

# **Western Power Distribution (South West) plc**

## **Regulatory Financial Statements**

**for the year ended 31 March 2010**



# Western Power Distribution (South West) plc

## Regulatory Financial Statements

### Table of contents

|   | Page<br>number |
|---|----------------|
| <b>1 Foreword</b>   | 1              |
| <b>2 Operating and Financial Review</b>   | 2              |
| <b>3 Corporate Governance</b>   | 18             |
| <b>4 Directors' Report</b>  | 24             |
| <b>5 Statement on link between directors' pay and standards of performance</b>                    | 27             |
| <b>6 Regulatory Financial Statements</b>  |                |
| 6.1 Statement of directors' responsibilities in respect of the Regulatory Financial<br>Statements | 29             |
| 6.2 Independent Auditors' Report  | 30             |
| 6.3 Profit and loss account   | 32             |
| 6.4 Statement of total recognised gains and losses  | 33             |
| 6.5 Balance sheet   | 34             |
| 6.6 Cashflow statement and notes  | 35             |
| 6.7 Notes   | 38             |

## 1 Foreword

The main activity of Western Power Distribution (South West) plc ("WPD South West" or the "Company") is the distribution of electricity within its service area of South West England. It is one of twelve licensed distribution network operators ("DNOs") within England and Wales.

Each DNO is a natural monopoly regulated by the Gas and Electricity Markets Authority (known as "Ofgem"). It is therefore subject to control on the prices it can charge. The principal legislation governing the structure of the electricity industry in Great Britain is the Electricity Act 1989, as amended by the Utilities Act 2000 and the Energy Act 2004. This legislation provides for a licence framework in which the operations of the DNOs are regulated, pursuant to which income generated is subject to an allowed revenue regulatory framework that provides economic incentives to minimise operating, capital and financing costs consistent with the DNOs providing an acceptably reliable distribution network and meeting their legal responsibilities. This licence framework is overseen by Ofgem.

Licences which govern DNOs require each DNO to produce regulatory accounts. These comprise two documents:

- Regulatory Financial Statements; and
- Regulatory Reporting Pack ("RRP").

The purpose of the *Regulatory Financial Statements* is to provide financial information on the same basis as that under the normal financial policies of the DNO. The financial statements themselves are in a similar format to a company's statutory accounts prepared under the Companies Act. This document contains these audited Regulatory Financial Statements.

The RRP was largely developed during the price review which concluded in November 2004 but continues to be improved. The RRP should better monitor performance against assumptions used in the last price review, and better inform the current price review. The level of detail should highlight the cost drivers within a DNO and thus ensure that the regulated allowance better reflects this.

## 2 Operating and financial review for the year to 31 March 2010

### Introduction

Western Power Distribution Holdings Limited is the parent of a group ("WPD" or "Group") whose principal activity is undertaken by WPD South West and Western Power Distribution (South Wales) plc ("WPD South Wales").

WPD South West distributes electricity to approximately 1.5 million end-users over an area of 14,400 square kilometres in the South West of England. The service area extends from Bristol and Bath in the north east to Lands End and beyond to the Isles of Scilly. It has a resident population of approximately 3.1 million.

Electricity distribution is the transport at a regional level of electricity at reducing voltages from national grid bulk supply points to final end users. A limited volume of electricity also enters the distribution network from embedded generation within WPD South West's area, such as windfarms and small hydro-electric plants.

The 1.5 million end-users are registered with licensed electricity suppliers, who in turn pay WPD South West for using its network.

WPD South West's network comprises 28,314 kilometres of overhead line, 21,705 kilometres of underground cable, service lines into customer premises, and 51,631 transformers.

During 2009/10, the maximum demand recorded was 2,933 megawatts (2008/09: 2,883 megawatts).

### Overview

WPD South West is a monopoly regulated by licence and operates under a price control regime. WPD South West's distribution licence authorises it to distribute electricity in an area extending from Bristol and Bath in the northeast, southwest along the peninsula to Land's End and beyond to the Isles of Scilly.

The operations of WPD South West are regulated under its distribution licence under which income is generated subject to a price cap regulatory framework that provides economic incentives to minimise operating, capital and financing costs. The charges made for the use of the distribution network are regulated on the basis of the RPI plus/minus X formula where RPI is a measure of inflation and X is an efficiency factor established by the regulator following review. The regulator currently sets the distribution price control formula for five year periods.

The electricity distribution price control ("DPC4") agreed with the regulatory body the Gas and Electricity Markets Authority (known as "Ofgem") commenced on 1 April 2005 and covered the five year period until 31 March 2010. WPD South West was allowed to increase its prices by inflation plus 1.5% from 1 April 2005. In each of the subsequent four years prices were allowed to increase by no more than the rate of inflation (i.e.  $X = 0$ ). The DPC4 price control maintained the emphasis on achieving further efficiencies in day to day running costs with a 1.5% per annum overall reduction in underlying costs required. It also placed a greater emphasis on performance than previous reviews and incorporated incentive mechanisms to encourage the reduction of electrical losses and improve the quality of service for customers particularly in relation to the number and duration of interruptions and the quality of telephone response.

## 2 Operating and financial review for the year to 31 March 2010

### Overview (continued)

The electricity distribution price control review for the five year period which commenced on 1 April 2010 ("DPC5") was agreed with Ofgem in December 2009. WPD South West will be allowed to increase its prices by an average of 7.5% plus inflation in each of the five years of this period. In return for the revenue WPD South West will be allowed to earn in this period, Ofgem introduced from 1 April 2010 new obligations with incentives to innovate and find more efficient ways to provide an appropriate level of security, reliability and quality of service.

The focus for the business during the year has been to continue to concentrate on the five key goals of safety, network reliability, customer service, environment and business efficiency. Operationally, the WPD Group has completed another successful year and continues to be a frontier performer in terms of network reliability despite a year of challenging weather conditions. Ofgem acknowledged WPD's exceptional operating performance during the DPC5 review process where WPD's strong performance within the sector was rewarded for both capital efficiency and service delivery. Following acceptance of the DPC5 final proposals, the focus has been on understanding the requirements of the package, communicating them to the relevant business owners, developing the business plan and ensuring implementation. There has also been a strong focus on communicating the outcome to customers via the press, media and a series of stakeholder workshops.

A combination of targeted investment and close monitoring of performance has ensured that we have outperformed in all areas of the business. During the year we met all of Ofgem's national Customer Guarantee Service Standards and exceeded all of our targets under the Quality of Service incentive scheme by a significant margin.

A series of road show presentations by the directors each year ensure that all staff within the WPD Group are aware of, and can contribute to, the corporate goals of safety, network reliability, customer service, environment and business efficiency.

In December 2009, WPD's proposals for additional workforce resources for DPC5 was formally agreed with Ofgem. During 2009/10, WPD's training team geared up to deliver the necessary training to the new staff; this included the appointment of three new members of training staff and the acquisition and commissioning of a new training satellite site in Devon. By the end of the year, approximately 200 new trainees and apprentices had joined WPD and are now progressing well through their training.

### Safety

Safety continues to be at the forefront of all of our business activities and a clear commitment to a practical and pragmatic safety culture from the "top down" remains an imperative. WPD continues to play an active role in many national committees and steering groups which concentrate on the future of safety and training policies across the industry.

The number of lost time accidents to staff working in WPD South West was one in the financial year 2009/10. This compares with zero reported last year and one reported in 2007/8. The number of lost time accidents reported within the WPD Group fell from four in 2008/9 to three in 2009/10 but non lost time accidents for the Group rose from 36 in 2008/9 (when WPD recorded its lowest ever figure for accident numbers) to 51 in 2009/10.

## 2 Operating and financial review for the year to 31 March 2010

### Safety (continued)

In the autumn of 2009, WPD launched a new initiative to promote the wearing of protective eyewear to protect all staff from the risk of incidental eye injury during low risk tasks. This included the issue of both prescription and non prescription safety glasses to all staff for use at home as well as at work. As part of the roll-out of this initiative, presentations were given to all staff about the importance and value of their eyesight. This was entitled "Think Cheese" and provided a memorable vision of why risk assessment is important and how multiple layers of safety help protect everyone.

WPD runs an annual safety competition for staff where teams are encouraged to develop safety initiatives and to suggest ideas. In addition, a cash prize for charity is offered to the teams that achieve the highest number of accident free days. The Company takes its role of educating the public about the dangers of electricity very seriously and this is an integral part of WPD's wider community support policy. Young people are very much the target and WPD regularly attends Crucial Crew and Junior Life Skills events where representatives join together with members of the emergency services to educate children about the risks associated with electricity. In addition, staff from the Company visit schools in areas where vandalism or incidents have occurred to reinforce the safety message.

No formal notices were received from Local Authorities, Department of Energy and Climate Change ("DECC") or the Health & Safety Executive ("HSE") during 2009/10. WPD continues to work in a constructive, collaborative manner with the HSE and DECC. An example of this constructive relationship has been the involvement of WPD's Safety and Training Manager with the HSE in developing a new updated version of the HSE document GS6 - Avoidance of Danger from Overhead Lines.

WPD hosted the Electricity Networks Association national Safety, Health and Environment Conference in Bath in April 2009. This prestigious event was attended by more than 200 managers and union safety representatives from the UK power industry as well as many senior people from government and the HSE. The keynote speech was delivered by Robert Symons, WPD's Chief Executive Officer, who emphasised the importance of clear, firm and focussed leadership.

WPD's Safety Management System conforms to OHSAS 18001 Occupational Health and Safety Management Systems, which is similar to the more widely recognised ISO 9001 quality standard. This is an indication that WPD health and safety management systems meet the standards expected by law and by the HSE.

### Network performance

Performance of the distribution network is measured in two key ways:

Security - the number of supply interruptions recorded per 100 connected customers ("CI"); and

Availability - the number of customer minutes lost per connected customer ("CML").

All licensees who operate a distribution system are required to report annually to Ofgem on their performance in maintaining system Security and Availability. The Quality of Service incentive scheme, also known as the Information and Incentives Scheme ("IIS") which was introduced by Ofgem in April 2002, financially incentivises all licensees including WPD with respect to both the Security and Availability of supply delivered to customers. In addition Ofgem incentivises the quality of telephone response customers receive when they contact the licensee. This is assessed by a customer survey carried out on a monthly basis.

## 2 Operating and financial review for the year to 31 March 2010

### Network performance (continued)

Network performance reported to Ofgem for the year was as follows:

|   | <u>Total</u> | <u>Target</u> |
|---|--------------|---------------|
| IIS Minutes lost per customer 2009/10       | 41.5         |               |
| Excluded events                             | (3.7)        |               |
| <b>IIS Performance 2009/10</b>              | <b>37.8</b>  | <b>62.2</b>   |
| IIS Performance 2008/09                     | 43.9         | 62.2          |
| IIS Interruptions per 100 customers 2009/10 | 54.4         |               |
| Excluded events                             | (5.0)        |               |
| <b>IIS Performance 2009/10</b>              | <b>49.4</b>  | <b>84.5</b>   |
| IIS Performance 2008/09                     | 58.4         | 84.5          |

The figures above cover all reportable interruptions longer than three minutes in duration occurring on the WPD South West network including those caused by bad weather and other faults together with 50% of CI and CML due to pre-arranged shutdowns for maintenance and construction. The 11kV network is the principal driver of customer minutes lost, with faults on overhead lines being the major contributor. In addition to the performance reported under IIS above, 84.5% of customers off supply in the South West as the result of a high voltage ("HV") fault were restored within one hour of the fault occurring. We believe that the WPD Group has the best one hour restoration performance of any Distribution Network Operator ("DNO").

Under the IIS scheme, performance is targeted at an underlying level of improvement. DNOs are thus permitted to claim an adjustment for events during the year which they believe were exceptional and had a significant impact on the total reported performance. An exceptional event can either be caused by a large number of weather related faults or be due to a one-off event which is outside of the DNO's control. In either case, the event must meet prescribed thresholds in terms of the numbers of faults experienced or, for a one-off event, in terms of either the number of customers affected or the duration of the incident. If an event meets these prescribed thresholds, the DNO must notify Ofgem who will conduct an audit to determine the impact of the event. As part of the audit process the DNO must demonstrate that it mitigated against the impact of the event to the best of its ability before Ofgem will exclude the CI and CML incurred.

WPD South West reported three weather-related exceptional events to Ofgem during the year associated with lightning and severe wind and gales during the summer months. The exclusion of the CI and CML associated with these events is subject to Ofgem confirmation.

Subject to Ofgem confirmation, our IIS CML and CI of 37.8 customer minutes lost and 49.4 interruptions per 100 customers for the year are within our targets of 62.2 and 84.5 respectively. The low level of CML relative to the target set by Ofgem is particularly gratifying as it shows the results of our focus on operational excellence and has been achieved in a year when we faced a number of operational challenges related to restoring customers in difficult working conditions.

## **2 Operating and financial review for the year to 31 March 2010**

### **Network performance (continued)**

The UK experienced a prolonged spell of cold and snowy weather during January 2010. The event was widely reported in the national press and media and described by the Met Office as the worst spell of prolonged freezing conditions and snow faced by the UK in 29 years. Network contingency plans were put in place to ensure that WPD was able to maximise any emergency response with network service teams operating on "red alert" for most of the month. In the event, despite heavy snowfall and arctic conditions, the network remained on normal operating conditions for the duration of the poor weather.

Work by Ofgem at the last price control review identified WPD as the best overall performer for network performance and we are pleased to be able to continue to demonstrate good restoration performance during harsh weather conditions. Ofgem has also recognised the wide gaps in performance between DNOs and acknowledged the severity of the targets set for WPD compared with the rest of the sector. We have agreed targets for the next five year price control period and are continuing to work with Ofgem to assist them in making comparisons between DNOs on an equitable basis.

The WPD Group will continue with those initiatives that have clearly demonstrated good improvements to quality of supply to date, and will seek new opportunities and initiatives for the future. Our focus for 2010/11 and beyond will be to further reduce interruptions by progressing an ongoing programme to increase the automation of the HV network. Good progress was made during the year when a total of 169 new automation schemes were commissioned in WPD South West. This will ensure that, when an HV fault occurs, the maximum number of customers have their supplies restored within three minutes through automated sequence switching logic.

### **Customer service**

We are committed to providing excellent customer service at all times and strongly believe that customer satisfaction is the key to the future success of the business. When dealing with customers our policy is to get it right "first time, every time". On the occasions when we fail to meet this standard, staff are encouraged to take personal responsibility for customer issues, to follow the problem through to the end, and to adopt our golden rule – "treat customers the way that we would like to be treated".

If customers are not happy with our efforts to resolve their complaint, they have historically been able to ask the statutory body, the Gas and Electricity Consumer Council (known as "energywatch"), to review the matter. Until 30 September 2008, when energywatch was disbanded, energywatch had received no complaints in respect of WPD South West since January 2005. energywatch was replaced by The Energy Ombudsman ("Ombudsman") with effect from 1 October 2008. WPD South West has received no complaints from the Ombudsman in the period to 31 March 2010.

We have developed a good working partnership with the Ombudsman to identify potential customer issues and resolve them before they develop into customer complaints. Regular meetings between WPD and the Ombudsman have resulted in a number of initiatives to improve our overall service to customers and drive standards up. WPD is the only DNO to have zero complaints referred to the Ombudsman during the first twelve months of operation of the statutory scheme.

## 2 Operating and financial review for the year to 31 March 2010

### Customer service (continued)

During the year Ofgem made further awards under its Discretionary Reward Scheme which was introduced as part of the price control as a mechanism to recognise best practice in areas of customer service that cannot be easily measured or incentivised through more mechanistic incentives. Now in its fourth year, Ofgem made awards in two categories. WPD was assessed to be the top performer in the UK for its work with vulnerable customers and will receive £300,000 for exceeding its obligations. WPD was also recognised specifically for an initiative within its contact centre which encourages improvements in the way staff engage with vulnerable customers. WPD will receive a flagship award of £50,000 in recognition of this particular initiative.

Ofgem also conducted a survey on the views of customers of the telephone response that they receive when they contact a DNO. Results published by Ofgem for the year show that the WPD Group performed above the national average. WPD South West was ranked third in the league table of all DNOs for the quality of its call centre performance. Ofgem also compared the speed of response that a DNO call centre provides and WPD was identified as a top performer with an average speed of response below 2 seconds compared to a national average of 35 seconds.

WPD's excellent customer service was further recognised when it was awarded the government's "Customer Service Excellence Standard" for the first time. This replaces the Charter Mark which WPD has held continually since its launch in 1992 and is a much tougher standard to meet. The government's assessor spent 2 days with staff at various locations assessing over 100 different elements of WPD's customer service. There were a number of areas where the assessor says WPD is performing above the standard:

- our customer focussed culture
- the contact centre's texting initiative
- leading the industry on substation flood protection
- our stakeholder engagement strategy
- the performance of the contact centre.

### Social and community issues

WPD's Community Support Policy is reviewed annually by WPD's executive and endorsed by our Chief Executive Officer. We identify areas where business issues link to social issues, and determine criteria that all community support projects must meet. We work in partnership with local community groups to deliver a wide range of projects. Our key themes are Education, Safety and Environment:

- The WPD tree scheme has been running for over 18 years and is one of our main community environmental initiatives. We work in partnership with British Trust for Conservation Volunteers and Silvanus Trust and use their expertise to help schools and community groups to improve and appreciate their environment through the planting of thousands of trees and shrubs each year across the WPD region.

## 2 Operating and financial review for the year to 31 March 2010

### Social and community issues (continued)

- WPD's Charitable Trust supports charities and community groups, often identified by staff, that help a range of good causes. This year many of the events supported care for those affected by life threatening illness, for example:
  - Breast cancer care Headstrong campaign
  - Ty Hafan children's hospice
  - British Heart Foundation Cardiff
  - Help for Heroes
  - FORCE Devon cancer charity Great West Run
  - Dorset and Somerset air ambulance.
  
- One of the main social impacts of our network is to keep the public safe from the potential hazards of our equipment. Our main focus with children is to raise awareness of electricity safety. We deliver our safety message to over 40,000 children each year at over 30 events across our region. We work with local authorities and emergency services to support a number of joint safety initiatives such as Crucial Crew, Junior Life skills, Hazard Alley and the Safety Zone. Our operational staff and apprentices attend many of these events. As well as the safety benefit, our safety message also has a business benefit by reducing vandalism to our substations and equipment, therefore reducing supply interruptions for our customers. Where incidents have occurred, we will work with local schools to target our safety message to prevent further incidents.

### Capital investment

Gross capital investment (before customers' contributions) during the year was £141.8m across the South West region and included the replacement of overhead lines and switchgear together with the introduction of new technology.

A number of significant projects were tackled during the year:

- Churchill Bulk Supply Point (BSP) is a two transformer substation supplying 34,000 customers in north Somerset. Increasing load in the area made it necessary to increase the capacity of the 33kV side of the substation. This involved replacing all the conductors and fittings from the grid transformers, GT1 and GT2, together with the busbars, isolators, clamps and fittings. To increase network security during the outages, temporary tele-controlled switching schemes were put in place to enable automatic restoration of consumers should we have a supply problem whilst the substation was being fed from one transformer.
  
- A new 33/11kV primary substation has been installed at Cotham in Bristol to supply additional load at Bristol Royal Infirmary and Bristol University. The job involved an extension to Lockleaze BSP and the laying of two new 33kV cables for 6.4km along some of the busiest roads in Bristol. The new substation was designed to fit onto a compact city centre site with landscaping to comply with planning regulations. The work was completed on time ready for the opening of the new heart unit at the hospital.

## 2 Operating and financial review for the year to 31 March 2010

### Capital investment (continued)

- Work is underway at Exeter City BSP to replace the 33kV switchboard. The BSP supplies about 50,000 customers in the city and surrounding areas. The existing switchboard dates back to 1950 and is being replaced with a modern indoor 24 panel switchboard. The site is also in a high flood risk area and, following a number of serious flooding events in the UK, flood resilience of essential infrastructure sites has become a priority for the government and regulators. Replacing this switchboard gave us the opportunity to make this site less vulnerable to flooding by raising the switch room and the scheme has been quoted as a case study of good practise by the Environment Agency's partners in the South West. Work is scheduled to be completed in December 2010.

### Staff

The average number of employees during the year was 1,382 (2009: 1,360). These exclude a proportion of WPD South West staff who work in part for WPD South Wales, and include a proportion of WPD South Wales staff who work in part for WPD South West.

The WPD Group's policies on equal opportunities and employee consultation are set out within the Directors' Report (section 4). WPD believes that its relations with its employees are good.

### Regulatory issues

2009/10 was the final year of a five year price control period. In their final proposals for the next price review, which covers the period from 1 April 2010 until 31 March 2015, Ofgem confirmed that the RPI-X mechanism will continue to apply and that WPD South West will be allowed to increase its prices by an average of 7.5% plus inflation in each of the next five years. The cost of capital set at 4.8% post-tax for DPC4 has been re-set at 4.0% post-tax from 1 April 2010 for DPC5. The final proposals, along with the detailed modifications to our distribution licence, were incorporated into our licence effective from 1 April 2010.

In order to comply with the requirements of our licence and the Competition Act, the WPD Group continued with its compliance programme to ensure that all our policies and procedures meet legal requirements. As part of the programme, all staff have received an updated code of conduct on fair competition.

During the eighth full year of Ofgem's IIS, the WPD Group believes it has, at a minimum, met its regulatory targets for each of the three key areas to which the incentive scheme applies, namely:

- the number of interruptions that customers experience;
- the duration of those interruptions; and
- the quality of telephone response from the distribution business to the customer.

As discussed previously, the incentive scheme can lead to an increase or a reduction in revenue of up to 3% depending on performance. Subject to confirmation of the declared year-end results by Ofgem's auditors, we have exceeded our targets for network performance and earned an income uplift for the year.

We have been set annual targets by Ofgem for customer minutes lost and customer interruptions for the next price control period which runs until March 2015.

## 2 Operating and financial review for the year to 31 March 2010

### Environment

The WPD Group is committed to conducting its business as a responsible steward of the environment. WPD plan new routes so as to minimise, as far as economically possible, their impact on the environment.

Every member of staff is made aware of WPD's environmental commitment to abide by environmental laws, regulations and corporate environmental policies, and their responsibilities for reporting any concerns on potential environmental compliance issues so that appropriate action can be taken.

WPD was the first DNO to gain independent accreditation (by Lloyd's Register) against British Standard PAS55 - Asset Management (2004). In May 2009, WPD successfully gained recertification (by Lloyd's Register) against British Standard PAS55 - Asset Management (2008). Whilst an asset management specification, PAS55 encompasses risk management, setting of and adherence to policies and procedures, and thus has relevance to control of environmental risk.

#### *Fluid filled cables*

The design of very high voltage underground cables has evolved over many years and our new cables all use a solid plastic like insulation. Old designs of 33kV and higher voltage cables used an insulating oil in ducts inside the cable. Whilst these cables are normally very reliable, in the event of a fault, or commonly damage by third parties digging the street, this oil may leak out, sometimes many hundreds of litres. In common with other UK distribution companies, WPD works to an operating code agreed with the Environment Agency ("EA"), and assesses both the condition and the environmental risk posed by the 214 km of fluid filled cables which WPD owns. The losses from WPD Group's fluid filled cables can vary from year to year dependent on the number of small leaks at disparate locations rather than high volume single events, often caused by third parties.

#### *Fluid losses (litres)* *WPD Group*

|         |       |
|---------|-------|
| 2005/06 | 6,778 |
| 2006/07 | 2,053 |
| 2007/08 | 3,880 |
| 2008/09 | 4,532 |
| 2009/10 | 9,225 |

Of the 9,225 litres lost in 2009/10, 1,545 were from one circuit in Bristol and 5,278 in multiple top-ups on another circuit in Plymouth. In both cases, leak location has proved difficult and leading edge PFT leak location techniques were applied, entailing flying in specialist contractors from the United States of America ('US'). Leak locations were identified on both circuits, repairs undertaken, and both have to date remained stable.

At the start of 2008, WPD initiated a regime of monthly leak reporting to the EA, following agreement in the joint EA and Energy Networks Association ("ENA") fluid filled cables group.

#### *SF6 gas*

Sulphur hexafluoride (SF6) is a man-made gas which has had widespread use such as in double glazing, tennis balls, training shoes as well as a number of industrial applications including high voltage switchgear. Unfortunately it is also a strong greenhouse gas, with a global warming potential 23,900 times greater than CO2.

## 2 Operating and financial review for the year to 31 March 2010

### Environment (continued)

#### *SF6 gas (continued)*

WPD carefully monitors its SF6 equipment and employs the ENA Engineering Recommendation S38 methodology for the reporting of SF6 banks, emissions and recoveries. That ENA document, drafted by WPD, employs approaches set out by The Intergovernmental Panel on Climate Change ("IPCC"), set up by the World Meteorological Organisation and the United Nations Environmental Programme.

WPD's losses from SF6 equipment in 2009/10 amounted to 193kg representing 0.78 % of its bank. Some 50kg of this loss was due to leakage from older technology bulk 132kV SF6 circuit breakers on one site. These circuit breakers are of complex high pressure design and account for some 3,500kg of WPD's SF6 bank. During the year, WPD used specialist contractors to recover 81kg of SF6 from equipment being scrapped. WPD have included a proposal in its price control submissions (DPC5) for early retirement of these circuit breakers by 2015.

WPD has been listed in the Fluorinated Greenhouse Gas Regulations 2009 as a Recognised Certification and Evaluation Body (HV Switchgear) under Regulation 33, and have now certified relevant WPD staff.

#### *Electric and magnetic fields ("EMFs")*

Concerns have been expressed by some members of the public regarding potential health effects of power frequency EMFs, which are emitted by all devices carrying electricity, including electric transmission and distribution lines and substation equipment. Government officials in the US and the UK have reviewed this issue. The US National Institute of Environmental Health Sciences concluded in 2002 that, for most health outcomes, there is no evidence of EMFs causing adverse effects. The agency further noted that there is some epidemiological evidence of an association with childhood leukaemia, but that this evidence is difficult to interpret without supporting laboratory evidence. The UK National Radiological Protection Board (part of the UK Health Protection Agency) concluded in 2004 that, while the research on EMFs does not provide a basis to find that EMFs cause any illness, there is a basis to consider precautionary measures beyond existing exposure guidelines.

SAGE (Stakeholder Advisory Group on Extremely Low Frequency EMF), a group set up by the UK Government, has issued two reports, one in April 2007 and another in June 2010, describing options for reducing public exposure to EMF. The UK Government agreed to implement some of the recommendations within the first report, including applying optimal phasing to dual circuit transmission lines to reduce EMF emissions, where this can be carried out at a low cost. The UK Government is currently considering the second SAGE report which concentrates on EMF exposure from distribution systems.

PPL Corporation and its subsidiaries believe the current efforts to determine whether EMFs cause adverse health effects should continue and are taking steps to reduce EMFs, where practical, in the design of new transmission and distribution facilities.

#### *General*

WPD has continued its tree scheme, an integral part of its "Keen to be Green" environmental initiative. During 2009, over 8,000 trees and shrubs were planted and more than 35,000 over the past six years.

WPD took occupation of new depots at Kingsbridge and Llandrindod Wells which were both awarded "Excellent" Ratings Under the Building Research Establishment's 'BREEAM' environmental benchmarking scheme. Both depots were also fitted with photovoltaic solar panels to provide their own renewable energy source.

## 2 Operating and financial review for the year to 31 March 2010

### Insurance arrangements

The WPD Group has a wholly-owned captive insurance company, Aztec Insurance Limited ("Aztec"), based in Guernsey. Depending on the nature of the risk, WPD South West carries all or an element of the risk itself ("self insured") or it underwrites insurance with a combination of Aztec and external insurers.

Insurance arrangements in place as at 31 March 2010 relating to the WPD Group's key risks were as follows:

- the distribution network is self insured.
- offices and depots including their contents and stock are self insured up to £500,000 for each claim and externally insured above that, subject to an annual maximum of £50.0m.
- combined liability covers employers' liability, public and product liability, and professional indemnity. The first £10,000 of each claim is self insured, Aztec cover the next £1.0m of any claim up to a maximum of £3.0m in any one year, and the excess is externally insured subject to certain limits.
- on motor related claims, damage to own vehicles is self insured if not recoverable from a third party, as is the first £5,000 of each third party claim. Aztec cover the next £1.0m for any claim and £1.3m in aggregate; beyond that is externally insured subject to certain limits.
- claims relating to death or injury to employees whilst on WPD business or travelling on business are externally insured subject to various limits.
- external insurance is also in place (subject to limits) for loss of money, securities or property through dishonest acts by employees and for wrongful acts by pension scheme trustees. Insurance in respect of directors and officers is maintained by the WPD Group's US parent, PPL Corporation.

Insurance arrangements are reviewed in detail annually.

### Treasury related matters

#### *Risk management*

The WPD Group does not undertake transactions in financial derivative instruments for speculative purposes.

All debt in WPD South West is denominated in sterling and therefore there is no currency risk exposure relating to debt. The Company holds as an investment in US dollar denominated debt issued by another WPD Group company; this is hedged by a foreign exchange derivative and thus there is no exposure to exchange movement.

#### *Interest rate risk*

The Group's debt is substantially long term and at fixed interest rates thus limiting exposure to interest rate fluctuations. In December 2006, WPD South West issued £225m nominal of index linked debt maturing in 2053 to 2056; this creates a natural hedge against a portion of WPD's regulated income, which varies in part in line with the RPI. In March 2010, WPD South West issued £200m nominal of 5.75% fixed rate debt maturing in 2040.

## 2 Operating and financial review for the year to 31 March 2010

### Treasury related matters (continued)

#### *Credit rate risk*

Both WPD South West and WPD South Wales are required by their distribution licences to maintain investment grade ratings, which they have done. WPD South West has the following long-term corporate credit ratings: Fitch BBB+, Moody's Baa1, and Standard & Poor's BBB+.

Any cash deposits are only made to third parties with a high credit rating and within strict limits imposed by the Board.

#### *Liquidity and going concern*

On a day-to-day basis, WPD South West generally provides liquidity to the WPD Group. However, in March 2010 WPD South Wales issued £200m nominal of long-term debt and is using these receipts for certain specific payments. WPD South West has borrowing arrangements in place with a range of third parties with high credit ratings. At 31 March 2010, WPD South West had committed borrowing facilities available of £210m maturing July 2012 in respect of which all conditions precedent had been met at that date; at 31 March 2010, nothing was drawn. In addition, it had uncommitted facilities of £60.0m (£30.0m of which can be utilised by WPD South Wales if required) all of which was undrawn at 31 March 2010.

In addition, at 31 March 2010 the WPD Group's parent Western Power Distribution Holdings Limited ("WPDHL") has a £150m committed borrowing facility that expires in January 2013 of which all conditions precedent had been met at that date; at 31 March 2010, it had drawn £142.9m against these facilities and thus had £7.1m undrawn. Of the £142.9m drawdown, £122.9m was utilised to fund a credit facility granted to a US based fellow subsidiary of PPL; this facility expires on 24 January 2013 and can be terminated earlier by WPDHL in certain circumstances. Any drawdown can be for a maximum of six months.

At 31 March 2010, WPD South West had £749.8m (2009: £570.6m) of external debt outstanding of which £61.4m (2009: £87.6m) was short term. It had cash and short-term deposits of £107.5m (2009: £1.7m).

At 31 March 2010, WPD South West owed net £81.6m to other WPD Group companies (31 March 2009: £364.1m owed by other WPD Group companies). The change relates primarily to the payment of dividends of £497.1m (2009: £4.9m) of which £340.9m was a dividend in specie comprising principal and accrued interest on loans due from Group companies.

After consideration, the directors of the Company have concluded that the Company has sufficient resources available to enable it to continue in existence for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements. This consideration included the availability of facilities as set out above, including the recent replacement of the committed credit facilities within the Company, the relatively stable and regulated nature of the business, the forecast long term business plan, and the anticipated ability of the Company to be able to raise additional long term debt in the future.

## 2 Operating and financial review for the year to 31 March 2010

### Treasury related matters (continued)

#### *Dividend policy*

The WPD Group is structured such that a proportion of WPD's debt is issued by Group companies other than WPD South West and WPD South Wales. Interest payments on this debt, together with other items, are funded primarily through dividend payments from WPD South West and WPD South Wales.

The Memorandum and Articles of Association of the WPD Group's parent, WPDHL, place restrictions on dividends or other value which can be paid to the WPD Group's owners. An independent director has been appointed to oversee this: he in turn may seek financial advice from an independent expert. No payment or transfer of value can be made without the independent director first certifying that certain financial tests have been met.

In 2009/10, dividends paid by the Company totalled £497.1m (2009: £4.9m). This included a dividend in January 2010 of £460.9m which comprised a dividend in specie of £340.9m (representing receivables and accrued interest on loans due from other Group members) together with £120.0m cash; the cash was subsequently repaid to WPD South West as loans from other Group companies. Dividends paid by the parent of the WPD Group, Western Power Distribution Holdings Limited, to its owners was £66.3m (2009: £18.8m).

### Regulatory financial statements

The regulatory financial statements within this document are prepared in a format which closely follows that which would apply for statutory accounts.

#### *Profit and loss account (Section 6.3)*

Profit before tax for 2010 was £111.3m compared with £115.0m for the previous year, a reduction of £3.7m. Operating profit at £131.3m was £20.6m higher with turnover up by £24.2m and operating expenses up by £3.6m. Turnover was impacted by the timing of the recovery of regulated income. Within operating expenses, staff costs were up £2.2m and depreciation was £2.6m higher; this was partly offset by a £1.0m reduction in bad debt provision and other items. Net interest deteriorated by £23.9m largely due to the reduction in net Group balances receivable following the dividend discussed above.

The tax charge increased by £7.3m, which is explained in 'Taxation' below.

#### *Balance sheet (Section 6.5)*

Total net assets at 31 March 2010 were £336.7m, a fall of £408.3m. This change was largely the result of the £497.1m dividend paid as discussed above partly offset by the profit earned during the year. Tangible fixed assets increased by a net £69.0m, with £112.1m additions (net of customer contributions) partly offset by £43.1m depreciation and write-outs.

#### *Cashflow statement (Section 6.6)*

Net cash inflow from operating activities at £134.7m was £12.4m lower than the previous year. Operating profit was £20.6m higher and a movement in creditor balances generated £9.2m cash flow; however, these were offset by an adverse movement in debtors of £46.0m caused by a £28.6m prepayment of pension contributions and £10.1m higher trade debtor balances.

## 2 Operating and financial review for the year to 31 March 2010

### Regulatory financial statements (continued)

#### *Cashflow statement (Section 6.6) (continued)*

Investment in fixed assets was at a similar level in both years.

Net interest paid was £13.9m higher than the previous year as a result of higher short-term borrowing prior to the debt issue and the change in balances with Group companies.

Equity dividends paid in cash were £151.3m higher than the previous year.

Overall, there was a cash outflow of £167.2m before management of liquid resources, financing and movements in cash balances.

During the year, £198.2m was raised by the issue of long-term debt and £101.0m from a fall in balances due from Group companies. There was an increase in short-term deposits of £80.0m and in cash of £25.8m. Short-term debt fell by £26.2m.

### Taxation

An analysis of the tax charge is given in Note 6 to the Regulatory Financial Statements. The overall tax charge has increased by £7.3m from £20.3m in 2009 to £27.6m in 2010. Of the change, current tax has increased by £6.5m and deferred tax by £0.8m.

#### *Effective rate*

The effective tax rate is the implied rate shown by dividing the tax charge in the profit and loss account by the profit on ordinary activities before tax as shown in that statement. The effective rate was 25% for 2010 and 18% for 2009 compared with a normal tax charge rate for the UK of 28%.

The effective rate in 2009 was reduced by 13% largely through the benefit of the adjustment to prior year tax on the gain on a business sale in 1999 and other issues agreed with HMRC. The movement in the discount on deferred tax had a beneficial impact of approximately 8% for 2010 compared with 2009.

## 2 Operating and financial review for the year to 31 March 2010

### Principal risks and uncertainties

#### *Regulatory risk*

The substantial part of the Company's revenue is regulated and is subject to a review every five years. The latest review concluded in December 2009 and became effective on 1 April 2010.

Under the review, Ofgem assesses the revenue and capital expenditure plans of the Company and determines what they consider an efficient level of that expenditure. Ofgem also considers the required cost of capital sufficient to encourage the required investment in the network, and determines customer service targets.

The Company's management invests considerable resources in the review process and has been proactive in working with Ofgem to establish better measures of cost recording to inform future reviews.

If the Company feels that, as a result of a review it would financially be unable to continue to operate and to meet its obligations under the licence, then it has the right to refer the matter to the Competition Commission for a determination.

The Company's regulated income and also the Regulatory Asset Value ("RAV") are to some extent linked to movements in the Retail Price Index ("RPI"). Reductions in the RPI would adversely impact revenues and the debt/RAV ratio.

#### *Network disruption*

Disruption to the network could reduce profitability both directly through the lower units delivered on which income is charged, and also through the system of penalties and rewards that Ofgem has in place relating to customer service levels (discussed under 'Network performance' above).

There are economic restrictions on the level of capital expenditure that can be incurred to make the network totally reliable. A certain level of risk must be accepted and this is recognised by Ofgem in its regulatory review. However, the Company believes that its network is robust. It targets capital expenditure on schemes which are assessed to have the greatest improvement in customer service levels. It also spends considerable sums on routine maintenance, including tree cutting to keep trees away from lines both for safety reasons and as trees have been proven to be a major cause of network interruptions. The Company has met Ofgem's targets for customer service.

#### *Reliance on suppliers*

WPD relies on a limited number of suppliers for cable laying and tree cutting services, and for the supply of cables, plant and machinery. However WPD consider that there are sufficient alternative suppliers such that, should an existing supplier be unable to continue to make supplies, then there will be no significant long-term impact on WPD's ability to operate the network.

Most of the electricity which enters WPD's network is carried on the national grid and enters WPD's network at a limited number of grid supply points. WPD is dependent on the national grid. However, this is also an activity regulated by Ofgem and thus a major failure is considered very remote.

## 2 Operating and financial review for the year to 31 March 2010

### Principal risks and uncertainties (continued)

#### *Environment*

Certain environmental issues are discussed above. There is always the risk that changes in legislation relating to environmental and other matters, including those imposed on the UK by the European Union, could result in considerable costs being incurred by the Company with no guarantee that Ofgem would allow them to be recovered through regulated income.

#### *Treasury*

The risks associated with the treasury activity, including the ability to raise funding to meet the Company's capital expenditure programme, are discussed in the 'Treasury related matters' section above.

#### *Financial*

Risks associated with financial processes are discussed in Section 3 'Corporate Governance'.

#### *Creditworthiness of customers*

Most of WPD's income is for the delivery of electricity to end-users and thus its customers are the suppliers to those end-users. It is a requirement that all licensed electricity distributors and suppliers become parties to the Distribution Connection and Use of System Agreement. This agreement sets out how creditworthiness will be determined and, as a result, whether the supplier needs to provide collateral. The risk of a significant bad debt is thus considered low.

#### *Pensions*

Most of the employees are members of a defined benefit pension scheme, which also has a considerable number of members who are either retired or have deferred benefits. There are risks associated with the financial performance of the assets within the scheme and with the estimate of the liabilities of the scheme including longevity of members. Currently, ongoing service costs and a proportion of the deficit costs are recoverable through the regulated income.

In March 2010 WPD announced that, with very limited exception, its defined benefit pension plan would be closed to new members. A defined contribution scheme will be offered to new employees instead. As time elapses, this will reduce WPD's exposure associated with defined benefit pension plans.

### 3 Corporate Governance

The Company is committed to the highest standards of corporate governance.

The Company is indirectly owned by one US-based corporate shareholder, PPL Corporation ("PPL" - see Section 4). The Company is thus not governed by the Listing Rules of the Financial Services Authority ('The Combined Code') and many of its requirements are not applicable to the Company. However, condition 44 of the Distribution Licence under which the Company operates requires it to publish a corporate governance statement as if it were subject to The Combined Code.

#### Board of directors

The Board of the Company comprises three executive directors and one non-executive director who together reflect a range of experience and expertise.

The Board of the Company has not formally appointed a Chairman. However Rick Klingensmith, who is the non-executive director of the Company, has been appointed the Chairman of the holding company of the WPD Group. Rick Klingensmith is the President of PPL Global the main operating activity of which is undertaken by the WPD Group; his time is thus substantially devoted to the WPD Group. His role has not changed during the year.

The Board of Western Power Distribution Holdings Limited ("WPDHL"), the holding company for the WPD Group, meets formally at least four times per annum. The Chairman is appointed by the Board. This Board comprises the same members as the Board of the Company together with two further PPL non-executive directors and one independent non-executive director.

The independent non-executive director has responsibilities under WPDHL's constitution relating to the ability of WPDHL to transfer value to other PPL group members, such as the declaration of a dividend. Until retirement, the independent director was a Senior Partner with Osborne Clarke, a large firm of solicitors.

The Board of WPDHL has set the parameters by which the WPD Group is managed. These have been cascaded to all subsidiaries. The directors are however fully aware of their duties under the Companies Act 2006. Each director acts in good faith in a way considered to be most likely to promote the success of the Company for the benefit of the members as a whole.

WPDHL needs to give its consent as indirect shareholder to the following:

- Group business and strategic plans.
- establishing and setting the Terms of Reference for Sub-Committees of the Board.
- setting the financial limits of the Chief Executive and approving transactions above those limits.
- the issuance, sale or exchange of any debt or equity securities together with the approval of guarantees relating thereto.
- policies and practices to be followed in managing financial risk, including the use of derivatives and other hedging techniques.
- third party financing facilities in excess of £2m.
- the acquisition of stock in another company in excess of £2m.
- dividend payments (subject to independent director certification where applicable).
- the settlement of legal disputes in excess of £1m.
- annual financial accounts and directors' report.
- material capital projects.
- internal audit operational plan.

### 3 Corporate Governance (continued)

#### Board of directors (continued)

The Board has also set out a framework of authority levels within which the executive directors may operate. In addition, the WPD Group's executive directors, non-executive directors and other shareholder representatives informally discuss the Company's operations on a regular basis.

Rick Klingensmith, as President of PPL Global, is an executive officer of PPL Corporation and thus attends their Board meetings. He can thus communicate the views of PPL Corporation as the indirect 100% shareholder in the Company.

There were 34 meetings of the Board of the Company for the year ended 31 March 2010. Actual attendance was:

|  |    |
|--|----|
| RA Symons, Chief Executive                                       | 34 |
| DG Harris, Resources and External Affairs Director               | 34 |
| DCS Oosthuizen, Finance Director                                 | 34 |
| RL Klingensmith, non-executive director and President PPL Global | 34 |

Attendance includes participation by telephone.

WPD's executive directors together with senior managers at PPL receive a detailed monthly group financial report. In addition, WPD's executive directors formally report both financial and non-financial performance for all operating companies at the WPDHL Board meetings.

Annually, the directors receive a briefing note from the Company's external legal advisors which reiterates their responsibilities as directors and which emphasises any legislative changes during the past year which impacts their responsibilities as directors.

The performance of the executive directors on the Board is measured through a number of goals and objectives set by the ultimate owners for each calendar year. These comprise:

- overall Group profitability
- leverage target (net debt to regulatory asset value)
- certain aspects of customer performance (as set out in Section 5)
- a discretionary element which considers safety, external affairs, compliance with Sarbanes-Oxley Act (discussed below), staff and management, IT and other items.

#### Board committees

Due to the nature of the ownership of the Company, there are no requirements for formal Nomination and Remuneration Committees. In particular, executive directors' remuneration has been set directly by PPL as shareholder. The WPD Group's operations are subject to internal audit examination and the results reported to both the WPDHL Board and to PPL's Audit Committee.

The responsibility for audit is assumed by the Board as opposed to being delegated to a sub committee. As set out below, copies of all WPD Corporate Audit reports were submitted to the General Manager of PPL Corporate Audit Services at PPL during the year.

The Executive Committee comprises the executive directors and meets on a monthly basis. Matters requiring disclosure at Board level are defined within the Company's policy document 'Standards and Management'. The Company Secretary ensures that all relevant items are disclosed.

### **3 Corporate Governance (continued)**

#### **Responsibilities of the directors and external auditors in respect of the accounts**

The respective responsibilities of the directors and of the external auditors are set out in Sections 6.1 and 6.2 respectively of this report.

#### **Going concern basis**

The financial statements have been prepared on a going concern basis as the directors consider that the Company has sufficient financial and other resources to continue in business for the foreseeable future.

More information is given under the 'Treasury related matters' heading of Section 2 'Operating and financial review for the year to 31 March 2010'.

In addition, the directors of the Company are obliged under condition 30 of its licence to prepare a certificate annually which states that there are sufficient financial resources in place that will enable the Company to carry on the distribution business for 12 months from the date of signing that certificate. The external auditors then review this and report to the regulator, Ofgem.

#### **Internal control environment**

The directors of WPD have overall responsibility for the system of internal controls and for reviewing the effectiveness of the system. The system of internal controls is designed to manage rather than eliminate the risk of failure to achieve business objectives. In pursuing these objectives, internal control can only provide reasonable and not absolute assurance against material mis-statement or loss.

There are many cultural features in WPD that contribute directly to the success of the Company and the results that it has achieved. These include:

- good definition and communication of short-term business objectives and targets.
- commitment to achievement of objectives and targets.
- speedy decision-making.
- business environment that empowers managers.
- an uncomplicated management structure that aids the flow of information both ways through the organisation.

In order for this success to occur, the control environment is one which empowers those with direct responsibility to take decisions within a clearly defined control framework. The control mechanisms have to be sufficient to limit risk but appropriate to the Company's ability to react quickly and effectively to events, therefore enabling the Company to deliver results over a sustained period of time.

It is important for an organisation to have a clearly defined structure of control expectations. The controls start at director level and make it clear to everyone concerned how the business should be conducted (policy) and how far each person can go in conducting that business (authority levels). This information is communicated effectively to all levels of staff.

As the WPD Group is owned by a US publicly quoted company, it is subject to the requirements of the US Sarbanes-Oxley Act of 2002. There are two main components of the Act, SOX302 and SOX 404.

### **3 Corporate Governance (continued)**

#### **Internal control environment (continued)**

Under Section 302 of this Act, senior managers affirm quarterly that disclosure controls have been evaluated and are operating effectively, that there are no material internal control issues or, if there are, that they have been reported to PPL's Audit Committee.

Section 404 is an annual process which includes the evaluation of internal controls for financial reporting. WPD comply with these requirements via a two stage approach.

Firstly, Company level controls which are pervasive across the Company are documented and tested. The controls cover the COSO elements of effective internal control which encompass:

- control environment
- risk assessment
- information and communication
- control activities
- monitoring.

Secondly, all the major financial processes have been documented with specific detail on the controls in place. Management monitor and test these controls on an ongoing basis. In addition, the controls are reviewed by the Internal Audit department and any issues identified and communicated back to management and the process owners to enable improvement to the controls. Annually, WPD's compliance with the Act is also reviewed in detail by the WPD Group's external auditors. Good controls together with appropriate documentation must be maintained, and this is subject to testing by management and both internal and external auditors on an annual basis. Since inception of the Act, no significant deficiencies nor material weaknesses have been identified in WPD's financial control environment.

#### **Identification and evaluation of risks and control objectives**

The Company's strategy is to follow an appropriate risk policy, which effectively manages exposures related to the achievement of business objectives.

Key stakeholders are responsible for identifying and assessing the key business risks associated with achieving the corporate objectives. Any actions required to further enhance the control environment are identified along with the person responsible for the management of the specific risk. Periodically a review of key risks is undertaken from which an operational plan is created and used by Internal Audit to assess the risks and the appropriateness of the controls which are in place to manage the risk. The progression of this operational plan is communicated to the owners on a quarterly basis as are all key observations. This method encourages the key stakeholders to actively manage the risks within their areas on a proactive basis.

The Internal Audit and Business Controls department helps to ensure that the risk management and internal control system is consistently adopted, updated and embedded into the business processes.

Individual risk assessment reports highlight the most significant risks affecting the business process, the actions being taken to mitigate these, and also ensures that individuals are responsible for the management of these risks. This information is provided to the Board, the US owner's audit department, and also the external auditors.

### **3 Corporate Governance (continued)**

#### **Identification and evaluation of risks and control objectives (continued)**

A risk management methodology has been produced and shared with the senior management team in order to ensure a consistent and co-ordinated approach to risk management is undertaken within the business. This methodology is available to all staff within the corporate electronic library.

Further comment is given in Section 2 under 'Principal risks and uncertainties'.

#### **Auditor independence**

As mentioned above, PPL is subject to the US Sarbanes-Oxley Act of 2002. This Act not only requires documentation and review of internal controls but also details how audit committees, management, and auditors carry out their respective responsibilities and interact with each other. Its purpose is to build and restore confidence in public financial reporting within the US. The Act lays out specific requirements for each of these parties as it relates to corporate responsibilities, auditor regulation and independence, and financial reporting.

As a wholly owned entity of PPL, the requirements of the Sarbanes-Oxley Act of 2002 extend to WPD. One of the main elements of the Act is concerned with registered public auditing firms being unable to undertake non-auditing services if they are performing auditing services for the group. However a public accounting firm may engage in non-audit services, including tax services, for an audit client, but only if the activity is approved in advance (pre-approved) by the audit committee of the parent company. Therefore any non-auditing services required by WPD, other than those regarded as de-minimis, are detailed to PPL in advance and require their approval. There were no material non-audit services provided to the Company during the year.

PPL has adopted a policy of tendering for its world-wide audit services at least every seven years. This is to ensure that best practice is followed in relation to corporate governance and that fees are competitive. Following a tender exercise during 2005, PPL selected Ernst & Young LLP to replace PricewaterhouseCoopers LLP during 2006 for their various world-wide audits.

#### **Code of Ethics and Legal Compliance Statement**

WPD has developed a formal "Code of Ethics" that defines the standards of personal behaviour to which individual Board members and all employees are required to subscribe. This is subject to annual revision and frequent communication to all employees.

Similarly, WPD has a "Legal Compliance Programme – Statement of Policy" which is also issued periodically to employees. This states that WPD "is dedicated to conducting its business with honesty, integrity and fairness". It also states that WPD will not tolerate retaliation against any employee who reports any illegal act by the Company or by a fellow employee. Any such reports may be made to a line manager or to a named Compliance Office within Human Resources, and may be made anonymously.

#### **Code of conduct on fair competition**

To ensure that the Company complies with its Distribution Licence and the Competition Act 1998, WPD has issued a "Code of conduct on fair competition". This is periodically updated and reissued to all staff; a copy is given to all new employees. It also applies to agents who work for WPD.

### **3 Corporate Governance (continued)**

#### **Political donations and expenditure**

WPD is a politically neutral organisation and has made no political donations during the year.

## **4 Directors' Report**

### **Principal activities**

WPD South West's principal activity is the distribution of electricity. Distribution involves the delivery of electricity across the distribution network within its authorised area covering South West England. The management of the WPD Group is involved in the management of the network in both South West England and South Wales, and where appropriate the South West and South Wales networks share engineering control and other systems.

### **Registered company number**

The Company's registered number is 2366894.

### **Ownership**

WPD South West is an indirect, wholly-owned subsidiary of Western Power Distribution Holdings Limited which is owned by PPL Corporation, an electricity utility of Allentown, Pennsylvania, US.

There were no transactions between WPD South West and the ultimate owner other than the settlement of the value of shares issued to the Company's Chief Executive Officer as part of his remuneration.

### **Business review**

This is contained in Section 2 to this document.

### **Results and dividends**

The profit for the financial year 2010 was £83.7m (2009: £94.7m). Profit before tax was £111.3m (2009: £115.0m).

Dividends paid by the Company during the year totalled £497.1m (2009: £4.9m). Further comment is given within Section 2 under 'Treasury related matters'.

### **Payment of creditors**

The WPD Group's policy in respect of its suppliers (other than those providing electricity utility supplies and services) is to require suppliers to accept our terms which are displayed on our official orders unless alternative terms of mutual benefit can be agreed. The average length of time for the payment of creditors during the year was 18 days (2009: 17 days).

### **Charitable donations**

During the year ended 31 March 2010, donations of £48,000 were made by the Company to community organisations of which £12,000 was donated to charities. In addition, WPD South West established a charitable foundation in 1996 with a £1.0m donation and, in May 2001, an affiliate donated a further £1.0m to the foundation. The foundation made donations of £38,000 to organisations in the South West in 2009/10.

## 4 Directors' Report (continued)

### Political donations and expenditure

The WPD Group is a politically neutral organisation and, during the year, made no political donations.

### Equal opportunities

The WPD Group is committed to equality of opportunity in employment and this is reflected in its equal opportunities policy and employment practices. Employees are selected, treated, and promoted according to their abilities and merits and to the requirements of the job. Applications for employment by people with disabilities are fully considered, and in the event of members of staff becoming disabled, every effort is made to ensure that their employment with the WPD Group continues by way of making adjustments to their role and/or working environment or through retraining arranged as appropriate. It is the policy of the WPD Group that the training, career development and promotion of disabled persons should, as far as possible, be identical to that of other employees.

### Employee consultation

The WPD Group places considerable value on the involvement of its employees in its affairs. Staff are kept informed of the WPD Group's aims, objectives, performance and plans, and their effect on them as employees through newsletters, regular team briefings and other meetings, as well as through the WPD Group's in-house journal. Formal meetings are held regularly between senior managers and representatives of staff and their unions to discuss matters of common interest. A series of road show presentations by the directors each year ensure that all staff are aware of, and can contribute to, WPD's corporate goals.

### Directors and their interests

The directors who served during the year were as follows :

|  |                                     |
|--|-------------------------------------|
| RA Symons, Chief Executive                                       | <u>Appointed</u><br>23 October 1997 |
| DG Harris, Resources and External Affairs Director               | 1 April 2004                        |
| DCS Oosthuizen, Finance Director                                 | 1 June 1999                         |
| RL Klingensmith, non-executive director and President PPL Global | 14 February 2007                    |

During and at the end of the financial year, no director was materially interested in any contract of significance in relation to the Company's business other than service contracts.

Insurance in respect of directors and officers is maintained by the WPD Group parent, PPL Corporation. The insurance is subject to the conditions set out in the companies acts and remains in force at the date of signing the Regulatory Financial Statements.

### Corporate governance

A discussion of corporate governance in WPD is given in Section 3 to this report.

#### **4 Directors' Report (continued)**

##### **Statement of disclosure to the auditors**

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditor in connection with preparing its report, of which the auditor is unaware. Having made enquiries of fellow directors and the Company's auditor, each director has taken all the steps that he is obliged to take as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

##### **Responsibility statements under the Disclosure and Transparency Rules**

Each of the directors listed above confirm to the best of their knowledge:

- (a) the Regulatory Financial Statements, prepared in accordance with UK Generally Accepted Accounting Practice, give a true and fair view of the assets, liabilities, financial position and profit of the Company; and
- (b) the Directors' report includes a fair review of the development and performance of the business and the position of the Company together with a description of the principal risks and uncertainties that it faces.

##### **Auditors**

Ernst & Young LLP have expressed their willingness to continue in office and a resolution proposing their re-appointment will be put before the Annual General Meeting.

## 5 Statement on link between directors' pay and performance

### Introduction

The directors' bonus arrangement includes both financial and non financial performance criteria. Set out below are the non financial criteria relating to customer service and network performance.

The executive directors' bonus arrangements contain a substantial incentive to maintain and improve customer service and network reliability standards as well as ensuring that safety levels are maintained:

- goals for each element of performance are determined by the owner (PPL) at the beginning of each calendar year, specifying target and maximum goals together with associated target and maximum bonus amounts;
- following the end of the calendar year, results are compared with the goals, with the maximum amount paid if the maximum goals are met or exceeded; one half of the maximum if the target goals are met; or no payment if the target goals are not met.

Bonus payments are made annually based on a calendar year, with payment usually in the March following the calendar year end.

### Year to 31 December 2009 goals

For the calendar year 2009, set out below are the maximum bonus amounts related to standards of performance included in the annual bonus programme as determined at the beginning of the year:

|                                      | <i>Maximum Bonus Amount (% of base pay)</i> |                  |   |
|--------------------------------------|---|------------------|---|
|                                      | Chief Executive                             | Finance Director | Resources and External Affairs Director |
| <i>Standard of performance goal:</i> |   |                  |   |
| Network reliability                  |   |                  |   |
| Minutes lost per customer            | 9.00%                                       | 8.00%            | 7.00%                                   |
| Customer interruptions               | 6.75%                                       | 6.00%            | 5.25%                                   |
| Customer impact                      | 6.75%                                       | 6.00%            | 5.25%                                   |
| Contact Centre performance           |   |                  |   |
| <b>Total</b>                         | <b>22.50%</b>                               | <b>20.00%</b>    | <b>17.50%</b>                           |

The above relates to the WPD Group as a whole.

Note:

(i) 'Minutes lost per customer' and 'customer interruptions' are defined as per Ofgem's Information and Incentives Scheme ("IIS") definitions.

(ii) 'Contact Centre performance' relates to the time taken to answer telephone calls from customers who have lost supply.

## **5 Statement on link between directors' pay and performance (continued)**

### **Year to 31 December 2009 results**

WPD's results in 2009 not only met or exceeded all of Ofgem's IIS targets (on a pro rata basis for the calendar year) but also met or exceeded WPD's maximum goals specified for these standards. Also, the Company achieved its highest level target of answering within 20 seconds at least 99% of calls from customers who had lost supply.

Accordingly the annual bonus payment made in March 2010 to each director in respect of 2009 performance included the maximum amounts for standards of service as specified in the above table.

### **2010 Goals**

The same basic bonus structure has been retained in the 2010 annual bonus programme for each director although the maximum bonus award relating to customer performance has been reduced. No bonuses are paid to directors unless the PPL consolidated group achieves a threshold level of earnings.

## 6.1 Statement of directors' responsibilities in respect of the Regulatory Financial Statements

Each DNO is a natural monopoly regulated by Ofgem. It is therefore subject to control on the prices it can charge and the quality of supply it must provide. The principal legislation governing the structure of the electricity industry in Great Britain is the Electricity Act 1989, as amended by the Utilities Act 2000 and the Energy Act 2004. This legislation provides for a licence framework in which the operations of the DNOs are regulated, pursuant to which income generated is subject to an allowed revenue regulatory framework that provides economic incentives to minimise operating, capital and financing costs consistent with the DNOs providing an acceptably reliable distribution network and meeting their legal responsibilities. This licence framework is overseen by Ofgem.

Licences which govern DNOs require each DNO to produce regulatory accounts. One of the documents which comprise the regulatory accounts is the Regulatory Financial Statements. This document contains the Regulatory Financial Statements, which are subject to audit.

The Regulatory Financial Statements are prepared on a similar basis to financial statements which a company is required to produce. Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom accounting standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. In preparing those 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 applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors confirm that they have complied with the above requirements in preparing the Regulatory Financial Statements.

The directors are responsible for keeping proper accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

## **6.2 Independent auditors' report to the Director General of the Gas and Electricity Markets Authority (the "Regulator") and to Western Power Distribution (South West) plc**

We have audited the Regulatory Financial Statements for the year ended 31 March 2010 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, the statement of cash flows and notes to the statement of cash flows A to C, and the related notes 1 to 24.

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

### **Basis of preparation**

The Regulatory Financial Statements have been prepared under the historical cost convention, as modified by the revaluation of derivative financial instruments, and in accordance with Condition 44 of the Company's regulatory licence and the accounting policies set out in Note 1.

The Regulatory Financial Statements are separate from the statutory financial statements of the Company.

### **Respective responsibilities of the Regulator, the directors and auditors**

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

The directors' responsibilities for preparing the Regulatory Financial Statements in accordance with Condition 44 of the regulatory licence are set out in the Statement of directors' responsibilities in respect of the Regulatory Financial Statements.

Our responsibility is to audit the Regulatory Financial Statements having regard to the guidance contained in Audit 05/03 '*Reporting to Regulators of Regulated Entities*'.

We report our opinion as to whether the Regulatory Financial Statements present fairly, in accordance with Condition 44 of the Company's regulatory licence and the accounting policies set out in Note 1, the results and financial position of the Company. We also report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read the other information contained within the Regulatory Financial Statements, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Financial Statements. The other information comprises only the foreword, the operating and financial review, the corporate governance statement, the directors' report and the statement on link between directors' pay and standards of performance.

## **6.2 Independent auditors' report to the Director General of the Gas and Electricity Markets Authority (the "Regulator") and to Western Power Distribution (South West) plc (continued)**

### **Basis of audit opinion**

We conducted our audit in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Financial Statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Regulatory Financial Statements, and of whether the accounting policies are 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 Regulatory Financial Statements are free from material mis-statement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Financial Statements are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under International Standards on Auditing (UK and Ireland).

Our opinion on the Regulatory Financial Statements is separate from our opinion on the statutory accounts of the Company on which we reported on July 2010, which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

### **Opinion**

In our opinion the Regulatory Financial Statements fairly present, in accordance with Condition 44 of the Company's regulatory licence and the accounting policies set out in Note 1, the state of the Company's affairs at 31 March 2010 and of its profit and cashflow for the year then ended, and have been properly prepared in accordance with that condition and those accounting policies.

**Trevor Denny, Senior Statutory Auditor,**  
for and on behalf of Ernst & Young LLP, Statutory Auditors,  
Bristol

July 2010

### 6.3 Profit and loss account

For the year ended 31 March 2010

|  | Note | 2010<br>£m     | 2009<br>£m |
|--|------|----------------|------------|
| <b>Turnover</b>  | 2    | <b>269.2</b>   | 245.0      |
| Operating expenses   | 3    | <b>(137.9)</b> | (134.3)    |
| <b>Operating profit</b>                                      | 4    | <b>131.3</b>   | 110.7      |
| Income from fixed asset investments                          |      | -              | 0.1        |
| Profit on sale of fixed assets                               |      | -              | 0.3        |
| <b>Profit on ordinary activities before interest and tax</b> |      | <b>131.3</b>   | 111.1      |
| Interest receivable and similar income                       | 5    | <b>13.3</b>    | 26.8       |
| Interest payable and similar charges                         | 5    | <b>(33.3)</b>  | (22.9)     |
| <b>Profit on ordinary activities before tax</b>              | 2    | <b>111.3</b>   | 115.0      |
| Tax on profit on ordinary activities                         | 6    | <b>(27.6)</b>  | (20.3)     |
| <b>Profit for the financial year</b>                         |      | <b>83.7</b>    | 94.7       |

All activities relate to continuing operations.

There is no difference between the profit on ordinary activities before tax and the profit for the financial year stated above, and their historical cost equivalents.

The accompanying notes are an integral part of these Regulatory Financial Statements.

#### 6.4 Statement of total recognised gains and losses

For the year ended 31 March 2010

|   | Note | 2010<br>£m  | 2009<br>£m  |
|---|------|-------------|-------------|
| Profit for the financial year                         |      | 83.7        | 94.7        |
| Movement on hedging reserve (net of tax)              | 20   | 5.1         | (5.6)       |
| <b>Total recognised gains and losses for the year</b> |      | <b>88.8</b> | <b>89.1</b> |

The accompanying notes are an integral part of these Regulatory Financial Statements.

## 6.5 Balance sheet

31 March 2010

|   | Note | 2010<br>£m     | 2009<br>£m |
|---|------|----------------|------------|
| <b>Fixed assets</b>                           |      |                |            |
| Tangible assets                               | 11   | 1,121.4        | 1,052.4    |
| Investments                                   | 12   | 34.9           | 36.9       |
|   |      | <b>1,156.3</b> | 1,089.3    |
| <b>Current assets</b>                         |      |                |            |
| Stocks  | 13   | 4.2            | 3.7        |
| Debtors                                       | 14   | 91.3           | 445.3      |
| Short-term deposits                           |      | 80.0           | -          |
| Cash at bank                                  |      | 27.5           | 1.7        |
|   |      | <b>203.0</b>   | 450.7      |
| <b>Creditors</b>                              |      |                |            |
| Amounts falling due within one year           | 15   | (203.4)        | (177.6)    |
| Derivative financial instruments              | 16   | (0.2)          | (0.7)      |
|   |      | <b>(0.6)</b>   | 272.4      |
| <b>Net current (liabilities)/assets</b>       |      |                |            |
|   |      | <b>(0.6)</b>   | 272.4      |
| <b>Total assets less current liabilities</b>  |      |                |            |
|   |      | <b>1,155.7</b> | 1,361.7    |
| <b>Creditors</b>                              |      |                |            |
| Amounts falling due after more than one year  | 15   | (688.4)        | (483.0)    |
| Derivative financial instruments              | 16   | (3.8)          | (12.7)     |
|   |      | <b>(126.8)</b> | (121.0)    |
| <b>Provisions for liabilities and charges</b> |      |                |            |
|   | 17   | <b>(126.8)</b> | (121.0)    |
| <b>Net assets</b>                             |      |                |            |
|   |      | <b>336.7</b>   | 745.0      |
| <b>Capital and reserves</b>                   |      |                |            |
| Called-up share capital                       | 19   | 223.2          | 223.2      |
| Share premium account                         | 20   | 4.1            | 4.1        |
| Capital redemption reserve                    | 20   | 6.2            | 6.2        |
| Hedging reserve                               | 20   | 1.2            | (3.9)      |
| Profit and loss account                       | 20   | 102.0          | 515.4      |
|   |      | <b>336.7</b>   | 745.0      |
| <b>Equity shareholders' funds</b>             |      |                |            |
|   | 21   | <b>336.7</b>   | 745.0      |

The accompanying notes are an integral part of these Regulatory Financial Statements.

The Regulatory Financial Statements on pages 32 to 56 were approved by the Board of Directors on 13 July 2010 and were signed on its behalf by:

RA Symons  
Chief Executive

DCS Oosthuizen  
Finance Director

## 6.6 Statement of cash flows

For the year ended 31 March 2010

|  | Note | 2010<br>£m     | 2009<br>£m |
|--|------|----------------|------------|
| <b>Net cash inflow from operating activities</b>   | A    | <b>134.7</b>   | 147.1      |
| <b>Returns on investments and servicing of finance</b>   |      |                |            |
| Interest received  |      | 15.6           | 22.2       |
| Interest paid  |      | (25.5)         | (19.5)     |
| Dividends received   |      | -              | 0.1        |
| Issue costs on new long-term loans   |      | (1.3)          | -          |
| Net cash (outflow)/inflow from returns on investments and servicing of finance                       |      | (11.2)         | 2.8        |
| <b>Tax paid</b>  |      | <b>(29.7)</b>  | (35.4)     |
| <b>Capital expenditure and financial investment</b>  |      |                |            |
| Purchase of tangible fixed assets  |      | (135.8)        | (135.8)    |
| Customers' contributions received  |      | 30.7           | 30.8       |
| Sale of tangible fixed assets  |      | 0.3            | 0.7        |
| Net cash outflow from capital expenditure and financial investment                                   |      | (104.8)        | (104.3)    |
| <b>Equity dividends paid</b>   |      | <b>(156.2)</b> | (4.9)      |
| <b>Cash (outflow)/inflow before use of liquid resources and financing</b>                            |      | <b>(167.2)</b> | 5.3        |
| <b>Management of liquid resources</b>  |      |                |            |
| (Increase)/decrease in short-term deposits   |      | (80.0)         | 64.7       |
| Net cash (outflow)/inflow from management of liquid resources  |      | (80.0)         | 64.7       |
| <b>Financing</b>   |      |                |            |
| New long-term loans  |      | 198.2          | -          |
| Decrease/(increase) in balances due from Group undertakings  |      | 101.0          | (146.9)    |
| Issue of deep discounted bonds to fellow Group subsidiary  |      | -              | 10.2       |
| Repayment of deep discounted bonds to fellow subsidiary  |      | -              | (11.0)     |
| (Decrease)/increase in short term debt   |      | (26.2)         | 77.3       |
| Increase in short-term borrowings to facilitate purchase of subsidiary from Group parent undertaking |      | -              | 111.0      |
| Purchase of subsidiary from Group parent undertaking   |      | -              | (110.8)    |
| Loan from acquired subsidiary undertaking  |      | -              | 110.8      |
| Repayment of short-term borrowings from proceeds of loan from acquired subsidiary undertaking        |      | -              | (111.0)    |
| Net cash inflow/(outflow) from financing   |      | 273.0          | (70.4)     |
| <b>Increase/(decrease) in cash in the year</b>   | B, C | <b>25.8</b>    | (0.4)      |

The accompanying notes are an integral part of these Regulatory Financial Statements.

## 6.6 Notes to the statement of cash flows

For the year ended 31 March 2010

### A. Reconciliation of operating profit to net cash inflow from operating activities

|   | 2010<br>£m | 2009<br>£m |
|---|------------|------------|
| Operating profit                          | 131.3      | 110.7      |
| Depreciation                              | 38.1       | 35.5       |
| Increase in stocks                        | (0.5)      | -          |
| (Increase)/decrease in debtors            | (38.3)     | 7.7        |
| Increase/(decrease) in creditors          | 2.7        | (6.5)      |
| Increase/(decrease) in provisions         | 1.4        | (0.3)      |
| Net cash inflow from operating activities | 134.7      | 147.1      |

### B. Reconciliation of movement in net debt

|  | At<br>1 April<br>2009<br>£m | Cash<br>Flow<br>£m | Other<br>non-cash<br>changes<br>£m | At<br>31 March<br>2010<br>£m |
|--|-----------------------------|--------------------|------------------------------------|------------------------------|
| Cash at bank                                   | 1.7                         | 25.8               | -                                  | 27.5                         |
| Short-term deposits                            | -                           | 80.0               | -                                  | 80.0                         |
| Debt due within one year:                      |                             |                    |                                    |                              |
| Bank loans and overdrafts                      | (87.6)                      | 26.2               | -                                  | (61.4)                       |
| Debt due after one year:                       |                             |                    |                                    |                              |
| £250m 5.875% sterling bonds 2027               | (247.1)                     | -                  | (0.2)                              | (247.3)                      |
| £200m 5.75% bonds 2040                         | -                           | (196.7)            | 0.3                                | (196.4)                      |
| £105m 1.541% index linked bonds 2053           | (110.1)                     | -                  | (4.1)                              | (114.2)                      |
| £120m 1.541% index linked bonds 2056           | (125.8)                     | -                  | (4.7)                              | (130.5)                      |
|  |                             | (170.5)            |                                    |                              |
| Balances with Group undertakings and affiliate | 364.1                       | (101.0)            | (344.7)                            | (81.6)                       |
|  | (204.8)                     | (165.7)            | (353.4)                            | (723.9)                      |

Other non-cash changes (other than balances with Group undertakings and affiliate) relate to the increase in the nominal value of the index linked bonds as a result of the impact of inflation during the year together with the amortisation of bond issue costs.

## 6.6 Notes to the statement of cash flows

For the year ended 31 March 2010

### C. Reconciliation of net cash flow to movement in net debt

|  | 2010<br>£m | 2009<br>£m |
|--|------------|------------|
| Increase/(decrease) in cash in the year        | 25.8       | (0.4)      |
| Increase/(decrease) in short-term deposits     | 80.0       | (64.7)     |
| Increase in external borrowings                | (170.5)    | (77.3)     |
| Change in balances with Group undertakings     | (101.0)    | 36.9       |
| Increase in net debt resulting from cash flows | (165.7)    | (105.5)    |
| Non-cash changes                               |            |            |
| Change in balances with Group undertakings     | (344.7)    | 112.4      |
| Other  | (8.7)      | (0.5)      |
| (Increase)/decrease in net debt in year        | (519.1)    | 6.4        |
| Net debt at start of year                      | (204.8)    | (211.2)    |
| Net debt at end of year                        | (723.9)    | (204.8)    |

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 1. Accounting policies

The principal accounting policies are summarised below.

#### Basis of preparation

The Regulatory Financial Statements have been prepared on the going concern basis under the historical cost convention, as modified by the revaluation of derivative financial instruments, and in accordance with the Companies Act 2006 and applicable accounting standards. Accounting policies are prepared under United Kingdom Generally Accepted Accounting Practice ("UK GAAP"). They have been applied consistently throughout the year and the preceding year except where changes have been made to previous policies on adoption of new accounting standards.

#### Changes in accounting policy

There were no new accounting standards which had an impact on the Company.

#### Going concern

The directors have prepared the Regulatory Financial Statements on a going concern basis as they have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. This is discussed further under 'Treasury related matters' in Section 2.

#### Turnover

Turnover is recognised to the extent that it is probable that economic benefits will flow to the Company and that the turnover can be reliably measured. Turnover comprises primarily use of energy system income. Turnover includes an assessment of the volume of unbilled energy distributed to customers between the date of the last meter reading and the year end. Remaining sales relate to the invoice value of other goods and services provided which also relate to the electricity network.

Where turnover received or receivable exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, no liability is recognised as such an adjustment to future prices relates to the provision of future services. Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

#### Leases

Rentals for operating leases are charged to the profit and loss account in equal annual amounts over the period of the lease.

#### Research

Expenditure on research is written off to the profit and loss account in the year in which it is incurred.

#### Pension costs

The Company participates in one defined benefit pension scheme, the Electricity Supply Pension Scheme ("ESPS"), to which most employees in the Group belong. Under the guidance of Financial Reporting Standard ("FRS") 17 "Retirement Benefits", where an entity cannot separate out its share of the scheme's assets and liabilities on a reasonable and consistent basis, the relevant entity should account for pensions as if the scheme were a defined contribution scheme, and charge contributions to the profit and loss account and capital expenditure as they become payable in accordance with the rules of the scheme. This applies in these Regulatory Financial Statements.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 1. Accounting policies (continued)

#### Pension costs (continued)

Any capital cost of ex gratia and supplementary pensions, including early retirement deficiency contributions, are charged to the profit and loss account when the contribution is paid to the pension scheme.

#### Share based payments

The Company operates a cash-settled phantom share option scheme for executive directors and senior managers. The cost of cash-settled transactions is measured at fair value using an appropriate option pricing model. Fair value is established at each balance sheet date from grant date until the awards are settled. During the vesting period a liability is recognised representing the product of the fair value of the award and the portion of the vesting period expired as at the balance sheet date. From the end of the vesting period until settlement, the liability represents the full fair value of the award as at the balance sheet date. Changes in the carrying amount of the liability are recognised in profit or loss for the year.

#### Interest costs

Interest charges are recognised in the profit and loss account as they accrue, on an effective rate basis.

#### Tangible fixed assets

Tangible fixed assets are stated at cost net of customer contributions, less amounts provided to write off the cost less anticipated residual value of the assets over their useful economic lives, which are as follows:

|   | Years    |
|---|----------|
| Distribution network assets:                      |          |
| Overhead lines and poles                          | 45       |
| Underground cables                                | 60       |
| Plant and machinery (transformers and switchgear) | 45       |
| Meters  | Up to 10 |
| Customer contributions                            | 55       |
| Other (towers and substation buildings)           | Up to 55 |
| Buildings - freehold                              | Up to 60 |
| Fixtures and equipment                            | Up to 20 |
| Vehicles and mobile plant                         | Up to 10 |

Freehold land is not depreciated.

The cost of self-constructed assets includes the cost of materials, direct labour and an appropriate proportion of production overheads, but excludes financing costs.

Significant IT consultancy and software development costs are capitalised when tangible benefits accrue and are amortised over their estimated useful economic life from the date of first use. Costs primarily relate to external suppliers; directly attributable internal costs are capitalised only if significant. Other IT consultancy and development costs are charged to the profit and loss account in the year in which they are incurred.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 1. Accounting policies (continued)

#### Tangible fixed assets (continued)

Assets are depreciated on a straight line basis. Customers' contributions towards distribution network assets, which include capital grants, are credited to the profit and loss account over the estimated useful lives of the related assets. The unamortised amount of such contributions is shown as a deduction from fixed assets. This is a departure from the Companies Act 2006 requirements which require fixed assets to be included at their purchase price or production cost and hence the unamortised amount of contributions would be presented as deferred income. However, contributions relate directly to the cost of fixed assets used in the distribution network and it is the opinion of the directors that the treatment adopted is necessary to give a true and fair view. The value of unamortised contributions is shown in Note 11.

The carrying values of tangible fixed assets are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

#### Property

Properties surplus to operational requirements are stated at the lower of cost and net realisable value. Profits are recognised when properties are sold. Sales are accounted for when there is an unconditional exchange of contracts.

#### Financial assets

Financial assets are classified as held-to-maturity loans and receivables or as derivatives designated as hedging instruments in an effective hedge, as appropriate. Financial assets include cash and cash equivalents, trade receivables, other receivables, loans, other investments, and derivative financial instruments. The Company determines the classification of its financial assets at initial recognition. Financial assets are recognised initially at fair value, normally being transaction price plus, in the case of financial assets not at fair value through profit or loss, directly attributable transaction costs.

The subsequent measurement of financial assets depends on their classification, as follows:

##### *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method if the time value of money is significant. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process. This category of financial assets includes trade and other receivables.

##### *Derivatives designated as hedging instruments in an effective hedge*

Such derivatives are carried on the balance sheet at fair value. The treatment of gains and losses arising from revaluation is described below in the accounting policy for derivative financial instruments and hedging activities.

##### *Investments*

Investment income is included in the financial statements of the year in respect of which it is receivable. Fixed asset investments are held to maturity and are stated at amortised cost less any provisions for impairment.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 1. Accounting policies (continued)

#### **Impairment of financial assets - loans and receivables**

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced, with the amount of the loss recognised in the Profit and loss account.

#### **Derecognition of financial assets**

Financial assets are derecognised on sale or settlement.

#### **Foreign currencies**

Transactions in foreign currencies are initially recorded in the entity's functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the Profit and loss account.

#### **Cash and cash equivalents**

Cash and cash equivalents comprise cash in hand, short-term deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

#### **Financial liabilities**

Financial liabilities are classified as derivatives designated as hedging instruments in an effective hedge, or as financial liabilities measured at amortised cost, as appropriate. Financial liabilities include trade and other payables, accruals, finance debt and derivative financial instruments. The Company determines the classification of its financial liabilities at initial recognition. The measurement of financial liabilities depends on their classification, as follows:

##### *Derivatives designated as hedging instruments in an effective hedge*

Such derivatives are carried on the balance sheet at fair value. The treatment of gains and losses arising from revaluation is described below in the accounting policy for derivative financial instruments and hedging activities.

##### *Financial liabilities measured at amortised cost*

All other financial liabilities are initially recognised at fair value. For interest-bearing loans and borrowings this is the fair value of the proceeds received net of issue costs associated with the borrowing.

After initial recognition, other financial liabilities are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses arising on the repurchase, settlement or cancellation of liabilities are recognised respectively in interest and other revenues and finance costs.

This category of financial liabilities includes trade and other payables and finance debt.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 1. Accounting policies (continued)

#### Derivative financial instruments

The Company uses derivative financial instruments, such as interest rate swaps and cross currency swaps, to hedge risks associated with interest rate and foreign currency fluctuations. It also uses derivative financial instrument products to lock in UK treasury rates (and interest rate spreads over treasury rates) in anticipation of future financing, when appropriate, to reduce its exposure to the expected future cash flow variability of its debt instruments. Such derivative instruments are recognised on the balance sheet at fair value. The method of recognising any resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the risk being hedged.

Hedges are classified as:

- Fair value hedges, where they hedge the exposure to changes in the fair value of a recognised asset or liability; or
- Cash flow hedges, where they hedge the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset, liability or forecasted transaction.

WPD South West currently does not have fair value hedges.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the Profit and loss account. Amounts accumulated in equity are recycled to the profit and loss account in the same period that the hedged item is recognised in the Profit and loss account.

If the forecast transaction or firm commitment is no longer expected to occur, amounts previously recognised in equity are transferred to profit or loss. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognised in equity remain in equity until the forecast transaction or firm commitment occurs.

Gains in relation to forward interest rate swaps terminated prior to a previous debt issuance, that are deferred in the hedging reserve, are being recycled to the profit and loss account over the term of the bond.

#### Stocks

Stocks are valued at the lower of cost and net realisable value which takes account of any provision necessary to recognise damage and obsolescence.

#### Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. The estimate is discounted to present value where the effect is material.

#### Taxation

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

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 1. Accounting policies (continued)

#### Taxation (continued)

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in years different from those in which they are recognised in the Regulatory Financial Statements.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued asset and the gain or loss expected to arise on sale has been recognised in the Regulatory Financial Statements. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is measured at the average tax rates that are expected to apply in the years in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a discounted basis to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse. The discount rates used reflect the post-tax yields to maturity that can be obtained on government bonds with similar maturity dates and currencies to those of the deferred tax assets or liabilities.

### 2. Segmental reporting

Substantially all of the Company's turnover and profit before tax are derived from the delivery of electricity across its distribution network in the United Kingdom and related activities.

### 3. Operating expenses

The directors consider that the nature of the business is such that the analysis of expenses shown below is more informative than that set out in the formats specified by the Companies Act 2006.

|                               | <b>2010</b>  | 2009  |
|-------------------------------|--------------|-------|
|                               | <b>£m</b>    | £m    |
| Cost of sales                 | <b>15.0</b>  | 17.6  |
| Distribution network expenses | <b>90.8</b>  | 84.4  |
| Other operating expenses      | <b>32.1</b>  | 32.3  |
| Operating expenses            | <b>137.9</b> | 134.3 |

Other operating expenses include certain pension costs, customer service, billing, and administration.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 4. Operating profit

|  | <b>2010</b> | 2009 |
|--|-------------|------|
|  | <b>£m</b>   | £m   |
| Operating profit is stated after charging:   |             |      |
| Depreciation   | <b>38.1</b> | 35.5 |
| Operating lease rentals:   |             |      |
| Plant, machinery and equipment   | <b>0.3</b>  | 0.4  |
| Land and buildings   | <b>1.7</b>  | 1.7  |
| Research and development   | <b>0.2</b>  | 0.2  |
| Auditors' remuneration:  |             |      |
| Fees payable to the Company's auditors for the audit of the<br>Company's annual accounts | <b>0.2</b>  | 0.2  |
| Fees payable for non audit services  | -           | -    |

### 5. Interest

|  | <b>2010</b>   | 2009   |
|--|---------------|--------|
|  | <b>£m</b>     | £m     |
| Interest payable and similar charges:    |               |        |
| On bank loans and overdrafts             | <b>3.0</b>    | 0.7    |
| On loans from fellow WPD Group companies | <b>1.0</b>    | 3.0    |
| Other loans                              | <b>29.3</b>   | 19.2   |
|  | <b>33.3</b>   | 22.9   |
| Interest receivable and similar income:  |               |        |
| On loans to fellow WPD Group companies   | <b>(13.2)</b> | (22.6) |
| Interest on tax prepayments              | -             | (0.9)  |
| Other                                    | <b>(0.1)</b>  | (3.3)  |
|  | <b>(13.3)</b> | (26.8) |
| Interest expense/(income) (net)          | <b>20.0</b>   | (3.9)  |

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 6. Tax on profit on ordinary activities

| (a) Analysis of charge in the year             | 2010<br>£m | 2009<br>£m |
|--|------------|------------|
| Current tax:                                   |            |            |
| UK corporation tax on profits for the year     | 25.3       | 26.7       |
| Adjustment in respect of prior years           | (0.1)      | (8.0)      |
| Total current tax (Note 6(b))                  | 25.2       | 18.7       |
| Deferred tax:                                  |            |            |
| Origination and reversal of timing differences | 5.5        | 2.7        |
| (Increase)/decrease in discount                | (3.4)      | 5.9        |
| Adjustment in respect of prior years           | 0.3        | (7.0)      |
| Total deferred tax (Note 18)                   | 2.4        | 1.6        |
| Tax charge on profit on ordinary activities    | 27.6       | 20.3       |

#### (b) Factors affecting the current tax charge for the year

The current tax assessed for the year is different to the standard rate of corporation tax in the UK of 28%. The differences are explained below:

|  | 2010<br>£m | 2009<br>£m |
|--|------------|------------|
| Profit on ordinary activities before tax   | 111.3      | 115.0      |
| Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 28%: | 31.2       | 32.2       |
| Effects of:  |            |            |
| Timing difference between capital allowances and depreciation                                  | (2.3)      | (1.7)      |
| Chargeable gain on sale of supply business   | 5.2        | -          |
| Other timing differences   | (8.4)      | (1.0)      |
| Adjustments to tax charge in respect of prior years  | (0.1)      | (8.0)      |
| Group relief surrendered at non-standard rates   | (0.4)      | (2.8)      |
| Current tax charge for the year (Note 6(a))  | 25.2       | 18.7       |

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 6. Tax on profit on ordinary activities (continued)

(c) Factor which will effect future tax charges

In his emergency budget statement on 22 June 2010, the Chancellor announced that the rate of corporation tax would reduce by 1% with effect from 1 April 2011, with further 1% reductions in each of the next 3 years bringing the rate down to 24% by 1 April 2014; these reductions are expected to be enacted separately each year. He also announced a reduction in capital allowance rates effective from 1 April 2012.

The changes have not been substantively enacted at the balance sheet date and therefore are not included in these Regulatory Financial Statements. The impact of a 1% reduction in the year to 31 March 2011 is expected to reduce the deferred tax liability provided at 31 March 2010 by approximately £6m with a corresponding credit to the Profit and loss account.

### 7. Dividends

|  | 2010<br>£m   | 2009<br>£m |
|--|--------------|------------|
| Dividends on equity shares:                                |              |            |
| Interim dividends - 35.0 pence per share (2009: 1.1 pence) | 156.2        | 4.9        |
| Dividend in specie   | 340.9        | -          |
|  | <b>497.1</b> | 4.9        |

The WPD Group is structured such that debt is held by UK holding companies. Dividends from WPD South West and other operating companies fund the interest on this debt. On 20 January 2010, the Company paid dividends in specie comprising principal and accrued interest on loans due from Group companies totalling £340.9m and cash of £120.0m; none of this was paid to the US parent company.

### 8. Employee costs and numbers (including executive directors)

| (a) Employee costs                                | 2010<br>£m    | 2009<br>£m |
|---|---------------|------------|
| Total employee costs during the year amounted to: |               |            |
| Wages and salaries                                | 50.0          | 48.2       |
| Social security costs                             | 4.2           | 4.0        |
| Pension costs - severance related                 | -             | 0.3        |
| Pension costs - other                             | 32.2          | 32.1       |
| Total employee costs                              | <b>86.4</b>   | 84.6       |
| Less allocated to capital expenditure             | <b>(43.0)</b> | (43.4)     |
| Charged to the profit and loss account            | <b>43.4</b>   | 41.2       |

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 8. Employee costs and numbers (including executive directors) (continued)

#### (b) Number of employees

The average number of employees during the year was 1,382 (2009: 1,360). The number of staff and costs shown exclude a proportion of WPD South West staff who work in part for WPD South Wales, and include a proportion of WPD South Wales staff who work in part for WPD South West.

#### (c) Share based payments

The Group issues to directors and senior employees share appreciation rights ("SARs") relating to the shares of the WPD Group's ultimate parent, PPL Corporation. The SARs require the Group to pay the intrinsic value of the SAR to the director or employee at the date of exercise. The Group has recorded liabilities of £0.8m (2009: £0.8m). Fair value of the SARs is determined by using the Black-Scholes option-pricing model using the assumptions noted below. In 2010, the Group recorded total credits of £nil (2009: £0.8m) allocated evenly between WPD South West and WPD South Wales. The total intrinsic value at 31 March 2010 was £0.2m (2009: £0.2m).

The inputs into the Black-Scholes option-pricing model were:

|                         | 2010   | 2009   |
|-------------------------|--------|--------|
| Expected volatility     | 28.57% | 26.06% |
| Expected life (years)   | 6      | 6      |
| Risk-free rate          | 2.50%  | 2.07%  |
| Expected dividend yield | 5.61%  | 3.48%  |

Expected volatility was determined by calculating the historical volatility of PPL Corporation's share price over the previous 5.4 years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions, and behavioural considerations.

### 9. Pension commitments

#### Electricity Supply Pension Scheme ("ESPS")

The Company participates in the Western Power Distribution Group segment of the ESPS. The ESPS provides pension and other related defined benefits based on final pensionable pay to employees throughout the electricity industry. One segment of the ESPS relates to the WPD Group as a whole and most employees of the Group are members of the ESPS. The assets are held in a trustee administered fund.

Effective 1 April 2010, the WPD Group of the ESPS was closed to new members except in very limited circumstances. Existing members will be unaffected. A defined contribution scheme is being offered to new employees.

Under the guidance of FRS 17, where an entity cannot separate out its share of the scheme's assets and liabilities on a reasonable and consistent basis, the relevant entity should account for pensions as if the scheme were a defined contribution scheme, and charge contributions to the profit and loss account and capital expenditure as they become payable in accordance with the rules of the scheme; this has been applied to WPD South West. Full FRS 17 disclosure for the ESPS is made in the consolidated financial statements of Western Power Distribution Holdings Limited. A summary however follows.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 9. Pension commitments (continued)

#### Electricity Supply Pension Scheme ("ESPS") (continued)

The financial assumptions used in calculating the figures for ESPS under FRS 17 in respect of the WPD Group were:

|   | 2010  | 2009  |
|---|-------|-------|
| Rate of increase in salaries            | 4.50% | 4.00% |
| Rate of increase to pensions in payment | 3.30% | 2.80% |
| Discount rate                           | 5.50% | 7.00% |
| Inflation                               | 3.25% | 2.75% |

The mortality assumptions are based on the recent actual mortality experience of members within the scheme and the assumptions also allow for future mortality improvements. The assumptions are that a member currently aged 60 will live on average for a further 25.8 years if they are male and for a further 28.3 years if they are female. For a member who retires in 2030 at age 60 the assumptions are that they will live on average for a further 27.0 years after retirement if they are male and for a further 29.3 years after retirement if they are female.

The assets and liabilities of the ESPS for the WPD Group as a whole, at 31 March, were as follows:

|                              | 2010<br>£m | 2009<br>£m |
|------------------------------|------------|------------|
| Present value of obligations | 1,543.6    | 1,167.7    |
| Fair value of plan assets    | (1,248.8)  | (896.4)    |
| Deficit in the scheme        | 294.8      | 271.3      |
| Related deferred tax asset   | (82.5)     | (76.0)     |
| Net pension liability        | 212.3      | 195.3      |

Employer contributions paid to the ESPS in respect of the WPD Group were £103.7m (2009: £52.7m); this included £50.0m as a prepayment of future contributions. In April 2010, a further £75.0m prepayment of employer contributions was made; this is expected to be the total employer contribution to be paid to the ESPS during the year ending 31 March 2011 in respect of the WPD Group.

ESPS pension costs borne by WPD South West are the full amounts as shown in Note 8.

#### Other scheme

The Company also operates a defined contribution scheme. The assets of the scheme are held separately from those of the Company in an independent fund administered by the scheme trustee. All of the active members in this scheme have transferred to the ESPS. At 31 March 2010 there were 275 members with deferred benefits in the scheme (2009: 278) and 1 pensioner (2009: 0). Market value of the assets was £1.5m (2009: £1.1m).

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 10. Directors' emoluments

The service contracts for the executive directors are with WPD South West. However, their emoluments include those for services to the WPD Group as a whole, which principally comprises WPD South West and WPD South Wales. The emoluments detail given in this note represents total emoluments of the directors for all services provided to WPD Group companies. The costs are borne evenly by WPD South Wales and WPD South West.

|  | <u>Highest paid director</u> |       | <u>Total</u> |       |
|--|------------------------------|-------|--------------|-------|
|  | <u>2010</u>                  | 2009  | <u>2010</u>  | 2009  |
|  | <u>£000</u>                  | £000  | <u>£000</u>  | £000  |
| The emoluments of the executive directors comprised:     |                              |       |              |       |
| Base salary (note i)                                     | <b>399</b>                   | 372   | <b>878</b>   | 818   |
| Performance dependent bonus (note ii)                    | <b>449</b>                   | 331   | <b>895</b>   | 656   |
| Long term incentive plan (note iii)                      | <b>116</b>                   | 740   | <b>116</b>   | 1,334 |
| Pension compensation allowance (note iv)                 | <b>263</b>                   | 248   | <b>686</b>   | 651   |
| Fees to the independent non executive director (note vi) | -                            | -     | <b>16</b>    | 30    |
|  | <b>1,227</b>                 | 1,691 | <b>2,591</b> | 3,489 |

(i) Base salary also includes benefits in kind.

(ii) The amount of the annual bonus is based on the WPD Group's financial performance, the reliability of the electricity network, customer satisfaction, and other factors.

(iii) Under a long term incentive plan, the three executive directors receive phantom stock options. The option price is set at the quoted share price of the WPD Group's parent in the US, PPL Corporation, at the date the phantom options are granted. The options may be exercised during fixed periods and the gain is payable through the payroll. The values above include any payments made to the executive directors in respect of gains in value of phantom options exercised in the year. In 2010, 3 directors were granted options (2009: 3) and no executive directors exercised options (2009: 3). In addition, WPD's Chief Executive Officer is also Vice President of PPL Global. As a result, he also receives annually a grant of PPL Corporation shares which he cannot generally access for 3 years. The value of these shares is shown within this line.

(iv) In anticipation of the change in tax applicable to UK pensions effective 6 April 2006, the executive directors resigned as active members of the Electricity Supply Pension Scheme ("ESPS" - Note 9) on 5 April 2006 and elected for enhanced protection. WPD thus no longer contributes for ongoing service to the ESPP in respect of the executive directors. Instead, WPD pays cash compensation to them individually equivalent to the value of WPD's contribution in to the fund that would have been made had they remained active members (as determined by external actuaries).

(v) The three executive directors are deferred members of the ESPP (see (iv) above). At 31 March 2010, the highest paid director had accrued annual pension benefits of £369,021 (2009: £347,878). The benefits shown assume that an option to convert an element of the annual benefits to a lump sum payable on retirement is not exercised.

(vi) The Group's independent UK non executive director is entitled to fees as determined by the Western Power Distribution Holdings Limited Board. No emoluments are paid to US based non executive directors, who are officers of PPL, in respect of their services as directors to the WPD Group.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 11. Tangible fixed assets

|                           | Non network<br>land &<br>buildings<br>£m | Distribution<br>network<br>£m | Fixtures &<br>equipment<br>£m | Vehicles<br>& mobile<br>& plant<br>£m | Deduct:<br>customers'<br>contributions<br>£m | Total<br>£m    |
|---------------------------|--|-------------------------------|-------------------------------|---------------------------------------|--|----------------|
| <b>Cost</b>               |  |                               |                               |                                       |  |                |
| At 1 April 2009           | 5.2                                      | 1,921.7                       | 25.9                          | 36.2                                  | (398.3)                                      | 1,590.7        |
| Additions                 | -  | 130.7                         | 5.0                           | 6.1                                   | (29.7)                                       | 112.1          |
| Disposals and retirements | (0.3)                                    | (4.7)                         | (5.6)                         | (2.2)                                 | -  | (12.8)         |
| At 31 March 2010          | 4.9                                      | 2,047.7                       | 25.3                          | 40.1                                  | (428.0)                                      | 1,690.0        |
| <b>Depreciation</b>       |  |                               |                               |                                       |  |                |
| At 1 April 2009           | 0.4                                      | 631.7                         | 11.4                          | 15.4                                  | (120.6)                                      | 538.3          |
| Charge for the year       | 0.4                                      | 39.8                          | 5.2                           | 3.7                                   | (6.3)  | 42.8           |
| Disposals and retirements | (0.3)                                    | (4.7)                         | (5.6)                         | (2.0)                                 | 0.1  | (12.5)         |
| At 31 March 2010          | 0.5                                      | 666.8                         | 11.0                          | 17.1                                  | (126.8)                                      | 568.6          |
| <b>Net book value</b>     |  |                               |                               |                                       |  |                |
| <b>At 31 March 2010</b>   | <b>4.4</b>                               | <b>1,380.9</b>                | <b>14.3</b>                   | <b>23.0</b>                           | <b>(301.2)</b>                               | <b>1,121.4</b> |
| At 1 April 2009           | 4.8                                      | 1,290.0                       | 14.5                          | 20.8                                  | (277.7)                                      | 1,052.4        |

All non network land and buildings are freehold. The net book value of land and buildings within the distribution network above is £93.1m (2009: £85.9m); these are all freehold.

Customers' contributions relate entirely to the construction of the distribution network.

Included within the Company's fixed assets are assets in the course of construction amounting at 31 March 2010 to £19.4m (2009 £10.4m) and land at a cost of £27.4m (2009: £25.6m).

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

|                                   | Group<br>debt <sup>(1)</sup><br>£m |
|-----------------------------------|------------------------------------|
| <b>12. Investments</b>            |                                    |
| <b>Cost</b>                       |                                    |
| At 1 April 2009                   | 36.9                               |
| Exchange adjustments              | (2.0)                              |
| At 31 March 2010                  | <b>34.9</b>                        |
| <b>Provision for impairment</b>   |                                    |
| At 1 April 2009 and 31 March 2010 | -                                  |
| <b>Net book value</b>             |                                    |
| <b>At 31 March 2010</b>           | <b>34.9</b>                        |
| At 1 April 2009                   | 36.9                               |

### *(1) Investment in Group parent debt*

Investments in Group debt relate to the Company's held-to-maturity interest in unsecured US dollar denominated bonds of WPDHL, maturing in 2028. The bonds are swapped into fixed value in sterling at a fixed interest rate (7.19%) (Note 16) to mirror the WPDHL liability under swaps. The exchange adjustment of £2.0m has been hedged and therefore has no net effect on the Profit and loss account.

## 13. Stocks

|                               | 2010<br>£m | 2009<br>£m |
|-------------------------------|------------|------------|
| Raw materials and consumables | 4.1        | 3.6        |
| Work in progress              | 0.1        | 0.1        |
|                               | <b>4.2</b> | 3.7        |

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

| <b>14. Debtors</b>                                   | <b>2010</b> | 2009  |
|--|-------------|-------|
|  | <b>£m</b>   | £m    |
| <b>Amounts falling due within one year:</b>          |             |       |
| Trade debtors  | <b>46.5</b> | 36.4  |
| Amounts owed by Group undertakings                   | <b>5.0</b>  | 399.9 |
| Other debtors  | <b>1.9</b>  | 3.4   |
| Prepayments and accrued income                       | <b>33.2</b> | 4.9   |
| <b>Amounts falling due after more than one year:</b> |             |       |
| Prepayments and accrued income                       | <b>4.7</b>  | 0.7   |
|  | <b>91.3</b> | 445.3 |

Amounts owed by Group undertakings are unsecured and are repayable on demand.

| <b>15. Creditors</b>                                       | <b>2010</b>  | 2009  |
|--|--------------|-------|
|  | <b>£m</b>    | £m    |
| <b>Amounts falling due within one year:</b>                |              |       |
| Bank loans and overdrafts                                  | <b>61.4</b>  | 87.6  |
| Payments received on account                               | <b>9.8</b>   | 9.0   |
| Trade creditors  | <b>6.3</b>   | 6.7   |
| Amounts owed to Group undertakings                         | <b>82.3</b>  | 31.5  |
| Amounts due to affiliate                                   | <b>4.3</b>   | 4.3   |
| UK corporation tax   | <b>6.4</b>   | 10.9  |
| Other taxation and social security                         | <b>4.3</b>   | 4.0   |
| Other creditors  | <b>9.1</b>   | 6.2   |
| Accruals and deferred income                               | <b>19.5</b>  | 17.4  |
|  | <b>203.4</b> | 177.6 |
| <b>Amounts falling due after more than one year:</b>       |              |       |
| Unsecured borrowings repayable after more than five years: |              |       |
| £250m 5.875% bonds 2027                                    | <b>247.3</b> | 247.1 |
| £200m 5.75% bonds 2040                                     | <b>196.4</b> | -     |
| £105m 1.541% index linked bonds 2053                       | <b>114.2</b> | 110.1 |
| £120m 1.541% index linked bonds 2056                       | <b>130.5</b> | 125.8 |
|  | <b>688.4</b> | 483.0 |

The bank loans and overdrafts are unsecured. The overdraft is repayable on demand and includes cheques issued but not yet presented. Bank loans are short term. Amounts owed to Group undertakings are unsecured and are repayable on demand.

Unsecured borrowings are stated net of unamortised issue costs of £3.3m (2009: £1.8m). These costs together with the interest expense are allocated to the Profit and loss account over the term of the bonds at a constant rate on the carrying amount.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 16. Derivatives and other financial instruments

As permitted by FRS 29 "Financial Instruments: Disclosure", full disclosure relating to derivative financial instruments is consolidated with those of the Western Power Distribution Holdings Limited Group and is incorporated in the disclosure in the Group financial statements.

An outline of the Company's financial risks and the policies and objectives pursued in relation to those risks is set out in 'Treasury related matters' in Section 2.

The fair values of derivative financial instruments are set out below.

|                      | 2010   | 2010        | 2010  | 2009   | 2009        | 2009   |
|----------------------|--------|-------------|-------|--------|-------------|--------|
| Cross-currency swaps | Assets | Liabilities | Total | Assets | Liabilities | Total  |
|                      | £m     | £m          | £m    | £m     | £m          | £m     |
| Current              | -      | (0.2)       | (0.2) | -      | (0.7)       | (0.7)  |
| Non-current          | -      | (3.8)       | (3.8) | -      | (12.7)      | (12.7) |
|                      | -      | (4.0)       | (4.0) | -      | (13.4)      | (13.4) |

### 17. Provisions for liabilities and charges

|                          | Deferred<br>taxation<br>(Note 18)<br>£m | Other<br>£m | Total<br>£m  |
|--------------------------|---|-------------|--------------|
| At 1 April 2009          | 117.5                                   | 3.5         | 121.0        |
| Arising during the year  | 4.4                                     | 1.6         | 6.0          |
| Utilised during the year | -                                       | (0.2)       | (0.2)        |
| At 31 March 2010         | <b>121.9</b>                            | <b>4.9</b>  | <b>126.8</b> |

Other provisions at 31 March 2010 substantially relate to uninsured losses and an expected settlement of liabilities to the Electricity Association Limited ("EA") and Electricity Association Technology Limited ("EATL") relating primarily to a pension deficit in those companies. Liabilities in respect of the EA and EATL are being settled over periods of approximately 1 and 8 years, respectively; the directors expect other provisions to be settled within the next two years.

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 18. Deferred tax

|  | 2010<br>£m | 2009<br>£m |
|--|------------|------------|
| Accelerated capital allowances                         | 167.6      | 165.2      |
| Chargeable gain on sale of electricity supply business | 24.0       | 29.2       |
| Other timing differences                               | 7.4        | (3.2)      |
| Undiscounted provision for deferred tax                | 199.0      | 191.2      |
| Discount   | (77.1)     | (73.7)     |
| Discounted provision for deferred tax (Note 17)        | 121.9      | 117.5      |

|   | 2010<br>£m | 2009<br>£m |
|---|------------|------------|
| Provision for deferred tax at 1 April                                       | 117.5      | 118.1      |
| Deferred tax charge in profit and loss account (Note 6(a))                  | 2.4        | 1.6        |
| Amount charged/(credited) to statement of total recognised gains and losses | 2.0        | (2.2)      |
| Provision for deferred tax at 31 March                                      | 121.9      | 117.5      |

### 19. Called-up share capital

|  | 2010<br>£   | 2009<br>£   |
|--|-------------|-------------|
| <b>Allotted, called-up and fully paid:</b> |             |             |
| 446,306,245 ordinary shares of 50p each    | 223,153,123 | 223,153,123 |

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 20. Reserves

|   | Share<br>premium<br>account<br>£m | Capital<br>redemption<br>reserve<br>£m | Hedging<br>reserve<br>£m | Profit<br>& loss<br>account<br>£m |
|---|-----------------------------------|--|--------------------------|-----------------------------------|
| At 1 April 2009   | 4.1                               | 6.2                                    | (3.9)                    | 515.4                             |
| Profit for the financial year                           | -                                 | -                                      | -                        | 83.7                              |
| Dividends paid  | -                                 | -                                      | -                        | (497.1)                           |
| Cash flow hedges fair value gains in year (net of tax)  | -                                 | -                                      | 6.6                      | -                                 |
| Cash flow hedges transfers from net profit (net of tax) | -                                 | -                                      | (1.5)                    | -                                 |
| At 31 March 2010  | <b>4.1</b>                        | <b>6.2</b>                             | <b>1.2</b>               | <b>102.0</b>                      |

The share premium account arose on the issue of shares under share option schemes and the capital redemption reserve is in respect of the purchase of its own shares by the Company, both prior to 1996.

The hedging reserve includes value received in respect of interest rate derivatives entered into in anticipation of the issue of long-term debt; the gain is being amortised through the profit and loss account over the term of the debt. The balance relates to cross currency swaps taken out in respect of the fixed asset investments (Notes 12 and 16).

Dividends paid included £340.9m dividends in specie (Note 7).

### 21. Reconciliation of movements in equity shareholders' funds

|   | 2010<br>£m     | 2009<br>£m |
|---|----------------|------------|
| Profit for the financial year                         | <b>83.7</b>    | 94.7       |
| Dividends   | <b>(497.1)</b> | (4.9)      |
| Net movement in hedging reserve                       | <b>5.1</b>     | (5.6)      |
| Net (decrease)/increase in equity shareholders' funds | <b>(408.3)</b> | 84.2       |
| Opening equity shareholders' funds                    | <b>745.0</b>   | 660.8      |
| Closing equity shareholders' funds                    | <b>336.7</b>   | 745.0      |

## 6.7 Notes to the Regulatory Financial Statements

For the year ended 31 March 2010

### 22. Capital and other commitments

a) There are annual commitments under operating leases which expire :

|                                      | <b>2010</b> | 2009 |
|--------------------------------------|-------------|------|
|                                      | <b>£m</b>   | £m   |
| In the second to fifth year          | <b>0.3</b>  | -    |
| Over five years - land and buildings | -           | 0.3  |

b) Fixed asset expenditure contracted but not provided for in the Regulatory Financial Statements at 31 March 2010 was £5.3m (2009: £2.6m).

### 23. Related party transactions

The Company, a wholly-owned subsidiary undertaking, has taken the exemption available from related party disclosure requirements of FRS 8 as the financial statements of a parent company are available to the public (Note 24).

### 24. Ultimate parent undertaking

The immediate parent undertaking of the Company is Western Power Distribution LLP, which is registered in England and Wales.

The smallest group in which the results of the Company are consolidated is headed by Western Power Distribution Holdings Limited. Copies of these financial statements may be obtained from the Company's registered office as stated below.

The largest group in which the results of the Company are consolidated is that headed by PPL Corporation, which is the ultimate parent undertaking. Copies of their accounts may be obtained from Two North Ninth Street, Allentown, Pennsylvania, PA18101-1179, US.

#### Registered office:

**Western Power Distribution (South West) plc**  
Avonbank  
Feeder Road  
Bristol BS2 0TB

Telephone : 0117 933 2000  
Fax : 0117 933 2001  
eMail: [info@westernpower.co.uk](mailto:info@westernpower.co.uk)

Registered number 2366894