributions from TXU administrator (net of tax in associates)	–	33.6
Disposal of telecoms sites assets (note 11)	55.0	–
Share of change in UK corporation tax rate in jointly controlled entities and associates	32.4	–
Exceptional loss on translation	(22.2)	–
	65.2	33.6
Certain re-measurements		
Movement on operating derivatives	(187.8)	61.3
Movement on financing derivatives	20.7	(10.6)
Share of movement on derivatives in jointly controlled entities (net of tax)	3.0	3.8
	(164.1)	54.5
(Loss)/profit before taxation	(98.9)	88.1
Exceptional items		
Effect of change in UK corporation tax rate on deferred tax liabilities and assets	55.4	–
Taxation on other exceptional items	(9.9)	(9.9)
	45.5	(9.9)
Taxation on certain re-measurements	50.7	(15.2)
Taxation	96.2	(25.1)
Impact on profit for the year	(2.7)	63.0

5. DIRECTORS AND EMPLOYEES**(i) Staff costs**

	2008 £m	Consolidated 2007 £m
Staff costs:		
Wages and salaries	433.1	369.0
Social security costs	38.9	35.5
Share-based remuneration (note 27)	10.8	6.8
Pension costs (note 26)	36.3	34.3
	519.1	445.6
Less: capitalised as property, plant and equipment	(60.9)	(48.3)
	458.2	397.3

Employee numbers:

	Consolidated		Company	
	2008 Number	2007 Number	2008 Number	2007 Number
Numbers employed at 31 March	16,892	13,427	4	4

The monthly average number of people employed by the Group (including Executive Directors) during the year was:

	Consolidated		Company	
	2008 Number	2007 Number	2008 Number	2007 Number
Power Systems	1,938	1,863	–	–
Generation and Supply	7,047	5,335	–	–
Contracting, Connections and Metering	5,312	4,648	–	–
Other businesses and corporate services	1,480	1,207	4	4
	15,777	13,053	4	4

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 74

5. Directors and Employees (continued) 6. Finance Income and Costs

(ii) Directors' remuneration and interests

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.

Information concerning Directors' remuneration, shareholdings, options, long term incentive schemes and pensions is shown in the Remuneration Report on pages 50 to 55. 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.

6. FINANCE INCOME AND COSTS**Recognised in income statement**

	2008			2007		
	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Total £m	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Total £m
Finance income:						
Return on pension scheme assets	141.4	–	141.4	130.1	–	130.1
Interest income from short term deposits	4.9	–	4.9	3.8	–	3.8
Other interest receivable:						
Scotia Gas Networks loan stock	35.4	–	35.4	35.8	–	35.8
Other jointly controlled entities and associates	10.8	–	10.8	9.5	–	9.5
Other receivable	10.1	–	10.1	14.2	–	14.2
Total finance income	202.6	–	202.6	193.4	–	193.4
Finance costs:						
Bank loans and overdrafts	(52.5)	–	(52.5)	(34.0)	–	(34.0)
Other loans and charges	(81.2)	–	(81.2)	(98.2)	–	(98.2)
Interest on pension scheme liabilities	(117.4)	–	(117.4)	(107.2)	–	(107.2)
Accretion of convertible debt component (note 21)	(4.6)	–	(4.6)	(3.6)	–	(3.6)
Notional interest arising on discounted provisions	(3.6)	–	(3.6)	(1.4)	–	(1.4)
Foreign exchange translation of monetary assets and liabilities	2.1	(22.2)	(20.1)			
Less: interest capitalised (ii)	23.3	–	23.3	13.5	–	13.5
Total finance costs	(233.9)	(22.2)	(256.1)	(230.9)	–	(230.9)
Changes in fair value of financing derivative assets or liabilities designated at fair value through profit or loss	–	20.7	20.7	–	(10.6)	(10.6)
Net finance costs	(31.3)	(1.5)	(32.8)	(37.5)	(10.6)	(48.1)
Finance income	202.6	–	202.6	193.4	–	193.4
Finance costs	(233.9)	(1.5)	(235.4)	(230.9)	(10.6)	(241.5)
Net finance costs	(31.3)	(1.5)	(32.8)	(37.5)	(10.6)	(48.1)

(i) Included within other interest receivable are credits from jointly controlled entities of £46.2m (2007 – £45.3m), including £35.4m (2007 – £35.8m) in respect of loan stock interest receivable from Scotia Gas Networks plc.

(ii) The capitalisation rate applied in determining the amount of borrowing costs to capitalise in the period was 5.52% (2007 – 5.42%).

Recognised in equity

	2008 £m	2007 £m
Gains/(losses) on effective portion of cash flow hedges (i)	27.8	(32.3)
Share of (losses)/gain on effective portion of cash flow hedges (i)	(9.7)	7.8
	18.1	(24.5)

(i) Before deduction of tax.

7. Taxation

Adjusted net finance costs are arrived at after the following adjustments:

	2008 £m	2007 £m
Net finance costs	(32.8)	(48.1)
(add)/less:		
Share of interest from jointly controlled entities and associates	(127.6)	(117.9)
Accretion of convertible debt component	4.6	3.6
Exceptional foreign exchange translation loss	22.2	-
Movement on financing derivatives	(20.7)	10.6
Adjusted finance income and costs	(154.3)	(151.8)
(add)/less:		
Return on pension scheme assets	(141.4)	(130.1)
Interest on pension scheme liabilities	117.4	107.2
Notional interest arising on discounted provisions	3.6	1.4
Adjusted finance income and costs for interest cover calculations	(174.7)	(173.3)

7. TAXATION

Analysis of charge recognised in the income statement:

	2008			2007		
	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Total £m	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Total £m
Current tax						
UK corporation tax	315.3	13.6	328.9	286.5	9.9	296.4
Adjustments in respect of previous years	(18.9)	-	(18.9)	(19.9)	-	(19.9)
Total current tax	296.4	13.6	310.0	266.6	9.9	276.5
Deferred tax						
Current year	11.4	(54.4)	(43.0)	7.1	15.2	22.3
Effect of UK corporation tax rate change	-	(55.4)	(55.4)	-	-	-
Adjustments in respect of previous years	(1.0)	-	(1.0)	2.7	-	2.7
Total deferred tax	10.4	(109.8)	(99.4)	9.8	15.2	25.0
Total taxation charge	306.8	(96.2)	210.6	276.4	25.1	301.5

The charge for the year can be reconciled to the profit per the income statement as follows:

	2008 £m	2008 %	2007 £m	2007 %
Group profit before tax	1,083.8		1,132.0	
Less: share of results of associates and jointly controlled entities	(108.5)		(23.9)	
Profit before tax	975.3		1,108.1	
Tax on profit on ordinary activities at standard UK corporation tax rate of 30% (2007 – 30%)	292.6	30.0	332.4	30.0
Tax effect of:				
Expenses not deductible for tax purposes	5.6	0.6	1.5	0.1
Non taxable income	(0.4)	-	(6.3)	(0.6)
Effect of change of UK corporation tax rate	(55.4)	(5.7)	-	-
Impact of foreign tax rates and foreign dividends	(0.6)	(0.1)	-	-
Adjustments to tax charge in respect of previous years	(21.0)	(2.1)	(17.1)	(1.5)
Consortium relief not paid for	(9.7)	(1.0)	(8.9)	(0.8)
Utilisation of tax losses	(0.5)	(0.1)	(0.1)	-
Group tax charge and effective rate	210.6	21.6	301.5	27.2

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 76

7. Taxation (continued)

The adjusted current tax charge is arrived at after the following adjustments:

	2008 £m	2008 %	2007 £m	2007 %
Total taxation charge	210.6	21.6	301.5	27.2
Effect of adjusting items (see below)	-	(4.5)	-	0.7
Total taxation charge on adjusted basis	210.6	17.1	301.5	27.9
(add)/less:				
Share of current tax from jointly controlled entities and associates	20.8	1.7	16.0	1.5
Exceptional items – current and deferred	(9.9)	(0.8)	(9.9)	(0.9)
Effect of change of UK corporation tax rate	55.4	4.5	-	-
Tax on movement on derivatives	50.7	4.1	(15.2)	(1.4)
Deferred tax (excluding share of jointly controlled entities)	(10.4)	(0.8)	(9.8)	(0.9)
Adjusted current tax charge and effective rate	317.2	25.8	282.6	26.2

The adjusted effective rate is based on adjusted profit before tax being:

	2008 £m	2007 £m
Profit before tax	1,083.8	1,132.0
(add)/less:		
Exceptional items and certain re-measurements	98.9	(88.1)
Share of tax from jointly controlled entities and associates	41.9	31.8
Accretion of convertible debt component (note 21)	4.6	3.6
Adjusted profit before tax	1,229.2	1,079.3

In the year, it was confirmed that the corporation tax rate applicable to the Group's UK businesses will change from 30% to 28% from 1 April 2008. Temporary differences which exist at 1 April 2008 will reverse at 28% rather than 30%, which was the basis at 31 March 2007. Consequently, the Group has recognised the following credits in respect of this in the period to 31 March 2008:

	£m	
Adjustments recognised in Income Statement in respect of Group entities	55.4	
Adjustments recognised in Equity in respect of Group entities	(0.6)	
	54.8	
Share of adjustments recognised in Income Statement in joint ventures and associates	32.4	
Share of adjustments recognised in equity in joint ventures and associates	(0.5)	
	86.7	
Tax charge/(credit) recognised directly in equity		
	2008 £m	2007 £m
Relating to:		
Pension scheme actuarial movements	(5.3)	14.2
Cash flow and net investment hedge movements	0.9	(9.8)
Share based payments	0.1	(8.8)
Convertible bond	(1.8)	-
Change in UK corporation tax rate	(0.6)	-
	(6.7)	(4.4)

All tax recognised directly in equity is deferred tax other than current tax relating to employee share awards £(0.8)m (2007 – £4.0m).

8. Dividends 9. Earnings Per Share

8. DIVIDENDS

	2008 £m	2007 £m
Amounts recognised as distributions from equity:		
Final dividend for the previous year of 39.9p (2007 – 32.7p) per share	345.5	281.3
Interim dividend for the current year of 18.1p (2007 – 15.1p) per share	157.3	130.0
	502.8	411.3
Proposed final dividend for the current year of 42.4p (2007 – 39.9p) per share	368.9	343.9

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. The final dividend paid, £345.5m (39.9p, 2007 – 32.7p), was declared on 31 May 2007, approved at the Annual General Meeting on 27 July 2007 and was paid to shareholders on 21 September 2007. An interim dividend, £157.3 (18.1p, 2007 – 15.1p), was paid on 25 March 2008.

9. EARNINGS PER SHARE

Basic earnings per share

The calculation of basic earnings per share at 31 March 2008 is based on the net profit attributable to equity shareholders and a weighted average number of ordinary shares outstanding during the year ended 31 March 2008. All earnings are from continuing operations.

Adjusted earnings per share

Adjusted earnings per share has been calculated by excluding the charge for deferred tax, net finance income relating to pensions, items disclosed as exceptional, and the impact of IAS 39.

	Year ended 31 March 2008 Earnings £m	Year ended 31 March 2008 Earnings per share pence	Year ended 31 March 2007 Earnings £m	Year ended 31 March 2007 Earnings per share pence
Basic	872.9	101.1	830.5	96.5
Exceptional items and certain re-measurements (note 4)	2.7	0.3	(63.0)	(7.3)
Basic excluding exceptional items and certain re-measurements	875.6	101.4	767.5	89.2
Adjusted for:				
Deferred tax (note 7)	10.4	1.2	9.8	1.1
Deferred tax from share of jointly controlled entities and associates results	21.1	2.5	15.8	1.8
Accretion of convertible debt component (note 6)	4.6	0.5	3.6	0.4
Adjusted	911.7	105.6	796.7	92.5
Basic	872.9	101.1	830.5	96.5
Convertible debt interest (net of tax)	9.8	1.1	10.7	1.2
Dilutive effect of convertible debt	–	(1.2)	–	(3.8)
Diluted	882.7	101.0	841.2	93.9
Exceptional items and certain re-measurements	2.7	0.3	(63.0)	(7.0)
Diluted excluding exceptional items and certain re-measurements	885.4	101.3	778.2	86.9

The weighted average number of shares used in each calculation is as follows:

	31 March 2008 Number of shares (millions)	31 March 2007 Number of shares (millions)
For basic and adjusted earnings per share	863.2	860.9
Effect of exercise of share options	2.0	1.8
	865.2	862.7
Effect of dilutive convertible debt	8.8	33.3
For diluted earnings per share	874.0	896.0

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 78

10. Intangible Assets

10. INTANGIBLE ASSETS

Consolidated

	Goodwill	Allowances and certificates (i)	Development assets (ii)	Wind farm developments (iii)	Brands (iv)	Other intangibles (v)	Total
	£m	£m	£m	£m	£m	£m	£m
Cost:							
At 1 April 2006	293.4	284.7	1.4	–	9.0	16.0	604.5
Additions	–	349.3	–	–	–	3.7	353.0
Other (note 14)	(0.2)	–	–	–	–	–	(0.2)
Disposals	–	(402.4)	–	–	–	–	(402.4)
At 31 March 2007	293.2	231.6	1.4	–	9.0	19.7	554.9
Acquisitions (note 14)	344.8	–	–	223.7	2.2	14.2	584.9
Additions	1.1	212.3	–	6.2	–	13.0	232.6
Transfer to property, plant and equipment (note 11)	–	–	–	(20.4)	–	–	(20.4)
Disposals	–	(23.9)	(1.4)	–	–	–	(25.3)
Exchange adjustments	19.9	–	–	13.2	0.2	0.4	33.7
At 31 March 2008	659.0	420.0	–	222.7	11.4	47.3	1,360.4
Aggregate amortisation and impairment:							
At 1 April 2006	–	–	–	–	(1.7)	(12.2)	(13.9)
Charge for the year	–	(53.9)	–	–	(0.9)	(2.4)	(57.2)
At 31 March 2007	–	(53.9)	–	–	(2.6)	(14.6)	(71.1)
Charge for the year	–	(25.2)	–	(2.0)	(1.1)	(4.2)	(32.5)
At 31 March 2008	–	(79.1)	–	(2.0)	(3.7)	(18.8)	(103.6)
Carrying amount:							
At 31 March 2008	659.0	340.9	–	220.7	7.7	28.5	1,256.8
At 31 March 2007	293.2	177.7	1.4	–	6.4	5.1	483.8
At 1 April 2006	293.4	284.7	1.4	–	7.3	3.8	590.6

Intangible assets have been analysed as current and non-current as follows:

	2008 £m	2007 £m
Current	340.9	177.7
Non-current	915.9	306.1
	1,256.8	483.8

(i) Allowances and Certificates

Allowances and Certificates consist of granted or purchased carbon emissions allowances and generated or purchased Renewable Obligation Certificates (ROCs). The impairment charge reflects the reduction in the fair value of granted carbon allowances following the date of grant. The value of carbon emissions liabilities was reduced by an identical amount resulting in nil impact on the income statement.

(ii) Development assets

Development costs relate to the design, construction and testing of renewable generation devices which the Group believes will generate probable future economic benefits.

(iii) Wind farm developments

Costs capitalised as development wind intangibles including options over land rights represent the costs incurred in bringing individual wind farm projects to the consented stage. Costs associated with reaching the consent stage include planning application costs and environmental impact studies. These may be costs incurred directly as part of the fair value exercise on acquisition of a controlling interest in a project. 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 11).

(iv) Brands

Included within brands is the Atlantic brand, acquired on the acquisition of Atlantic Electric and Gas Limited (in administrative receivership) during the year ended 31 March 2005. In addition to this, the Airtricity brand used in Ireland has also been included. The Group have assessed the economic life of brands to be 10 years and the brand is being amortised over this period. The charge is reported as part of operating costs.

(v) Other intangible assets

Included within other intangible assets are application software license fees, software development work, software upgrades and purchased PC software packages. These assets are amortised over 5 years. Also included are customer lists and contracts associated with the acquisitions of CHP Supply Limited, Hills E&M Limited, Seeboard Trading Limited street lighting contracts, and the Supply business of Airtricity. Amortisation is over the shorter of the contract term or five years.

The Company does not hold intangible assets.

Analysis of goodwill:

Goodwill description	Cash-generating unit	2008 £m	2007 £m
Airtricity	As noted (i)	358.2	–
Swalec	Supply (ii)	187.0	187.0
Medway	Generation (iii)	22.2	22.2
Fiddlers Ferry and Ferrybridge	Generation (iii)	17.7	17.7
Slough Heat and Power	Generation (iii)	2.8	–
Hornsea	SSE Hornsea Limited (iv)	56.2	56.2
Neos	Neos Networks Limited (v)	7.8	7.8
Telia	SSE Telecommunications Limited (v)	1.1	–
Connect South West	Contracting (vi)	0.8	0.8
Eastern Contracting	Contracting (vi)	0.9	0.9
Harrison Smith (Batley)	Contracting (vi)	0.6	0.6
Hills E&M	Contracting (vi)	3.7	–
		659.0	293.2

Impairment review of goodwill balances

Goodwill is tested annually for impairment or more frequently if there are indications that amounts may be impaired. The impairment test involves management's view of goodwill and its carrying value estimating the recoverable amount of the cash generating unit, which is the higher of fair value less costs to sell or the value in use.

Value in use calculations have been used to determine the recoverable amounts for the cash generating units noted above. With the exception of Airtricity, these are based on five year projected cash flows extracted from the corporate business model which has been approved by the Executive and the Board.

Discount rates applied to the cash flows in determining recoverable amounts are derived from the Group's approved weighted average cost of capital. The Generation and Supply business segment, is managed and accounted for as an integrated business unit. Management have reviewed the relevant cash generating units within Generation and Supply for the purpose of impairment testing. Where cash flows have been extrapolated beyond the period covered by the most recent corporate business model, the basis of so doing is noted.

The key assumptions applied in the value in use calculations used to determine the recoverable amounts for the individual cash generating units are as follows:

(i) Airtricity

The acquired assets of the Airtricity group included goodwill which was attributable to two cash generating units, Ireland wind farms (£252.9m) and UK wind farms (£105.3m).

The impairment test on the attributed goodwill for each cash generating unit was based on updated discounted cash flow forecasts for the Airtricity group extracted from the 25-year acquisition model. The pre-tax discount rates applied were 7.5% for onshore assets and 10.5% for offshore assets.

(ii) Supply

The impairment test on the carrying value of goodwill relating to Swalec is based on an assessment of the recoverable amount of the Group's Electricity and Gas retail supply function. Judgement has necessarily been applied to separate this as a separable cash generating unit given the integrated nature of the Generation and Supply business. The projected cash flows of this cash generating unit have been assessed solely in order to comply with the requirements of IAS 36. In projecting the gross margin for the business, factors such as market demand, customer retention, market share and forward wholesale energy prices are considered. The pre-tax discount rate applied to cash flows was 7.6%.

Impairment review of goodwill balances continued

(iii) Generation

The impairment test on the carrying value of goodwill relating to Medway, Fiddler's Ferry/Ferrybridge and Slough Heat and Power is based on an assessment of the recoverable amount of the Group's combined Generation assets excluding wind farm assets, which are dealt with as separate cash generating units. The projected cash flows of this cash generating unit have been assessed solely in order to comply with the requirements of IAS 36. In projecting the gross margin for the combined Generation assets, factors such as market demand, market share and forward wholesale energy prices have been considered. The pre-tax discount rate applied to cash flows of the Group's hydro, gas, biomass and coal plants ranged from 9% to 14.6%.

(iv) SSE Hornsea Limited

The impairment test on the carrying value of goodwill associated with Hornsea has been carried out based on the recoverable amount of SSE Hornsea Limited. This is based on projected cash flows which include management estimates of projected demand for gas storage, injection and withdrawal tariffs and wholesale gas prices. The pre-tax discount rate applied to cash flows was 10.4%.

(v) Neos Networks Limited/SSE Telecommunications Limited

The impairment test on the carrying value of goodwill associated with Neos has been carried out based on the recoverable amount of Neos Networks Limited. The discounted cash flow exercise was built around an estimated annual sales growth rate of 10%. The pre-tax discount rate applied to these cash flows was 10.4%.

(vi) Contracting

The impairment test on the carrying value of goodwill related to the acquisitions of Eastern Contracting, Connect South West, Harrison Smith (Batley) and, in the current financial year, Hills E&M were based on cash flow projections of the acquiring subsidiary entity, Southern Electric Contracting, which has successfully integrated these businesses into its operations. The pre-tax discount rate applied to cash flows was 9%. The carrying value of the goodwill associated with Harrison Smith (Batley) was reassessed as £0.6m in the year ended 31 March 2007.

In all cases management concludes that the projected cash flows are sufficient to support the carrying value of the recognised goodwill and the other cost generating unit assets. Management believe that while cash flow projections are subject to inherent uncertainty, any reasonably possible changes to the key assumptions utilised in assessing recoverable amounts have been considered in determining the recoverable amounts of the cash generating units identified. Management's approach to assessing the value in use takes into account past experience and other relevant external information.

Scotia Gas Networks investment in gas distribution networks

The Group's share of Scotia Gas Networks' investment in the gas distribution networks includes an amount of acquired goodwill. In testing for impairment, management believe that both the fair value less costs to sell of the business and the value in use of the cash generating unit support the carrying value of goodwill inherent in the Group's financial statements. The pre-tax discount rate applied to the cash flow forecasts was 7.5%.

Goodwill is allocated to the following business segments:

	2008 £m	2007 £m
Generation and Supply	587.9	226.9
Other businesses	71.1	66.3
	659.0	293.2

11. Property, Plant and Equipment

11. PROPERTY, PLANT AND EQUIPMENT

Consolidated

	Power generation and gas storage assets £m	Land and buildings £m	Network assets £m	Vehicles and miscellaneous equipment £m	Total £m
Cost:					
At 1 April 2006	2,690.5	95.2	4,336.4	222.5	7,344.6
Additions	343.1	24.4	242.2	21.2	630.9
New decommissioning provision (i)	-	-	-	3.3	3.3
Disposals (ii)	(1.1)	(0.2)	(4.5)	(13.9)	(19.7)
At 31 March 2007	3,032.5	119.4	4,574.1	233.1	7,959.1
Additions	392.8	33.6	324.4	31.4	782.2
Acquisitions (iii)	751.8	-	-	4.8	756.6
Transfer from intangible assets (note 10) (iv)	20.4	-	-	-	20.4
Disposals (ii)	(11.1)	(7.1)	(23.5)	(8.4)	(50.1)
Exchange rate adjustments	30.7	-	-	-	30.7
At 31 March 2008	4,217.1	145.9	4,875.0	260.9	9,498.9
Depreciation:					
At 1 April 2006	788.3	21.5	1,714.6	173.6	2,698.0
Charge for the year	102.0	2.7	116.1	16.9	237.7
Disposals (ii)	(0.8)	-	(4.3)	(13.6)	(18.7)
At 31 March 2007	889.5	24.2	1,826.4	176.9	2,917.0
Charge for the year (v)	121.3	2.8	126.8	16.9	267.8
Disposals (ii)	(2.7)	-	(9.2)	(8.3)	(20.2)
At 31 March 2008	1,008.1	27.0	1,944.0	185.5	3,164.6
Net book value					
At 31 March 2008	3,209.0	118.9	2,931.0	75.4	6,334.3
At 31 March 2007	2,143.0	95.2	2,747.7	56.2	5,042.1
At 1 April 2006	1,902.2	73.7	2,621.8	48.9	4,646.6

(i) The net book value of generation and gas storage assets includes decommissioning costs with a net book value of £25.0m, (2007 – £20.3m). In the year to 31 March 2008, the net book value of decommissioning costs related to office and computer equipment was increased by £0.2m to £3.5m (2007 – £3.3m). This arises from the Group's obligations under the EU Waste Electrical and Electronic Equipment (WEEE) directive.

(ii) Assets disposed include those assets which have been replaced after damage or obsolescence in the year.

(iii) Assets acquired in business combinations include the operational and under construction wind farm assets of Airtricity and the combined heat and power biomass generation asset at Slough Heat and Power.

(iv) Represents the carrying value of wind farm development assets transferred from intangible assets (note 10) which have reached the consent stage and have been approved for construction.

(v) Included within the charge for the year are impairment charges against Generation assets of £12.2m (2007 – £13.9m). These impairments were made following identification of indications of impairment and a subsequent review of the projected cash flows associated with the assets. In line with Group policy, these charges have been reported in Cost of Sales.

Land is predominantly heritable or freehold. The net book value of other land and buildings includes freehold £67.9m (2007 – £47.0m) and short leasehold £nil (2007 – £nil). Generation assets comprise generating stations and related plant and machinery and include all hydro civil assets. Cumulative interest capitalised for the Group, included in the cost of tangible fixed assets amounts to £68.0m (2007 – £44.7m).

At the balance sheet date the cumulative amounts capitalised in respect of assets in the course of construction were as follows:

	2008 £m	2007 £m
Generation and gas storage assets	842.9	454.7
Transmission and distribution assets	88.0	56.9
Corporate land and buildings	34.2	16.7
	965.1	528.3

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 82

11. Property, Plant and Equipment (continued) 12. Investments

Included within the assets in the course of construction is the Group's share of expenditure on the Aldbrough gas storage facility and the Beatrice offshore wind farm project which are managed under joint participation agreements. Also included was the cost of acquired assets under construction of £187.5m (2007 – £nil) in relation to the Airtricity group.

Included within property, plant and equipment are the following assets held under finance leases:

	Network assets £m	Vehicles and miscellaneous equipment £m	Total £m
Cost			
At 1 April 2006 and 31 March 2007	5.1	7.0	12.1
At 31 March 2008	5.1	7.0	12.1
Depreciation			
At 1 April 2006	4.3	5.8	10.1
Charge for the year	0.2	0.2	0.4
At 31 March 2007	4.5	6.0	10.5
Charge for the year	0.2	0.2	0.4
At 31 March 2008	4.7	6.2	10.9
Net book value			
At 31 March 2008	0.4	0.8	1.2
At 31 March 2007	0.6	1.0	1.6
At 1 April 2006	0.8	1.2	2.0

The Company does not hold any property, plant or equipment.

12. INVESTMENTS

(a) Associates and joint ventures

	Scotia Gas Networks		Other Jointly Controlled Entities		Associates		Total £m
	Investment £m	Shareholder loans £m	Investment £m	Shareholder loans £m	Investment £m	Shareholder loans £m	
Consolidated							
Share of net assets/cost							
At 1 April 2006	168.1	286.9	62.4	103.4	81.5	0.8	703.1
Initial equity investment	–	–	5.0	–	–	–	5.0
Increase in shareholder loans	–	18.0	–	5.5	–	–	23.5
Repayment of shareholder loans	–	(23.0)	–	(10.8)	–	(0.8)	(34.6)
Dividends received	–	–	(21.5)	–	(1.2)	–	(22.7)
Share of (loss)/profit after tax	(15.3)	–	17.3	–	21.9	–	23.9
Share of other reserves adjustments	4.1	–	–	–	–	–	4.1
At 31 March 2007	156.9	281.9	63.2	98.1	102.2	–	702.3
Acquisitions (note 14)	–	–	119.7	–	–	–	119.7
New equity investments	–	–	5.8	–	8.1	–	13.9
Increase in shareholder loans	–	–	–	5.6	–	–	5.6
Repayment of shareholder loans	–	–	–	(10.8)	–	–	(10.8)
Dividends received	–	–	(19.5)	–	(15.6)	–	(35.1)
Share of (loss)/profit after tax	52.6	–	33.8	–	22.1	–	108.5
Share of other reserves adjustments	9.6	–	–	–	–	–	9.6
Exchange rate adjustments	–	–	4.1	–	–	–	4.1
At 31 March 2008	219.1	281.9	207.1	92.9	116.8	–	917.8

Company	Scotia Gas Networks plc		Other Joint Ventures and associates		Total £m
	Investment £m	Shareholder loans £m	Investment £m	Shareholder loans £m	
Share of net assets/cost					
At 1 April 2006	235.0	286.9	–	–	521.9
Increase in shareholder loans	–	18.0	–	–	18.0
Repayment of shareholder loans	–	(23.0)	–	–	(23.0)
At 31 March 2007 and 31 March 2008	235.0	281.9	–	–	516.9

The investment in Scotia Gas Networks is disclosed separately to aid understanding of the Group's financial performance. Prior to the investment in Scotia Gas Networks, the Company did not have any investments in joint ventures or associates.

Details of the principal jointly controlled entities, operations and associates are as follows:

	Country of incorporation	31 March 2008 Holding %	31 March 2007 Holding %	Principal activity
Jointly controlled entities				
PriDE (South East Regional Prime) Limited (ii)	England and Wales	50	50	Defence estates contractor
Seabank Power Limited (iii)	England and Wales	50	50	Electricity generation
Scotia Gas Networks plc (v)	England and Wales	50	50	Investment in gas networks
Marchwood Power Limited (i)	England and Wales	50	50	Electricity generation
Braes of Doune Limited (vi)	Scotland	50	–	Wind generation
Midas Energy Limited (vi)	Republic of Ireland	50	–	Wind generation
Greater Gabbard Offshore Winds Limited (vi)	England and Wales	50	–	Wind development
St John's Hill Limited (vi)	Scotland	50	–	Wind development
IE CHP (UK and Eire) Limited (iv)	Scotland	50	–	Fuel cell power systems
Aquamarine Power Limited (i)	Scotland	50	–	Marine energy conversion
Associates				
Barking Power Limited (i)	England and Wales	30.4	30.4	Electricity generation
Derwent Cogeneration Limited (i)	England and Wales	49.5	49.5	Electricity generation
Vital Holdings Limited (iv)	England and Wales	30	–	Efficient energy provision
Insource Energy Limited (iv)	England and Wales	33.3	–	Energy and waste management
Onzo Limited (iv)	England and Wales	24.5	–	Energy displays
	Location of operations	31 March 2008 Holding %	31 March 2007 Holding %	Principal activity
Jointly controlled operations (unincorporated)				
Aldbrough	England	66.7	66.7	Development of gas storage facility
Beatrice	Scotland	50	50	Development of offshore wind farm facility

The above companies' shares consist of ordinary shares only. 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.

- (i) Shares held by SSE Generation Limited
- (ii) Shares held by SSE Contracting Group Limited
- (iii) Shares held by SSE Seabank Investments Limited
- (iv) Shares held by SSE Venture Capital Limited
- (v) Shares held by Scottish and Southern Energy plc
- (vi) Shares held by Airtricity Holdings Limited (or subsidiaries)

At 31 March 2008, the Group had invested £16.1m in Marchwood Power Limited. In addition to this, the Group had provided an interest-bearing loan of £44.5m to Marchwood Power, which is reported in Other receivables (note 16).

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 84

12. Investments (continued)

(a) Associates and joint ventures *continued*

The material significance of the Scotia Gas Networks plc investment warrants separate disclosure from other jointly controlled entities. Accordingly, the result from the Group's share of these businesses is included as a separate segment in the analysis of Group operating profit (note 2). The results of Scotia Gas Networks plc, of which the Group has a 50% share, can be illustrated thus:

	2008			2007		
	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Total £m	Before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Total £m
Operating profit	323.0	–	323.0	206.3	–	206.3
Finance costs: excluding loan stock	(165.4)	8.4	(157.0)	(141.2)	10.9	(130.3)
Finance costs: interest on loan stock	(70.8)	–	(70.8)	(71.6)	–	(71.6)
Profit/(loss) before tax	86.8	8.4	95.2	(6.5)	10.9	4.4
Taxation	(42.4)	52.4	10.0	(31.7)	(3.2)	(34.9)
Profit/(loss) for the year	44.4	60.8	105.2	(38.2)	7.7	(30.5)
SSE share of profit/(loss)	22.2	30.4	52.6	(19.1)	3.8	(15.3)

As an investor, Scottish and Southern Energy plc received £35.4m (2007 – £35.8m) in relation to loan stock interest payable to the Group.

The balance sheet of Scotia Gas Networks plc can be summarised as follows (100%):

	Non-current assets £m	Current assets £m	Current liabilities £m	Non-current liabilities £m
Scotia Gas Networks plc				
31 March 2008	4,764.2	161.8	(609.2)	(3,878.6)
31 March 2007	4,483.6	93.0	(513.1)	(3,750.1)

The financial statements of the Group's other jointly controlled entities and associates can be summarised as follows (100%):

	Current assets £m	Non-current assets £m	Current liabilities £m	Non-current liabilities £m	Revenues £m	Profit after tax £m
Jointly controlled entities						
31 March 2008	147.6	443.3	(214.6)	(231.7)	313.4	57.0
31 March 2007	110.6	361.3	(180.8)	(183.2)	211.9	34.6
Associates						
31 March 2008	137.6	468.2	(74.7)	(192.4)	292.4	62.0
31 March 2007	288.8	538.4	(135.3)	(365.5)	453.1	68.4

(b) Other investments

	Solarcentury £m	Sigma Sustainable Energy Fund £m	Other £m	Total £m
At 1 April 2006	1.0	–	2.2	3.2
Additions in the year	2.0	0.5	0.3	2.8
Disposals	–	–	(1.9)	(1.9)
At 31 March 2007	3.0	0.5	0.6	4.1
Additions in the year	1.1	0.8	–	1.9
At 31 March 2008	4.1	1.3	0.6	6.0

13. Subsidiary Undertakings

13. SUBSIDIARY UNDERTAKINGS

Details of the principal subsidiary undertakings are as follows:

	Country of incorporation	2008 Holding %	2007 Holding %	Principal activity
SSE Services plc (i)	England and Wales	100	100	Finance and IT support services
SSE Energy Supply Limited (i)	England and Wales	100	100	Electricity supply
Airtricity Holdings Limited (i)	Ireland	100	–	Wind farm developer
SSE Telecommunications Limited (i)	Scotland	100	100	Telecommunication services
SSE Generation Limited (i)	England and Wales	100	100	Electricity generation
Tay Valley Lighting (Stoke on Trent) Limited (i)	England and Wales	50	50	Contracting services
Tay Valley Lighting (Newcastle and North Tyneside) Limited (i)	England and Wales	50	50	Contracting services
Tay Valley Lighting (Leeds) Limited (i)	England and Wales	50	50	Contracting services
Medway Power Limited (ii)	England and Wales	100	100	Electricity generation
Keadby Generation Limited (ii)	England and Wales	100	100	Electricity generation
Slough Heat and Power Limited (ii)	England and Wales	100	–	Electricity generation
Scottish Hydro-Electric Transmission Limited (iii)	Scotland	100	100	Transmission of electricity
Scottish Hydro-Electric Power Distribution plc (iii)	Scotland	100	100	Distribution of electricity
Southern Electric Power Distribution plc (iii)	England and Wales	100	100	Distribution of electricity
S+S Limited (iii)	Scotland	100	100	Electricity connections
Southern Electric Contracting Limited (iv)	England and Wales	100	100	Electrical contractor
Seaboard Trading Limited (iv)	England and Wales	100	–	Contracting services
Southern Electric Gas Limited (v)	England and Wales	100	100	Gas supply
SSE Hornsea Limited (v)	England and Wales	100	100	Gas storage
Neos Networks Limited (vi)	England and Wales	100	100	Telecommunication services

The above companies' shares consist of ordinary shares only. All companies operate in the United Kingdom and the Republic of Ireland. All companies have accounting periods ending on 31 March.

A full list of Group companies will be included in the Company's annual return and the shares are held by:

- (i) Scottish and Southern Energy plc
- (ii) Shares held by SSE Generation Limited
- (iii) Shares held by SSE Power Distribution Limited
- (iv) Shares held by SSE Contracting Group Limited
- (v) Shares held by SSE Energy Supply Limited
- (vi) Shares held by SSE Telecommunications Limited

Investment in subsidiaries

Company	Total Em
At 1 April 2006 and 31 March 2007	777.9
Acquired in the year	1,349.1
Increase in existing investments	10.8
At 31 March 2008	2,137.8

In the year the Company acquired 100% of the issued share capital in Airtricity Holdings Limited. Details of this acquisition are included at note 14. 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: IFRS 2 Group and Treasury Share Transactions.

Service concession arrangements

In 50:50 partnership with Royal Bank Leasing Limited, the Group has established three companies to provide street lighting services to councils under the Private Finance Initiative (PFI). These services are thereafter sub-contracted to Southern Electric Contracting Limited, a wholly owned subsidiary. The companies established are as follows:

Company	Council
Tay Valley Lighting (Stoke on Trent) Limited	Stoke-on-Trent
Tay Valley Lighting (Newcastle and North Tyneside) Limited	Newcastle and North Tyneside
Tay Valley Lighting (Leeds) Limited	Leeds City Council

Service concession arrangements continued

Under SIC-12 Consolidation – Special Purpose Entities, despite being 50% owned, the Tay Valley Lighting companies are categorised as subsidiaries and are accounted for accordingly. 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 acquired 100% of the issued share capital of the Seeboard Trading Limited group on 3 March 2008 which performs similar services under three PFI contracts. The terms of the service concession arrangement are similar to those operated by the Tay Valley Lighting companies. 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

Characteristics of the arrangements**Description**

The contracts are 25 year arrangements to replace ageing street-lighting stock and to subsequently maintain the new assets throughout each 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 licenced to replace and maintain the assets for the period of the contract. This obligation is passed down to Southern Electric Contracting Limited or to other companies within the Seeboard Trading group through the operating sub-contract. Any failure to provide the services to the required standards will result in financial penalties which are taken from the unitary charge.

The companies have 25 year contracts with no extension options. Termination during this period can be initiated through a number of routes including service provider default, force majeure or the event of a risk becoming uninsurable, authority default, voluntary authority termination, or termination for a prohibited act or breach of refinancing provisions. In all cases, a formula exists for calculating compensation payments to the service provider.

Throughout the contract period there are a number of circumstances under which the companies could potentially be required to provide additional services:

(i) Changes in the law

If circumstances arise where by a change in legislation would mean a change in the way the services are to be provided the companies would be liable for part of the cost of this change. This liability is capped.

(ii) Final survey

The Councils have the ability to deduct 20% 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.

The Group's exposure to unforeseen obligations is insured.

14. ACQUISITIONS AND DISPOSALS**(a) Acquisitions****(i) Airtricity**

On 15 February 2008, the Company acquired 100% of the issued share capital in Airtricity Holdings Limited (Airtricity) for a combined consideration of £1,349.1m (€1,801.4m). The principal activity of Airtricity is the development, construction and operation of offshore and onshore wind generation assets in the UK, the Republic of Ireland and elsewhere in Europe. The acquired group is also a significant supplier of electricity in Ireland. In addition, Airtricity has wind development opportunities in China.

The total value of the businesses acquired was £1,010.8m (€1,349.7m). This included cash assets of €793.2m including the remaining proceeds of Airtricity's disposal of its North American business in late 2007. The transaction was initially funded by a combination of cash and short term bank borrowings. The consideration was in cash (€1,302.2m) with an element of deferred consideration.

The analysis of assets and liabilities acquired and the fair value of the acquisition is shown overleaf. All intangible assets acquired were recognised at their respective fair values. The residual over the net assets acquired is recognised as goodwill. The fair values are provisional.

Including the Group's costs of financing the acquisition, the acquired Airtricity business contributed a net loss after tax of £3.4m in the period of ownership. On a consistent basis, the net loss to the Group had the acquisition date been 1 April 2007 is estimated to be £40.9m.

The provisional book values and fair values of the assets and liabilities acquired were as follows:

	Carrying value of acquired entities £m	Fair value of acquired entities £m
Intangible assets	62.5	228.2
Property, plant and equipment	401.4	707.0
Investment in jointly controlled entities	49.8	119.7
Derivatives and other financial assets	(1.9)	13.2
Cash and cash equivalents	594.0	594.0
Other net current assets/(liabilities)	15.3	17.4
Loans and borrowings	(517.3)	(522.3)
Deferred tax	(3.0)	(146.4)
Net assets	600.8	1,010.8
Goodwill		338.3
Total consideration		1,349.1

The book values of assets and liabilities have been adjusted to align with the fair value of assets and liabilities acquired. The adjustments to intangible assets mainly relate to the acquired wind farm development portfolio and the adjustments to property, plant and equipment relate to the operational and under construction wind farm assets. Goodwill has arisen in relation to the future development potential of the Airtricity businesses including synergies relating to the purchase. Goodwill also includes recognition of deferred tax on the fair value adjustments made. Goodwill has been subject to impairment test review (note 10).

(ii) Slough Heat and Power

On 1 January 2008, SSE Generation Limited acquired 100% of the issued share capital in Slough Heat and Power Limited for a provisional consideration of £48.7m (initial cash £49.5m). The analysis of assets and liabilities acquired and the fair value of the acquisition is shown below. All intangible assets acquired were recognised at their respective fair values. The residual over the net assets acquired is recognised as goodwill. The fair values are provisional. Including the Group's cost of financing the acquisition, the acquired business contributed a net loss after tax of £2.2m in the period of ownership. On a consistent basis, had the acquisition date been 1 April 2007, the business would have contributed an estimated profit after tax to the Group of £2.5m.

The provisional book values and fair values of the assets and liabilities acquired were as follows:

	Carrying value of acquired entities £m	Fair value of acquired entities £m
Intangible assets	–	0.1
Property, plant and equipment	46.0	49.0
Other financial assets	–	16.9
Other net current assets/(liabilities)	3.2	1.8
Deferred tax	(8.7)	(16.3)
Other provisions	(0.9)	(5.6)
Net assets	39.6	45.9
Goodwill		2.8
Total consideration		48.7

Goodwill has been subject to impairment test review (note 10).

(iii) Other acquisitions

On 25 January 2008, the Group acquired CHP Supply Limited, an electricity supply business based in the Republic of Ireland for cash consideration of £2.0m (goodwill £nil). The Group acquired Hills E&M, an electrical contracting company, on 8 February 2008, for cash consideration of £0.2m (goodwill £3.7m). On 29 February 2008, the Group acquired the street lighting contracting group Seeboard Trading Limited from EdF Energy for cash consideration of £9.5m (goodwill £nil). On 20 December 2007, the Group acquired the wind farm development company I&H Brown Toddleburn Limited from I&H Brown for cash consideration of £4.5m (goodwill £nil). No significant profit or loss was recognised from these acquisitions in the period to 31 March 2008.

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 88

14. Acquisitions and Disposals (continued) 15. Inventories 16. Trade and Other Receivables 17. Cash and Cash Equivalents

(a) Acquisitions *continued*

(iii) Other acquisitions *continued*

The provisional book values and fair values of the assets and liabilities acquired in relation to these acquisitions were as follows:

	Carrying value of acquired entities £m	Fair value of acquired entities £m
Intangible assets	–	11.8
Property, plant and equipment	0.9	0.6
Inventories	9.8	9.7
Cash and cash equivalents	3.3	3.3
Other net current assets/(liabilities)	19.5	13.8
Loans and borrowings	(25.7)	(25.7)
Deferred tax	0.2	0.2
Other provisions	–	(1.2)
Net assets	8.0	12.5
Goodwill		3.7
Total consideration		16.2

Goodwill has been subject to impairment test review (note 10).

15. INVENTORIES

	Consolidated	
	2008 £m	2007 £m
Fuel and consumables	224.5	196.5
Work in progress	32.6	19.4
Goods for resale	2.3	6.0
Less: provisions held	(8.2)	(7.8)
	251.2	214.1

The Group has expensed inventories of £798.9m in the year (2007 – £766.4m) and have also recognised £3.4m (2007 – £15.3m) relating to stock write-downs and increases in provisions held. The Company does not hold any inventories.

16. TRADE AND OTHER RECEIVABLES

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Current assets				
Amounts owed by subsidiary undertakings	–	–	2,328.5	1,726.5
Trade receivables	2,042.2	1,473.9	–	–
Other receivables	389.4	117.8	100.7	27.8
Prepayments and accrued income	968.7	675.0	–	–
	3,400.3	2,266.7	2,429.2	1,754.3
Non-current assets				
Amounts owed by subsidiary undertakings	–	–	1,772.7	1,783.5
	3,400.3	2,266.7	4,201.9	3,537.8

Other receivables includes £44.5m (2007 – £22.0m) receivable from Marchwood Power Limited (note 12). Other receivables include financial assets totalling £176.0m (2007 – £37.1m).

Trade receivables are part of the Group's financial exposure to credit risk as explained in note 28.

17. CASH AND CASH EQUIVALENTS

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Bank balances	125.8	17.5	0.7	2.5
Call deposits	129.5	38.6	103.5	3.3
Cash and cash equivalents	255.3	56.1	104.2	5.8

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.

18. Trade and Other Payables 19. Current Tax Liabilities 20. Construction Contracts 21. Loans and Other Borrowings

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Cash and cash equivalents (from above)	255.3	56.1	104.2	5.8
Bank overdraft (note 21)	(12.2)	(7.7)	–	–
Cash and cash equivalents in the statement of cash flows	243.1	48.4	104.2	5.8

18. TRADE AND OTHER PAYABLES

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Current liabilities				
Amounts due to subsidiary undertakings	–	–	3,526.7	2,570.2
Trade payables	2,134.6	1,412.2	–	–
Other creditors	910.4	526.1	53.5	3.7
Accruals and deferred income (i)	556.9	402.1	–	–
	3,601.9	2,340.4	3,580.2	2,573.9
Non-current liabilities				
Accruals and deferred income (ii)	490.1	327.7	–	–
	4,092.0	2,668.1	3,580.2	2,573.9

(i) Current accruals and deferred income includes customer contributions of £14.9m (2007 – £15.1m) and government grants of £0.1m (2007 – £0.1m).

(ii) Non-current accruals and deferred income includes customer contributions of £246.9m (2007 – £252.7m) and government grants of £2.1m (2007 – £2.2m).

19. CURRENT TAX LIABILITIES

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Corporation tax	220.8	199.2	9.0	10.1

20. CONSTRUCTION CONTRACTS

	2008 £m		2007 £m	
	Contracts in progress at balance sheet date:			
Amounts due from contract customers included in trade and other receivables (note 16)		32.0		28.8
Amounts due to contract customers included in trade and other payables (note 18)		(26.8)		(20.5)
Contract costs incurred plus recognised profits less recognised losses to date		189.1		150.3
Less: Progress billings		(202.9)		(152.3)
		(13.8)		(2.0)

In the year to 31 March 2008, contract revenue of £403.8m (2007 – £305.9m) was recognised.

At 31 March 2008, retentions held by customers for contract work amounted to £0.9m (2007 – £1.8m). Advances received from customers for contract work amounted to £4.1m (2007 – £5.9m).

At 31 March 2008, amounts of £nil (2007 – £nil) included in trade and other receivables and arising from construction contracts are due for settlement after more than 12 months.

The Company does not hold any construction contracts.

21. LOANS AND OTHER BORROWINGS

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Current				
Bank overdraft	12.2	7.7	–	–
Other short-term loans	1,835.3	466.6	1,696.3	349.5
	1,847.5	474.3	1,696.3	349.5
Obligations under finance leases	0.1	0.5	–	–
	1,847.6	474.8	1,696.3	349.5

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 90

21. Loans and Other Borrowings (continued)

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Non current				
Loans including convertible debt	2,073.1	1,803.2	372.4	580.6
Obligations under finance leases	0.5	0.6	–	–
Amounts owed to subsidiary undertakings	–	–	240.2	240.2
	2,073.6	1,803.8	612.6	820.8

(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 swapped into Sterling). The Group has £650m (2007 – £650.0m) of committed credit facilities in place maturing in 2009. These provide a back-up facility to the commercial paper programmes and at 31 March 2008 the facility was undrawn.

The Group also has a €2.5bn bridge facility, maturing in 2009, and at 31 March 2008, €1.9bn of this facility was drawn down. This facility did not exist at 31 March 2007.

Analysis of borrowings**Loans and borrowings**

	2008 Weighted average interest rate (viii) %	2008 Face value £m	2008 Fair value £m	2008 Carrying amount £m
Current				
Bank overdrafts (i)	6.25	12.2	12.2	12.2
Other short-term loans – amortising (ii)	7.72	23.4	24.4	23.4
Other short-term loans – non-amortising (iii)	5.12	1,697.0	1,696.3	1,696.3
Non-recourse funding (iv)	6.23	8.5	8.5	8.5
Airtricity (ix)	10.86	107.1	107.3	107.1
Total current		1,848.2	1,848.7	1,847.5
Non-current				
Bank loans – amortising (ii)	7.15	45.6	47.6	45.6
Bank loans – non-amortising (v)	5.71	250.0	255.0	250.0
3.75% Convertible bond repayable on 29 October 2009 (vii)	3.75	79.3	123.3	76.3
Non-recourse funding (iv)	6.19	39.4	39.4	39.4
Airtricity (ix)	9.07	235.9	238.1	235.9
Between two and five years		650.2	703.4	647.2
Bank loans – amortising (ii)	5.69	1.4	1.5	1.4
Bank loans – non-amortising (v)	5.20	100.0	101.0	100.0
Non-recourse funding (iv)	6.29	50.9	50.9	50.9
5.875% Eurobond repayable on 26 September 2022	5.88	300.0	290.8	296.1
5.50% Eurobond repayable on 19 June 2032	5.50	350.0	324.8	350.3
4.625% Eurobond repayable on 20 February 2037	4.63	325.0	260.6	323.3
1.429% Index linked bond repayable on 20 October 2056	5.29	104.0	105.9	104.0
Airtricity (ix)	6.55	199.9	203.0	199.9
Over five years		1,431.2	1,338.5	1,425.9
Fair value adjustment (note 28)		–	–	–
Total non-current		2,081.4	2,041.9	2,073.1
Total		3,929.6	3,890.6	3,920.6

Loans and borrowings

	2007 Weighted average interest rate (viii) %	2007 Face value £m	2007 Fair value £m	2007 Carrying amount £m
Current				
Bank overdrafts (i)	6.25	7.7	7.7	7.7
Other short-term loans – amortising (ii)	7.70	21.4	22.6	21.4
Other short-term loans – non-amortising (iii)	5.56	376.0	374.5	374.5
Non-recourse funding (iv)	6.21	9.2	9.2	9.2
US\$100m repayable on 1 May 2007 (vi)	7.78	61.5	51.0	61.5
Total current		475.8	465.0	474.3
Non-current				
Bank loans – amortising (ii)	7.43	64.9	68.1	64.9
Bank loans – non-amortising (v)	5.45	150.0	149.5	150.0
3.75% Convertible bond repayable on 29 October 2009 (vii)	3.75	300.0	515.0	284.9
Non-recourse funding (iv)	6.21	36.3	36.3	36.3
Between two and five years		551.2	768.9	536.1
Bank loans – amortising (ii)	5.88	5.5	5.6	5.5
Bank loans – non-amortising (v)	5.65	200.0	200.0	200.0
Non-recourse funding (iv)	6.42	2.9	2.9	2.9
5.875% Eurobond repayable on 26 September 2022	5.88	300.0	307.1	295.5
5.50% Eurobond repayable on 19 June 2032	5.50	350.0	358.1	350.3
4.625% Eurobond repayable on 20 February 2037	4.63	325.0	293.6	323.3
1.429% Index linked bond repayable on 20 October 2056	5.08	100.0	96.8	100.0
Over five years		1,283.4	1,264.1	1,277.5
Fair value adjustment (note 28)		–	(10.4)	(10.4)
Total non-current		1,834.6	2,022.6	1,803.2
Total		2,310.4	2,487.6	2,277.5

- (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 and cash advances.
- (iv) The Tay Valley Lighting companies formed under 50:50 partnership with Royal Bank Leasing Limited to provide street-lighting services are categorised as subsidiaries under SIC-12 (note 13). 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 reset quarterly at a rate normally less than three month LIBOR. Other loans include a mixture of fixed and floating debt repayable between 2007 and 2014.
- (vi) The US\$100M loan which existed at 31 March 2007 was swapped into Sterling with £60.0m being fixed at an effective rate of 7.78%.
- (vii) The liability component of the convertible bond is presented separately under IAS 32.
- (viii) The weighted average interest rates are as noted. The weighted average interest rates for the Group (including swaps) for the year ended 31 March 2008 was 5.23% (2007 – 5.31%).

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 92

21. Loans and Other Borrowings (continued)

(i) Borrowings *continued*

(ix) The Airtricity loans and borrowings can be analysed as follows:

	2008 Weighted average interest rate %	2008 Face value £m	2008 Fair value £m	2008 Carrying amount £m
Current				
Operating wind farms – senior debt	6.28	13.8	13.9	13.8
Operating wind farms – junior debt	9.00	1.0	1.0	1.0
Construction loans	5.95	3.8	3.9	3.8
Other	11.81	88.5	88.5	88.5
	10.86	107.1	107.3	107.1
Non-current				
Operating wind farms – senior debt	6.29	60.5	60.6	60.5
Operating wind farms – junior debt	9.00	3.1	3.1	3.1
Construction loans	6.31	32.8	34.7	32.8
Other	10.92	139.5	139.7	139.5
Between two and five years	9.07	235.9	238.1	235.9
Operating wind farms – senior debt	6.43	133.7	133.7	133.7
Operating wind farms – junior debt	9.50	9.1	9.1	9.1
Construction loans	6.36	57.1	60.2	57.1
Other	–	–	–	–
Over five years	6.55	199.9	203.0	199.9
Total non-current	7.91	435.8	441.1	435.8
Total	8.49	542.9	548.4	542.9

Of the Airtricity loans and borrowings noted above, 58% are project specific, repayable over a period of two to 15 years. Other borrowings include corporate debt payable over a period of one to two years.

Convertible bond

The convertible bond was issued on 26 October 2004 in exchange for £300.0m in cash. The bond entitles holders to convert the bond into ordinary shares at any time up to 24 October 2009 at the applicable conversion share price of £9.00 per ordinary share at the date of issue. The conversion price is subject to adjustment in certain circumstances set out in the offering circular including payment of dividends greater than amounts set out in the circular, capital restructuring and change of control. Conversion is at the option of the bond holder.

At 31 March, bond holders had converted debt with a nominal value of £220.7m at the £9.00 per share conversion price. Conversion took place in the following periods:

	Nominal value of bond converted £m	Number of shares
Year to 31 March 2007	0.1	11,111
Year to 31 March 2008	220.6	24,512,537
Total at 31 March 2008	220.7	24,523,648

The net proceeds received from the issue of the bond have been split between a liability element and an equity component, the liability element representing the initial fair value of the debt excluding the embedded option to convert the liability into equity of the Group.

	At 31 March 2008 £m	At 1 April 2007 £m
Nominal value of issue of convertible bond	79.3	299.9
Costs of issue	(0.3)	(1.4)
Net proceeds of convertible bond issued	79.0	298.5
Less: equity component and accreted debt element	(2.7)	(13.6)
Liability component	76.3	284.9

On partial conversion, a debt element of £208.6m was converted from debt to equity. The costs of issue of the bond are amortised over the term of the bond. An additional interest charge of £4.6m (2007 – £3.6m) was recorded.

For the purpose of diluted Earnings per Share (EPS), convertible bond interest of £14.0m (2007 – £15.3m) is added back to earnings and the number of potential ordinary shares to be issued includes the following in respect of this bond:

	2008 Number of shares	2007 Number of shares
Weighted average number of shares	8,809,685	33,322,222

(ii) Finance lease liabilities

Future finance lease commitments are as follows:

	Minimum lease payments		Present value of minimum lease payments	
	2008 £m	2007 £m	2008 £m	2007 £m
Amounts payable:				
Within one year	0.1	0.5	0.1	0.5
Between one and five years	0.4	0.5	0.3	0.4
After five years	0.5	0.6	0.3	0.2
	1.0	1.6	0.7	1.1
Less: future finance charge	(0.4)	(0.5)		
Present value of lease obligations	0.6	1.1		

The average lease term is 12 to 13 years. For the year ended 31 March 2008, the average effective borrowing rate was 8% (2007 – 8%). Interest rates are fixed at the contract date. All leases, held by the Group's telecoms businesses, are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments. 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.

22. Deferred Taxation

22. 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 £m	Fair value gains/(losses) on derivatives £m	Convertible bond £m	Retirement benefit obligations £m	Share based payments £m	Other (i) £m	Total £m
Consolidated							
At 1 April 2006	897.7	14.0	5.1	(58.1)	(1.4)	(24.2)	833.1
Charge/(credit) to Income Statement	0.3	15.2	(1.1)	16.3	1.5	(7.2)	25.0
Charge/(credit) to equity	–	(9.8)	–	14.2	(4.8)	–	(0.4)
At 1 April 2007	898.0	19.4	4.0	(27.6)	(4.7)	(31.4)	857.7
Effect of tax rate change – Income Statement	(60.2)	1.7	(0.2)	–	–	3.3	(55.4)
Effect of tax rate change – equity	–	0.4	–	(1.3)	0.3	–	(0.6)
Acquisitions	18.5	(1.0)	–	–	–	145.0	162.5
Charge/(credit) to Income Statement	4.0	(50.7)	(1.4)	20.5	(0.3)	(16.1)	(44.0)
Charge/(credit) to equity	–	7.7	(1.8)	(5.3)	0.6	(9.0)	(7.8)
Exchange adjustments	0.8	(0.1)	–	–	–	11.1	11.8
At 31 March 2008	861.1	(22.6)	0.6	(13.7)	(4.1)	102.9	924.2

	Accelerated capital allowances £m	Fair value gains/(losses) on derivatives £m	Convertible bond £m	Retirement benefit obligations £m	Share based payments £m	Other (i) £m	Total £m
Company							
At 1 April 2006	–	(6.3)	5.1	27.1	–	(1.0)	24.9
Charge/(credit) to Income Statement	–	(1.2)	(1.1)	6.0	–	0.1	3.8
Charge/(credit) to equity	–	(6.1)	–	5.3	–	–	(0.8)
At 1 April 2007	–	(13.6)	4.0	38.4	–	(0.9)	27.9
Exceptional credit relating to tax rate change	–	0.6	(0.2)	–	–	0.1	0.5
Effect of tax rate change – equity	–	–	–	(2.6)	0.3	–	(2.3)
Charge/(credit) to Income Statement	–	12.9	(1.4)	6.2	–	(6.3)	11.4
Charge/(credit) to equity	–	0.3	(1.8)	(18.0)	0.6	(9.0)	(27.9)
At 31 March 2008	–	0.2	0.6	24.0	0.9	(16.1)	9.6

(i) Includes deferred tax on fair valuation adjustments in business combinations under IAS 12.

Certain deferred tax assets and liabilities have been offset, including the asset balances analysed the tables above. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Deferred tax liabilities	967.3	923.7	9.6	27.9
Deferred tax assets	(43.1)	(66.0)	–	–
Net deferred tax liabilities	924.2	857.7	9.6	27.9

The deferred tax assets disclosed relate to the Group's pension scheme liabilities.

At the balance sheet date, the Group has unused tax losses of £39.3m (2007 – £40.6m) available for offset against future profits.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognised was £2.1m (2007 – £2.1m). No liability has been recognised in respect of these differences because the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that such differences will not reverse in the foreseeable future.

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 credit of £10.1m (2007 – £17.5m charge).

23. Provisions 24. Share Capital

23. PROVISIONS

	Onerous energy contracts (i) £m	Decommissioning (ii) £m	Other (iii) £m	Total £m
Consolidated				
At 1 April 2007	62.6	29.2	20.6	112.4
Charged in the year	0.4	–	6.2	6.6
Unwind of discount	2.2	1.4	–	3.6
Utilised during the year	(12.0)	–	(0.6)	(12.6)
Acquired (note 14)	1.2	0.9	4.7	6.8
At 31 March 2008	54.4	31.5	30.9	116.8
At 31 March 2008				
Non-current	53.1	31.3	22.9	107.3
Current	1.3	0.2	8.0	9.5
	54.4	31.5	30.9	116.8
At 31 March 2007				
Non-current	61.3	28.5	14.6	104.4
Current	1.3	0.7	6.0	8.0
	62.6	29.2	20.6	112.4

- (i) The onerous energy contracts provision relates to future losses on purchase contracts designated as own use under IAS 39 and future losses on specific contracts. The purchase contract losses will be incurred over a maximum period to 2011 when the contracts terminate. The other contract losses will be incurred over a maximum period to 2019.
- (ii) Provision has been made for the estimated net present cost of decommissioning certain generation and gas storage assets. The estimate is based on a forecast of 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. In the year to March 2008, the Group has also increased the provision in relation to its projected decommissioning obligations under the EU Waste Electrical and Electronic Equipment (WEEE) directive by £0.2m to £3.5m (2007 – £3.3m).
- (iii) Other provisions include balances held in relation to restructuring, 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.

The Company does not hold provisions.

24. SHARE CAPITAL

	Number (millions)	£m
Company		
Equity: Ordinary shares of 50p each: Authorised: At 31 March 2008 and 1 April 2007	1,200.0	600.0
Allotted, called up and fully paid:		
At 1 April 2007	861.9	431.0
Issue of shares (i)	0.4	0.2
Conversion of convertible debt to equity (ii)	24.5	12.2
Repurchase of shares (iii)	(16.7)	(8.3)
At 31 March 2008	870.1	435.1

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) The Company issued 351,433 (2007 – 1,651,166) shares during the year under the savings-related share option schemes, and discretionary share option schemes for a consideration of £2.2m (2007 – £9.2m).

During the year, the Company purchased 833,332 shares (2007 – 702,057) for a consideration of £12.4m (2007 – £8.2m) to be held in trust for the benefit of employee share schemes. At 31 March 2008, the trust held 2,691,677 shares (2007 – 1,976,506) which had a market value of £37.8m.

- (ii) During the year, the Company issued 24,512,537 shares under the terms of the convertible bond at a conversion rate of £9 per ordinary share.
- (iii) The repurchased and subsequently cancelled ordinary shares represent 1.9% of the issued share capital. The total cost of the repurchase, including expenses, was £239.8m which has been charged against the profit and loss reserve. Of the £239.8m, only £237.0m was paid in cash, the remainder being accrued at the balance sheet date.

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 96

25. Reserves

25. RESERVES

	Share premium account £m	Capital redemption reserve £m	Equity reserve £m	Hedge reserve £m	Translation reserve £m	Retained earnings £m	Minority interest £m	Total £m
Consolidated								
Reconciliation of movement in reserves								
At 1 April 2006	90.7	13.7	14.6	6.6	-	1,589.6	-	1,715.2
Profit for the year	-	-	-	-	-	830.5	-	830.5
Effective portion of changes in fair value of cash flow hedges	-	-	-	(22.6)	-	-	-	(22.6)
Premium on issue of shares	8.4	-	-	-	-	-	-	8.4
Actuarial gains on retirement benefit schemes (net of tax)	-	-	-	-	-	33.2	-	33.2
Jointly controlled entities:								
Share of change in fair value of effective cash flow hedges	-	-	-	5.5	-	-	-	5.5
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	(1.4)	-	(1.4)
Dividends to shareholders	-	-	-	-	-	(411.3)	-	(411.3)
Credit in respect of employee share awards	-	-	-	-	-	6.8	-	6.8
Investment in own shares	-	-	-	-	-	(8.2)	-	(8.2)
Current and deferred tax recognised in equity in respect of employee share awards (note 7)	-	-	-	-	-	8.8	-	8.8
At 31 March 2007	99.1	13.7	14.6	(10.5)	-	2,048.0	-	2,164.9
Profit for the year	-	-	-	-	-	872.9	0.3	873.2
Effective portion of changes in fair value of cash flow hedges	-	-	-	11.6	-	-	-	11.6
Transferred to income and expense on cash flow hedges	-	-	-	8.0	-	-	-	8.0
Net investment hedge charge to equity	-	-	-	-	(21.1)	-	-	(21.1)
Premium on issue of shares	2.0	-	-	-	-	-	-	2.0
Repurchase of shares	-	8.3	-	-	-	(239.8)	-	(231.5)
Convertible bond converted to equity	214.6	-	(10.7)	-	-	-	-	203.9
Exchange differences on translation of foreign investment	-	-	-	-	46.5	-	-	46.5
Actuarial gains on retirement benefit schemes (net of tax)	-	-	-	-	-	(17.4)	-	(17.4)
Jointly controlled entities:								
Share of change in fair value of effective cash flow hedges	-	-	-	(6.8)	-	-	-	(6.8)
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	16.4	-	16.4
Dividends to shareholders	-	-	-	-	-	(502.8)	-	(502.8)
Credit in respect of employee share awards	-	-	-	-	-	10.8	-	10.8
Investment in own shares	-	-	-	-	-	(12.4)	-	(12.4)
Current and deferred tax recognised in equity in respect of employee share awards (note 7)	-	-	-	-	-	(0.1)	-	(0.1)
At 31 March 2008	315.7	22.0	3.9	2.3	25.4	2,175.6	0.3	2,545.2

26. Retirement Benefit Obligations

	Share premium account £m	Capital redemption reserve £m	Equity reserve £m	Hedge reserve £m	Translation reserve £m	Retained earnings £m	Total £m
Company							
Reconciliation of movement in reserves							
At 1 April 2006	90.7	13.7	14.6	3.1	-	575.1	697.2
Profit for the year	-	-	-	-	-	415.8	415.8
Effective portion of changes in fair value of cash flow hedges	-	-	-	(14.0)	-	-	(14.0)
Premium on issue of shares	8.4	-	-	-	-	-	8.4
Actuarial gains on retirement benefit schemes (net of tax)	-	-	-	-	-	12.3	12.3
Dividends to shareholders	-	-	-	-	-	(411.3)	(411.3)
At 31 March 2007	99.1	13.7	14.6	(10.9)	-	591.9	708.4
Profit for the year	-	-	-	-	-	571.7	571.7
Effective portion of changes in fair value of cash flow hedges	-	-	-	18.0	-	-	18.0
Net investment hedge charge to equity	-	-	-	-	(21.1)	-	(21.1)
Premium on issue of shares	2.0	-	-	-	-	-	2.0
Convertible bond converted to equity	214.6	-	(10.7)	-	-	-	203.9
Repurchase of ordinary shares for cancellation	-	8.3	-	-	-	(239.8)	(231.5)
Actuarial gains on retirement benefit schemes (net of tax)	-	-	-	-	-	(43.3)	(43.3)
Investment in own shares	-	-	-	-	-	(12.4)	(12.4)
Increase in investment in subsidiaries	-	-	-	-	-	10.8	10.8
Dividends to shareholders	-	-	-	-	-	(502.8)	(502.8)
Current and deferred tax recognised in equity in respect of employee share awards	-	-	-	-	-	(0.1)	(0.1)
Other movements	-	-	-	-	-	1.3	1.3
At 31 March 2008	315.7	22.0	3.9	7.1	(21.1)	377.3	704.9

The profit for the year attributable to shareholders dealt with in the financial statements of the Company was £571.7m (2007 – £415.8m). As allowed by section 230 of the Companies Act 1985, the Company has not presented its own income statement.

The hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedge derivative instruments related to hedged transactions that have not yet occurred.

The equity reserve comprises the equity component of the Group's convertible bond (note 21).

The translation reserve comprises exchange differences on foreign currency net investments offset by exchange translation differences on borrowings and derivatives classified as net investment hedges under IAS 39.

26. 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 Group matches employee contributions up to a specified limit, in most circumstances this is set at 6%. The Group may also provide additional contributions of 3% after five and ten years' continuous service. The Keadby Generation Limited (KGL) pension scheme became part of the Southern Electric pension scheme on 1 February 2006.

Pension summary:

Scheme type	Net actuarial gain/(loss) recognised in respect of the pension asset in the SoRIE		Net pension (liability)/asset	
	2008 £m	2007 £m	2008 £m	2007 £m
Scottish Hydro Electric (Company)	146.3	17.6	85.8	128.1
Southern Electric (incorporating KGL)	38.7	29.8	(134.9)	(220.0)
	185.0	47.4	(49.1)	(91.9)

The Scottish Hydro Electric net asset of £85.8m is presented after of an irrecoverable surplus restriction of £210.6m. The Scheme's surplus increased largely due to the increased yield on corporate bonds to such an extent that the Group (and Company) was only able to recognise the surplus to the extent that it is recoverable.

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 98

26. Retirement Benefit Obligations (continued)

Defined benefit schemes *continued*

The individual pension scheme details based on the latest formal actuarial valuations are as follows:

	Scottish Hydro Electric	Southern Electric	KGL
Latest formal actuarial valuation	31 March 2006	31 March 2004	31 March 2004
Valuation carried out by	Hymans Robertson	Hewitt, Bacon & Woodrow	Hewitt, Bacon & Woodrow
Value of assets based on valuation	£970.0m	£770.5m	£46.4m
Value of liabilities based on valuation	£942.0m	£1,046.0m	£60.1m
Valuation method adopted	Projected Unit	Projected Unit	Projected Unit
Average investment rate of return	4.9%	6.0%	6.5%
Average salary increase	5.3%	4.9%	3.9%
Average pension increase	3.0%	3.0%	2.8%
Value of fund assets/accrued benefits	103.0%	73.7%	77.2%

An actuarial valuation of the Southern Electric Pension Scheme (incorporating KGL) as at 31 March 2007 remains in progress and is due to be completed in the year to 31 March 2009. All schemes have been updated to 31 March 2008 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 2008	At 31 March 2007
Rate of increase in pensionable salaries	5.0%	4.6%
Rate of increase in pension payments	3.5%	3.1%
Discount rate	6.9%	5.4%
Inflation rate	3.5%	3.1%

The assumptions relating to longevity underlying the pension liabilities at 31 March 2008 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 based on the weighted average of membership in both schemes are as follows:

	At 31 March 2008 Male	At 31 March 2008 Female	At 31 March 2007 Male	At 31 March 2007 Female
Currently aged 65	21	23	21	23
Currently aged 45	23	25	22	24

Valuation of combined pension schemes

	Consolidated				Company			
	Long-term rate of return expected at 31 March 2008 %	Value at 31 March 2008 £m	Long-term rate of return expected at 31 March 2007 %	Value at 31 March 2007 £m	Long-term rate of return expected at 31 March 2008 %	Value at 31 March 2008 £m	Long-term rate of return expected at 31 March 2007 %	Value at 31 March 2007 £m
Equities	8.0	939.6	8.0	1,253.6	8.0	383.1	8.0	579.3
Government bonds	4.5	481.5	4.5	378.6	4.5	268.5	4.5	173.3
Corporate bonds	6.9	343.0	5.4	221.4	6.9	232.3	5.4	98.0
Other investments	5.6	316.9	5.7	256.8	5.6	121.7	5.7	139.6
Total fair value of plan assets		2,081.0		2,110.4		1,005.6		990.2
Irrecoverable surplus		(210.6)		–		(210.6)		–
Present value of defined benefit obligation		(1,919.5)		(2,202.3)		(709.2)		(862.1)
(Deficit)/surplus in the scheme		(49.1)		(91.9)		85.8		128.1
Deferred tax thereon		13.7		27.6		(24.0)		(38.4)
Net pension (liability)/asset		(35.4)		(64.3)		61.8		89.7

Movements in the defined benefit obligation during the year

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
At 1 April	(2,202.3)	(2,211.1)	(862.1)	(865.6)
Movements in the year:				
Service costs	(29.2)	(30.3)	(12.1)	(12.7)
Member contributions	(7.5)	(7.7)	(2.8)	(2.8)
Benefits paid	95.0	89.2	36.3	33.7
Interest on pension scheme liabilities	(117.4)	(107.2)	(46.0)	(42.0)
Actuarial gains	341.9	64.8	177.5	27.3
At 31 March	(1,919.5)	(2,202.3)	(709.2)	(862.1)

Movements in scheme assets during the year

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
At 1 April	2,110.4	2,017.3	990.2	955.8
Movements in the year:				
Expected return on pension scheme assets	141.4	130.1	66.7	63.4
Assets distributed on settlement	(95.0)	(89.2)	(36.3)	(33.7)
Employer contributions	73.6	61.9	13.4	11.6
Member contributions	7.5	7.7	2.8	2.8
Actuarial (losses)	(156.9)	(17.4)	(31.2)	(9.7)
Irrecoverable surplus	(210.6)	-	(210.6)	-
At 31 March	1,870.4	2,110.4	795.0	990.2

Charges/(credits) recognised

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Current service cost (charged to operating profit)	29.2	30.3	12.1	12.7
Charged/(credited) to finance costs:				
Expected return on pension scheme assets	(141.4)	(130.1)	(66.7)	(63.4)
Interest on pension scheme liabilities	117.4	107.2	46.0	42.0
	(24.0)	(22.9)	(20.7)	(21.4)

History of surplus/(deficit)

	2008 £m	Consolidated			2008 £m	Company		
		2007 £m	2006 £m	2005 £m		2007 £m	2006 £m	2005 £m
Total fair value of plan assets	2,081.0	2,110.4	2,017.3	1,651.3	1,005.6	990.2	955.8	785.8
Irrecoverable surplus	(210.6)	-	-	-	(210.6)	-	-	-
Present value of defined benefit obligation	(1,919.5)	(2,202.3)	(2,211.1)	(1,878.9)	(709.2)	(862.1)	(865.6)	(686.9)
(Deficit)/surplus in the scheme	(49.1)	(91.9)	(193.8)	(227.6)	85.8	128.1	90.2	98.9

Return on assets

As required by IAS 19, the expected return on assets is based on the long-term expectation of returns for each asset class at the beginning of the year. The return on equities is 3.5% per annum in excess of the yield on government bonds. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The assumed long-term rate of return on each asset class is set out within this note. The overall expected rate of return on assets is then derived by aggregating the expected rate for each asset class over the actual asset allocation at 31 March 2008.

The actual return on plan assets is as follows:

	Consolidated		Company	
	2008 £m	2007 £m	2008 £m	2007 £m
Actual return on plan assets	(12.0)	112.7	35.5	53.7

History of experience gains and losses

	2008 £m	Consolidated			2008 £m	Company		
		2007 £m	2006 £m	2005 £m		2007 £m	2006 £m	2005 £m
Total actuarial gains and (losses) recognised in the Statement of Recognised Income and Expense before adjustment for taxation	185.0	47.4	(14.1)	(18.3)	146.3	17.6	(29.0)	6.2
Experience (losses) on scheme liabilities	(122.2)	(40.0)	(123.3)	(38.0)	-	-	-	-

The cumulative actuarial gains and losses recognised in the Statement of Recognised Income and Expense, before adjustment for taxation, since the adoption of IAS 19 is £200.0m (2007 – £15.0m).

Defined contribution scheme

The total contribution paid by the Group to defined contribution schemes was £7.1m (2007 – £4.0m).

Employer financed retirement benefit (EFRB) pension costs

The reduction in the year in relation to the EFRB was £1.1m (2007 – £1.1m increase to the provision) to a total of £6.2m (2007 – £8.0m). This is included in other provisions (note 23). In addition to the reduction in the provision, £0.6m was utilised as a result of payments made to the Group defined benefit schemes.

Staff costs analysis

The pension costs in note 5 can be analysed thus:

	2008 £m	2007 £m
Service costs	29.2	30.3
Defined contribution scheme payments	7.1	4.0
	36.3	34.3

Expected contribution in the year to 31 March 2009

The Group expects to make contributions of £14.0m and £57.0m to the Scottish Hydro Electric Pension Scheme and the Southern Electric Pension Scheme in the year to 31 March 2009, respectively.

27. 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) Discretionary share option scheme

In the past, the Company operated this scheme, under which senior executives and staff were awarded share options. The options granted to the senior executives from 1996 were subject to the performance criterion of normalised earnings per share over a three year period showing average compound annual growth rate of at least 2% above the increase in the UK retail price index for that year. This criterion was met and any remaining discretionary share options are now exercisable. This scheme has now ended and no options have been granted under this scheme since 1998.

(ii) 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 or five years. At the end of this period, the employees have six months to exercise their options by using the cash saved (including a bonus equivalent to interest). If the option is not exercised, the funds may be withdrawn by the employee and the option expires.

(iii) 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 on the final business day of each month. These shares are then held in trust for a period of five years, at which point they are transferred at no further cost to the employee. These shares may be withdrawn at any point during the five years, but tax and national insurance would then be payable on any amounts withdrawn.

In addition to the shares purchased on behalf of the employee, the Company will also match the purchase up to a maximum of five shares (Matching shares) per month. Again these shares are held in trust for the five years until they are transferred to the employee. If an employee leaves during the first three years, or removes his/her Partnership shares, these Matching shares are forfeited.

In addition to the above, at 31 March 2005 and 31 March 2007 the Company made a special award of 50 and 20 free shares respectively. These awards were made to all employees in employment at both 31 March and 20 August 2005 for the 2005 award, and 31 March and 30 May 2007 for the 2007 award, in recognition of their contribution to the success of the Company. Under the arrangements for the award, the shares will be held in trust for five years, at which point they will be transferred to the employees at no cost to the employee. These shares may be withdrawn at any point during years four and five, but tax and national insurance would then be payable on any amounts withdrawn.

(iv) Deferred bonus scheme

This scheme applied to senior managers and Executive Directors. Those eligible were awarded shares based on performance in the year.

This amount was then used to purchase shares in the market which are held in trust on behalf of the employee for a period of three years, at which point the employee is entitled to exercise the award. In addition to shares purchased using the adjusted bonus award, additional shares will also be purchased using any dividends received on the shares held by the trust. If the employee resigns, they lose all outstanding awards.

This scheme has been replaced by the current Annual Bonus Scheme. Under this scheme, 25% of eligible employees' annual bonus is deferred into shares which only vest after three years, subject to continued service. The number of shares awarded is determined by dividing the relevant pre-tax bonus amount by the share price shortly after the announcement of the results for the financial year to which the bonus relates.

(v) Performance Share Plan

This scheme applies to Executive Directors and senior executives. Those eligible are awarded a maximum value of share awards of up to 150% of base salary (previously 100%). These awards will vest after three years to the extent that certain performance conditions are met. These performance conditions are as follows: 50% of the award is subject to a Total Shareholder Return (TSR) target relative to other FT-SE100 companies over the performance period, with full vesting if the Company is above the 75th percentile and 25% (2007 – 30%) vesting if the Company is at the median, with pro rata vesting between the median and 75th percentile; the remaining 50% of the award is subject to an Earnings Per Share (EPS) growth target with full vesting occurring if adjusted EPS is 9% (2007 – 8%) above RPI per annum and 25% (2007 – 30%) vesting if adjusted EPS is 3% above RPI per annum with pro rata vesting between 3% and 9% (2007 – 3% to 8%) above RPI. There will be no vesting of the relevant portion of the award if the TSR minimum target is not met or the minimum EPS growth target is not achieved.

As allowed by IFRS 2, only options granted since 7 November 2002, which were unvested at 1 January 2005, have been included.

A charge of £10.8m (2007 - £6.8m) was recognised in the Income Statement in relation to these schemes.

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

(i) Discretionary share option scheme

Date of grant	Number at 31 March 2008	Price (pence)	Date from which exercisable	Expiry date
July 1998	98,430	547	July 2001	July 2008

No additional costs were expensed in relation to this scheme as no options have been granted after 7 November 2002.

(ii) Savings-related share option scheme

Grant date	25 July 2003		16 July 2004		14 July 2005		11 July 2006		10 July 2007	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
Consolidated										
Outstanding at the start of the year										
Shares	805,170	1,469,934	857,688	908,043	1,537,213	1,631,394	1,085,987	-	-	-
Option price	562	562	622	622	886	886	999	-	-	-
Granted										
Shares	-	-	-	-	-	-	-	1,107,199	927,313	-
Option price	-	-	-	-	-	-	-	999	1,306	-
Forfeited										
Shares	(12,328)	(36,183)	(18,542)	(36,652)	(44,772)	(85,227)	(64,327)	(21,202)	(23,620)	-
Option price	562	562	622	622	886	886	999	999	1,306	-
Exercised										
Shares	(6,301)	(628,581)	(287,827)	(13,703)	(5,650)	(8,954)	(3,166)	(10)	(22)	-
Weighted average price at date of exercise	1,523	1,330	1,484	1,248	1,525	1,273	1,526	1,523	1,456	-
Outstanding at the end of the year										
Shares	786,541	805,170	551,319	857,688	1,486,791	1,537,213	1,018,494	1,085,987	903,671	-
Option price	562	562	622	622	886	886	999	999	1,306	-
Exercisable at the end of the year										
Shares	-	3,169	3,516	-	-	-	-	-	-	-
Option price	-	562	622	-	-	-	-	-	-	-
Company										
Outstanding at the start of the year										
Shares	1,700	1,700	2,287	2,287	3,655	3,655	-	-	-	-
Option price	562	562	622	622	886	886	-	-	-	-
Granted										
Shares	-	-	-	-	-	-	-	-	144	-
Option price	-	-	-	-	-	-	-	-	1,306	-
Outstanding at the end of the year										
Shares	1,700	1,700	2,287	2,287	3,655	3,655	-	-	144	-
Option price	562	562	622	622	886	886	-	-	1,306	-

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 102

27. Employee Share-Based Payments (continued)

(iii) Savings-related share option scheme *continued*

No options were forfeited or exercised in the year. Of the outstanding options at the end of the year, none were exercisable.

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

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

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

(iii) Share Incentive Plan

Matching shares

	Consolidated				Company			
	2008		2007		2008		2007	
	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	750,971	1,034	527,237	874	940	959	700	832
Granted during the year	287,023	1,506	263,772	1,330	240	1,507	240	1,332
Forfeited during the year	(26,235)	1,211	(20,413)	874	-	-	-	-
Exercised during the year	(17,306)	1,503	(19,625)	1,251	-	-	-	-
Expired during the year	-	-	-	-	-	-	-	-
Outstanding at end of year	994,453	1,170	750,971	1,034	1,180	1,071	940	959
Exercisable at end of year	204,167	747	117,834	632	480	747	240	632

The fair value of these shares is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price paid for the shares at the grant date as shares are acquired out of the market as at that date to satisfy awards made under the scheme.

Shares purchased under this scheme prior to 7 November 2002 have not been included as permitted by the transitional rules under IFRS 1.

Free shares

	Consolidated				Company			
	2008		2007		2008		2007	
	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	433,300	965	477,450	965	200	965	200	965
Granted during the year	245,020	1,484	-	-	80	1,484	-	-
Forfeited during the year	(22,860)	1,182	(22,300)	965	-	-	-	-
Exercised during the year	(7,230)	1,503	(21,850)	1,218	-	-	-	-
Expired during the year	-	-	-	-	-	-	-	-
Outstanding at end of year	648,230	1,161	433,300	965	280	1,113	200	965

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

The fair value of these shares is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price paid for the shares at the grant date as shares are acquired in the market as at that date to satisfy awards made under the scheme.

28. Financial Instruments and Risk

(iv) Deferred bonus scheme

	Consolidated				Company			
	2008	Price (pence)	2007	Price (pence)	2008	Price (pence)	2007	Price (pence)
Outstanding at start of year	600,030	976	525,395	860	325,147	924	266,135	784
Granted during the year	118,276	1,455	244,423	1,146	33,666	1,455	126,149	1,146
Forfeited during the year	(2,189)	1,220	–	–	–	–	–	–
Exercised during the year	(141,633)	1,452	(169,788)	1,183	(58,287)	1,434	(67,137)	1,149
Expired during the year	–	–	–	–	–	–	–	–
Outstanding at end of year	574,484	1,273	600,030	976	300,526	984	325,147	924
Exercisable at end of year	105,330	665	33,727	626	72,635	665	19,116	626

The fair value of these shares is not subject to valuation using the Black-Scholes model. However, the fair value of shares granted in the year is equal to the weighted average price paid for the shares at the grant date as shares are acquired in the market as at that date to satisfy awards made under the scheme.

(v) Performance Share Plan

	Consolidated				Company			
	2008	Price (pence)	2007	Price (pence)	2008	Price (pence)	2007	Price (pence)
Outstanding at start of year	256,554	1,220	–	–	151,351	1,220	–	–
Granted during the year	374,013	1,434	256,554	1,220	214,183	1,434	151,351	1,220
Forfeited during the year	–	–	–	–	–	–	–	–
Exercised during the year	–	–	–	–	–	–	–	–
Expired during the year	–	–	–	–	–	–	–	–
Outstanding at end of year	630,567	1,347	256,554	1,220	365,534	1,345	151,351	1,220

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.

28. FINANCIAL INSTRUMENTS AND RISK

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

This note presents information about the fair value of the Group's financial instruments, the Group's exposure to each of the noted risks, 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 Board has overall responsibility for the establishment and oversight of the Group's risk management framework. The Board established the Risk Committee, a standing committee of the Board comprising three Executive Directors and senior managers from the Generation and Supply and Finance functions, to oversee the control of these activities. This committee is discussed further in the Directors Report.

The Group's policies for risk management are established to identify the risks faced by the Group, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. These policies and the systems used to monitor activities are reviewed regularly by the Risk 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 identical policies to the Group, where applicable. Separate disclosure is provided where necessary.

(i) Qualitative risk disclosures

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty fails to meet its contractual obligations.

(i) Qualitative risk disclosures continued**Credit risk** continued

Credit risk arising from the Group's normal commercial operations is controlled by individual business units operating in accordance with Group policies and procedures. Generally, for significant contracts, individual business units enter into contracts or agreements with counterparties having investment grade credit ratings only, or where suitable collateral or other security has been provided. Counterparty credit validation is undertaken prior to contractual commitment.

Credit risk management for the Group's regulated businesses is performed in accordance with industry standards as set out by the Regulator and is controlled by the individual business units. The Group's greatest credit risks lie with the non-regulated operations of the Generation and Supply business and the activities carried out by the Group's Treasury function, for which specific credit risk controls that match the risk profile of those activities are applied.

Exposure to credit risk in the supply of electricity and gas arises from the potential of a customer defaulting on their invoiced payables. The financial strength and creditworthiness of business customers is assessed before commencing, and during, their contract of supply. Domestic customers' creditworthiness is assessed 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 Generation and Supply business, increasing volumes of commodity derivative products are now traded through cleared exchanges to further mitigate credit risk. Such exchanges are subject to strict regulation by the UK Financial Services Authority (FSA) and participants in these exchanges are obliged to meet rigorous capital adequacy requirements.

Individual counterparty credit exposures are monitored by category of credit risk and are subject to approved limits. At 31 March 2008, the Group's Generation and Supply business had pledged £135m (2007 – £90m) of cash collateral and letters of credit and had received £74m (2007 – £27m) of cash collateral and letters of credit principally to reduce exposures on commodity price 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 Committee.

Liquidity risk

Liquidity risk, the risk that the Group will have insufficient funds to meet liabilities, is managed by the Group's Treasury function.

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. The department's operations are governed by policies determined by the Board and any breaches of these policies are reported to the Risk 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.

The Group's approach to managing liquidity is to ensure that the Group has available committed borrowings and facilities equal to at least 105% of forecast borrowings over a rolling 12 month period. The Group uses a cash flow forecast to monitor its ongoing borrowing requirements. Typically, the Group will fund any short term borrowing positions by issuing commercial paper or borrowing from uncommitted bank lines and will invest in money market funds when it has a cash surplus. In addition to the borrowing facilities listed at note 21, the Group has £75m of uncommitted bank lines and a £20m overdraft facility.

Treasury also manage the Group's interaction with its relationship banks (defined as those banks that support the Company's financing activities through their ongoing participation in the committed lending facilities that are maintained by the Group). These are each allocated financial limits, subject to the maintenance of a minimum credit rating of 'A' or equivalent allocated by a recognised major ratings group. In respect of short-term cash management, counterparties are subject to review and approval according to defined criteria.

Commodity risk

The Group's Generation and Supply business faces exposure to energy commodity price movements and also to physical commodity volume requirements as part of its normal course of business. This arises from the Group's requirement to source gas or electricity to supply customers, or to procure fuel to produce electricity from its generation assets.

The Group's strategy is to manage all exposures to commodity risk through volumetric limits and to measure the exposure by use of a Value at Risk (VaR) model. The exposure is subject to financial limits established by the Board and managed by the Risk Committee and 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 fair value that represents the exposure of the Group's commodity price risk under IFRS 7. This follows because commodity contracts that are financial instruments under IAS 39 are accounted 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, while the overall Group VaR associated with the Generation and Supply business is outside the scope of IAS 39 is monitored for internal risk management purposes, these measures are not required to comply with IFRS 7.

Operationally, the economic risks associated with this exposure are managed through a selection of longer and shorter term contracts for commodities such as gas, electricity, coal and oil, and also the flexibility of the Group's fleet of generation assets.

Short-term exposures arise from the requirement to match volumes of procured gas, electricity and power station fuel with demand for gas and electricity by its customers, which can vary from expectations and result in a requirement to close the resulting positions at unfavourable prices. This aspect of commodity risk is managed through the ability to increase or decrease energy production either in the form of flexible purchase contracts or assets such as pumped storage generating plant, flexible hydro generating plant, standby oil plant and gas storage.

Longer-term exposures are managed through the Group's generation plant and longer term contracts (including forwards, futures contracts and other financial instruments). These, in turn, are used to reduce short-term market exposures.

Certain commodity contracts are entered into primarily for own use purposes to supply to existing customers or to fuel existing power stations. However, a number of these contracts do not qualify for own use treatment under IAS 39 and are subject to fair value measurement through the income statement. In addition to this, the Group enters into certain contracts to manage commodity price and volume risk. These are also subject to fair value measurement through the income statement. Finally, certain other physical contracts are treated as the hedging instrument in documented cash flow hedging relationships where the hedged item is the forecast future purchase requirement to meet production or customer demand. The accounting policies associated with such items 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 Committee. The Group's exposure to Commodity risk is reported to and monitored by the Risk Committee and to the Board by exception.

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. Most exposure is transactional in nature, and relate primarily to procurement contracts, commodity purchasing and related freight requirements, commodity hedging, long term plant servicing and maintenance agreements, and the purchase and sale of carbon emission certificates. The 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.

As a consequence of the purchase of Airtricity, the Group has acquired foreign operations with consequent currency exposure issues. The financing of the acquisition was in Euros and the acquired group has significant Euro-denominated debt balances. The Group's policy is to hedge its net investment in Airtricity by ensuring the acquired net assets whose functional currency cash flows are denominated in Euros are matched by borrowings in Euros. For the acquired net assets whose functional cash flows are in Sterling, the Group will ensure Sterling denominated borrowings are in place to minimise currency risk. At the balance sheet date, the short term funding in place in relation to the acquisition had not been refinanced. Consequently, the Group is holding Euro borrowings in relation to net assets with a Sterling functional currency. The Group has recognised an exceptional translation loss on revaluation of this component of its Euro borrowings. The remaining component has been recorded as an effective net investment hedge.

Significant exposures are reported to, and discussed by, the Risk Committee on an ongoing basis and additionally form part of the bi-annual Treasury report to the Audit Committee.

Interest rate risk

Interest rate risk derives from the Group's exposure to changes in 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 less than LIBOR and cash advances from the European Investment Bank (EIB).

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28. Financial Instruments and Risk (continued)

(ii) Categories of financial assets and liabilities and fair values

The fair values of the primary financial assets and liabilities of the Group together with their carrying values are as follows:

	2008 Amortised cost or other (i) £m	2008 Designated at fair value (ii) £m	2008 Total carrying value £m	2008 Fair value £m
Financial assets				
Current				
Trade receivables	2,042.2	–	2,042.2	2,042.2
Other receivables	176.0	–	176.0	176.0
Cash and cash equivalents	255.3	–	255.3	255.3
Derivative financial assets	–	1,106.5	1,106.5	1,106.5
	2,473.5	1,106.5	3,580.0	3,580.0
Non-current				
Derivative financial assets	–	318.9	318.9	318.9
	2,473.5	1,425.4	3,898.9	3,898.9
Financial liabilities				
Current				
Trade payables	2,134.6	–	2,134.6	2,134.6
Bank loans and overdrafts	1,847.5	–	1,847.5	1,848.7
Derivative financial liabilities	–	1,229.4	1,229.4	1,229.4
	3,982.1	1,229.4	5,211.5	5,212.7
Non-current				
Loans and borrowings (iii)	2,073.1	–	2,073.1	2,041.9
Derivative financial liabilities	–	313.3	313.3	313.3
	2,073.1	313.3	2,386.4	2,355.2
	6,055.2	1,542.7	7,597.9	7,567.9
Net financial liabilities	3,581.7	117.3	3,699.0	3,669.0

(i) Recorded at amortised cost, available for sale, or loans and receivables.

(ii) IAS 39 financial derivatives.

(iii) Includes non-recourse borrowings.

	2007 Amortised cost or other (i) £m	2007 Designated at fair value (ii) £m	2007 Total carrying value £m	2007 Fair value £m
Financial assets				
Current				
Trade receivables	1,473.9	–	1,473.9	1,473.9
Other receivables	37.1	–	37.1	37.1
Cash and cash equivalents	56.1	–	56.1	56.1
Derivative financial assets	–	452.9	452.9	452.9
	1,567.1	452.9	2,020.0	2,020.0
Non-current				
Derivative financial assets	–	54.5	54.5	54.5
	1,567.1	507.4	2,074.5	2,074.5
Financial liabilities				
Current				
Trade payables	1,412.2	–	1,412.2	1,412.2
Bank loans and overdrafts	474.3	–	474.3	465.0
Derivative financial liabilities	–	351.9	351.9	351.9
	1,886.5	351.9	2,238.4	2,229.1
Non-current				
Loans and borrowings (iii)	1,813.6	(10.4)	1,803.2	2,022.6
Derivative financial liabilities	–	120.9	120.9	120.9
	1,813.6	110.5	1,924.1	2,143.5
	3,700.1	462.4	4,162.5	4,372.6
Net financial liabilities	2,133.0	(45.0)	2,088.0	2,298.1

The fair values of the primary financial assets and liabilities of the Company together with their carrying values are as follows:

	2008 Amortised cost or other (i) £m	2008 Designated at fair value (ii) £m	2008 Total carrying value £m	2008 Fair value £m
Financial assets				
Current				
Cash and cash equivalents	104.2	–	104.2	104.2
Amounts owed by subsidiary undertakings	2,328.5	–	2,328.5	2,328.5
Derivative financial assets	–	1.1	1.1	1.1
	2,432.7	1.1	2,433.8	2,433.8
Non-current				
Amounts owed by subsidiary undertakings	1,772.7	–	1,772.7	1,772.7
	1,772.7	–	1,772.7	1,772.7
	4,205.4	1.1	4,206.5	4,206.5
Financial liabilities				
Current				
Amounts owed to subsidiary undertakings	3,526.7	–	3,526.7	3,526.7
	3,526.7	–	3,526.7	3,526.7
Non-current				
Convertible bond	76.3	–	76.3	123.3
Bank loans	296.1	–	296.1	290.8
Amounts owed to subsidiary undertakings	240.2	–	240.2	240.2
	612.6	–	612.6	654.3
	4,139.3	–	4,139.3	4,181.0
Net financial assets	66.1	(1.1)	67.2	25.5

(i) Recorded at amortised cost, available for sale, or loans and receivables.

(ii) IAS 39 financial derivatives.

	2007 Amortised cost or other (i) £m	2007 Designated at fair value (ii) £m	2007 Total carrying value £m	2007 Fair value £m
Financial assets				
Current				
Cash and cash equivalents	5.8	–	5.8	5.8
Amounts owed by subsidiary undertakings	1,726.5	–	1,726.5	1,726.5
	1,732.3	–	1,732.3	1,732.3
Non-current				
Amounts owed by subsidiary undertakings	1,783.5	–	1,783.5	1,783.5
	1,783.5	–	1,783.5	1,783.5
	3,515.8	–	3,515.8	3,515.8
Financial liabilities				
Current				
Bank loans and overdrafts	349.5	–	349.5	349.4
Amounts owed to subsidiary undertakings	2,570.2	–	2,570.2	2,570.2
	2,919.7	–	2,919.7	2,919.6
Non-current				
Convertible bond	284.9	–	284.9	515.0
Bank loans	295.7	–	295.7	307.1
Derivative financial liabilities	–	44.9	44.9	44.9
Amounts owed to subsidiary undertakings	240.2	–	240.2	240.2
	820.8	44.9	865.7	1,107.2
	3,740.5	44.9	3,785.4	4,026.8
Net financial (liabilities)	(224.7)	(44.9)	(269.6)	(511.0)

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 108

28. Financial Instruments and Risk (continued)

(ii) Categories of financial assets and liabilities and fair values *continued***Basis of determining fair value**

Certain assets and liabilities designated and carried at amortised cost or are loans and receivables. For certain current assets and liabilities their carrying value is equivalent to fair value due to short term maturity.

Assets and liabilities designated at fair value and the fair value of other financial assets and liabilities have been determined by reference to closing rate market values. This basis has been used in valuing interest rate instruments, foreign currency hedge contracts and denominated long-term fixed rate debt. Commodity contracts fair values are based on published price quotations.

The fair values are stated at a specific date and may be different from the amounts which will actually be paid or received on settlement of the instruments. The fair value of items such as property, plant and equipment, internally generated brands or the Group's customer base are not included as these are not financial instruments.

(iii) Credit risk

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 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:

	2008 £m	2007 £m
Power Systems		
Scotland	18.6	12.6
England	19.7	6.5
	38.3	19.1
Generation and Supply		
Retail customers	493.5	519.0
Other	1,300.8	798.7
Other businesses	209.6	137.1
	2,042.2	1,473.9

The Generation and Supply segment accounts for 87.9% (2007 – 89.4%) of the Group's trade receivables. Trade receivables associated with the Group's 8.45 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 Group's biggest customer balance, due from a wholesale electricity customer, is around 5% of the total.

The ageing of trade receivables at the reporting date was:

	2008 £m	2007 £m
Not past due	1,873.8	1,285.5
Past due 0-30 days	106.0	108.2
Past due 31-90 days	61.6	64.1
Over 90 days	116.5	101.4
	2,157.9	1,559.2
Less: impairment	(115.7)	(85.3)
	2,042.2	1,473.9

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.

The Group has other receivables which are financial assets totalling £176.0m (2007 – £37.1m).

The Company does not have trade receivables.

The movement in the allowance for impairment of trade receivables was:

	2008 £m	2007 £m
Balance at 1 April	85.3	62.8
Increase in allowance for impairment	69.5	44.3
Impairment losses recognised	(41.6)	(21.8)
Acquired allowance	2.5	-
Balance at 31 March	115.7	85.3

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 debtors 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.

(iv) Liquidity risk

The following are the contractual liabilities of financial liabilities excluding the impact of netting agreements:

Liquidity risk

	Carrying value £m	Contractual cash flows £m	2008			
			0-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m
Financial liabilities						
Loans and borrowings						
Bank overdrafts	12.2	(12.2)	(12.2)	-	-	-
Commercial paper and cash advances	1,696.3	(1,706.7)	(1,706.7)	-	-	-
Bank loans – fixed	150.0	(187.8)	(7.8)	(7.5)	(145.9)	(26.6)
Bank loans – fixed	270.2	(331.0)	(39.0)	(39.3)	(173.0)	(79.7)
Unsecured bonds – fixed	1,073.6	(2,755.0)	(53.4)	(53.4)	(160.6)	(2,487.6)
Convertible bond	76.3	(83.7)	(3.0)	(80.7)	-	-
Non-recourse funding	99.1	(99.0)	(8.6)	(8.8)	(30.5)	(51.1)
Airtricity debt (note 21)	542.9	(726.6)	(145.9)	(214.7)	(117.9)	(248.1)
	3,920.6	(5,902.0)	(1,976.6)	(404.4)	(627.9)	(2,893.1)
Finance lease obligations	0.6	(0.6)	(0.2)	(0.2)	(0.2)	-
	3,921.2	(5,902.6)	(1,976.8)	(404.6)	(628.1)	(2,893.1)
Derivative financial liabilities						
Operating derivatives designated at fair value	1,492.3	3,478.0	2,881.2	496.8	78.0	22.0
Interest rate swaps used for hedging	12.8	(12.8)	(3.8)	(3.7)	(4.2)	(1.1)
Interest rate swaps designated at fair value	24.4	(24.4)	(1.3)	(1.3)	(3.8)	(18.0)
Forward exchange contracts held for hedging	3.8	(88.8)	(58.4)	(21.6)	(8.8)	-
Forward exchange contracts designated at fair value	9.4	(46.5)	(9.1)	(4.8)	(25.2)	(7.4)
	1,542.7	3,305.5	2,808.6	465.4	36.0	(4.5)
Other financial liabilities						
Trade payables	2,134.6	(2,134.6)	(2,134.6)	-	-	-
	2,134.6	(2,134.6)	(2,134.6)	-	-	-
Total	7,598.5	(4,731.7)	(1,302.8)	60.8	(592.1)	(2,897.6)
Derivative financial assets						
Operating derivatives designated at fair value	(1,389.8)	(3,957.9)	(3,245.7)	(497.3)	(211.0)	(3.9)
Financing derivatives	(35.6)	(197.3)	(104.8)	(27.6)	(25.4)	(39.5)
	(1,425.4)	(4,155.2)	(3,350.5)	(524.9)	(236.4)	(43.4)
Net total (i)	6,173.1	(8,886.9)	(4,653.3)	(464.1)	(828.5)	(2,941.0)

(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.

05 Notes on the Financial Statements for the year ended 31 March 2008 continued 110

28. Financial Instruments and Risk (continued)

(iv) Liquidity risk continued

Liquidity risk

	Carrying value £m	Contractual cash flows £m	2007			
			0-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m
Financial liabilities						
Loans and borrowings						
Bank overdrafts	7.7	(7.7)	(7.7)	-	-	-
Commercial paper and cash advances	349.5	(351.0)	(351.0)	-	-	-
Bank loans – fixed	316.8	(395.7)	(64.6)	(39.0)	(126.7)	(165.4)
Bank loans – floating	150.0	(199.9)	(8.3)	(8.3)	(25.0)	(158.3)
Unsecured bonds – floating	61.5	(61.9)	(61.9)	-	-	-
Unsecured bonds – fixed	1,069.1	(2,808.4)	(53.4)	(53.4)	(160.4)	(2,541.2)
Convertible bond	284.9	(328.0)	(11.2)	(11.2)	(305.6)	-
Non-recourse funding	48.4	(48.4)	(9.2)	(9.2)	(27.1)	(2.9)
Fair value adjustment	(10.4)	-	-	-	-	-
	2,277.5	(4,201.0)	(567.3)	(121.1)	(644.8)	(2,867.8)
Finance lease obligations	1.1	(1.1)	(0.5)	(0.2)	(0.2)	(0.2)
	2,278.6	(4,202.1)	(567.8)	(121.3)	(645.0)	(2,868.0)
Derivative financial liabilities						
Operating derivatives designated at fair value	406.3	(109.9)	(626.0)	363.3	152.8	-
Interest rate swaps used for hedging	15.9	(15.9)	(11.9)	(0.9)	(2.6)	(0.5)
Forward exchange contracts held for hedging	15.6	(137.2)	(100.7)	(22.5)	(13.9)	(0.1)
Interest rate swaps designated at fair value	17.8	(17.8)	(3.9)	(0.8)	(2.4)	(10.7)
Forward exchange contracts designated at fair value	15.3	(205.6)	(90.1)	(32.6)	(46.9)	(36.0)
	470.9	(486.4)	(832.6)	306.5	87.0	(47.3)
Other financial liabilities						
Trade payables	1,412.2	(1,412.2)	(1,412.2)	-	-	-
	1,412.2	(1,412.2)	(1,412.2)	-	-	-
Total	4,161.7	(6,100.7)	(2,812.6)	185.2	(558.0)	(2,915.3)
Derivative financial assets						
Operating derivatives designated at fair value	(507.4)	469.6	509.0	64.9	(104.3)	-
Financing derivatives	-	-	-	-	-	-
	(507.4)	469.6	509.0	64.9	(104.3)	-
Net total (i)	3,654.3	(5,631.1)	(2,303.6)	250.1	(662.3)	(2,915.3)

(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.

The Company has the following liquidity maturity profile:

Liquidity risk

	Carrying value £m	Contractual cash flows £m	2008			
			0-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m
Financial liabilities						
Loans and borrowings						
Commercial paper and cash advances	1,696.3	(1,706.7)	(1,706.7)	-	-	-
Unsecured bonds – fixed	296.1	(564.4)	(17.6)	(17.6)	(52.9)	(476.3)
Convertible bond	76.3	(83.7)	(3.0)	(80.7)	-	-
	2,068.7	(2,354.8)	(1,727.3)	(98.3)	(52.9)	(476.3)
Derivative financial liabilities						
Interest rate swaps used for hedging	20.4	(20.4)	(1.0)	(1.0)	(3.0)	(15.4)
Forward exchange contracts held for hedging	(9.8)	(202.8)	(90.8)	(43.4)	(28.8)	(39.8)
Forward exchange contracts designated at fair value	(11.7)	(130.8)	(82.1)	(10.6)	(30.7)	(7.4)
	(1.1)	(354.0)	(173.9)	(55.0)	(62.5)	(62.6)
Other financial liabilities						
Amounts due to subsidiary undertakings	3,526.7	(3,526.7)	(3,526.7)	-	-	-
	3,526.7	(3,526.7)	(3,526.7)	-	-	-
Total	5,594.3	(6,235.5)	(5,427.9)	(153.3)	(115.4)	(538.9)

Liquidity risk

	Carrying value £m	Contractual cash flows £m	2007			
			0-12 months £m	1-2 years £m	2-5 years £m	> 5 years £m
Financial liabilities						
Loans and borrowings						
Commercial paper and cash advances	349.5	(351.0)	(351.0)	-	-	-
Unsecured bonds – fixed	295.7	(582.0)	(17.6)	(17.6)	(52.9)	(493.9)
Convertible bond	284.9	(328.0)	(11.2)	(11.2)	(305.6)	-
	930.1	(1,261.0)	(379.8)	(28.8)	(358.5)	(493.9)
Derivative financial liabilities						
Interest rate swaps used for hedging	14.0	(14.0)	(0.7)	(0.7)	(2.1)	(10.5)
Forward exchange contracts held for hedging	15.6	(137.2)	(100.7)	(22.5)	(13.9)	(0.1)
Forward exchange contracts designated at fair value	15.3	(205.6)	(90.1)	(32.6)	(46.9)	(36.0)
	44.9	(356.8)	(191.5)	(55.8)	(62.9)	(46.6)
Other financial liabilities						
Amounts due to subsidiary undertakings	2,570.2	(2,570.2)	(2,570.2)	-	-	-
	2,570.2	(2,570.2)	(2,570.2)	-	-	-
Total	3,545.2	(4,188.0)	(3,141.5)	(84.6)	(421.4)	(540.5)

05 Notes on the Financial Statements for the year ended 31 March 2008 continued 112

28. Financial Instruments and Risk (continued)

(v) Commodity risk

The factors which contribute to the Group's commodity risk are explained on page 104 and 105. 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 31 March 2008 assuming that a reasonably possible change in the relevant commodity price had occurred at 31 March 2008 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 treated as financial instruments under IAS 39 remains consistent with those at that point. Excluded from this analysis are all commodity contracts that are not financial instruments under IAS 39.

	Base price (i)	2008 Reasonably possible increase in variable	Reasonably possible decrease in variable	Base price (i)	2007 Reasonably possible increase in variable	Reasonably possible decrease in variable
Commodity prices						
UK gas (p/therm)	63	+10	-10	39	+6	-6
UK power (£/MWh)	59	+7	-7	37	+4	-4
UK coal (US\$/tonne)	121	+12	-12	71	+7	-7
UK emissions (€/tonne)	22	+4	-4	17	+3	-3
UK oil (US\$/bbl)	100	+10	-10	68	+7	-7

(i) The base price represents the average forward market price over the duration of the active market curve used to calculate the sensitivity analysis.

The impacts of reasonably possible changes in commodity prices on profit after taxation based on the rationale described are as follows:

	Impact on profit (£m)	2008 Impact on equity (£m)	Impact on profit (£m)	2007 Impact on equity (£m)
Incremental profit/(loss)				
Commodity prices combined – increase	(28.9)	(0.8)	(60.9)	(0.8)
Commodity prices combined – decrease	28.9	0.8	60.9	0.8

The sensitivity analysis provided is hypothetical only and should be used with caution as the impacts provided are not necessarily indicative of the actual impacts that would be experienced. It should be noted that the 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.

(vi) Currency risk

At the balance sheet date, the total nominal value of outstanding forward foreign exchange contracts that the Group has committed to is:

	2008 £m	2007 £m
Forward foreign exchange contracts	916.3	677.7

The Group's exposure to foreign currency risk was as follows:

At 31 March 2008

	DKKm	€m	\$m
Loans and borrowings	–	1,115.0	100.0
Purchase contract commitments and commodity contracts	241.2	203.6	1,936.6
Gross exposure	241.2	1,318.6	2,036.6
Forward exchange contracts	241.2	202.4	1,458.9
Net exposure (in currency)	–	1,116.2	577.7
Net exposure (in £m)	–	888.1	290.8

At 31 March 2007

	DKKm	€m	\$m
Loans and borrowings	–	–	250.0
Purchase contract commitments and commodity contracts	–	245.0	1,146.0
Gross exposure	–	245.0	1,396.0
Forward exchange contracts	–	238.8	1,090.9
Net exposure (in currency)	–	6.2	305.1
Net exposure (in £m)	–	4.2	155.0

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 2008 £m	At 31 March 2007 £m	At 31 March 2008 £m	At 31 March 2007 £m
US Dollars	–	–	23.3	12.1
Euro	39.8	–	31.3	0.4
DKK	–	–	–	–
	39.8	–	54.6	12.5

The impact of a decrease in rates would be an identical reduction in the annual charge. There is no impact on equity as the analysis relates to the Group's net exposure at the balance sheet date. Contracts qualifying for hedge accounting are by definition part of the Group's covered position.

(vii) Interest rate risk

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 floating-to-fixed 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:

	2008 Carrying amount £m	2007 Carrying amount £m
Interest bearing/earning assets and liabilities:		
– Fixed	(2,381.4)	(1,857.6)
– Floating	(1,320.4)	(398.6)
	(3,701.8)	(2,256.2)
Represented by:		
Cash and cash equivalents	255.3	56.1
Derivative financial liabilities	(35.9)	(33.7)
Loans and borrowings	(3,920.6)	(2,277.5)
Finance lease obligations	(0.6)	(1.1)
	(3,701.8)	(2,256.2)

Following from this, the table overleaf represents the expected impact of a change in 100 basis points in short term interest rates at the reporting date in relation to equity and income statement. The analysis assumes that all other variables, in particular foreign currency rates, remain constant. An increase in exchange rates would be a change to either the income statement or equity. The assessment is based on a revision of the fair value assumptions included in the calculated exposures in the previous table.

All sensitivity analysis has been prepared on the basis of the proportion of fixed to floating instruments being consistent as at the balance sheet date.

05 Notes on the Financial Statements for the year ended 31 March 2008 continued 114

28. Financial Instruments and Risk (continued)

(vii) Interest rate risk continued

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.

	2008 £m	2007 £m
Income statement	13.2	4.0
Equity	–	–
	13.2	4.0

The impact of a decrease in rates would be an identical reduction in the annual charge. There is no impact on equity as the analysis relates to the Group's net exposure at the balance sheet date. Contracts qualifying for hedge accounting are by definition part of the Group's covered position.

(viii) Income 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:

	2008 £m	2007 £m
Operating derivatives		
Total result on operating derivatives (i)	135.7	(134.5)
Less: Amounts settled (ii)	(323.5)	195.8
Movement in unrealised derivatives	(187.8)	61.3
Financing derivatives (and hedged items)		
Total result on financing derivatives (i)	(116.8)	(117.7)
Less: Amounts settled (ii)	137.5	107.1
Movement in unrealised derivatives	20.7	(10.6)
Net income statement impact	(167.1)	50.7

(i) Total result on derivatives in the income statement represents the total amounts (charged) or credited to the income statement in respect of operating and financial derivatives.

(ii) Amounts settled in the year represent the result on derivatives transacted which have matured or been delivered and have been included within the total result on derivatives.

The net derivative financial assets and (liabilities) are represented as follows:

	2008 £m	2007 £m
Derivative financial assets		
Non-current	318.9	54.5
Current	1,106.5	452.9
	1,425.4	507.4
Derivative liabilities		
Non-current	(313.3)	(120.9)
Current	(1,229.4)	(351.9)
	(1,542.7)	(472.8)
Fair value adjustment to hedged item (note 21)	–	10.4
	(117.3)	45.0

(ix) 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 hedge a forecast transaction or cash flow risk generally arising from a change in interest rates or foreign exchange currency 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

	Carrying amount	Expected cash flows	2008			
			0-12 months	1-2 years	2-5 years	> 5 years
Interest rate swaps:						
Liabilities	(5.9)	(5.9)	(1.8)	(1.7)	(2.2)	(0.2)
	(5.9)	(5.9)	(1.8)	(1.7)	(2.2)	(0.2)
Forward exchange contracts:						
Assets	13.1	(114.4)	(32.9)	(21.8)	(19.9)	(39.8)
Liabilities	(3.4)	(88.4)	(57.9)	(21.6)	(8.9)	-
	9.7	(202.8)	(90.8)	(43.4)	(28.8)	(39.8)

Cash flow hedges

	Carrying amount	Expected cash flows	2007			
			0-12 months	1-2 years	2-5 years	> 5 years
Interest rate swaps:						
Liabilities	(5.5)	(5.5)	-	(0.6)	(2.3)	(2.6)
	(5.5)	(5.5)	-	(0.6)	(2.3)	(2.6)
Forward exchange contracts:						
Assets	0.1	(5.6)	(2.2)	(2.5)	(0.9)	-
Liabilities	15.6	(131.6)	(98.5)	(19.9)	(13.0)	(0.2)
	15.7	(137.2)	(100.7)	(22.4)	(13.9)	(0.2)

Net investment hedge

The Group's net investment hedges consists of debt issued in the same currency (Euros) as the net investment in Airtricity. The hedge compares the element of the net assets of Airtricity which functional cash flows are denominated in Euros to the matching portion of the Euros borrowings held by the Group. This therefore provides protection against movements in foreign exchange rates.

Gains and losses in the hedge are recognised in equity and will be transferred to the income statement on disposal of the foreign operation (£30.1m, 2007 – nil). Gains and losses on the ineffective portion of the hedge are recognised immediately in the income statement (£22.2m loss, 2007 – nil). The loss recognised in the income statement is considered to be exceptional as Euro debt associated with the net assets of Airtricity whose functional cash flows are denominated in pounds Sterling has been replaced by pounds Sterling issued debt in the period from the balance sheet date.

(x) Capital management

The Board's policy is to maintain a strong balance sheet so as to maintain investor, creditor and market confidence and to sustain future development of the business.

From time to time the Group purchases its own shares on the market; the timing of these purchases depends on market prices. 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.

There were no changes to the Group's capital management approach during the year.

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29. Related-Party Transactions

29. RELATED-PARTY TRANSACTIONS

The following transactions took place during the year between the Group and entities which are related to the Group but which are not members of the Group. Related parties are defined as those in which the Group has control, joint control or significant influence over.

	Sale of goods and services 2008 £m	Purchase of goods and services 2008 £m	Other transactions 2008 £m	Sale of goods and services 2007 £m	Purchase of goods and services 2007 £m	Other transactions 2007 £m
Jointly controlled entities:						
Seabank Power Limited	19.5	(150.6)	27.0	8.9	(113.4)	29.8
PriDE (South East Regional Prime) Limited	39.2	-	-	26.2	-	-
Scotia Gas Networks plc	56.0	(106.9)	35.3	68.7	(80.3)	9.6
Marchwood Power Limited	-	-	2.7	-	-	2.1
Associates:						
Barking Power Limited	0.7	(85.0)	0.4	11.6	(139.6)	-
Derwent Cogeneration Limited	22.0	(82.2)	-	45.7	(68.2)	-

The transactions with Seabank Power Limited, Barking Power Limited and Derwent Co-generation Limited relate to the contracts for the provision of energy or the tolling of energy under power purchase arrangements. PriDE (South East Regional Prime) Limited operates a long-term contract with Defence Estates for management of MoD facilities in the South East of England. All operational activities are sub-contracted to the ventures partners including Southern Electric Contracting Limited. Scotia Gas Networks plc has operated the gas distribution networks in Scotland and the South of England from 1 June 2005. The Group's gas supply activity incurs gas distribution charges while the Group also provides services to Scotia Gas Networks in the form of a management service agreement for corporate services, stock procurement services and the provision of the capital expenditure on the development of front office management information systems. The transactions with Marchwood Power Limited relate to fees and loan interest.

The balances outstanding with related parties at 31 March were as follows:

Consolidated

	Amounts owed by related parties		Amounts owed to related parties	
	2008 £m	2007 £m	2008 £m	2007 £m
Jointly controlled entities:				
Seabank Power Limited	82.9	93.7	57.0	32.5
PriDE (South East Regional Prime) Limited	0.4	3.8	-	-
Scotia Gas Networks plc	303.7	305.0	0.4	0.6
Marchwood Power Limited	60.7	22.3	-	-
Associates:				
Barking Power Limited	0.3	-	7.5	6.7
Derwent Cogeneration Limited	0.1	2.0	9.5	6.9

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 12.

During the year, the Company entered into the following transactions with its subsidiaries (note 13):

	2008 £m	2007 £m
Company		
Loans granted to subsidiaries	-	-
Loans repaid by subsidiaries	-	-
Interest charged to subsidiaries	67.6	64.7
Sale of goods	-	-
Purchase of goods	-	-
Balances outstanding at 31 March:		
Loan balances outstanding at the year end	858.1	858.1

30. Commitments and Contingencies

Remuneration of key management personnel

The remuneration of the Executive Directors, who are the key management personnel of the Group, is set out below in aggregate.

	2008 £000	2007 £000
Short-term employment benefits	3,483	3,419

In addition, the key management personnel receive share based remuneration, details of which are found at note 27. Further information about the remuneration of individual Directors is provided in the audited part of the Directors' Remuneration Report. The key management personnel are employed by the Company.

Information regarding transactions with post-retirement benefit plans is included in note 26.

30. COMMITMENTS AND CONTINGENCIES**(i) Capital commitments**

	2008 £m	2007 £m
Capital expenditure: Contracted for but not provided	447.3	450.8

(ii) Operating lease commitments**(a) Leases as lessee:**

	2008 £m	2007 £m
Amount included in the income statement relating to the current year leasing arrangements		
Minimum lease payments	173.6	169.2
Other power purchase agreement capacity fees	87.5	61.2
Other lease payments	7.8	5.4
	268.9	235.8

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:

	2008 £m	2007 £m
Power purchase agreements		
Within one year	211.1	159.5
In second to fifth years inclusive	596.9	345.9
After five years	331.9	30.0
	1,139.9	535.4
Other leases		
Within one year	16.9	13.8
In second to fifth years inclusive	25.1	21.9
After five years	72.0	26.2
	114.0	61.9
Total		
Within one year	228.0	173.3
In second to fifth years inclusive	622.0	367.8
After five years	403.9	56.2
	1,253.9	597.3

The average PPA lease is five years.

The obligations under power purchase agreements with various power generating companies are not deemed to qualify as finance leases under IAS 17.

05 Notes on the Financial Statements for the year ended 31 March 2008 *continued* 118

30. Commitments and Contingencies (continued) 31. Analysis of net debt

(ii) Operating lease commitments *continued*

(b) Leases as lessor:

The Group leases out two combined heat and power plants under finance leases. The leases typically run for a period of 15 years, with an average of nine years to run, with an option to renew the lease after that date. None of the leases include contingent rentals.

The future minimum lease payments under non-cancellable leases are as follows:

	2008 £m	2007 £m
Within one year	0.3	0.3
In second to fifth years inclusive	1.0	1.0
After five years	0.8	1.0
	2.1	2.3

During the year ended 31 March 2008 £0.3m was recognised as rental income in the income statement (2007 – £0.3m). Lease payments are straight line over the term of the lease.

The Company has no operating lease commitments as either a lessee or a lessor.

(iii) Guarantees and indemnities

Scottish and Southern Energy plc has provided guarantees on behalf of subsidiary and associated undertakings as follows:

	2008 £m	2007 £m
Bank borrowing	34.9	50.0
Performance of contracts	437.0	379.9
Purchase of gas	120.5	120.5

In addition, unlimited guarantees have been provided on behalf of subsidiary undertakings in relation to four 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 Electric pension scheme in respect of the funding required by the scheme.

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.

31. ANALYSIS OF NET DEBT

	At 1 April 2007 £m	Decrease in cash and cash equivalents £m	(Increase)/ decrease in debt £m	At 31 March 2008 £m
Cash and cash equivalents (note 17)	56.1	199.2	–	255.3
Bank overdraft (i)	(7.7)	(4.5)	–	(12.2)
	48.4	194.7	–	243.1
Loans and borrowings (ii)	(2,287.9)	–	(1,632.7)	(3,920.6)
Finance lease creditors (note 21)	(1.1)	–	0.5	(0.6)
Bank overdrafts (i)	7.7	–	4.5	12.2
	(2,281.3)	–	(1,627.7)	(3,909.0)
Net debt	(2,232.9)	194.7	(1,627.7)	(3,665.9)

(i) Bank overdrafts are reported on the balance sheet as part of current loans and borrowings. For cash flow purposes, these have been included as cash and cash equivalents.

(ii) Loans and borrowings are adjusted for £nil (2007 – £10.4m) of fair value adjustments to borrowings (note 21).

Company's Website – www.scottish-southern.co.uk

The company's website contains a wide range of information including a dedicated Investor Centre section where shareholders can find more information about the services available to them, download forms, view and update their shareholding online, manage their portfolio and view share price and dividend histories and trading graphs.

Shareholder Services

Scottish and Southern Energy offers a number of services including:

- elect for eCommunications;
- telephone and internet share dealing services with ShareGift option;
- merge multiple share accounts; and
- dividend reinvestment plan.

Further information on these services and other services can be found on the company's website at www.scottish-southern.co.uk> investor centre>shareholder services.

Shareholder Enquiries

Shareholders can contact the registrar, Computershare Investor Services PLC (Computershare), by phoning the dedicated shareholder helpline on 0845 143 4005, or writing to them at: The Pavilions, Bridgwater Road, Bristol BS99 6ZY.

Voting Electronically

The website and the Guidance Notes on the reverse of the Proxy Form contain information on how shareholders can appoint their proxy electronically. Online proxies can be checked and updated up until 12 noon on 22 July 2008 (48 hours prior to the AGM).

Share Price Information

The share price of Scottish and Southern Energy appears on www.scottish-southern.co.uk. It also appears in the financial columns of the national press and on various broadcast interactive services.

Company Communications

Following the introduction of the Companies Act 2006 shareholders now have a choice on how to receive company communications such as the annual report.

A letter from the Chairman was sent to shareholders as part of the dividend mailing in March 2008 asking shareholders to elect:

- to receive email notification of company communications, view documentation online and lodge their proxy over the internet;
- to receive written notification of the availability of company communications on the website; or
- to continue to receive paper copies of company communications.

eCommunications Programme

Shareholders can help Scottish and Southern Energy reduce its impact on the environment and save paper by electing to receive company communications electronically by joining the eCommunications Programme.

A donation of £2 will be made to WWF's International Forest Programme.

Registering for the eCommunications Programme

Shareholders can register their email addresses by visiting the company's website www.scottish-southern.co.uk/ecomms (shareholders will be asked to provide their Shareholder Reference Number).

Benefits of eCommunication

- Shareholders will receive email notification of the availability of the interim results and have access to annual reports and company announcements.
- Shareholders can lodge their proxy appointments securely over the internet.
- A donation of £2 will be made to WWF's International Forest Programme.

Keep us Informed

Where delivery of an email fails, the company is required to recommence sending paper copies of documents. Shareholders can help to avoid this by:

- keeping the company informed of changes to their email addresses by visiting www.scottish-southern.co.uk/ecomms and clicking on the 'click here' link and following the instructions under 'address change'; and
- regularly clearing out their inboxes.

Multiple Share Accounts

If shareholders receive more than one Annual Report mailing, this may be due to having more than one share account due to minor differences in name and address details. Shareholders can merge multiple share accounts by completing a Multiple Share Account Form. Shareholders can obtain a form by calling the registrar's dedicated shareholder helpline on 0845 143 4005.

A donation of £2 will be made to WWF's International Forest Programme for every merged share account.

Dividend Reinvestment Plan (DRP)

The DRP is a simple and cost effective way to build shareholding in the company by using cash dividends to buy additional shares. Shareholders can join the DRP by downloading a Dividend Reinvestment Plan Mandate Form and the Terms and Conditions from www.scottish-southern.co.uk>investor centre>shareholder services>dividend reinvestment or telephoning the dedicated shareholder helpline on 0845 143 4005 to request a form.

Share Dealing Service

A telephone share dealing service has been arranged with Stocktrade which provides a simple way of buying or selling Scottish and Southern Energy plc ordinary shares. Full details can be obtained by telephoning 0845 601 0995 and quoting reference 'Low Co 33'.

Also, Computershare Investor Services offer telephone and internet share dealing services to buy or sell SSE plc ordinary shares. Further details can be obtained from www.computershare.com/dealing/uk or by telephoning 0870 703 0084.

The value of shares can fall and shareholders may get back less than they invest. Shareholders should consult a professional adviser authorised under the Financial Services and Markets Act 2000 if they are in any doubt about the suitability of an investment.

Financial Calendar

Annual General Meeting
24 July 2008

Ex dividend date
20 August 2008

Record date
22 August 2008

Final dividend payable
26 September 2008

Interim announcement
12 November 2008

The Group's half-year results will be published on the company's website at www.scottish-southern.co.uk on 12 November 2008, and will detail ex dividend and record dates for the interim dividend payable in March 2009. Paper copies of the half-year results are not distributed to individual shareholders, although shareholders who have elected for eCommunications receive notification of the publication of the half-year results on the company's website.

Copy Reports

Copies of the following documents can be obtained, free of charge, from the Company Secretary, Scottish and Southern Energy plc, Inveralmond House, 200 Dunkeld Road, Perth PH1 3AQ or by accessing the company's website at www.scottish-southern.co.uk:

- Annual Report and Accounts 2008.
- Corporate Responsibility Report 2008.



SSE's core purpose is to provide the energy people need in a reliable and sustainable way. In line with this, its strategy has been, and will continue to be, the delivery of sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of regulated and non-regulated energy and utility businesses.

Shareholders expect companies not simply to be profitable, but to be responsible in how those profits are made. For SSE, this means that its Generation activities should be as sustainable as possible and that the energy it supplies should be as affordable as possible. In addition, its networks should be reliable and its energy-related services dependable.

For further information about Scottish and Southern Energy, please contact:

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