



20 May 2011

**Scottish and Southern Energy plc**  
**Financial report for the year to 31 March 2011**

	Mar 2011	Mar 2010	Change	Mar 2009
Full-Year Dividend	75.0p	70.0p	<b>+7.1%</b>	66.0p
Adjusted Profit Before Tax*	£1,310.1m	£1,290.1m	<b>+1.6%</b>	£1,253.7m
Adjusted Profit After Tax*	£1,041.9m	£1,016.0m	<b>+2.5%</b>	£953.3m
Adjusted Earnings Per Share*	112.3p	110.2p	<b>+1.9%</b>	108.0p
Investment and Capital Expenditure	£1,443.7m	£1,315.2m	<b>+9.8%</b>	£1,279.8m
Power Station Availability (Gas)	88%	94%	<b>-6.4%</b>	76%
Power Station Availability (Coal)	84%	92%	<b>-8.7%</b>	89%
Energy Supply Customers (GB and Ire)	9.65m	9.35m	<b>+300,000</b>	9.10m
Customer Minutes Lost (SHEPD)	78	74	<b>+4 mins</b>	75
Customer Minutes Lost (SEPD)	64	65	<b>-1 min</b>	66
Number of Employees	20,249	20,177	<b>+72</b>	18,795
Total Recordable Injury Rate	0.12	0.14	<b>-14.3%</b>	0.16
Reportable Environmental Incidents	0	2	<b>-2</b>	1

**Lord Smith of Kelvin, Chairman of SSE, said:**

“SSE’s key financial objective is to deliver above-inflation increases in the dividend every year, and this has again been achieved. SSE is one of just six FTSE 100 companies to have delivered real dividend growth every year since 1999, when the company paid its first dividend.

“Despite lower-than-expected output of renewable energy and higher-than-forecast wholesale gas prices, SSE also achieved another increase in adjusted profit before tax\*. This reflects the fact that SSE’s balanced business model, with both economically-regulated and market-based businesses, makes the company resilient and able to deliver solid financial results and annual dividend growth even when the business environment is challenging.

“Despite the challenges, SSE has delivered sector-leading service to energy customers and maintained a strong record of reliability in energy networks. Important additions have been made to its asset base through its investment programme, delivery of which is beginning to gather momentum. In doing so, the groundwork has been laid upon which SSE can extend its record of annual real dividend growth, with another increase, of at least 2% more than RPI inflation, being targeted for 2011/12.”

\* In line with SSE’s approach since September 2005, this financial report describes adjusted operating profit before exceptional items, remeasurements arising from IAS 39, and after the removal of taxation and interest on profits from jointly controlled entities and associates, unless otherwise stated. In addition, it describes adjusted profit before tax before exceptional items, remeasurements arising from IAS 39 and after the removal of taxation on profits from jointly-controlled entities and associates. It also describes adjusted earnings and earnings per share before exceptional items, remeasurements arising from IAS 39 and deferred tax.

## **DELIVERING DIVIDEND GROWTH NOW AND IN THE FUTURE**

### **Delivering....a 7.1% dividend increase**

The recommended full-year dividend is up 7.1% to 75p per share. This is the 12<sup>th</sup> successive above-inflation dividend increase delivered by SSE. The 75p full-year dividend is covered 1.5 times by SSE's adjusted profit after tax.

### **Delivering....a 12<sup>th</sup> successive increase in adjusted PBT\***

Adjusted PBT\* is up 1.6% to £1,310.1m. This means SSE has delivered 12 successive increases in adjusted PBT\*, which is now 50% higher than it was five years ago.

### **Delivering...new assets from capital investment**

During 2010/11, SSE commissioned 90MW of new onshore wind capacity and 40mcm (net) of new gas storage capacity and added £400m to the Regulated Asset Value of its energy networks businesses.

### **Delivering...capital investment for dividend growth**

Capital and investment expenditure totalled £1,443.7m in 2010/11, an increase of 9.8%. SSE has invested around £1.5bn in assets which were still largely under construction at 31 March 2011 and which have yet to make a meaningful contribution to earnings.

### **Delivering...effective financial management**

Adjusted net debt and hybrid capital was £5.89bn at 31 March 2011, up from £5.29bn the previous year. This was lower than expected because of capital expenditure phasing, lower cash dividend payments because of the Scrip dividend scheme and strong operating cash flow through successful working capital management.

### **Delivering...a strong debt structure**

Of SSE's £4.9bn of medium- to long-term borrowings, just over £100m will mature in 2011/12. SSE's average debt maturity is 10.6 years. Its adjusted net debt includes cash and cash equivalents totalling £476.9m. SSE successfully issued hybrid capital during 2010/11.

### **Delivering...significant progress in large capital projects**

Key milestones have been reached in each of SSE's large capital projects, and in the repair of the Glendoe hydro electric scheme. There remain contractual issues between Greater Gabbard Offshore Winds Ltd and its principal contractor.

### **Delivering...opportunities for future investment**

While adhering to the criteria for a single 'A' credit rating SSE has maintained the financial flexibility to pursue the best opportunities for future investment, such as the 68-85MW wind farm development with consent for construction which it has acquired from RES. The development is close to SSE's power station at Keadby.

### **Delivering....sector-leading customer service**

SSE now has over 10 million customer accounts across Great Britain and Ireland, including electricity, gas and home services. It maintained its leading position in the main independent surveys of customer service in energy supply in Great Britain and has increased customer numbers in Ireland to over 500,000.

### **Delivering...first steps in upstream gas**

SSE has taken its first steps in the upstream gas sector with the acquisition from Hess Limited of North Sea natural gas and infrastructure assets and the agreement with Faroe Petroleum plc (in which it has taken a 5% stake) to work together to acquire producing North Sea oil and gas assets.

## STRATEGY

### **Strategy designed for dividend growth**

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

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

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

The delivery of annual above-inflation increases in the dividend paid to shareholders is a clear, measurable and practical goal which sets the long-term financial context for SSE's operational and investment decisions.

### **Financial discipline underpinning dividend growth**

The requirement on SSE to maintain a disciplined, consistent and long-term approach to management is underpinned by a series of financial principles:

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

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

### **Delivering dividend growth – a twelfth successive increase**

For 2010/11, the Board is recommending a final dividend of 52.6p per share, making a full-year dividend of 75p, an increase of 7.1% on the previous year. The full-year dividend is covered 1.5 times by SSE's adjusted profit after tax\* and is more than double the dividend per share paid eight years ago, in 2002/03.

The recommended full-year dividend increase of 7.1% represents the twelfth successive above-inflation dividend increase since SSE paid its first full-year dividend in 1999. SSE is one of just six FTSE 100 companies to have delivered better-than-inflation dividend growth every year during this period, and ranks fourth amongst that group in terms of compound annual growth rate over that time.

Of the 50 companies which have been FTSE 100 constituents since 1998 SSE is ranked eighth for Total Shareholder Return.

### **Targeting further dividend increases**

According to Capita Registrars Dividend Monitor, published in February 2011, dividend payments by UK companies fell by 3.3% in 2010. This followed a 15% fall in 2009. As Capita said: 'Dividends are too often overlooked as a component of company return... A company's value depends, most fundamentally of all, on the ability of the firm to make money and return

it to shareholders. Ultimately, dividends are the principal way in which corporate profits are distributed.'

Dividends are certainly not overlooked at SSE, as is evidenced by the fact its key financial objective is the delivery of sustained annual above-inflation increases in the dividend paid to shareholders. In view of this, SSE's targets are to deliver:

- a full-year dividend increase of at least 2% more than Retail Price Index (RPI) inflation for 2011/12;
- a full-year dividend increase of at least 2% more than RPI inflation for 2012/13; and
- annual RPI-plus dividend increases thereafter.

In this context, inflation is defined as the average annual rate across each of the 12 months to March. SSE believes that these targets can be achieved while maintaining a dividend cover around its established range.

#### **Diversity maintained for dividend growth**

SSE is unique among companies listed on the London Stock Exchange in owning and operating a balanced group of economically-regulated energy businesses, such as electricity networks, and market-based energy businesses, such as electricity generation and energy supply. It is thus able to pursue operational, investment and acquisition opportunities throughout the electricity and gas sector to help achieve the levels of profitability required to support sustained real dividend growth.

This is because SSE is able to derive:

- stable and relatively predictable levels of profit from its economically-regulated energy networks; and
- more variable levels of profit, but also greater potential for growth, from its market-based businesses such as Generation and Supply.

As a result of this balance, SSE has greater resilience to risks associated with shorter-term trends or individual issues within its sector or the wider economy than do other companies which have less diversity within their business model.

Moreover, SSE's strategy of maintaining a balanced range of economically-regulated and market-based energy businesses provides a broad platform from which to maintain sustained real dividend growth. This breadth is illustrated by the fact that:

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

These businesses, assets and investment options are almost entirely in Great Britain and Ireland. This means SSE is able to focus closely on issues, giving greater experience, analysis and focus to the identification, consideration and management of issues and opportunities. It has, therefore, diversity with depth.

#### **Delivering dividend growth in the future**

The context for delivering future dividend growth is set by the EU Climate Change and Renewable Energy Package, which aims to achieve by 2020:

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

In addition, the EU has a non-binding target to achieve a 20% reduction in energy consumption by 2020.

Against this background, the new UK government published its Annual Energy Statement in July 2010. Its goal is to support the transition to a 'secure, low-carbon, affordable' energy system in the UK and mobilise commitment to ambitious action on climate change internationally.

In its Programme for a National Government, the new government of the Republic of Ireland said in March 2011 that 'we will publish a Climate Change Bill which will provide certainty surrounding government policy and provide a clear pathway for emissions reductions, in line with negotiated EU 2020 targets'.

The European Commission adopted, in November 2010, a 'strategy for competitive, sustainable and secure energy'. It said that Europe's energy sector is on the threshold of 'an unprecedented period of change... to diversify existing resources and replace equipment and to cater for challenging and changing energy requirements'.

### **Sector developments to be faced over the next decade**

Against this background, a large number of issues in the energy sector will have to be faced over the next decade. They include:

- a likely surge in the global demand for energy as emerging economies industrialise;
- a potential plateau in oil production as a result of which supply will be unable to keep pace with demand;
- a greater understanding of the output potential, cost and environmental impact of shale gas;
- the closure of a number of coal- and oil-fired power stations by 2015, under the EU's Industrial Emissions Directive;
- the end of the design life of many nuclear power stations, with a number of advanced gas-cooled reactor (AGR) stations scheduled to close;
- the impact of the increasing age and relative inefficiency of a number of gas-fired power stations;
- the increasing requirement for renewable sources of energy in response to legally-binding targets set for Member States under the EU Renewable Energy Directive;
- the requirement for flexible electricity generation capacity to respond to variations in output from renewable energy;
- implementation of potentially significant reforms to the Great Britain wholesale electricity and retail energy markets;
- continued downward pressure on energy consumption, with the possible EU adoption of legally-binding energy efficiency targets;
- the digitisation of energy supply following the roll-out of smart meters to all customers in Great Britain;
- the implementation of the RIIO (Revenue = Incentives + Innovation + Output) model for economic regulation of energy networks;
- an upgrading of transmission and distribution networks to accommodate new, and more decentralised, sources of electricity;
- increasing interconnection between electricity systems; and
- significant regulatory and political scrutiny of all aspects of the energy sectors in Great Britain and Ireland and at EU level.

SSE believes that the scale and significance of these issues are, in themselves, very good reasons for it to maintain a balanced and diverse range of energy businesses, so it can exploit opportunities and manage risks. More broadly, it believes that energy, as something which people *need* rather than *want*, will become increasingly valued, in the broad sense of the word. This means that SSE's strategy – the efficient delivery of operations and investments - should enable it to deliver above-inflation dividend increases in the decade ahead.

### **Delivery priorities for SSE**

SSE believes that these 'challenging and changing energy requirements' mean the following priorities should feature in its business activities:

- **Networks:** delivering upgraded electricity transmission networks and operational efficiency and innovation in electricity and gas distribution networks as they respond to the decarbonisation and decentralisation of energy;
- **Generation:** investing in the new capacity for renewable energy that will be needed in the transition to a lower-carbon economy while maintaining diversity in the type of assets owned, and the type of fuels used, to generate electricity to support security of supply;
- **Supply:** evolving from the simple retailing of electricity and gas to the provision of a broader range of smarter products and services consistent with the long-term decarbonisation of energy production and consumption;
- **Gas Production:** securing medium- and long-term gas supplies to meet future energy needs; and
- **Gas Storage:** reinforcing the security of energy supplies by providing storage capacity, as UK imports of gas rise.
- **Energy and Utility Services:** providing key services for private and public sector organisations as they seek to install or upgrade existing energy and utility infrastructure.

As the energy company with the broadest range of operations in the UK and the fastest rate of growth in Ireland, SSE is well-placed to capitalise on the variety of operational and investment opportunities that are presenting themselves in the energy sector, without being over-exposed to risks associated with any of them.

#### **Delivery depends on safe and sustainable working**

While SSE's first financial responsibility to shareholders is to deliver above-inflation increases in the dividend, it will only be able to achieve this if it exercises a wider corporate responsibility. It seeks to do this by maintaining a strong emphasis on its six core values, the 'SSE SET' of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork.

Safety comes first in every sense. SSE believes that the effective management of safety issues is a barometer of effective management of all operational and investment-related activities. In 2010/11, its Total Recordable Injury Rate per 100,000 hours worked fell from 0.14 to 0.12. SSE's ultimate goal is injury-free working and its Safety Management System is designed to achieve this by focusing on the five 'Ps' of:

- Policy;
- People;
- Processes;
- Plant; and
- Performance.

In addition, and in keeping with its commitment to sustainability, SSE's target for every year is zero environmental incidents which result in it being served with a formal statutory notice by a government-sponsored environment protection agency. There were no such incidents during 2010/11. More broadly, SSE's sustainability priorities are to:

- reduce emissions of greenhouse gases, especially carbon dioxide;
- facilitate customers' carbon dioxide reductions;
- use resources efficiently and with the minimum possible waste; and
- avoid pollution and improve environmental practice.

#### **The outlook for 2011/12 and beyond**

The economic outlook for the UK and Ireland in 2011/12 continues to be uncertain, and the global nature of energy markets means that SSE, like every other company in the sector, has to be prepared to manage the energy consequences of exceptional and unpredictable events such as political upheaval in the Middle East and the March 2011 earthquake and tsunami in Japan.

Against this uncertain background, and with its strategic focus on efficiency in operations and investment, SSE's core operational priorities during 2011/12 are to:

- carry out all work in a safe and responsible manner, with a lower Total Recordable Injury Rate;
- maintain strong cost control throughout all business activities;
- distribute electricity and (through Scotia Gas Networks) gas with the minimum possible interruptions to supplies;
- demonstrate innovation in the management of electricity and gas networks;
- optimise the management of its portfolio of energy assets and contracts;
- ensure power stations maintain a high level of availability to generate electricity in response to customers' needs and market conditions;
- improve the standards of service delivered to energy supply customers and build on its sector-leading performance;
- develop and sustain long-term relationships and contracts with key customers of its other energy and utility services; and
- work with the UK government and Ofgem to secure a stable and competitive framework for electricity generation and energy supply.

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

- commissioning new assets in renewable energy, electricity networks and gas storage which contribute to the diversity of its portfolio;
- meeting other development and construction milestones in its investment programme;
- taking forward the wide range of additional options that it has identified for investment from the middle of this decade onwards, especially in electricity generation; and
- preparing for the transformation of energy supply, characterised by the forthcoming roll-out of smart meters in Great Britain.

The delivery of a strong operational performance and the achievement of its investment priorities should enable SSE to discharge its first financial responsibility to shareholders: to deliver its targets for annual dividend growth.

## FINANCE

### Focus on Adjusted Profit Before Tax\*

These results for the year to 31 March 2011 are reported under International Financial Reporting Standards, as adopted by the EU. SSE's focus has consistently been, and remains, on profit before tax before exceptional items, remeasurements arising from IAS 39, and after the removal of taxation on profits from jointly controlled entities and associates.

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

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

The tables below reconcile SSE's reported profit before tax to its adjusted profit before tax\* and set out the position after tax and in respect of adjusted earnings per share\*.

	Mar 11 £m	Mar 10 £m	Mar 09 £m
<b>Adjusted Profit before Tax*</b>	<b>1,310.1</b>	<b>1,290.1</b>	<b>1,253.7</b>
Movement on derivatives (IAS 39)	1,423.3	399.8	(1,262.1)
Exceptional items	(625.0)	-	102.7
Tax on JCEs and Associates	3.3	(51.3)	(40.4)
Interest on convertible debt	-	-	(0.6)
<b>Reported Profit before Tax*</b>	<b>2,111.7</b>	<b>1,638.6</b>	<b>53.3</b>

	Mar 11 £m	Mar 10 £m	Mar 09 £m
Adjusted Profit Before Tax*	1,310.1	1,290.1	1,253.7
Adjusted current tax charge	(268.2)	(274.1)	(300.4)
<b>Adjusted Profit after Tax*</b>	<b>1,041.9</b>	<b>1,016.0</b>	<b>953.3</b>
<b>Reported Profit after Tax</b>	<b>1,504.5</b>	<b>1,235.5</b>	<b>112.3</b>
Number of shares for basic and adjusted EPS (million)	<b>927.6</b>	<b>921.9</b>	<b>883.0</b>
<b>Adjusted EPS*</b>	<b>112.3p</b>	<b>110.2p</b>	<b>108.0p</b>
<b>Basic EPS</b>	<b>162.2p</b>	<b>134.0p</b>	<b>12.7p</b>

### Increasing Adjusted Profit Before Tax\* in 2010/11

Adjusted profit before tax\* rose by 1.6%, from £1,290.1m to £1,310.1m. The increase in adjusted profit before tax\* is mainly attributable to growth in **Energy Networks** as a result of:

- changes in the price of electricity units distributed following the introduction of the new Price Control for 2010-15;
- increased allowed revenue in respect of the electricity transmission network; and
- the continued focus on efficiency and cost control in the networks businesses.

At the same time, however, adjusted profit before tax\* was constrained by the following issues in **Generation and Supply**:

- the lower-than-expected output of renewable energy from SSE's hydro electric schemes and wind farms, including that qualifying for Renewable Obligation Certificates, due to relatively dry and still weather conditions;

- the higher-than-forecast wholesale gas prices;
- the underlying reduction of almost 2.5% in electricity consumption by household customers in the GB market; and
- the increase in some costs in Generation, such as operations, maintenance and business rates.

The financial performance of **Other Energy and Utility Services** (Gas Production; Gas Storage; Contracting, Utility Solutions and Metering; and Telecoms) was mixed. There was, for example, the decline in the price attained for Standard Bundled Units of gas storage capacity. At the same time, however, the expansion in recent years of SSE's metering activities, along with strong performance in particular areas such as lighting services, supported profitability.

#### **Movement on derivatives (IAS 39)**

At 31 March 2011, there was a net derivative financial asset in SSE's balance sheet arising from IAS 39 of £438.8m, before tax, compared with a net liability of £985.1m, before tax, at 31 March 2010. These balances principally relate to some of the forward commodity purchase contracts for gas, coal, oil, carbon and wholesale electricity that SSE, like all major energy suppliers, has to enter into to ensure that the future requirements of its customers are met. IAS 39 requires SSE to record these contracts at their 'fair value'.

This involves comparing their contractual price against the prevailing forward market price at the financial year end. At 31 March 2011 the average contractual price was lower than the market price (in other words, 'in the money'). The market price rose particularly significantly towards the end of the financial year in response to developments in the Middle East and Japan. The actual value of the contracts will be determined as the relevant commodity is used to meet customers' energy needs. For around 60% of the total energy volume, this will be over the next 12 months. As a result, SSE believes the movement in fair value of the contracts is not relevant to the financial year in question, in this case 2010/11.

The movement on derivatives under IAS 39 of £1,423.3m shown in the table above and on the face of the Income Statement is primarily due to the contrast between the 'in the money' position at 31 March 2011 and the 'out of the money' position that existed on 31 March 2010, when the average contractual price was higher than the prevailing forward market price. SSE sets out these movements in fair value separately, as re-measurements, as the extent of the actual profit or loss arising over the life of the contracts giving rise to this liability will not be determined until they unwind.

#### **Exceptional items**

The pre-tax exceptional item of £625.0m relates to impairment and other charges against the value of some electricity generation plant. Almost all of the total is non-cash and is mainly due to:

- the expiry of certain tolling arrangements at SSE's associate investments, Barking Power Ltd and Derwent Cogeneration Ltd, and to low 'spark' spreads associated with gas-fired generation;
- the impact of low 'spark' spreads and a reduced economic life attributable to the Keadby and Medway power stations;
- the new Industrial Emissions Directive-related restrictions on running hours at SSE's Fiddler's Ferry and Ferrybridge power stations from 2015, and the stations' probable closure in 2023, in accordance with the terms of the IED; and
- a range of issues relating to the operation and continuing rationalisation of SSE's portfolio of renewable and sustainable energy developments, such as the SSE Mineral Solutions (formerly RockTron (Widnes) Ltd) plant at Fiddler's Ferry, and development assets in Germany, which were disposed of during 2010/11.

#### **Delivering Adjusted Profit Before Tax\* in 2011/12**

SSE's emphasis is on adjusted profit before tax\* on a full-year, as opposed to half-year, basis. Since it first reported full-year results in 1999 it has delivered 12 successive increases in adjusted profit before tax\*.

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

SSE's adjusted profit before tax\* in any single year will always be determined by issues such as:

- the availability of its gas- and coal-fired power stations to generate electricity;
- the performance of assets in gas production and gas storage;
- the output of renewable energy from its hydro electric stations and wind farms;
- the impact of the weather on energy production and consumption;
- the actual underlying level of customers' energy consumption;
- the interaction between wholesale prices for energy and fuel and the prices for the electricity and gas charged to customers; and
- the timely commissioning of new assets.

In terms of 2011/12, SSE believes that its balanced range of market-based and economically-regulated energy businesses, and the diversity of opportunities within those businesses, should deliver a level of adjusted profit before tax\* capable of supporting the achievement of its principal financial objective, a full-year dividend increase of at least 2% more than RPI inflation, while maintaining dividend cover around the established range.

SSE will provide an update on its financial, operational and investment progress during 2011/12 when it presents its results for the six months to 30 September 2011. It does not, however, expect to provide an outlook for adjusted profit before tax\* in 2011/12 before the publication of its Interim Management Statement in early 2012, not least because its principal financial objective is dividend growth.

#### **Increasing Adjusted Earnings Per Share\* in 2010/11**

To monitor financial performance over the medium term, SSE continues to focus on adjusted earnings per share\* because it has the straightforward benefit of defining the amount of profit after tax that has been earned for each Ordinary Share and so reflects a clear view of underlying financial performance. In 2010/11, SSE's adjusted earnings per share\* were 112.3p, based on 927.6 million shares, compared with 110.2p, based on 921.9 million shares, in the previous year.

## **Dividend**

#### **Increasing the Final Dividend for 2010/11**

SSE's first financial responsibility to its shareholders is to remunerate their investment through the delivery of sustained, above-inflation increases in the dividend. The Board is recommending a final dividend of 52.6p per share, compared with 49p in the previous year, an increase of 7.3%. This will make a full-year dividend of 75p, which is:

- an increase of 7.1% compared with 2009/10;
- a real-terms increase of 2.2%, based on the average annual rate of RPI inflation in the UK between April 2010 and March 2011, which exceeds the target of 2%;
- the twelfth successive above-inflation dividend increase since the first full-year dividend of 25.7p paid by SSE for 1998/99;
- double the dividend paid in 2002/03, since when there has been compound annual growth of 10%; and
- covered 1.5 times by SSE's adjusted profit after tax\*.

#### **Targeting further dividend increases in 2011/12 and beyond**

SSE is aiming to deliver an increase in the full-year dividend of at least 2% more than RPI inflation in 2011/12. The same target is in place for 2012/13, with sustained annual real growth thereafter also being targeted.

### Scrip Dividend Scheme option for shareholders

At the Annual General Meeting in July 2010, SSE's shareholders approved the introduction of a Scrip Dividend Scheme, to give them the option to receive new fully paid ordinary shares in the company in place of their cash dividend payments. Scrip dividend take-up was as follows:

- **September 2010:** 30,841 shareholders elected to receive the final dividend of 49p per share, in respect of 172,173,451 ordinary shares, in the form of Scrip dividend. This resulted in the issue of 7,524,682 new ordinary shares, fully paid, an increase of 0.82% on the issued share capital at the dividend record date of 30 July 2010; and
- **March 2011:** 30,482 shareholders elected to receive the interim dividend of 22.4p per share, in respect of 275,550,234 ordinary shares, in the form of Scrip dividend. This resulted in the issue of 5,264,873 new ordinary shares, fully paid, an increase of 0.57% on the ordinary issued share capital at the dividend record date of 28 January 2011.

This had the effect of reducing by £146.1m the amount of dividends paid in cash during 2010/11. The total number of shares in issue at 31 March 2011 was 936.9 million.

### Investment and Capital Expenditure

Investment and Capex Summary	Mar 11 £m	Mar 10 £m
Thermal Generation	126.5	146.2
Renewable Generation	784.4	666.6
Gas Storage	52.6	46.3
Electricity Networks	328.5	334.5
Other	151.7	121.6
<b>Total investment and capital expenditure</b>	<b>1,443.7</b>	<b>1,315.2</b>
<b>50% of SGN capital/replacement expenditure</b>	<b>199.7</b>	<b>206.4</b>

#### Investing for sustained dividend growth

SSE's capital and investment expenditure totalled £1,443.7m, building on the expenditure of £1,315.2m in the previous year. During 2010/11:

- the investment of £126.5m in **thermal generation** included work at Peterhead power station to enhance its ability to operate on a 'two shift' basis;
- the investment of £784.4m in **renewable generation** included SSE's share of the investment at the Greater Gabbard and Walney offshore wind farms;
- the investment of £52.6m in **gas storage** included £29.4m invested in the new facility at Aldbrough, which takes the total invested by SSE in this development to £237.3m; and
- the investment of £328.5m in **electricity networks** included £28.6m on works related to the upgrade of the Beaulieu-Denny transmission line.

Including investment of £165.4m in 2010/11, SSE's cumulative investment in Greater Gabbard is now £538m, excluding transmission costs.

A total of £1.5bn has been invested by SSE in assets which were still largely under construction at 31 March 2011. The majority of these assets will make some contribution to SSE's earnings in 2011/12.

SSE is committed to constructing robust assets, from which revenue can be generated on a reliable basis and which support future dividend growth. This entails rigorous scrutiny and control of the costs of large capital projects but also a clear focus on the return which completed projects will generate.

In line with this, SSE keeps the economic evaluation of its investment programme under continuous review and remains confident that significant value is being created from its capital

and investment expenditure programme, based on actual project delivery and on the most up-to-date project costs and schedules.

In addition to its own capital and investment expenditure programme, SSE effectively has a 50% interest in Scotia Gas Networks' capital and replacement expenditure, through its 50% equity share in that business. SGN is self-financing and all debt relating to it is separate from SSE's balance sheet. Nevertheless, it is a very substantial business which gives SSE, through its 50% stake, a major interest in gas distribution.

In 2010/11, a 50% share of SGN's capital and replacement expenditure was £199.7m, compared with £206.4m in the previous year. SGN's total capital investment in 2010/11 was £142.7m, taking the amount so far for the 2008-13 gas Distribution Price Control period to £668.0m.

### **Future investment priorities in 2011/12 and beyond**

In November 2010, SSE announced that it expects that its investment and capital expenditure will be in the range of £1.5bn to £1.7bn in each of the five years to March 2015. Capital and investment expenditure is expected to be around £1.7bn during 2011/12.

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

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

Around one third of the potential total spend over the four years to 2015 is in the uncommitted category and the majority of the uncommitted spend would be incurred towards the end of the period. It will only be incurred if it is consistent with SSE's financial principles.

A programme with these principles, this shape and on this scale is designed to allow SSE to maintain the development of a balanced and diverse range of assets to support sustained, above-inflation dividend growth while remaining consistent with the criteria for a single A credit rating without the need to issue new shares. Each individual investment decision will be made:

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

SSE's investment programme will deliver:

- a significantly-enhanced asset base in key businesses, including economically-regulated electricity networks;
- additional fuel for electricity in the form of renewable sources of energy; and
- additional cash flows and profits to support future dividend growth.

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

### **Delivering investment efficiently**

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

- consistent with SSE's financial principles and so should achieve returns which are greater than the cost of capital (with a risk premium applied to the expected rate of

- return from individual projects where appropriate), enhance earnings and contribute to dividend growth; and
- governed, developed, approved and executed in an effective manner, consistent with SSE's Large Capital Project Governance Framework which is, in itself, regularly updated.

In October 2010, to help ensure the effective implementation of this framework, and in keeping with its long-standing approach of retaining specialist contractors to assist with major developments, SSE appointed KBR, a leading engineering, procurement and construction company, as Project Management Partner to help maintain the processes, systems and skills needed to deliver large capital projects and to act as SSE's 'critical friend' in this area.

KBR teams have now been established alongside SSE teams and are supporting a range of individual projects as well as contributing to overall project management and reporting. As a result, KBR is supplementing and complementing the work done by SSE's four in-house specialist large capital projects teams which cover:

- onshore renewable energy developments;
- offshore renewable energy developments;
- thermal generation developments (including SSE's interests in nuclear power); and
- electricity transmission upgrades.

These teams were augmented in 2010/11 to increase further SSE's capacity to manage major projects, and ensuring there is enough senior management and other types of resource in place to support the delivery of the projects will remain a key priority for SSE.

## Financial management and balance sheet

Key Performance Indicators	Mar 11	Mar 10
Adjusted net debt and hybrid capital (£bn)	5.891	5.292
Average debt maturity (years)	10.6	11.0
Underlying interest cover (excluding SGN)	7.3	6.3
Shares in issue at 31 March (m)	936.9	923.1
Shares in issue (weighted average) (m)	927.6	921.9

### Maintaining a prudent treasury policy

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

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

As a matter of policy, a minimum of 50% of SSE's debt is subject to fixed, or inflation-linked, rates of interest. Within this policy framework, SSE borrows as required on different interest bases, with derivatives and forward rate agreements being used to achieve the desired out-turn interest rate profile. At 31 March 2011, after taking account of interest rate swaps, over 70% of SSE's borrowings were at fixed rates.

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

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

- procurement contracts;
- fuel and carbon purchasing;

- commodity hedging and energy trading operations; and
- long-term service agreements for plant.

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

#### Managing net debt and maintaining cash flow

SSE's adjusted net debt and hybrid capital was £5.891bn at 31 March 2011, compared with £5.292bn at 31 March 2010. This was lower than expected because of:

- lower than forecast capital expenditure;
- lower cash dividend payments because of the Scrip dividend scheme; and
- strong operating cash flow through improved working capital management, particularly in reducing energy customers' aged debt and in SSE Contracting.

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

<b>Adjusted Net Debt</b>	<b>Mar 11</b>	<b>Mar 10</b>
	£m	£m
Loans and Borrowings	(5,606.4)	(6,047.0)
Cash and Cash Equivalents	476.9	261.7
<b>Unadjusted Net Debt</b>	<b>(5,129.5)</b>	<b>(5,785.3)</b>
Less: Finance Leases	372.2	384.4
Add: Outstanding Liquid Funds	28.1	108.7
<b>Adjusted Net Debt</b>	<b>(4,729.2)</b>	<b>(5,292.2)</b>
Add: hybrid capital	(1,161.4)	-
<b>Adjusted Net Debt and hybrid capital</b>	<b>(5,890.6)</b>	<b>(5,292.2)</b>

Shortly after the end of the financial year, in April 2011, SSE received proceeds of £178.4m relating to the sale of its equity interest in three onshore wind farms.

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

SSE's objective is to maintain a balance between continuity of funding and flexibility, with debt maturities staggered across a broad range of dates. Its average debt maturity as at 31 March 2011 was 10.6 years, compared with 11.0 years at 31 March 2010.

SSE's debt structure remains strong, with around £4.9bn of medium- to long-term borrowings in the form of issued bonds, European Investment Bank debt and long-term project finance and other loans. In addition, in September 2010, SSE issued hybrid capital of £1.16bn (see table above and 'Ensuring investment is well-financed' below). The balance of SSE's adjusted net debt is financed with short-term commercial paper and bank debt. SSE's adjusted net debt includes cash and cash equivalents totalling £476.9m.

Just over £100m of medium-to-long-term borrowings will mature in the year to 31 March 2012.

#### Ensuring investment is well-financed

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

- 'A-', with a 'stable' outlook (Standard & Poors; reaffirmed in June 2010); and

- 'A3' with a 'stable' outlook (Moody's; reaffirmed in July 2010).

SSE is committed to maintaining financial diversity and will move quickly to take the right financing options, including issuing new bonds and loans. During 2010/11 it:

- signed an amendment agreement with banks to extend its revolving credit facilities (£1bn) by three years, to 2015, and reduce its price by around £5m per annum. The facility is, and is expected to remain for the foreseeable future, undrawn, and SSE's liquidity position is very strong; and
- launched an issue of hybrid capital, a financial instrument which brings together features of both debt and equity and is perpetual and subordinate to all senior creditors. The dual tranche issue comprised £750m and €500m and has an all-in funding cost to SSE of around 5.6% per annum. There is no fixed redemption date but SSE may, at its sole discretion, redeem all, but not part of, these bonds at their principal amount on 1 October 2015 or 1 October 2020 or any subsequent coupon payment date.

The hybrid capital issue in Sterling was the first ever by a UK-listed company outside the financial services sector, and the launch was the first ever by a utility company which is not state-owned. It provides another source of attractively-priced funding for SSE to complement its already well-financed investment programme.

Indeed, the well-financed nature of SSE's investment programme has resulted in some external analysis suggesting that its commitment to the criteria for a single A credit rating could result in it missing out on opportunities to increase earnings. SSE believes, however, that it has sufficient financial flexibility to pursue the best opportunities to increase earnings. At the same time, it also believes that history – most recently the 'credit crunch' – demonstrates how companies with a commitment to the long term must be disciplined when managing their balance sheets and cautious in financing their activities.

### Net Finance Costs

The table below reconciles reported net finance costs to adjusted net finance costs, which SSE believes is a more meaningful measure. In line with this, SSE's adjusted net finance costs during 2010/11 were £342.8m, compared with £335.9m in the previous year.

	Mar 11 £m	Mar 10 £m
Reported net finance costs	256.1	265.3
add/(less):		
Share of JCE <sup>1</sup> /Associate interest	139.9	107.1
Exceptional charges	(8.8)	-
Movement on derivatives	(44.4)	(36.5)
<b>Adjusted net finance costs</b>	<b>342.8</b>	<b>335.9</b>
Return on pension scheme assets	141.9	100.7
Interest on pension scheme liabilities	(150.2)	(127.5)
Finance lease interest	(39.7)	(13.2)
Notional interest arising on discounted provisions	(4.3)	(3.5)
<b>Adjusted interest costs<sup>2</sup></b>	<b>290.5</b>	<b>292.4</b>

<sup>1</sup>Jointly Controlled Entities      <sup>2</sup>Adjusted finance income and costs for interest cover calculation

There was no charge for hybrid debt interest during the year. In future, any charge will be presented within dividends and reflected within adjusted earnings per share\*.

The average interest rate for SSE, excluding JCE/Associate interest, during the year was 5.43%, compared with 5.35% for the previous year. Based on adjusted interest costs, SSE's underlying interest cover was (previous year's comparison in brackets):

- 7.3 times, excluding interest related to SGN (6.3 times); and
- 5.7 times, including interest related to SGN (5.6 times).

Excluding shareholder loans, SGN's net debt at 31 March 2011 was £3.16bn, and within the adjusted interest costs of £290.5m, the element relating to SGN's net finance costs was £90.4m (compared with £63.0m in the previous year), after netting loan stock interest payable to SSE. Its contribution to SSE's adjusted profit before tax\* was, therefore, £96.4m, compared with £120.7m in the previous year.

### Contributing to employees' pension schemes

In line with the IAS 19 treatment of pension scheme assets, liabilities and costs, pension scheme liabilities of £668.6m are recognised in the balance sheet at 31 March 2011, gross of deferred tax. This represents a decrease in net liabilities of £51.7m compared with the position at March 2010, principally due to deficit repair contributions made to schemes.

During 2010/11, employer cash contributions amounted to:

- £48.5m for the Scottish Hydro Electric scheme, including deficit repair contributions of £29.5m; and
- £58.1m for the Southern Electric scheme, including deficit repair contributions of £38.8m.

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

## Tax

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

	Mar 11 £m	Mar 10 £m
Reported tax charge	607.2	403.1
add back:		
Share of JCE/Associate tax	(3.3)	51.3
less:		
Deferred tax	(83.3)	(69.4)
Tax on exceptional items/certain remeasurements	(252.4)	(110.9)
<b>Adjusted current tax charge</b>	<b>268.2</b>	<b>274.1</b>

The effective adjusted current tax rate, based on adjusted profit before tax\*, was 20.5%, compared with 21.2% in the previous year, on the same basis. The impact of SSE's higher capital expenditure programme and the changes introduced in Budget 2007 have had, and will continue to have, a positive impact on the effective current tax rate.

The Emergency Budget in June 2010 and Budget 2011 announced a series of annual reductions in the UK Corporation Tax rate for future years. The deferred tax balance has been remeasured to reflect the first of these rate reductions (from 28% to 26%) and the effect of this has been disclosed as an exceptional item. The deferred tax balances for future years will be remeasured as each subsequent rate reduction is enacted.

Budget 2011 also included an increase in Supplementary Corporation Tax, which has had an impact on SSE's recently-acquired gas production assets, the effect of which has also been disclosed as an exceptional item.

The reported tax charge for 2010/11 is £607.2m, compared with a tax charge of £403.1m in the previous year. The increase reflects the deferred tax associated with the mark to market movements on derivatives, and the impairment of fixed assets.

SSE's cash contribution to government revenues in the UK, including Corporation Tax, Employers' National Insurance Contributions and Business Rates, totalled £507.5m during 2010/11, compared with £474.6m in the previous year. The total includes joint ventures and associates.

## Further information

### Disclaimer

This financial report contains forward-looking statements about financial and operational matters. Because they relate to future events and are subject to future circumstances, these forward-looking statements are subject to risks, uncertainties and other factors. As a result, actual financial results, operational performance and other future developments could differ materially from those envisaged by the forward-looking statements.

### Provisional Investor Timetable

Annual Report 2011 on website	
AGM (Perth)	21 July 2011
Ex-dividend date	27 July 2011
Record date	29 July 2011
Final date for Scrip Elections	25 August 2011
Payment date	23 September 2011
Interim results (provisional)	9 November 2011

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### Analysts' presentation

Start: 0900 (BST)

Location: The Lincoln Centre, 18 Lincoln's Inn Fields, London WC2A 3ED

#### Webcast facility

You can join the webcast by visiting [www.sse.com](http://www.sse.com) and following the link on the homepage.

#### Conference call

UK +44 (0)20 7138 0836

US +1 718 354 1172

When asked please provide conference number **7214233**.

### Online information

News releases and announcements are made available on SSE's website at [www.sse.com](http://www.sse.com). You can also follow the latest news from SSE through Twitter at [www.twitter.com/sse](http://www.twitter.com/sse).

## NETWORKS

### A balanced group of energy network companies

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

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

The electricity networks transmit and distribute electricity to around 3.5 million businesses, offices and homes via almost 130,000km of overhead lines and underground cables and the gas networks distribute gas to around 5.7 million homes, offices and businesses via 75,000km of gas mains.

SSE estimates that the total Regulatory Asset Value (RAV) of its economically-regulated 'natural monopoly' businesses is now £5.36bn, comprising:

- £515m for electricity transmission;
- £2.70bn for electricity distribution; and
- £2.15bn for gas distribution (ie 50% of the businesses' total RAV of £4.3bn).

SSE is the only energy company in the UK to be involved in electricity transmission, electricity distribution and gas distribution. Together, these lower-risk economically-regulated natural monopoly businesses, featuring RPI inflation-linked revenue, provide a financial backbone and operational focus for SSE and balance its activities in the competitive Generation and Supply markets.

### Focus on operational and investment efficiency

The aim of economic regulation is to attract investment in electricity and gas networks and encourage companies to operate them as efficiently as possible. Against this background, SSE's objectives in energy networks are to:

- comply fully with all safety standards and environmental requirements;
- ensure that they are managed as efficiently as possible, including maintaining tight controls over operational expenditure;
- provide good performance in areas such as reliability of supply, customer service and innovation and thus earn additional incentive-based revenue under the various Ofgem schemes;
- deliver efficient and innovative capital expenditure programmes, so that the number and duration of power cuts and gas supply interruptions experienced by customers is kept to a minimum, and so that there is adequate capacity to meet demand on the electricity system;
- increase the RAV of the networks businesses and so secure increased revenue from them; and
- engage constructively with the regulator, Ofgem, to secure regulatory outcomes that meet the needs of customers and investors.

### Financial performance in Energy Networks

Operating profit\* in Energy Networks increased by 7.1%, from £599.5m to £642.3m, contributing 38.9% of SSE's total operating profit\*. This comprised:

- £455.5m in electricity networks, compared with £415.8m in the previous year; and
- £186.8m representing SSE's share of the operating profit\* for SGN, compared with £183.7m in the previous year.

<b>Energy Networks Key Performance Indicators</b>	<b>Mar 11</b>	<b>Mar 10</b>
<b>ASSETS</b>		
Electricity network Regulated Asset Value (RAV) - £bn	3.21	2.97
Gas network RAV (share) - £bn	2.15	1.97
<b>Total RAV of energy network assets - £bn</b>	<b>5.36</b>	<b>4.94</b>
Electricity network capital expenditure - £m	328.5	334.5
Gas network capital/replacement spend (share) - £m	199.7	206.4
<b>OPERATIONS</b>		
SEPD customer minutes lost	64	65
SEPD customer interruptions	64	61
SHEPD customer minutes lost	78	74
SHEPD customer interruptions	74	78
SEPD/SHEPD Performance-based revenue - £m	16.3	24.0
SGN uncontrolled gas escapes attended within one hour	97.2	97.9
SGN gas mains replaced - km	1,102	1,062
<b>VOLUME (TERA WATT HOURS – TWh)</b>		
SEPD electricity units distributed	33.6	33.7
SHEPD electricity units distributed	8.5	8.4
SGN gas volume transported (Scotland)	55.8	55.2
SGN gas volume transported (Southern)	110.4	107.8

## Electricity Distribution and Transmission

### Performance in Southern Electric Power Distribution

In Southern Electric Power Distribution (SEPD) in 2010/11:

- operating profit\* increased by 11.9% to £287.4m;
- electricity distributed fell by 0.1TWh to 33.6TWh;
- the average number of minutes of lost supply per customer was 64, down from 65;
- the number of supply interruptions per 100 customers was 64, up from 61; and
- performance-based additional income of £10.8m is expected to be earned, compared with the final out-turn of £15.8m in the previous year.

The increase in operating profit follows changes in the price of units distributed under the electricity Distribution Price Control for 2010-15, plus a continued focus on efficiency and cost control and some benefit from the 'over-recovery' of allowed income. Performance in respect of both minutes lost and interruptions was ahead of the targets set by Ofgem under its Interruptions Incentive Scheme (IIS), which gives financial benefits to distribution network operators that deliver good performance for customers. Performance-based income covers a number of issues, including the quality of service provided to customers and innovation.

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

In Scottish Hydro Electric Power Distribution (SHEPD) and Scottish Hydro Electric Transmission (SHETL) in 2010/11:

- operating profit\* increased by 5.8% to £168.1m;
- electricity distributed increased by 0.1TWh to 8.5TWh;
- the average number of minutes of lost supply per customer was 78, up from 74;
- the number of supply interruptions per 100 customers was 74, down from 78; and
- performance-based additional income of £5.5m is expected to be earned, compared with the final out-turn of £8.2m in the previous year.

The increase in operating profit reflects changes in the price of units distributed under the Price Control 2010-15, increased allowed revenue in respect of the transmission network and a continued focus on efficiency and cost control. Performance in respect of customer interruptions was ahead of the IIS targets set by Ofgem. The position on customer minutes

lost was negatively affected by the severe weather experienced in the north of Scotland in early March 2011.

### **Volume of electricity distributed**

The total volume of electricity distributed by SSE during 2010/11 was 42.1TWh unchanged from the previous year. Under the electricity Distribution Price Control for 2010-15, the volume of electricity distributed will no longer affect companies' overall allowed revenue. This has further reduced the level of risk associated with energy networks businesses.

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

SSE's two networks earned additional revenue of £59.4m in nominal prices in the five years to March 2010 for their performance in respect of Customer Interruptions and Customer Minutes Lost. On this measure, they were ranked first (SEPD) and fourth (SHEPD) among the 14 electricity distribution companies in Great Britain. This reflects effective investment in the automation of the networks and effective operational responses to electricity supply interruptions.

### **Operating electricity networks efficiently**

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

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

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

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

2010/11 was the first year of the electricity Distribution Price Control for 2010-15. The new Price Control changed the framework for operating and capital expenditure to remove the perceived bias in favour of the latter and to ensure the delivery of not only the investment itself but of agreed outputs from it. The most successful electricity distribution companies, therefore, will be those that apply efficiency and innovation to maximise outputs from agreed expenditure.

In response to this, SSE has undertaken a fundamental review of all of the processes around operating and capital expenditure, looking at every step in the value chain, in order to secure the maximum possible outputs from any expenditure. As a result, it has identified a number of solutions and interventions for wider deployment in 2010-15 to ensure its success throughout the Price Control period. This means SSE has robust and cost efficient network investment processes that deliver real value for customers. It has also identified a number of technological advancements that are delivering cost savings and minimising disruption.

For example, use of directional drilling units, a method of cable installation, is well established in SSE. The directional drill burrows underground holes for cables, resulting in minimum disturbance to the highway and thereby reduces disruption to the public and the costs associated with ground reinstatement. This has been taken a stage further with the first use in the UK for underground cable replacement of a 'wash-over' drill head, which injects water at high pressure to loosen soil around cabling. The old cable can then be removed and a new one installed along the same route. The idea was developed and introduced to SSE by an employee under its 'Licence to Innovate' scheme and in 2010/11 reduced open excavations/highway closures by an estimated 620 days.

Techniques such as these will be more widely deployed and developed during the new Price Control. Their deployment, plus good performance in response to Ofgem's enhanced

incentive mechanisms in areas such as customer service, and the headline allowed weighted average cost of capital, should enable SSE to achieve the post-tax real return in excess of 5% which it is targeting in electricity distribution.

Against this background, capital expenditure in electricity networks (including transmission and the Beaulieu-Denny upgrade – see below) during 2010/11 was £328.5m. The need for further significant investment in Great Britain's electricity networks, to maintain and/or replace ageing assets or to provide additional capacity, is likely to mean SSE will invest in 2011/12 around:

- £250m in its electricity distribution networks; and
- £220m in its electricity transmission network, including around £180m on upgrades, such as the replacement of the Beaulieu-Denny line (around £100m in the year).

Significant distribution projects include a £40m project to install new 132kV plant at Bracknell and Camberley substations and new 132kV cables between the substations. The project will help to meet demand for electricity in a key area between the M3 and M4 motorways and should be completed in 2014.

### **Making electricity networks smart**

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

SSE, with Smarter Grid Solutions Ltd, an associate company, has already deployed commercially smart grid technology on SSE's power distribution network on Orkney, allowing the connection of 15MW of extra new renewable energy generation, an increase of one third, with the potential for this to grow further. The Orkney Smart Grid is based on the principle that capacity exists in real-time on the power distribution grid due to variation in demand for electricity and diversity in the output of grid-connected generators. This innovative smart grid technology permits greater numbers of renewable generators to be connected to the existing electricity network, in a much cheaper and faster way than traditional means, by allowing generators to access power network capacity not normally available under conventional network planning requirements.

SSE has two other principal projects to support smart grid developments, working with a wide range of organisations and partners:

- **Northern Isles New Energy Solutions (NINES) in Shetland:** NINES features: installing 'smart' storage heaters and hot water tanks in up to 1,000 homes which can help balance the electricity network; adding a new electric boiler to the existing district heating system, which will be associated with the proposed medium-scale Gremista wind farm; deploying new technology on the network that will allow more small scale renewable generators to connect to the network; introducing new commercial arrangements to encourage businesses to change the times at which they use most energy; and installing a 1MW battery, part-funded by the Department for Energy and Climate Change, at Lerwick Power Station; and
- **Thames Valley Vision (TVV) in and around Bracknell:** TVV aims to demonstrate that applying new technologies to Bracknell's network will provide a lower cost alternative to redeveloping the substation to meet increasing electricity demand, with the potential to significantly reduce costs to customers. TVV involves: monitoring - measuring and understanding power flows and usage patterns; modelling - taking data produced by monitoring and applying sophisticated demand prediction techniques; and managing - installing network automation and constraint management systems, energy storage technologies and automated demand response to manage network flows predicted by modelling.

SSE is committed to making sure that both areas benefit from the ideas put forward. It is working with Ofgem to ensure sufficient funding is secured under the Price Control for 2010-15 to allow NINES to move forward. SSE aims to finance TVV with sums received from Ofgem's Low Carbon Networks Fund; it will submit a bid for funding in August 2011.

### **Supporting deployment of electric vehicles**

Electric vehicles (EVs) will be an essential part of the move towards a low-carbon transport infrastructure. The potential number of EVs on UK roads is predicted to be over one million by 2020. One study in 2010 forecast that EVs will overtake hybrids in UK market share and will reach a combined total of over 20% by the end of the decade.

Against this background, SSE has been a full participant in two EV projects - the MINI E and the Ford Transit Connect consortia. These are pioneering trials to evaluate the psychological, social and technical aspects of living with an all-electric vehicle.

- The MINI E consortium is led by BMW and includes SSE, Oxford Brookes University, the South East England Development Agency (SEEDA), Oxford City Council and Oxfordshire County Council.
- The Ford Transit Connect project is led by Ford and includes SSE, the University of Strathclyde and the London Borough of Hillingdon.

Financial support for both these projects has come from the Technology Strategy Board.

As part of the projects SSE completed, in January 2011, the installation of a public network of over 20 re-charging points in Oxford and a similar number in Hillingdon. In a pioneering move to further widen the availability of such charging points across the UK, the Oxford and Hillingdon networks are linked to a new 'sister' network in Milton Keynes, so drivers can charge their cars in any of these locations. This kind of 'interoperability' between the two networks will be crucial as electric cars become more popular in the decades ahead. SSE had already installed home charging points for each driver taking part in the project. It is planning other public charging points across central southern England.

SSE is also a major partner in the Mayor of London's ambitious "SourceLondon" scheme to install EV charging points in the capital, a major adopter of EV technology, and has already installed EV charging points in more than 20 NCP car parks as part of this project.

When their numbers become significant, EVs could change greatly the volume and pattern of electricity demand, and it is for this reason – in addition to supporting the low-carbon objectives behind them – that SSE is so actively involved in projects such as these.

### **Upgrading Scotland's electricity transmission network**

Scottish Hydro Electric Transmission Ltd (SHETL) is responsible for operating, maintaining and investing in the transmission network in its area, which serves around 70% of the land mass of Scotland. As the licensed transmission company for the area, SHETL has to ensure there is sufficient network capacity for those seeking to generate electricity from renewable and other sources within it.

A series of major developments have the potential to transform the scale and scope of SSE's electricity transmission business:

- **Knockna Gael Substation, Beaulieu-Blackhillock-Kintore and Beaulieu-Dounreay:** Ofgem has authorised pre-construction and construction funding for these three upgrades in the SHETL area, which form part of the first phase of transmission projects to help connect renewable energy to the electricity network. These projects have a total value of almost £200m and should all be completed between 2011 and 2015.
- **Beaulieu-Denny:** Scottish Ministers granted consents, with associated conditions, in January 2010, to install a 400kV overhead electricity transmission line to replace the existing 132kV overhead transmission line between Beaulieu and Denny. The existing line will be dismantled. Construction works in line with the £58.8m of initial funding authorised by Ofgem in September 2010 are well under way. Substantive progress

has also been made in satisfying conditions associated with Scottish Ministers' consent to replace the line which apply to the SSE section. Proposals were submitted to Ofgem in December 2010 for authorisation of the remainder of SSE's share of the project expenditure (around £500m). Independent consultants appointed by Ofgem have confirmed that SSE's submission represents 'a prudent assessment of efficient costs' and Ofgem will shortly undertake a consultation. Subject to that and to continued progress, full construction work on the replacement line, including the erection of new pylons, should begin later this year, with the replacement line being completed in 2014.

- **Beaully-Mossford:** SHETL has undertaken public consultations on the proposal to reinforce the existing 132kV electricity transmission infrastructure, including a new substation and a new line to accommodate a higher capacity. An application for consent to undertake the work was submitted to Scottish Ministers in January 2011. Based on early estimates, the two parts of the project are likely to require total investment of around £45m.
- **Shetland:** SHETL has now secured consent for converter stations associated with the proposed 320km subsea/25km onshore underground high voltage direct current (HVDC) transmission link between the Shetland Islands and Moray on the Scottish mainland to accommodate renewable energy developments in Shetland. The link would also connect properties in Shetland to the mainland electricity network for the first time. Related to this, in December 2009, the European Commission announced that SSE had been successful in securing a capital grant of up to €74m under the European Energy Programme for Recovery. The grant is towards the incremental cost of including an intermediate offshore HVDC hub off Caithness on the route of the proposed Shetland link and increasing the capacity of the southern section to Moray. The hub is at the centre of a potential, innovative three-ended 'Y' configuration, with legs from Caithness and Shetland to accommodate substantial planned renewable energy developments in the far north east of Scotland and the Northern isles and could be the first step towards an offshore 'super grid'.
- **Western Isles:** In October 2010, SHETL concluded that the lack of financial underwriting from electricity generators (attributed to the level of transmission charges) relating to the link from the Western Isles to the mainland meant it would not be able to conclude a contract for the supply of the necessary electricity cable. As a result, it withdrew its request to Ofgem for authorisation to make the investment. The project remains active and SSE will prepare a new request for authorisation to invest in the link as soon as these issues are resolved. In practice, this is likely to take around one year.

Based on current estimates (although these will inevitably be revised) the Shetland and Western Isles links could require investment of around £900m.

The charging arrangements for electricity and gas transmission networks are currently the subject of an Ofgem-sponsored independent review named Project TransmiT which was launched in September 2010. It is designed to ensure that the framework for transmission charging promotes security of supply and a low carbon future, while keeping the cost of transmission to customers under control. The outcome of Project TransmiT will have a bearing on the amount of electricity from renewable sources that is developed in Scotland and, therefore, on the way in which the transmission network is upgraded.

Looking to the longer term, SSE has participated in the Electricity Networks Strategy Group, sponsored by Ofgem and the UK Department of Energy and Climate Change and involving all of the transmission companies in Great Britain. It has identified a potential need for subsea cable links between Scotland and England known as 'bootstraps'. SSE expects to be a major participant in this and other transmission developments over the next decade and beyond.

#### **'Keeping the lights on and supporting growth'**

'Keeping the lights on and supporting growth' was the name given to the public consultation issued by Scottish Hydro Electric Transmission Ltd (SHETL) in February 2011 through which it sought the views of customers and other stakeholders on the key activities and investments

that should be included in its business plan for the new electricity Transmission Price Control that is due to run for eight years from 1 April 2013.

The consultation stemmed from Ofgem's new RIIO (Revenue = Incentives + Innovation + Outputs) model for economic regulation. RIIO is designed to encourage the efficient investment and innovation needed to secure energy supplies and meet environmental targets while delivering long-term value for money for customers.

In March 2011, Ofgem published its strategy for the new electricity Transmission Price Control (RIIO-T1). The financial package addressed key issues such as:

- the length of time over which assets will be depreciated, with 20 years for existing assets and 45 years for new assets;
- the allowed cost of equity, with an indicative range of 6.0-7.2%; and
- the allowed cost of debt, with the use of an index for determining companies' debt costs.

This package represented a step forward in reaching an acceptable Price Control, but extensive engagement with Ofgem and other stakeholders is required to ensure the final settlement fulfils the objectives that have been set for it. Transmission companies such as SHETL are required to develop business plans by the end of July 2011, demonstrating how they will 'meet the sustainability challenge, fund network investment and ensure continued safe and reliable operation of the networks and high levels of customer service'.

### **Electricity Distribution and Transmission priorities in 2011/12 and beyond**

During 2011/12 SSE's priorities in electricity networks are to:

- maintain safe and reliable supplies of power and to restore supplies as quickly as possible in the event of interruptions;
- respond effectively to the new arrangements in electricity distribution for allocating costs between support activities (expenses) and networks (capital);
- deliver successfully its investment plans in its electricity distribution networks;
- deploy innovative techniques to maximise the returns from good performance in electricity networks;
- make further progress in upgrading the transmission network in the north of Scotland; and
- continue to work with stakeholders to secure an acceptable outcome to the new electricity Transmission Price Control.

With such significant investment requirements over the next few years, not least in providing the infrastructure to accommodate electricity produced from renewable sources, the scope for additional incremental growth in electricity networks is clear.

## **Gas Distribution**

### **Performance in SGN**

SSE receives 50% of the distributable earnings from Scotia Gas Networks (SGN), in line with its equity holding, and also provides it with corporate and management services. In SGN in 2010/11:

- SSE's share of operating profit was £186.8m, up from £183.7m in the previous year;
- gas transported increased by 3.2TWh to 166.2TWh; and
- 97.2% of uncontrolled gas escapes were attended within one hour of notification, compared with 97.9% in the previous year.

SGN's two networks therefore both achieved the 97% standard for uncontrolled gas escapes.

The increase in operating profit for SGN is primarily due to two things:

- the impact of the price changes agreed as part of the five-year gas Distribution Price Control to March 2013; and
- underlying operational efficiencies achieved during the year.

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

#### **Operating gas networks efficiently**

When SGN acquired its networks in June 2005, National Grid was contracted to provide it with services with a total value of £30m per annum. In the period since, services have been brought within SGN, and SGN's remaining service contracts with National Grid total £7m per annum. These Managed Services Agreement contracts cover transmission services, control and IT services and emergency call handling, and the process of bringing them within SGN is continuing. During 2011/12, it will stop using National Grid's Gas Transportation Management System and replace it with its new Distribution Network Control System.

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

The five-year gas Distribution Price Control, which began in April 2008, provides the opportunity for SGN to increase significantly investment in its gas distribution networks, thereby reinforcing their safety and reliability and securing another significant increase in their RAV. By 2013, SGN estimates that its total RAV will be around £4.8bn.

During 2010/11, SGN invested £399.3m in capital expenditure and mains and services replacement projects, compared with £412.8m in the previous year:

- The most high profile capital project is the £21m replacement of the under-sea gas main between the south coast mainland and the Isle of Wight, which is nearing completion. The project involves connecting Lepe and Gurnard through the longest directional drill ever undertaken (3.9km). Two tunnels have been bored, meeting around 40 metres below the seabed, to take the two 12 inch diameter pipes.
- The majority of the mains replacement expenditure was incurred under the 30:30 mains replacement programme which was started in 2002. This requires that all iron gas mains within 30 metres of homes and premises must be replaced over a 30-year period. During 2010/11, SGN replaced 1,102km of its metallic gas mains with modern polyethylene pipes.
- SGN is also committed to making new gas connections to existing homes that are not on mains gas as affordable as possible, and is running a new Assisted Connections scheme, under which 4,700 properties were connected to its networks during 2010/11. A further 5,000 properties are expected to be connected in 2011/12.

Investment will continue to be a top priority for SGN and, in line with that, it expects to invest around £400m in capital expenditure and mains and service replacement projects during 2011/12.

#### **Earning financial rewards for corporate responsibility**

In September 2010, SGN was awarded £1.1m under Ofgem's scheme for rewarding companies for developing and adopting best practice in serving the interests of customers, society and the environment. This was the second successive year in which SGN secured the highest award under the scheme. Amongst other things, the award was in respect of SGN's 'Green Gas' project to introduce biomethane from sewerage into the gas network. The scheme, which is judged by a panel of industry experts, was established as part of Ofgem's gas Distribution Price Control 2008-13.

#### **Making gas networks more sustainable**

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

SGN has long recognised that renewable heat is an untapped resource. Working with a water company and a gas supplier, it began the delivery and supply of biomethane to 200 homes in Oxfordshire. Under the scheme, the first of its kind in Britain, sludge is subjected to the process of anaerobic digestion to create biogas which, after the removal of impurities, is fed into the gas distribution network. It is estimated that biomethane could account for up to 15% of domestic gas needs in the UK in 2020.

SGN is now developing this technology so that larger volumes of biomethane at other sites can be commissioned into the network and is progressing around 50 enquiries for biomethane network entry points from anaerobic digestion and landfill gas projects in Scotland and southern England.

### **Preparing for the new gas Distribution Price Control**

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

In March 2011, Ofgem published its strategy for the new gas Distribution Price Control (RIIO-T1). In addition to the allowed cost of equity and allowed cost of debt (see 'Keeping the lights on and supporting growth above') the financial package included proposals to refine the depreciation profile, so that it is entirely 'front loaded', and to capitalise all replacement expenditure (only 50% is capitalised at present).

As in electricity transmission this package represents a step forward in reaching an acceptable Price Control, but still requires extensive engagement with Ofgem and other stakeholders to ensure the final settlement fulfils the objectives that have been set for it.

### **Gas Distribution priorities in 2011/12 and beyond**

During 2011/12, SGN's priorities are to:

- deliver a safe and secure gas supply to customers;
- deliver to time and budget the 2011/12 mains replacement and capital works programmes;
- establish the new Distribution Network Control System;
- continue to work with stakeholders to secure an acceptable outcome to the new gas Distribution Price Control; and
- support sustainable developments in gas distribution.

## GENERATION AND SUPPLY

### **A vertically-integrated business**

SSE operates the business of electricity generation and the supply of electricity and the supply of gas in Great Britain and Ireland as a single, vertically-integrated Generation and Supply business.

This means that SSE seeks to meet the energy requirements of its customers through the ownership and operation of power stations, power purchase agreements with other generators and fuel supply contracts, and it is the meeting of the energy supply requirements of its customers which is the key determinant of SSE's operational and investment decisions in Generation. Under this model, customers benefit from lower exposure to wholesale price volatility and from price stability through 'smoothing'.

As at 31 March 2011, SSE supplied energy to:

- 9.16 million customer accounts in Great Britain; and
- 490,000 customer accounts in Northern Ireland and the Republic of Ireland.

Its generation capacity, including its share of joint ventures and associates, was around:

- 10,800MW in Great Britain;
- 80MW in Northern Ireland; and
- 410MW in the Republic of Ireland.

Overall, SSE seeks to maintain a well-balanced portfolio of customers, assets (including stakes in gas production assets) and contracts, including longer-term contracts for purchasing gas and power purchase agreements. In line with this, it purchases most of the gas and some of the electricity it needs to supply customers via bilateral contracts of varying lengths and also through trading in wholesale markets. SSE also buys gas, coal, oil and biomass to use in the production of electricity from its power stations, as well as carbon dioxide emissions allowances.

Its Energy Portfolio Management team is responsible for contract management and for SSE's participation in wholesale markets for electricity and gas, as well as the markets for coal, oil and carbon dioxide emissions allowances. Through analysis of generation plant availability (in SSE's own portfolio and elsewhere in the market), customer demand and its contractual position SSE can assess, and therefore manage, its exposure to market prices.

The wholesale price of energy can fluctuate greatly, according to variables such as physical supply, customers' demand, the weather, the availability of delivery infrastructure and geopolitical issues. SSE's approach is designed to 'hedge' its requirements in a way that minimises its costs while ensuring its exposure to market prices is not excessive. Given there are uncertainties around the volume of energy that will be required at any particular point, SSE is unlikely to be fully hedged until close to the delivery of the energy itself.

This balanced, integrated business features a diverse range of assets and contracts to support the supply of energy to customers. It therefore provides:

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

In March 2011, Ofgem published its findings and initial proposals from the Retail Market Review it launched in November 2010. It confirmed that it 'expects efficient firms to make a profit'. At the same time, it said that 'further action is needed to make energy retail markets in

Great Britain work more effectively in the interests of consumers'. The proposals include actions to 'improve further the transparency in vertically-integrated utilities'. Ofgem described its proposals as 'high-level and preliminary' and confirmed that they will be subject to 'further rounds of consultation'.

SSE believes that Ofgem's proposals would represent significant changes to the energy market in Great Britain. It believes the market is fundamentally sound, but is participating constructively in Ofgem's process of consultation and will strongly support steps which assist customers and the competitive market in general.

On 10 May 2011, in a case at Guildford Crown Court, SSE was found guilty on two counts (out of seven) relating to the use of direct sales aids in February 2009. The case was brought by Surrey County Council Trading Standards. The sales aids in question are not now in use, and SSE is confident that its sales processes continue to be fair and responsible.

SSE remains very disappointed with the verdict and is considering legal options, which includes the possibility of an appeal. It has 28 days from the jury's verdict to lodge an appeal.

### **Financial performance in Generation and Supply**

Operating profit\* in Generation and Supply fell by 1.5%, from £896.0m to £882.8m. It contributed 53.4% of SSE's total operating profit\* in 2010/11. The reasons behind this performance are set out under 'Increasing Adjusted Profit Before Tax\*'.

Total revenue for Generation and Supply was £27.2bn, which accounted for 93% of SSE's total revenue in 2010/11, of which £8bn was in relation to sales of electricity and gas to industrial, commercial and domestic customers.

### **Generating and supplying electricity in Great Britain**

During 2010/11, in Great Britain, SSE (previous year's numbers in brackets):

- generated 42.9TWh, based on contracted output of electricity from all thermal power stations in which it has an ownership interest (42.0TWh);
- generated 3.7TWh, based on contracted output from renewable sources of energy in which it has an ownership interest, including pumped storage (4.0TWh); and
- purchased 7.4TWh of electricity through long-term contracts with other generators (7.7TWh).

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

- supplied 27.7TWh of electricity to its industrial and commercial customers; and
- supplied 29.0TWh to its small business and household customers.

This means that, during the year, SSE:

- generated or purchased under long term contracts the equivalent of over 90% of the electricity needed to supply all of its customers; and
- generated over 150% of the electricity needed to supply its household and small business customers.

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

### **'Profound developments' in Generation and Supply**

In its February 2011 report into future energy scenarios, *Signals & Signposts*, Royal Dutch Shell said that, over the next four decades, the world's energy system will see 'profound developments'. It also said that:

- there is a 'step change in energy use', as developing nations enter their most energy-intensive phase of economic growth, which could see underlying global demand for energy triple from its 2000 level by 2050;

- natural innovation and competition could spur improvements in energy efficiency to moderate underlying demand;
- supply will struggle to keep pace with demand - by the end of the coming decade, growth in the production of easily accessible oil and gas will not match the projected rate of demand growth; and
- even if it were possible for fossil fuels to maintain their current share of the energy mix and respond to increased demand, carbon dioxide emissions would then be on a pathway that could severely threaten human well-being.

The UK government's Annual Energy Statement 2010 predicted that demand for electricity in the UK will double over the next 40 years as a result of the need to electrify large parts of the heat and transport sectors. It also said that for this to have the required impact on emissions, the electricity being consumed will need to be almost exclusively from low carbon sources.

The 'required impact' refers to the fact that:

- under the EU Renewable Energy Directive, the UK has a legally-binding target to meet 15% of its energy requirements from renewable sources by 2020 (for Ireland, it is 16%); and
- under the Climate Change Act 2008, the UK is required to achieve a reduction of 34% in emissions of greenhouse gases, such as carbon dioxide, by 2020 (compared with 1990 levels).

It is in this context that SSE is managing the operation of, and investment in, its Generation and Supply business. As well as being subject to a process of decarbonisation, the UK energy sector will also become more decentralised. The introduction of a Renewable Heat Incentive in the UK, from July 2011, which will in due course encourage and support installations down to the domestic level, is an example of this.

#### **Consolidated Segmental Statement**

Ofgem introduced a requirement on electricity generators and suppliers to publish a Consolidated Segmental Statement (CSS) showing revenue, costs and profits from electricity generation and electricity and gas supply activities. SSE published its statement for 2009/10 on 28 September 2010. The CSS required SSE to report financial information in a different way from which the Generation and Supply business is operated. SSE's next CSS will be published by 30 September 2011. Reporting requirements may evolve in the coming years as part of Ofgem's proposals to 'improve further the transparency in vertically-integrated utilities'.

## Generation

<b>Electricity Generation Key Performance Indicators</b>	<b>Mar 11</b>	<b>Mar 10</b>
<b>ASSETS (MW)*</b>		
Gas- and oil-fired generation capacity	4,470	4,590
Coal-fired generation capacity (inc biomass co-firing)	4,370	4,370
Renewable generation capacity (inc pumped storage)	2,450	2,370
<b>Total electricity generation capacity (MW)</b>	<b>11,290</b>	<b>11,330</b>
<b>OPERATIONS (%)</b>		
Gas power station availability	88	94
Coal power station availability	84	92
Hydro storage	61	52
Wind farm availability	97	97
<b>OUTPUT (TWh/GWh)**</b>		
Gas- and oil-fired (inc CHP) – TWh	29.3	31.3
Coal-fired (inc biomass co-firing) – TWh	13.6	10.7
<b>Total output from thermal power stations – TWh</b>	<b>42.9</b>	<b>42.0</b>
Conventional hydro – GWh	2,558	3,016
Wind energy – GWh	1,653	1,444
Dedicated biomass – GWh	200	218
<b>Total output of renewable energy – GWh</b>	<b>4,411</b>	<b>4,678</b>
<b>Total output from pumped storage – GWh</b>	<b>370</b>	<b>380</b>

\* Wholly-owned and share of joint ventures

\*\* Electricity from power stations in which SSE has an ownership interest (output based on SSE's contractual share).

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

The operation of, and investment in, SSE's Generation portfolio is founded on a series of principles:

- compliance: with all safety standards and environmental requirements;
- capacity: to meet the electricity needs of domestic and small business customers;
- diversity: to avoid over-dependency on particular fuels or technologies;
- availability: to respond to customer demand and market conditions;
- flexibility: to ensure that changes in demand for electricity can be addressed; and
- sustainability: to deliver a 50% cut in the carbon dioxide content of electricity produced.

### A diverse Generation portfolio

SSE's 31 March 2011 portfolio of 11,290MW of capacity for generating electricity compares with 11,330MW the year before. During 2010/11 it:

- commissioned 90MW of new onshore wind farm capacity as a result of its investment programme;
- sold onshore wind farm capacity at Ardrossan; and
- suspended operations at 120MW of gas-fired generation capacity at Fife.

Subsequently, in April 2011, capacity totalling 96.8MW at three onshore wind farms in Scotland and Northern Ireland was sold after the end of the financial year for a cash payment of £178.4m.

In line with the Generation principle of diversity, SSE currently maintains a balance between:

- gas- and coal-fired generation capacity; and
- fossil fuel and renewable sources of energy.

The practical application of this balance means that SSE's Generation portfolio comprised at 31 March 2011:

- 4,470MW of gas- and oil-fired capacity;
- 4,370MW of coal-fired capacity (with biomass co-firing capability); and
- 2,450MW of renewable (hydro, wind and dedicated biomass) capacity.

As a result of this, SSE has the greatest diversity in fuels for generating electricity among UK generators. This means it:

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

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

### **Meeting longer-term energy requirements**

SSE's long-term power purchase agreements with Barking Power Ltd (in which it has a 30.4% stake), Derwent Cogeneration Ltd (in which it has a 49.5% stake) and British Energy all expired during 2010/11. In order to provide continuing long-term stability to the energy portfolio, further contractual arrangements have been agreed in recent years. These include the 15-year tolling agreement with Marchwood Power Ltd which commenced in 2009 and the re-negotiated contract for electricity output from Seabank Power Ltd entered into in 2008.

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

SSE owns 4,470MW of gas- and oil-fired electricity generation capacity, including its share of joint ventures but excluding Fife power station (see below). Good performance in Generation and Supply is dependent on plant at power stations being available to generate electricity as and when required by customer demand and market conditions. During 2010/11, SSE's principal wholly-owned gas-fired power stations (Keadby, Medway and Peterhead) achieved 88% of their maximum availability to generate electricity, excluding planned outages, compared with 94% availability in the previous year. The main reason for the decline in availability was a generator fault at Keadby, which was returned to service in early May 2011 after successful repair work was carried out.

From time to time, the stations at Peterhead, Keadby and Medway have been required to operate on a flexible 'two shift' basis. The requirement to do this is likely to increase over the medium term, and further work is being designed by SSE's Engineering Centre to apply modifications to support more frequent 'two shifting' in the future. In addition, updated long-term gas turbine maintenance contracts are being entered into to support more flexible operations at Keadby and Medway in the future.

Marchwood, the 840MW CCGT owned by Marchwood Power Ltd, a 50:50 joint venture between SSE and ESB International, completed its first full financial year of commercial operation in 2010/11 and achieved 93% of its maximum availability to operate during the year. All of the station's output is contracted to SSE.

The amount of electricity generated by SSE at gas-fired power stations in which it has an ownership or contractual interest, including CHP, was 29.3TWh in 2010/11 (including 13.3TWh from wholly-owned stations), compared with 31.3TWh in the previous year (including 15.4TWh from wholly-owned stations).

All of SSE's power stations have to be able to operate economically over the medium term. The market for smaller gas-fired generation has become increasingly difficult. Fife Power Station was loss-making in 2010/11 and was forecast to remain so, particularly when the impact of the very high transmission access charges that apply in Scotland are taken into account. As a result, SSE suspended commercial operations at the plant in February 2011.

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

The UK Government's *Electricity Market Reform* consultation document, published in December 2010, said that gas-fired generation will 'continue to play an important role in the electricity sector – providing vital flexibility to support an increasing amount of low-carbon generation and to maintain security of supply'.

In February 2011, SSE secured consent, under Section 36 of the Electricity Act 1989, for the construction and operation of a two-unit CCGT power station of up to 870MW at the Abernedd brownfield site in South Wales. Subsequently, SSE released Transmission Entry Capacity (TEC) rights to reduce them to 450MW, and intends to pursue the development of a single CCGT unit only – the most economic option in the context of the development requirements for a two-unit site and of the medium-term outlook for gas-fired generation.

An investment decision on the scaled-back Abernedd project will not be taken until next year at the earliest and will depend, amongst other things, on the emerging shape of the electricity market following the UK government's consultation. This means that the power station, if built, will not be operational until late 2015. When SSE acquired Abernedd in May 2009, it was envisaged that a two-unit, 870MW CCGT would be developed, with the first unit becoming operational around 2013.

SSE agrees that CCGT is a cleaner fossil fuel technology, which has the necessary flexibility to support security of supplies as the presence of wind energy on the electricity system increases, but believes the right market signals need to be there if the necessary investment decisions are to be taken. SSE has potential options for additional CCGT capacity at two other power stations:

- it has effective consent to develop 710MW of capacity at Keadby; and
- Barking Power Ltd, in which it has a 30.4% stake, has consent to develop 470MW of capacity.

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

SSE owns 4,370MW of coal-fired generation capacity at three power stations: Fiddler's Ferry, Ferrybridge and Uskmouth. The stations also co-fire fuels from renewable sources in order to displace fossil fuels. All of the capacity at Fiddler's Ferry and Uskmouth and half of the capacity at Ferrybridge (over 3,300MW in total) complies with the EU Industrial Emissions Directive and so can remain operational beyond 2015 and up to 2023.

During 2010/11, SSE generated 13.6TWh of electricity at its coal-fired power stations at Fiddler's Ferry, Ferrybridge and Uskmouth, compared with 10.7TWh in the previous year (excluding Uskmouth, which was acquired in August 2009). The stations achieved 84% of their maximum availability to generate electricity, excluding planned outages, compared with 92% in the previous year. Availability at Ferrybridge was affected by a number of technical issues which emerged during planned outages and which were subsequently resolved.

Nevertheless, all of SSE's coal-fired power stations demonstrated their ability to operate flexibly in response to customer demand and electricity market conditions during 2010/11. The value of electricity from coal-fired power stations was demonstrated following the Japanese earthquake in March 2011 and the political upheaval in the Middle East.

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

Existing coal-fired power stations still have a significant part to play in maintaining secure supplies of electricity. Moreover, the sites they occupy benefit from key infrastructure such as:

- electricity network connections;
- access to water necessary for power generation operations; and
- established transport links.

During 2010/11, SSE decided against proceeding with the installation of Selective Catalytic Reduction (SCR) technology at Fiddler's Ferry after it was confirmed that the EU Industrial Emissions Directive (IED) means it can operate the station for 17,500 hours between 2016 and 2023, even if SCR is not fitted to meet new IED limits on emissions of nitrogen oxides.

SSE does, however, retain the option of installing Selective non-Catalytic Reduction technology at Fiddler's Ferry if it is economically and environmentally viable for it to do so.

It is SSE's belief that no new coal-fired power generation plant should be built in the UK without carbon dioxide abatement and that no coal-fired plant without such abatement should remain operational beyond 2030. This is consistent with the UK Committee on Climate Change's recommendation that the UK should commit to a 60% cut in carbon dioxide emissions by 2030, with 'radical decarbonisation' of the electricity sector.

Future operations at SSE's coal-fired power stations, and the associated investment decisions, will therefore be determined by three main factors:

- the need to maintain and improve the day-to-day performance of the stations while they are operational;
- the prospects for the development of alternative sources of energy; and
- the continuing UK government commitment to the development of CCS technology.

Against this background, SSE's investment strategy for Fiddler's Ferry, Ferrybridge and Uskmouth is as follows:

- it is continuing to invest in the operation and maintenance of the three stations, with a total of £69.9m invested in the stations in 2010/11;
- it is seeking planning consent so it has the option to develop a multi-fuel facility at Ferrybridge, using predominantly refuse-derived fuels from which to generate around 65MW of electricity;
- it is developing a project at Uskmouth to repower a coal-fired generating unit into a 100MW biomass unit; and
- it is building Europe's largest post-combustion carbon dioxide capture trial at Ferrybridge, in collaboration with Doosan Babcock and Vattenfall, where construction work is now well under way in advance of the trial beginning later this year (see 'Making progress on Carbon Capture and Storage' below).

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

Coal remains a critically important fuel for the UK, because of its flexibility, its availability and because it reduces reliance on imported gas. As a result, existing coal-fired power stations still have a crucial role to play in maintaining secure supplies of electricity but, longer term, the use of coal to generate electricity will depend on the extent to which CCS technology can be applied to abate carbon dioxide emissions.

Moreover, if long-term targets for reducing carbon dioxide emissions are to be met, CCS technology will need to be applied as widely as possible. The November 2010 decision by the UK government to include gas-fired generation plant in its CCS demonstration programme was a clear recognition of this.

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

- **Coal at Ferrybridge:** This project is Europe's largest post-combustion carbon dioxide capture trial. The scale of the project, equivalent to 5MW of coal-fired power generating capacity producing 100 tonnes of carbon dioxide per day, bridges the gap between the various laboratory-scale trials that are under way and the larger-scale projects envisaged by the UK government. The significance of the project therefore lies in its scale and its ability to demonstrate the operational characteristics of capture plant on an actual power station and the performance of the amine solvent on real flue gas. It is due to become operational later this year.
- **Gas at Peterhead:** The proposed project will design and develop a full chain, post-combustion CCS facility which will be capable of capturing the CO<sub>2</sub> from one 385MW combined cycle gas turbine unit. Current plans are that the CO<sub>2</sub> will then be transported via an existing underground pipeline to St Fergus for further compression and then transported via an undersea pipeline to an existing gas reservoir in the North Sea operated by Shell U.K. Limited that will have ceased production and is

being redeveloped by CO<sub>2</sub> Deep Store. In May 2011, the UK government announced that the project is one of seven CCS applications to the European Investment Bank for consideration in the next round of the EU's New Entrant Reserve scheme to support CCS and renewable energy projects across the EU. Up to three such projects may be supported per member state.

### **Securing value from ash at coal-fired power stations**

The overall sustainability of coal-fired power stations has improved in recent years. In October 2010, having previously held a 49.9% shareholding, SSE assumed 100% ownership of RockTron (Widnes) Ltd, now named SSE Mineral Solutions Ltd. It owns and operates an ash separation plant at Fiddler's Ferry, where fresh and stored ash produced by the power station is processed into marketable minerals and materials such as cement substitutes. Long-term options for the plant are currently being assessed.

### **Participating in the EU Emissions Trading Scheme**

Phase II of the EU Emissions Trading Scheme (EU ETS) began on 1 January 2008. Across its electricity generation portfolio (taking account of contractual shares), SSE now has an allocation of 18.9 million tonnes of carbon dioxide emissions allowances per calendar year, including the allowances for Marchwood and Uskmouth. SSE's emissions allowances requirement for 2010/11, beyond those allocated under EU ETS, was 5.6 million tonnes. This compares with 4.9 million tonnes in the previous year. During 2010/11, the price of allowances ranged from around €13/tonne to around €17/tonne.

From 2013, all of the carbon dioxide emissions allowances for electricity producers will be auctioned. Moreover, in Budget 2011, the UK government announced proposals for the introduction of a 'floor' for the price of allowances in the electricity sector, so that they are around £16/tonne in 2013, rising to around £30/tonne in 2020 (based on 2009 prices).

### **Tackling emissions of carbon dioxide**

In 2010/11, emissions of carbon dioxide from power stations in which SSE has an ownership or contractual interest totalled 24.5 million tonnes, compared with 23.1 million tonnes in the previous year, reflecting increased output from coal-fired power stations and the first full year of operation of Marchwood power station. SSE's carbon emissions data is externally verified by a UK Accreditation Service (UKAS)-accredited organisation.

SSE's target is to reduce the amount of carbon dioxide per kilowatt-hour of electricity generated at plant in which it has an ownership or contractual interest by 50%, between 2006, the first full year after it acquired coal-fired power stations, when it was just over 600g/kWh, and 2020. On this basis, its carbon intensity in 2010/11 was 504g/kWh, compared with 494g/kWh in the previous year, reflecting the increase in carbon dioxide emissions described above.

SSE expects to achieve its 2020 target by:

- reducing output of electricity from coal-fired power stations;
- optimising the efficiency with which primary fuel is converted into electricity at gas-fired power stations; and
- increasing significantly the output of electricity from renewable sources.

More broadly, SSE has joined other energy companies in Europe in calling for the EU to adopt a greenhouse gas emissions reduction target of 25% (up from 20% at present) as part of a long-term move away from fossil fuel-based electricity generation and full decarbonisation by 2050.

### **SSE's position in the Carbon Disclosure Project (CDP)**

In September 2010, SSE was commended by the CDP, which represents over 500 institutional investors with US\$64 trillion in assets under management, for its approach to climate change disclosure and for the action it is taking to reduce global emissions and mitigate the risks of climate change. SSE is featured in:

- the Carbon Disclosure Leadership Index, which highlights the constituent companies within the FTSE Global 500 which have displayed the most professional approach to corporate governance in respect of climate change disclosure practices; and
- the Carbon Performance Leadership Index, which highlights those companies which have demonstrated commitment to strategy, governance, stakeholder communications and, most of all, emissions reduction in their CDP responses.

### **Renewable Energy – Overview**

The EU Renewable Energy Directive means that the UK has a legally-binding target to meet 15% of its energy requirements from renewable sources by 2020; for Ireland, the target is 16%. In practice, this means that over 30% of the countries' electricity requirements will have to be met from renewable sources, up from around 6.5% and 14.5% respectively at present.

The drive for additional renewable sources of energy is supported by public policies to encourage the necessary investment by enhancing the value of the output. The key policies are:

- the **Renewables Obligation** in the UK, under which generators receive Renewable Obligation Certificates (ROCs) for electricity generated from eligible renewable sources and electricity suppliers are required to source an increasing proportion of their electricity from eligible renewable sources; and
- the **Renewable Energy Feed In Tariff (REFIT)** in the Republic of Ireland, which supports renewable energy by providing a guaranteed price for output and a 15% rebate (subject to a cap) on suppliers' purchase of REFIT energy.

The existence of these schemes is a practical demonstration of the fact that the viability of wind energy remains dependent on government-sponsored financial support. The UK government's work on Electricity Market Reform is explicitly designed to make sure that low carbon technologies such as energy from renewable sources 'become a more attractive choice for investors'. As a result, SSE does not detect or foresee any weakening of public policy commitment to renewable energy in either the UK or Ireland. Nevertheless, it remains a key priority for SSE to avoid dependency on a single generation technology or related financial support.

### **Increasing capacity for renewable energy**

At 31 March 2011 SSE had almost 2,450MW of commissioned renewable energy capacity in the UK and Ireland, including its share of joint ventures, comprising:

- 1,150MW conventional hydro;
- 910MW onshore wind;
- 5MW offshore wind;
- 80MW dedicated biomass; and
- 300MW pumped storage

Of this, output from over 850MW qualifies for ROCs, the key financial support scheme for renewable energy in the UK, with:

- 1.0 ROCs/MWh for qualifying hydro and onshore wind;
- 1.5 ROCs/MWh for qualifying dedicated biomass; and
- 2.0 ROCs/MWh for qualifying offshore wind.

In the year to 31 March 2011, SSE commissioned almost 90MW of new onshore wind farm capacity. It has disposed of capacity as follows:

- in May 2010, it sold its equity interest (which was 51% on 31 March 2010, increasing to 100% in April 2010) in the 30MW Ardrossan wind farm to Infinis, a Terra Firma company, in a transaction with a total value of £53.8m; and
- in April 2011 it sold its 100% interest in three onshore wind farms in Scotland and Northern Ireland with a total capacity of 96.8MW, also to Infinis, for a cash payment of £178.4m.

All of the electricity generated from the capacity disposed of in Scotland is sold to a third party.

The net result is that SSE remains on course to own around 3,500MW of capacity for renewable energy that is in operation or under construction in the UK and Ireland by the end of 2012/13. This will mean SSE is:

- making a significant contribution to the achievement of the legally-binding 2020 targets for renewable energy in the UK and Ireland;
- harnessing water and wind, which are free and indigenous sources of primary energy; and
- reducing its exposure to volatile prices for fossil fuels, which are becoming more difficult to source while also being in much more demand around the world.

#### **Producing electricity from renewable sources**

Total output from all of SSE's conventional hydro electric schemes, wind farms and its dedicated biomass plant was 4,411GWh during 2010/11, compared with 4,678GWh in 2009/10. It was around 20% lower than forecast because of dry and still weather conditions experienced during the year.

#### **Producing electricity from hydro electric schemes**

SSE owns and operates just over 1,450MW of capacity in hydro electric schemes, including the 300MW pumped storage facility at Foyers, on Loch Ness. In the last 30 years, electricity output from conventional hydro electric schemes has ranged from a high of 3,896GWh to a low of 2,429GWh. During 2010/11 (previous year's comparison in brackets):

- total output from all of SSE's conventional hydro electric schemes was 2,558GWh (3,016GWh); and, within this,
- total output from SSE's hydro electric capacity qualifying for ROCs (just over 500MW) was 1,193GWh (1,456GWh).

As at 31 March 2011, the total amount of water held in SSE's reservoirs which could be used to generate electricity was 61% of the maximum, compared with 52% in the previous year.

#### **Restoring generation at the Glendoe hydro electric scheme**

In August 2009, SSE identified a blockage caused by a fall of rock in the tunnel carrying water from the reservoir to the power station at the 100MW Glendoe hydro electric scheme, thus stopping operations at the power station. The first of the two new tunnels required to by-pass the blockage in the existing tunnel has been completed and work on the second tunnel has progressed beyond the geological fault zone at the site. This work is being undertaken by BAM Nuttall.

If good momentum is maintained, the process of re-filling the reservoir at Glendoe is expected to begin this winter and electricity generation should resume in the first half of 2012. Meanwhile, SSE is continuing to make sure that the contractual and insurance issues arising from the fall of rock are dealt with satisfactorily.

#### **Options for investment in hydro electric schemes**

Hydro electric schemes which use impounded water to generate electricity have an important part to play in meeting peak demand and also complement the variable output from the growing number of wind farms. SSE has developed four main options for new hydro electric schemes:

- **Kildermorie:** In September 2010, SSE received consent to develop a new 7.5MW hydro electric power station near Ardross in Ross-shire. It will consist of a new dam and storage reservoir, a buried pipeline and a semi-buried powerhouse with associated tailrace. Construction is likely to begin in the second half of 2012.
- **Sloy:** In September 2010, SSE secured from Scottish Ministers consent to develop a 60MW pumped storage scheme as part of its 152MW Sloy power station, near Loch Lomond. This means that, in addition to electricity produced from water collected and held in the Loch Sloy reservoir, Sloy will be able to generate an additional 100GWh of

electricity in a typical year using water pumped from Loch Lomond to the reservoir. SSE now expects that developing a pumped storage facility at Sloy will require investment of around £40m, and is expecting to take a final decision on the investment after it has completed further technical and engineering studies and considered the outcome of the UK government's consultation on electricity market reform.

- **Coire glas:** SSE is proposing to develop a new large scale pumped storage scheme at Loch Lochy with an installed capacity of between 300MW and 600MW and a capability to produce in excess of 1,000GWh of electricity in a typical year. A planning application for the scheme is expected to be submitted during 2012.
- **Balmacaan:** SSE is also proposing to develop a 300MW-600MW pumped storage scheme at Loch Ness, with a similar expected electricity output to Coire glas. While this project is entirely independent of Coire glas, it is at a similar stage, a similar timetable for submitting a planning application is envisaged and the two projects are managed by a single development team.

Construction of Coire glas and/or Balmacaan would not begin before 2014 at the earliest and, subject to planning consent, SSE will have the option to build neither, one or both of the schemes. They would be the first new pumped storage schemes to be developed in Great Britain since work began on the Dinorwig scheme in Wales in 1974.

Final decisions on these and on other renewable energy developments will also depend upon acceptable charging arrangements being in place for the use of the transmission network in Great Britain, an issue which is the subject of the Project TransmiT review launched by Ofgem in September 2010.

#### **Producing electricity from wind farms**

At 31 March 2011, SSE owned and operated 910MW of wind farm capacity and output during 2010/11 was as follows (previous year's comparison in brackets):

- 739GWh in the UK, (615GWh); and
- 914GWh in the Republic of Ireland, (829GWh).

On average, the turbines at SSE's wind farms in the UK and Ireland achieved 97% of their maximum availability to generate electricity, the same as in the previous year. Their average load factor was lower than expected, at 24%, compared with 26% in the previous year, due to the still weather conditions experienced during much of the year.

#### **Developing wind farms to produce electricity**

When SSE entered into the agreement to acquire Airtricity in January 2008, the combined business had just over 870MW of **onshore wind farm capacity** in operation, in construction or with consent for development in the UK and Ireland. At 31 March 2011, this had more than doubled, to over 1,900MW, comprising (net):

- 910MW in operation;
- 710MW in construction or pre-construction; and over
- 300MW with consent for development.

In addition, SSE has also submitted for approval by the relevant planning authorities in the UK and Ireland proposals for onshore wind farms with a total capacity of over 800MW. This includes its share of the capacity contained in the proposal by Viking Energy, the joint venture between Viking Energy Ltd (which is 90% owned by the Shetland Charitable Trust) and SSE to develop on Shetland's Central Mainland a wind farm with a capacity expected to be around 450MW.

In addition to its onshore capacity, SSE has **offshore wind farm capacity** in operation or under construction totaling almost 350MW, comprising:

- a 50% stake in the 10MW Beatrice offshore wind farm in the Moray Firth;
- a 25.1% share of the 367MW Walney offshore wind farm now under construction in the Irish Sea; and

- a 50% share of the 500MW Greater Gabbard development now under construction in the outer Thames Estuary.

This means that SSE now has 3,750MW of renewable energy capacity (onshore wind, offshore wind, hydro and dedicated biomass) in operation, under construction or with consent for development in the UK and the Republic of Ireland. This excludes the possible Arklow wind farm scheme off the east coast of the Republic of Ireland.

### **Maximising electricity output from wind farms**

While capacity, as measured by megawatts, is of central importance in on- and offshore wind farm development, there are four other critical factors which help determine the electricity output from that capacity and thus the value of any development:

- site selection;
- wind analysis carried out by a specialist team;
- site optimisation to maximise output, including turbine layout; and
- turbine selection to match turbine characteristics with wind conditions and ensure reliability.

SSE has an experienced wind energy development team comprising more than 250 people with the specialist skills to make sure that these factors are rigorously applied so that the electricity output from the wind farm capacity it develops is maximised.

### **Building new onshore wind farms**

The main projects within SSE's onshore wind farm construction portfolio are Clyde (350MW) in South Lanarkshire, Griffin (156MW) in Perthshire and Gordonbush (70MW) in Sutherland.

- **Clyde:** Consent has been secured from North Lanarkshire Council for the development of a permanent new primary radar facility to provide the necessary level of coverage for the site, and construction work on the new facility has begun. It should become operational in early 2012. To ensure aviation safety in the meantime, agreement on a temporary solution is being reached following extensive discussions involving the Civil Aviation Authority and NATS (En Route) plc. As a result, the first generation of electricity at the site is expected in the next few weeks and the most advanced of the wind farm's three sections, South (130MW), should be completed by around the time of SSE's six-month financial results announcement in November. The wind farm as a whole is on course for completion in 2012. This is consistent with the timetable set out in SSE's Annual Report 2009. The wind farm is expected to produce over 1,000GWh of electricity in a typical year and its total construction cost is forecast to be over £500m.
- **Griffin:** Construction work is well under way at the site, and the installation of turbines at the site has started, with the first electricity being generated earlier than expected in the first week of May 2011. The wind farm should be completed in the spring of 2012. The electricity output is expected to be between 350GWh and 400GWh in a typical year and the construction cost is expected to be over £200m.
- **Gordonbush:** Construction work is well under way at the site, with turbine delivery and installation due to begin later this year. The wind farm should be commissioned around the end of the current financial year. The electricity output is expected to be around 180GWh in a typical year and its construction cost is expected to be just over £100m.

In addition to Clyde, Griffin and Gordonbush, SSE has the following onshore wind farm projects currently under construction or pre-construction in the UK and Ireland (MW are SSE's share):

- Slieve Kirk (27MW);
- Calliachar (27MW);
- Athea (19MW);
- Glenconway (19MW);
- Rathcahill (12MW);
- Tiev (10MW);

- Balmurrie Fell (9MW);
- Tilbury (9MW); and
- Bindoo Extension (6MW)

SSE has also completed the acquisition, from RES, of a 34 turbine/68-85MW wind farm project for which consent for construction has been granted at a site close to its Keadby power station in North Lincolnshire. As a result, Keadby has become SSE's first consented wind farm in England. Subject to a final investment decision, SSE expects to begin construction of the wind farm during 2012/13, with work expected to take up to 18 months. Keadby is expected to be part of SSE's investment programme to 2015.

#### **Building new offshore wind farms**

SSE is developing Greater Gabbard in partnership with RWE npower renewables (through Greater Gabbard Offshore Winds Limited) and Walney in partnership with DONG Energy (through Walney (UK) Offshore Windfarms Ltd) and believes that partnerships of this kind represent the best means of managing the risks associated with offshore wind farms and maximising the development and construction capability.

- **Greater Gabbard:** (500MW development; SSE stake in Greater Gabbard Offshore Winds Limited - 50%): Over 70% of the project's assets are installed. All 140 monopile foundations are in place at the wind farm and 108 turbines have been installed. Turbine installation will resume later this year; in the meantime, other work at the site will continue, including subsea cabling. The first 17 turbines have now been energised. GGOWL remains in a contractual dispute with Fluor Limited, the principal contractor for the wind farm, relating to the need for assurance of the quality of potentially up to 52 of the turbine foundations used in the early stages of development. Despite these issues, the wind farm remains scheduled to be completed as planned in 2012, although there is some potential risk to this timetable as a result of the GGOWL/Fluor Limited dispute. The total annual electricity output is expected to be around 1,900GWh in a typical year, of which SSE will take half, and SSE's share of the construction cost is expected to be around £650m (excluding the cost of connection to the electricity grid).
- **Walney:** (367MW development; SSE stake in Walney (UK) Offshore Windfarms Ltd - 25.1%): All 51 turbines for the first phase of the wind farm have been installed and all the array cables have been put in place and connected to the turbines. The first 45 turbines have now been energised and the whole of phase one of the wind farm (183.6MW) is expected to be completed in early summer. Construction of the second phase of the wind farm is now under way, with the wind farm as a whole on schedule for full commercial operation in 2012. SSE's share of the construction cost is expected to be around £250m (excluding connection to the electricity grid).

#### **Developing more new offshore wind farms**

SSE's priority for the next year is the successful completion and commissioning of Greater Gabbard and Walney. These projects have given it significant experience of offshore wind farm development and construction.

SSE believes that harnessing the power of offshore wind will enable the UK to generate significant amounts of low-carbon electricity from a renewable source and therefore help meet the country's energy security and climate change objectives. Against this background, it intends to maintain an orderly, phased and continuing programme of development, with the next two offshore wind farm projects to be developed taking priority:

- the 500MW Galloper wind farm, close to the existing Greater Gabbard development, a 50:50 partnership with RWE npower renewables; and
- the 1,000MW Beatrice wind farm in the Moray Firth, a 75:25 partnership with SeaEnergy.

Planning applications in respect of these developments are expected to be submitted in the course of 2011/12. Beyond this, SSE has secured from The Crown Estate rights for the possible development of additional offshore wind farm assets later in the decade with a total potential capacity of up to 4.8GW (net). SSE's disciplined approach to the consideration of

the options that such rights have given it was demonstrated by its decision, in February 2011, to halt work on the development of its proposed offshore wind farm at Kintyre following detailed environmental studies and consultation with local stakeholders.

### **Building a supply chain for offshore wind**

Offshore wind farms are a new and evolving technology, and fulfilling their potential requires the development of a sustainable supply chain, including design, manufacture and installation. Moreover, they are characterised by high up-front capital costs, on which it is vital to exert a downward pressure.

In response to this, SSE has:

- entered into a joint venture with Marsh Wind Technology Ltd, the UK subsidiary of Marsh Global Holdings Ltd, which has completed the purchase of the Skykon wind turbine tower manufacturing and assembly plant at Machrihanish, Campbeltown, from its Administrators;
- formed an alliance of companies, including Siemens, to collaborate on its offshore wind programme, with the aim of securing substantial reductions in the cost of delivered power, in February 2011;
- signed a strategic agreement with Mitsubishi to co-operate on low carbon energy developments, in July 2010; and
- acquired a 15% stake in Burntisland Fabrications (BiFab), the offshore energy structure fabricator, in April 2010. In addition to the equity stake, SSE secured an agreement with BiFab for the supply of at least 50 jacket substructures annually to support SSE's offshore wind developments.

The energy potential of offshore wind is vast, and in a resource- and carbon-constrained world it is potential that needs to be fulfilled while developing an effective supply chain and keeping costs as low as possible. SSE is aiming to do this through these initiatives, and others such as ongoing participation in the Carbon Trust's Offshore Wind Accelerator, a research and development initiative to reduce costs.

### **Establishing an intermediate holding company for offshore renewable energy**

SSE has decided to establish a single intermediate holding company for all of its offshore renewable energy assets and interests (mainly wind), including assets in operation, under construction or in development. It will be wholly-owned by SSE for the foreseeable future and its establishment will give SSE a company for the financing of offshore renewable energy developments. The new company is likely to be formed during 2011/12.

### **Developing marine sources of electricity**

The UK enjoys major advantages in the development of marine energy technologies, with the huge potential resource of marine energy itself, allied to significant commitment to the operation and development of testing facilities. While marine energy could play some part in helping to meet renewable energy targets set for 2020, its longer-term potential is much more significant and it is in that context that marine energy developments should be considered.

SSE has a two-pronged approach to the development of marine energy technologies and to fulfilling the potential of marine energy resources:

- it has a 43% stake in the wave energy developer, Aquamarine Power, following further investment of £2.7m in November 2010, taking the total over the past three years to £19.8m. Aquamarine Power is currently developing an innovative wave energy converter, Oyster 2, which is expected to be deployed during 2011. Its existing Oyster device has been undergoing sea trials at the European Marine Energy Centre in Orkney; and
- it currently retains exclusive rights from The Crown Estate to develop 400MW of wave and tidal energy at sites in the Pentland Firth and Orkney Waters and a further 400MW with Aquamarine Power and OpenHydro. SSE has submitted an application to National Grid for an electricity connection relating to three of these sites and is working closely with The Crown Estate and other stakeholders to develop applications to construct the developments.

### **Generating electricity from alternative sources like biomass**

SSE's plant at Slough has a current generating capacity of 80MW and remains the UK's largest dedicated biomass energy facility. During 2010/11, it produced 200GWh of electricity from renewable sources, compared with 218GWh during the previous year. Qualifying output from dedicated regular biomass plants attracts 1.5 ROCs per MWh.

### **Looking to the future of alternative energy**

The plant at Slough has given SSE practical experience which it can deploy when considering investment in biomass and other alternative fuels such as those derived from refuse (RDF). Such fuels could play a very valuable role in securing firm, controllable generation of electricity from renewable sources to complement other more variable sources such as wind. SSE has developed a diverse range of options from which to select potential investments which could deliver up to 250MW of new alternative energy capacity:

- the possible 65MW multi-fuel CHP facility at Ferrybridge (see 'Looking to the future of coal-fired power stations' above);
- the possible re-powering of an entire coal-fired generating unit at Uskmouth into a 100MW biomass unit, fuelled by an industrial grade wood pellet (see above also); and
- the possible re-powering of the Slough plant into a new 80MW biomass unit.

The creation of RDF for use in electricity generation is a practical means for organisations to avoid Landfill Tax, and the generator is, therefore, paid to take the fuel. At the same time, the reliability of fuel sources is often a critical issue in any alternative energy development. A major milestone in the development of the multi fuel plant at Ferrybridge was achieved in April 2011 when 3SE, the joint venture company between Shanks and SSE, was confirmed as preferred bidder for the waste from Barnsley, Doncaster and Rotherham Council areas (BDR). After Shanks has processed the waste, the resultant fuel will secure, locally, around one fifth of the overall requirements of the proposed plant.

In addition, Forth Energy, the joint venture between SSE and Forth Ports PLC, has now submitted planning applications to develop dedicated biomass power stations, with a total capacity of 500MW, at four sites in Scotland.

In May 2010, SSE took part in a £13.5m agreement to invest in the construction of Scotland's largest biogas plant at a former landfill site at Barkip in North Ayrshire. The investment made SSE the first energy company in the UK to commit to the construction and operation of an anaerobic digestion biogas plant of this type. The site will be capable of processing around 75,000 tonnes of waste (such as food, manures and organic effluent sludges) annually, producing around 2.5MW of renewable electricity. It has received its first loads and has entered the commissioning phase, after the successful completion of plant construction.

Biogas developments such as Barkip have the potential to provide an important sustainable energy solution, capturing the energy contained in waste. They offer opportunities beyond on-site electricity generation to include connections to the gas distribution network, an issue that will be of increasing significance in the future as changes are made to the source of heat for buildings in the UK, in line with the Renewable Heat Incentive. Progress at Barkip is, therefore, of direct interest to both SSE and SGN.

### **Investing in new ventures in energy**

SSE Ventures (SSEV) was set up in 2007 to develop and grow a portfolio of investments in small and medium-sized enterprises offering renewable, sustainable and energy efficiency-enhancing products and services. Amongst other things, investments were made to help SSE anticipate, be at the forefront of and adapt to the kind of changes in energy production and consumption that are likely to occur over the next decade.

Since its establishment, SSEV has invested or committed to invest a cumulative total of £138.4m, including equity and loans in a total of 40 companies. It is now examining its strategy to ensure the optimum approach to investment in these companies in the years ahead.

### **A cautious approach to nuclear power development**

It is expected that the total capacity of the UK's nuclear power stations will fall by over 7,000MW by 2020, even if advanced gas-cooled reactor (AGR) stations are allowed by the Nuclear Installations Inspectorate to operate for five years beyond their existing planned closure dates.

In November 2010, SSE said in its six-month financial statement, that: 'the cost, development issues and timetable and operational efficacy of nuclear power stations all require the greatest possible scrutiny before a commitment to invest [in new nuclear power stations] can be made'. This was before the devastating events at Fukushima, which have thrown these issues into even sharper relief.

Nevertheless, SSE continues to believe that the development of new nuclear power stations should be an option for the future. Its joint venture with GDF Suez SA and Iberdrola SA, NuGeneration Ltd (NuGen), in which it has a 25% stake, is developing plans for a new nuclear power station of up to 3.6GW on land adjacent to Sellafield in Cumbria, for which it secured an option in October 2009.

These plans will be prepared in consultation with safety authorities and local stakeholders and should be submitted for consideration by the relevant planning authorities, with the aim of a final investment decision being taken in the middle of the decade. On this basis, any new power station would not be commissioned until 2023 at the earliest.

### **Generation priorities for 2011/12 and beyond**

SSE's key operational objective in Generation during 2011/12 is to be consistent with its established principles and in particular:

- comply fully with all safety standards and environmental requirements;
- ensure power stations are available to respond to customer demand and market conditions; and
- operate power stations efficiently to achieve the optimum conversion of primary fuel into electricity.

During 2011/12, SSE expects to invest almost £1bn in maintaining and upgrading existing generation assets and in developing new assets. Its Engineering Centre supports the process of asset maintenance and investment. Against this background, SSE's investment priorities are to:

- complete asset maintenance and refurbishment programmes on time and on budget;
- maximise the potential for existing thermal power stations to operate flexibly;
- meet key milestones in new asset development and construction; and
- make progress in developing the diverse range of investment options it has created for the second half of this decade.

SSE's investment programme is designed to abate the environmental impact of existing assets and extend their working lives and to deliver new assets, principally in renewable energy but also other forms of generation. All of this will support security of energy supply.

This focus on good operational performance and on effective investment is designed to give SSE a balanced portfolio of efficient electricity generation assets, with a diminishing environmental impact, in which its exposure to fossil fuel price volatility is increasingly diluted.

SSE will also actively seek to maintain optionality and diversity in the future development of its generation portfolio so that it remains on course to reduce by 50% the carbon dioxide intensity of electricity produced at power stations in which it has an ownership or contractual interest, over the period from 2006 to 2020. The future development of its portfolio will depend to a significant extent on the outcome of the UK government's consultation on Electricity Market Reform, SSE believes a workable package of reforms can emerge from this process, based around carbon price support, a mechanism to reward all electricity capacity that is available to generate electricity and continuing support for the production of electricity from renewable sources. The UK government is expected to publish a White Paper later this year.

## Supply

<b>Supply Key Performance Indicators</b>	<b>Mar 11</b>	<b>Mar 10</b>
Electricity customer accounts (GB domestic) - m	5.16	5.17
Gas customer accounts (GB domestic) - m	3.57	3.54
Energy customers (GB business sites) - m	0.43	0.45
<b>Total GB energy customer accounts - m</b>	<b>9.16</b>	<b>9.16</b>
All-Island Energy Market customers (Ire) - m	0.49	0.19
Home services customer accounts (GB) - m	0.42	0.41
<b>Total customer accounts (GB and Ire) – m</b>	<b>10.07</b>	<b>9.76</b>
Electricity supplied household average (GB) - kWh	4,408	4,465
Gas supplied household average (GB) – therms	563	558
Customer complaints to third parties (GB)*	1,161	1,231

\* Energy Ombudsman, Consumer Focus and Consumer Direct

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

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

- offering consistently competitive prices over the medium term;
- delivering the highest possible quality of service; and
- providing market-leading products and services to help transform energy consumption.

Energy supply has one key characteristic which makes it different from almost any other sector: there are specific requirements on energy suppliers to help reduce their customers' consumption of electricity and gas. This means that sustainable performance in energy supply is about delivering services and adding value to customers in ways which support this movement towards greater energy efficiency.

### **Increasing customer numbers in GB and Ireland**

SSE supplies electricity and gas in Great Britain and Ireland as:

- Southern Electric and SSE (England);
- Swalec (Wales);
- Scottish Hydro (Scotland);
- Atlantic; and
- Airtricity (Northern Ireland and the Republic of Ireland)

During 2010/11, it achieved a net gain of 300,000 energy customer accounts in Great Britain and Ireland, taking the total to 9.65 million. It also achieved a small increase in the number of home services customers, taking the total to 420,000. SSE's customer accounts therefore totalled 10.07 million at 31 March 2011 comprised:

- 5.16 million household electricity customer accounts in GB;
- 3.57 million household gas customer accounts in GB;
- 430,000 business electricity and gas sites in GB;
- 490,000 energy accounts in Northern Ireland and the Republic of Ireland (90% household and 10% industrial and commercial); and
- 420,000 home services customer accounts, including gas boiler, central heating and wiring maintenance and installation products and services and telephone line rental, calls and broadband services.

The increase in customer account numbers was, therefore, the result of success in Ireland where, in April 2011, SSE, through Airtricity, passed the 500,000 customer accounts milestone. In contrast, there was a slight reduction in customer numbers in Great Britain in the second half of the year, reflecting the highly competitive market conditions.

Within the total, 3.05 million customer accounts in Great Britain are for loyalty products such as:

- energyplus Argos, which rewards customers with money-off discount vouchers;
- energyplus Pulse, under which customers are able to support the British Heart Foundation (which received almost £120,000 from SSE in respect of energyplus Pulse customers during 2010/11, taking the total since the product was launched to almost £1.3m); and
- M&S Energy, available to customers through M&S' stores and website.

SSE's customer growth is partly founded on telephone and face-to-face sales. Ofgem introduced new licence conditions to govern sales processes in 2009 and in September 2010 launched an investigation to 'establish whether' four suppliers, including SSE, are complying with the licence conditions. SSE is committed to high standards in its sales processes and is co-operating fully with the investigation, which is ongoing.

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

On a weather-corrected basis, SSE household customers have continued to reduce their use of energy, and on an actual basis in 2010/11 SSE household customers used, on average:

- 563 therms of gas, compared with 558 therms in the previous year, and 598 therms in 2008/09; and
- 4,408kWh of electricity, compared with 4,465kWh in the previous year, and 4,748kWh in 2008/09.

As a result of the underlying fall in energy consumption, households are less exposed to the impact of high unit prices than they otherwise would be.

### **Helping customers use less energy**

Using energy more efficiently is the fastest and most cost-effective way of reducing customers' energy costs, sustaining supplies for the long term and reducing emissions of carbon dioxide. As an energy supplier, SSE has obligations under the Carbon Emissions Reduction Target (CERT) scheme to deliver energy efficiency measures to households throughout Great Britain and in 2010/11 funded the installation of cavity wall insulation in 87,000 homes and loft insulation in 106,000 homes (excluding DIY insulation).

In its CERT Annual Report, a review of CERT in 2009/10, published in August 2010, Ofgem stated that SSE had met 78% of its overall carbon emissions reduction obligation for the three years to 2011. SSE is the energy supplier which has delivered the highest share of its CERT obligations through appliances, via a number of consumer electronics schemes. These have the benefit of helping to address directly demand for electricity.

Complementing CERT, the Community Energy Savings Programme (CESP) is an obligation placed on energy suppliers and electricity generators to make savings in customers' homes by helping to install energy efficiency measures. The programme is designed to ensure that suppliers work in the lower income areas and to incentivise a 'whole house' approach to energy savings. SSE's first CESP programmes got under way in 2010/11 at locations throughout England, Scotland and Wales.

CESP and CERT will be superseded by the 'Green Deal' and Energy Company Obligation (ECO) when they are introduced:

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

The 'Green Deal' and ECO are subjects of the Energy Bill, which is making its way through the UK Parliament and are expected to be implemented, following extensive secondary legislation, from 2012. The Secretary of State for Energy and Climate Change will be responsible for determining what energy efficiency measures will be eligible for the Green Deal, and providing such measures could represent a significant opportunity for SSE to market products and services.

### **Helping vulnerable customers**

The UK government has appointed Professor John Hills to lead an independent review of 'fuel poverty'. A household is currently classed as being in 'fuel poverty' if it would need to spend more than 10% of its income on fuel to keep their home warm enough. The review will examine the definition of 'fuel poverty' and the government targets relating to it. It is expected to conclude in 2012.

SSE believes that any type of poverty, including 'fuel poverty', results fundamentally from an individual or household having insufficient income. Nevertheless, SSE fulfils two key responsibilities in order to help those of its customers who struggle to pay for their basic energy needs:

- Under the voluntary agreement struck with the UK government in 2008, SSE operated schemes with a value of around £28m in 2010/11 to help vulnerable customers. It introduced a 'tiered' approach to assistance, featuring its energyplus Care tariff, rebate tariffs and other services, and helped around 200,000 customers in the year. This agreement has now been replaced by the Warm Home Discount, which requires energy companies to give discounts on energy bills to vulnerable customers.
- SSE helps customers who may be having difficulties in paying for the electricity and gas they use by offering 'tailor-made' payment arrangements that suit their financial and other circumstances. In March 2011, over 240,000 customers were taking advantage of these arrangements.

### **Retail energy bills in Great Britain**

SSE increased its prices for household gas supply by 9.4% on 1 December 2010. Forward annual wholesale prices for gas rose by over 25% in the period between March 2010, when SSE previously announced a package of changes to prices for household gas, and October 2010, when the price change was announced. Throughout this time, domestic gas supply was a loss-making activity for SSE and its gas supply business, Southern Electric Gas, has traded at a loss for most of the past few years.

In November 2010, Ofgem adopted, for analytical and comparative purposes, a new typical annual domestic gas consumption of 16,500kWh, a reduction of 4,000kWh, following a consistent decline in average domestic gas consumption levels. This demonstrated that the co-operation seen in recent years between energy suppliers, government, Ofgem, consumer organisations, and the associated investment, is delivering a sustained reduction in the amount of gas being consumed in Britain's homes.

The distinction between the price of a unit of energy and the amount customers pay for heating and powering their homes is illustrated by the £132 difference between the cost of 20,500kWh of gas and 16,500kWh. With greater energy efficiency, households are less exposed to the impact of high unit prices than they otherwise would be, because they are using less energy, and further improvements in this area remain a top priority for SSE.

When it published its initial proposals from its Retail Market Review in March 2011, Ofgem claimed to have 'evidence that energy prices have tended to rise in response to wholesale cost increases more quickly than they have fallen with decreases'. It acknowledged that 'this finding is dependent on both the analysis techniques used, as well as how we assume suppliers hedge their energy purchases'.

In fact, Ofgem's analysis on this particularly sensitive point is flawed because it assumes a constant level of energy consumption between 2004 and 2010 when, in fact, consumption has declined. The analytical flaw arises because energy suppliers like SSE recover some of their

fixed costs (such as network costs in gas) through charges on units of energy used. This means that if consumption is reduced, some fixed costs are not recovered by suppliers who, as a result, have to ensure unit prices are at a level that enables them to recover fixed costs.

Future trends in energy prices for domestic customers will ultimately depend on what happens in wholesale electricity and gas markets, with public policy and regulatory decisions on energy production, distribution and consumption also having a significant impact. For example, the costs associated with the EU ETS, RO and the CERT are all on an increasing trend, as are the costs of distributing energy. Moreover, forward annual wholesale prices for electricity and gas have risen by around one quarter and around one third respectively in the six months following SSE's 29 October 2010 announcement of a price increase for household gas supply.

#### **How people pay their energy bills**

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

#### **Keeping customers' energy debt under control**

As at 31 March 2011, the total aged debt (ie debt that is overdue by more than six months) of SSE's domestic and small business electricity and gas customers in Great Britain and Ireland was £89.2m, compared with £94.9m in March 2010. A bad debt-related charge to profits, covering both provision and write-off, of £47.4m has been made. This compares with a charge of £76.1m in the previous year.

The general economic climate meant 2010/11 posed significant debt management challenges, with the volume of work in this area for SSE's Customer Service division again increasing. SSE has sought to manage this situation by taking a number of steps, including rigorous assessment of the credit-worthiness of potential business customers, and making earlier contact with the customer (business or household) when it becomes apparent from analysis that payments are in arrears, so that the issues are more manageable from everyone's point of view. The work of office-based credit agents is supplemented by the work of field-based teams who work with customers to resolve debt.

#### **Providing sector-leading service to customers**

SSE's growth in energy supply has been achieved while being independently and consistently recognised as the customer service benchmark for the rest of the energy supply industry. To provide customers with the best possible value for money, SSE believes that it needs to provide best-in-sector service and products, as well as competitive prices over the medium term.

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

- the UK Customer Satisfaction Index, published in July 2010, in which SSE achieved the top ranking in the utility sector;
- the Customer Satisfaction Report from uSwitch.com, published in September 2010, in which SSE was ranked the best energy supplier for the seventh successive time;
- the JD Power and Associates 2010 UK Electricity and Gas Supplier Customer Satisfaction Study, published in November 2010, in which three of SSE's supply brands occupied the top three places in the study of electricity suppliers; and
- the Consumer Focus customer complaints rankings, published in March 2011, in which SSE again emerged as the best performer, being the only Company with a 'four star' rating.

During 2010/11, there were 1,161 SSE-related complaints to the following third party organisations: the Energy Ombudsman, Consumer Focus and Consumer Direct. This was a reduction from the 1,231 complaints in the previous year.

Although SSE maintained its best-in-sector position in customer service during 2010/11, it was a year in which the profile of the energy supply sector remained very high. In total, SSE's energy supply customers in Great Britain made just over 20 million calls to the Company's teams in Basingstoke, Cardiff, Cumbernauld, Havant and Perth during the year. These conversations allow SSE to assess, consider and respond to customers' concerns and, over time, adapt the services and products it provides accordingly.

#### **Making services available online**

Web and email are now firmly established as the second most common means of communication with the Company used by SSE's customers. Around one third of SSE's transactions with customers now take place online.

Moreover, SSE's customers in the Great Britain and Ireland markets now have 1.3 million online billing accounts, up from just over 800,000 a year before. Online customers can view their account and payment history, submit meter readings and receive an up-to-date balance on their account, make secure payments on their account and other such services.

This, in turn, indicates that the popularity of e-services such as paperless billing is likely to continue to increase rapidly over the next few years. Enabling customers to carry out more transactions online if they choose is now one of SSE's top customer service priorities.

#### **Developing new energy products and services**

The energy supply market in Great Britain is evolving from the simple retailing of electricity and gas to the provision of a comprehensive range of smarter products and services, consistent with the long-term decarbonisation of energy production and consumption. This process will receive additional impetus with the introduction of the Renewable Heat Incentive from July 2011, forthcoming roll-out of smart meters in Great Britain and the introduction of the 'Green Deal'.

SSE launched 'better plan' four years ago as part of its commitment to work in partnership with its customers to help them reduce their energy use and to create a more sustainable level of energy consumption. By the end of 2010/11, the number of 'better plan' customer accounts had increased to 227,000.

The 'better plan' is a practical example of SSE's commitment to product and service innovation in energy supply. It was followed in the autumn of 2010 by 'iplan', a new energy product which delivers smart energy features to customers, allowing them to track their energy usage by providing the real-time and historic information they need to change the way they use energy, thus helping to lower their energy costs.

SSE is more than just a retailer of electricity and gas. It has, for example, developed a number of products based on solar PV, solar thermal and air-source heat pumps. This reflects the fact that while Feed-in Tariffs for localised electricity generation (introduced in April 2010) and the phased introduction of the Renewable Heat Incentive will reinforce the decline in customers' electricity and gas consumption, they are also creating opportunities for SSE to broaden the range of products and services it delivers.

Microgeneration is a very small market at the moment, but it is growing fast. SSE's turnover in this area more than trebled during 2010/11 and milestones achieved included:

- the completion, in March 2011, of its first social housing project for ground-source heat pumps, in conjunction with Geothermal International, an investee company of SSE Ventures;
- the installation of a solar PV installation for a housing association in Oxfordshire; and
- the alignment of SSE's domestic solar PV business with its gas and electrical installation businesses to achieve greater synergies and a better-aligned package of products and services.

In summary, SSE is aiming to build on its position as the sector leader in service provision and on the development of transition products such as the iplan by accelerating the long-term transformation of its energy supply products and services that is already under way. This will

require sustained, but disciplined and pragmatic, investment in systems and processes over the next few years and SSE is developing comprehensive plans to do this.

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

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

As the UK government said in March 2011, when it published its plans for the national roll-out, smart meters will deliver a range of benefits to customers, energy suppliers and energy network companies:

- customers will have real-time information on their energy consumption to help them control energy use, and thereby save money and reduce emissions, and bring an end to estimated bills;
- energy suppliers will have access to accurate data for billing, and will be able to deliver enhanced customer service and reduced costs; and
- energy network companies will have better information with which to manage and plan current activities and the move towards smart grids.

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

- the foundation stage to enable the energy industry to build and test all the systems needed to start the roll-out, ensure positive customer engagement and deliver energy savings and to enable the government to establish the Data Communications Company to manage smart meter communications; and
- the roll-out stage, between 2014 and 2019, during which the meters themselves will be installed.

In line with its measured and realistic approach to the roll-out, SSE installed 2,000 gas and electricity smart meters in 1,000 dual fuel customers' homes in the Midlands and Southern regional electricity areas during 2010/11. It plans to build on this with the installation of up to 10,000 smart meters during 2011/12 and by making substantive progress on the necessary IT systems to support the wider roll-out.

### **Delivering zero carbon homes**

Products and services provided by energy companies have to change because the way people consume energy has to change. People are customers of energy companies, and so the only sustainable option is for companies to change also.

In line with this, SSE completed a development of 10 zero carbon homes on a brownfield site in Slough in September 2010, when it was opened by the Secretary of State for Energy and Climate Change. They feature triple glazing, mechanical ventilation systems, solar PV tiles, solar thermal panels and an energy centre with a biomass boiler and a ground-source heat pump and conform to the highest specification for sustainable building, Code 6 in the Code for Sustainable Homes.

The homes are now occupied and information is being gathered about how householders adapt and respond to zero carbon living to help inform future developments in the decarbonisation of the energy sector.

### **Supply priorities in 2011/12 and beyond**

With smart metering and other developments, SSE is moving towards a much more dynamic, two-way relationship with customers. During 2011/12, and beyond, SSE will seek to build momentum in this direction and:

- provide consistently competitive prices;
- retain and gain customer accounts across the markets in Great Britain and Ireland;

- secure further efficiencies in day-to-day operations, including the ways in which customers are retained and gained and the ways in which they are given the services they need;
- maintain the highest standards of operations, delivering best-in-sector service, including improvements in billing, call handling times and enhancements to online and smart services;
- deliver energy efficiency improvements, principally through the CERT and CESP programmes;
- make substantive preparations for the roll-out of smart meters and related developments; and
- continue to develop the energy-related products and services provided to customers, including microgeneration and insulation.

SSE will seek to achieve all of this while engaging constructively with Ofgem as it takes forward the findings and initial proposals from its Retail Market Review.

In summary, SSE is aiming to build on its position as sector leader for the quality of service provided to electricity and gas customers and develop a broader, deeper energy services offering capable of being geared towards, and targeted at, the needs of individual customers.

## OTHER ENERGY AND UTILITY SERVICES

### Substantial market-based businesses complementing SSE's core activities

As well as being involved in Energy Networks and Generation and Supply, SSE provides other energy and utility services:

- Gas Production;
- Gas Storage;
- Contracting, Utility Solutions and Metering; and
- Telecoms.

The operating profit of this group of businesses has grown from just over £91m to £134.7m in the five years to March 2011. This represents less than 10% of SSE's operating profit, and in SSE's financial statements they are presented as a single operating segment, in line with how they are reviewed by the Board. During 2010/11, SSE acquired its first gas production assets. Its other energy and utility services businesses are substantial in their own fields. For example:

- SSE's onshore gas storage facility at Hornsea is the largest in the UK;
- SSE's contracting business is the second largest mechanical and electrical contracting business in the UK; and
- SSE's telecoms business is the fourth largest telecoms network company in the UK.

As well as being substantial in their own fields, these businesses give SSE an important presence in areas of significance to the UK's infrastructure requirements:

- the UK government's Annual Energy Statement in July 2010 confirmed the need for more gas storage capacity;
- it also confirmed the need to modernise the UK's energy infrastructure, with much greater decentralisation; and
- telecoms networks are clearly recognised as being central to the competitiveness of any economy and the success of any substantial organisation.

The UK government's Annual Energy Statement also stated that indigenous supplies of oil and gas remain important and that the UK must 'maximise economic production while applying effective environmental and safety regulations'.

<b>Other Energy and Utility Services Key Performance Indicators</b>	<b>Mar 11</b>	<b>Mar 10</b>
Gas storage customer nominations met - %	100	100
Gas storage net capacity - mcm	440	400
SSE Contracting order book - £m	98	115
Out-of-area networks in operation	74	53
New gas connections	11,120	6,700
Meters read - m	13.8	10.7

## Gas Production

### Securing upstream supplies of gas

SSE needs on average around 13.5 million therms of gas per day to supply its customers and to fuel its power stations. Its goal is to build up a presence in the upstream gas sector in a measured way to provide an additional source of primary fuel and a hedge for its gas-fired generation and gas supply activities. During 2010/11 it:

- signed, in November 2010, an agreement with Faroe Petroleum plc, the independent oil and gas company, to work together to identify, assess and, where good value can be obtained, acquire producing oil and gas assets in the North Sea. It also subscribed in a placing for just over 5% of the enlarged share capital of Faroe Petroleum plc at a cost of around £18m. The partnership's combined expertise and

relationships across the market provide an opportunity to acquire high quality oil and gas production and benefits from respective strengths; and

- completed, in February 2011, the acquisition from Hess Limited of North Sea natural gas and infrastructure assets. Gas delivery from the assets that are currently in production is expected to be around 200 million therms in 2011 and, subject to the success and phasing of development fields, could increase up to 300 million therms, which would provide around 6% of SSE's gas needs. Production is then forecast to decline over the next 10 years. The main production asset operators are BP and Perenco. The total consideration for the acquisition was £197.2m.

In the two months since SSE acquired its assets, Gas Production delivered an operating profit of £4.6m.

The acquisition and agreement represent SSE's first steps into the upstream gas sector, and it hopes to build its presence in the sector over time – but in a careful, measured way, consistent with its financial principles and, therefore, only where fair value can be secured.

#### **Gas Production priorities in 2011/12**

SSE's priorities in Gas Production in 2011/12 are to:

- complete the integration of recently-acquired gas production assets into its portfolio; and
- pursue further opportunities to secure upstream gas assets, while adhering to its key financial principles.

## **Gas Storage**

#### **Providing capacity to store gas**

As production of North Sea gas declines in the coming years, UK imports will continue to increase to meet demand from domestic customers, gas-fired power stations and other industrial and commercial users. Imports could be put at risk by periods of unusually low temperatures, operational failures in pipelines delivering gas to the UK, political disputes in gas-producing regions or high demand in other parts of the world. This is why gas storage capacity is important, and will remain so even though liquefied natural gas (LNG) has recently helped to diversify sources of gas in the UK and thereby had a negative financial impact on gas storage.

Gas Storage delivered an operating profit\* of £23.7m, during 2010/11, compared with £41.8m in the previous year. Profitability has been affected by a decline in the price achieved for Standard Bundled Units of capacity. This, in turn, reflects a reduction in the differentials between forward summer and winter gas prices, reflecting the increased availability of LNG.

SSE has an ownership interest in two major gas storage facilities in East Yorkshire:

- the UK's largest onshore gas storage facility, at Hornsea, in which around 325 million cubic metres (mcm) of gas can be stored in a total of nine caverns. Hornsea accounts for around 7% of the total gas storage capacity in the UK and 15% of deliverability; and
- the UK's newest onshore gas storage facility, at Aldbrough, which SSE is developing with Statoil (UK) Ltd. An initial 170mcm of capacity in six caverns is already available for commercial operation. The capacity at the Aldbrough development is divided between SSE and Statoil (UK) Ltd on a two thirds/one third basis.

To form caverns such as those at Aldbrough and Hornsea, salt deposits around 2km under ground are leached out by seawater which, in turn, is replaced (dewatered) by gas under pressure. Leaching of all nine caverns at Aldbrough has now been completed, which should allow the final three caverns to be ready for operation by the summer of 2012 and SSE's forecast total investment for the development remains around £290m.

When fully commissioned, Aldbrough will ultimately have the capacity to inject gas and store around 330mcm in nine underground caverns (of which SSE will own two thirds). It will have

the capacity to deliver gas to the National Transmission System at a rate of up to 40mcm per day, equivalent to the average daily consumption of eight million homes, and the ability to have up to 30mcm of gas per day injected.

SSE and Statoil (UK) Ltd have consent to increase the storage capacity at the Aldbrough site beyond that currently under development but concluded during 2010 that an investment decision on the development should be deferred while the UK government develops its policy on gas security.

#### **Making sure storage capacity is available**

At Hornsea, gas can be injected at a rate of 2mcm per day and delivered to the National Transmission System at a rate of 18mcm per day, which is equivalent to the requirements of around four million homes. During 2010/11, Hornsea maintained its good record of dependability and was 100% available to customers, except in instances of planned maintenance. This enabled storage customers to manage their gas market risks and respond to gas trading opportunities. The capacity which became available at Aldbrough also performed well during 2010/11, its first full year of commercial operation.

#### **Gas Storage priorities in 2011/12 and Beyond**

SSE's operational and investment priorities in Gas Storage during 2011/12 are to:

- ensure safe and effective operation of capacity at Hornsea and Aldbrough; and
- complete construction work at Aldbrough.

## **Contracting, Utility Solutions and Metering**

#### **Overall performance in Contracting, Utility Solutions and Metering**

Operating profit\* in Contracting, Utility Solutions and Metering was £88.5m during 2010/11, compared with £80.2m in the previous year, reflecting in particular the contribution from SSE's in-sourced Metering business (see below).

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

SSE Contracting has three main areas of activity:

- industrial, commercial and domestic mechanical and electrical contracting;
- electrical and instrumentation engineering; and
- public and highway lighting services.

It is one of the largest mechanical and electrical contracting businesses in the UK. It operates from regional offices throughout Great Britain.

#### **Sustaining SSE Contracting through economic uncertainty**

While SSE Contracting has continued to make solid progress during 2010/11, its order book ended the year at £98.3m, compared with £115m in 2010 and £101m in 2009. This reflects economic uncertainty in the UK. Nevertheless, the order book features a number of important new contracts with customers as diverse as Frimley Park Hospital and Dartford Tunnel.

A major proportion of SSE Contracting's business has historically come from public sector bodies and end-user client organisations with a high degree of 'repeat' business or long-term contracts. In line with this, PriDE, the joint venture company between SSE Contracting and Interserve Defence Ltd, has signed a £108m, two-year extension to its South East Regional Prime contract with the Defence Infrastructure Organisation. The contract will now run to March 2014.

With public sector budgets being curtailed following the UK Spending Review in October 2010, SSE Contracting is encouraged by the increasing number of enquiries from the private sector. It is also focusing on post-sales control, particularly in terms of costs, and maintaining strong customer relationships, with careful analysis of the markets and areas of work it should prioritise. The structure of the business is also being kept under review, with, for example, some rationalisation of depots, being undertaken.

### **Maintaining leadership in lighting services provision**

SSE Contracting remains the UK's and Ireland's leading street-lighting contractor. It has:

- contracts with 24 local authorities in England, Wales and Scotland to maintain over 600,000 lighting units;
- contracts with 28 local authorities in the Republic of Ireland to maintain over 275,000 lighting units, through Airtricity Utility Solutions; and
- contracts with 12 local authorities, under the Private Finance Initiative, and through the wholly-owned subsidiary Tay Valley Lighting Ltd, to replace and maintain over 600,000 lighting units.

The PFI contracts include the 25-year contract awarded by Knowsley Metropolitan Council in April 2011 for the maintenance of over 24,000 lighting columns, traffic bollards and traffic signs and for the replacement of more than 70% of these during the initial four-year investment period.

Under the contract, the innovative 'Mayflower' Central Management System technology will be installed on all illuminated apparatus. Mayflower is owned by SSE and the technology enables variable light control, fault detection and energy consumption measurement to be undertaken from a central location, allowing the local authority to manage lighting levels and therefore energy consumption, throughout the contract.

Including PFI and maintenance contracts in Great Britain and the Republic of Ireland, SSE now maintains almost 1.5 million lighting units. A public tender process for street light maintenance in Northern Ireland will begin in 2012.

### **Providing comprehensive Utility Solutions**

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

- **Electricity Networks:** in the summer of 2010, SSE signed a contract which will result in the development of its 100<sup>th</sup> embedded electricity network outside the areas served by its economically-regulated subsidiaries Scottish Hydro Electric Power Distribution and Southern Electric Power Distribution. SSE now owns and operates 74 energised electricity networks of this kind. A further 14 are under construction and contracts have been signed for the development of an additional 29, taking the total to 117. In total, SSE has 740MW of network capacity, including almost 300MW of existing demand and 440MW of connections to be completed.
- **Gas Pipelines:** SSE is also a licensed gas transporter, installing, owning and operating gas mains and services on new housing and commercial developments throughout the UK. The total number of new premises connected to its gas networks has continued to grow, and during 2010/11, it connected a further 11,120 premises, taking the total number of connections to over 78,000.
- **Water:** SSE Water (SSEW) is the first new company to offer both water and sewerage services since privatisation in England and Wales in 1989, and its establishment will enable SSE to provide, over the long term, a more comprehensive multi-utility solution to customers in the property development and house-building sectors, through being able to install, own, operate and supply water and sewerage services alongside its existing electricity and gas services. An 'inset' appointment is the route by which one company replaces another as the appointed water and/or sewerage company for a specified area. SSEW now has nine such appointments and provides, or has secured contracts to provide, water and sewerage services to over 15,000 properties in England and Wales.
- **Heat:** SSE uses a range of sustainable technical solutions, including Combined Heat and Power (CHP) generation, biomass boilers and ground- and air-source heat pumps and combines these with community heating schemes where appropriate. For example, in August 2010, it secured a contract to adopt, own and operate the new

heat network for two adjacent sites totalling 750 plots in the London Borough of Hackney.

### **Maintaining a national Metering business**

SSE's Metering business provides services to most electricity suppliers with customers in central southern England and the north of Scotland. Previously, SSE relied on a combination of its own employees in central southern England and the north of Scotland and up to nine external agencies elsewhere in the country to read electricity and gas meters and install and repair electricity meters. Following the successful completion of a programme of in-sourcing in March 2010, it undertakes meter reading operations and meter operator work in all other parts of Great Britain. It supplies, installs and maintains domestic meters and carries out metering work in the commercial, industrial and generation sectors. It also offers data collection services to the domestic and SME sectors.

In total, SSE owns 3.8 million meters. During 2010/11, the first full-year after the completing of in-sourcing, it collected:

- 8.4 million electricity readings, up from 6.8 million in the previous year; and
- 5.4 million gas readings, up from 3.9 million.

This increase reflects the completion, during 2009/10, of the in-sourcing of its meter reading and electricity meter operation services throughout Great Britain. Longer-term, SSE's Great Britain-wide metering team will be able to support the transition to smart meters which will take place in the coming decade and will help SSE deploy other energy-related services and products during that time (see 'Preparing for the roll-out of smart meters' above).

### **Contracting, Utility Solutions and Metering priorities in 2011/12 and beyond**

SSE's priorities in Contracting, Utility Solutions and Metering are to:

- deliver a high standard of service to all customers;
- focus on strong cost control and maintaining and developing customer contacts;
- increase the number of contracts secured across all activities; and
- help prepare for the roll-out of smart meters.

## **Telecoms Networks**

### **Operating one of the UK's largest telecoms networks**

The origins of SSE's Telecoms business lie in the installation, a decade ago, of fibre optic cable on SSE's electricity network. The business combines SSE Telecoms and Neos Networks and a number of acquisitions and now operates a 11,200km UK-wide telecoms network.

This network provides capacity and bandwidth services for companies, public sector organisations, internet service providers, application service providers and other licence operators and now comprises:

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

As a result, this is the fourth largest telecoms network company in the UK. As a subsidiary of SSE, it is also able to position itself as one of the UK's most financially secure telecoms network operators, which gives it an important competitive advantage, especially during an economic downturn.

To complement its core telecoms network business, SSE's Fareham-based data centre provides capacity for more than 1,200 racks for the co-location of IT services within the 80,000 square feet secure site and 10MW of power in a resilient and energy efficient environment. During the summer of 2010, what is believed to be the UK's largest commercial

solar PV installation was placed on the roof of the data centre. Customers for the data centre include Thomson Reuters and Kingfisher.

#### **Telecoms' financial performance**

SSE's combined Telecoms business achieved an operating profit\* of £17.9m during 2010/11, compared with £16.4m. The year was characterised by a challenging environment for sales in respect of the network, which made tight control on operating costs especially important.

The Telecoms business undertook capital expenditure of £34.7m in 2010/11, focused on improving network reliability and reach and on the Fareham data centre.

#### **Telecoms priorities in 2011/12 and beyond**

SSE's priorities in Telecoms in 2011/12 are to:

- retain and gain customers for key services such as capacity and bandwidth; and
- add to the number of customers for its data centre business.

The achievement of these priorities should enable SSE Telecoms to continue to make progress towards becoming the UK's leading alternative telecoms network.

#### **Disclaimer**

This preliminary results statement contains forward-looking statements about financial and operational matters. Because they relate to future events and are subject to future circumstances, these forward-looking statements are subject to risks, uncertainties and other factors. As a result, actual financial results, operational performance and other future developments could differ materially from those envisaged by the forward-looking statements.

**Consolidated Income Statement**  
for the year ended 31 March 2011

		2011		2010			
	Note	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 6) £m	Total £m	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 6) £m	Total £m
					Restated	Restated	Restated
<b>Revenue</b>	5	28,334.2	-	28,334.2	21,550.4	-	21,550.4
Cost of sales		(26,094.1)	948.8	(25,145.3)	(19,466.3)	432.2	(19,034.1)
<b>Gross profit</b>		<b>2,240.1</b>	<b>948.8</b>	<b>3,188.9</b>	2,084.1	432.2	2,516.3
Operating costs		(886.0)	-	(886.0)	(722.2)	-	(722.2)
<b>Operating profit before jointly controlled entities and associates</b>		<b>1,354.1</b>	<b>948.8</b>	<b>2,302.9</b>	1,361.9	432.2	1,794.1
Jointly controlled entities and associates:							
Share of operating profit		298.8	(103.2)	195.6	264.1	-	264.1
Share of interest		(139.9)	-	(139.9)	(107.1)	-	(107.1)
Share of movement on derivatives		-	5.9	5.9	-	4.1	4.1
Share of tax		(58.2)	61.5	3.3	(50.1)	(1.2)	(51.3)
<b>Share of profit on jointly controlled entities and associates</b>		<b>100.7</b>	<b>(35.8)</b>	<b>64.9</b>	106.9	2.9	109.8
<b>Operating profit</b>	5	<b>1,454.8</b>	<b>913.0</b>	<b>2,367.8</b>	1,468.8	435.1	1,903.9
Finance income	7	250.2	-	250.2	203.2	-	203.2
Finance costs	7	(453.1)	(53.2)	(506.3)	(432.0)	(36.5)	(468.5)
<b>Profit before taxation</b>		<b>1,251.9</b>	<b>859.8</b>	<b>2,111.7</b>	1,240.0	398.6	1,638.6
Taxation	8	(354.8)	(252.4)	(607.2)	(292.2)	(110.9)	(403.1)
<b>Profit for the year</b>		<b>897.1</b>	<b>607.4</b>	<b>1,504.5</b>	947.8	287.7	1,235.5
<b>Attributable to:</b>							
Equity holders of the parent		897.1	607.4	1,504.5	947.6	287.7	1,235.3
Non-controlling interest		-	-	-	0.2	-	0.2
Basic earnings per share	10			<b>162.2p</b>			134.0p
Diluted earnings per share	10			<b>162.0p</b>			133.9p
Dividends paid in the year	9			<b>£659.8m</b>			£618.5m

The accompanying notes are an integral part of the financial information in this announcement.

**Consolidated Statement of Comprehensive Income**  
For the year ended 31 March 2011

	2011 £m	2010 £m
<b>Profit for the year</b>	<b>1,504.5</b>	1,235.5
<b>Other comprehensive income:</b>		
Gains/(losses) on effective portion of cash flow hedges	32.3	(26.6)
Transferred to assets and liabilities on cash flow hedges	(7.0)	-
Taxation on cashflow hedges	(5.9)	2.1
	<b>19.4</b>	<b>(24.5)</b>
Exchange difference on translation of foreign operations	(78.3)	0.4
Gains/(losses) on net investment hedge	4.3	(47.2)
Taxation on net investment hedge	(1.2)	13.2
	<b>(75.2)</b>	<b>(33.6)</b>
Actuarial losses on retirement benefit schemes	(8.8)	(508.8)
Taxation on actuarial losses on defined benefit pension schemes	(7.9)	142.5
	<b>(16.7)</b>	<b>(366.3)</b>
<b>Jointly controlled entities and associates:</b>		
Share of (loss) on effective portion of cash flow hedges	(4.1)	(30.0)
Share of taxation on cashflow hedges	(0.3)	19.1
	<b>(4.4)</b>	<b>(10.9)</b>
Share of actuarial (losses) on retirement benefit schemes	(11.6)	(82.1)
Share of taxation of actuarial losses on retirement benefit schemes	1.8	23.0
	<b>(9.8)</b>	<b>(59.1)</b>
<b>Net share from jointly controlled entities and associates</b>	<b>(14.2)</b>	<b>(70.0)</b>
<b>Other comprehensive income, net of taxation</b>	<b>(86.7)</b>	<b>(494.4)</b>
<b>Total comprehensive income for the period</b>	<b>1,417.8</b>	<b>741.1</b>
<b>Attributable to:</b>		
Equity holders of the parent	1,417.8	740.9
Non-controlling interest	-	0.2
	<b>1,417.8</b>	<b>741.1</b>

**Consolidated Balance Sheet**  
as at 31 March 2011

	2011	2010
		Restated (note 4)
Note	£m	£m
<b>Assets</b>		
Property, plant and equipment	8,513.1	8,204.2
Biological assets	4.4	4.4
Intangible assets:		
Goodwill	685.3	726.3
Other intangible assets	287.8	288.2
Equity investments in associates and jointly controlled entities	760.8	635.2
Loans to associates and jointly controlled entities	1,124.6	970.5
Other investments	39.6	9.2
Deferred tax assets	161.7	157.1
Derivative financial assets	990.1	466.3
<b>Non-current assets</b>	<b>12,567.4</b>	<b>11,461.4</b>
Other intangible assets	325.6	213.3
Inventories	217.5	272.5
Trade and other receivables	5,068.1	4,450.4
Cash and cash equivalents	476.9	261.7
Derivative financial assets	2,525.5	1,468.3
Current assets held for sale	269.4	-
<b>Current assets</b>	<b>8,883.0</b>	<b>6,666.2</b>
<b>Total assets</b>	<b>21,450.4</b>	<b>18,127.6</b>
<b>Liabilities</b>		
Loans and other borrowings	446.5	903.7
Trade and other payables	5,078.0	4,064.5
Current tax liabilities	268.2	216.9
Provisions	9.9	6.5
Derivative financial liabilities	2,307.5	2,020.7
<b>Current liabilities</b>	<b>8,110.1</b>	<b>7,212.3</b>
Loans and other borrowings	5,159.9	5,143.3
Deferred tax liabilities	1,068.3	624.0
Trade and other payables	304.2	324.5
Provisions	169.2	83.2
Retirement benefit obligations	668.6	720.3
Derivative financial liabilities	769.3	899.0
<b>Non-current liabilities</b>	<b>8,139.5</b>	<b>7,794.3</b>
<b>Total liabilities</b>	<b>16,249.6</b>	<b>15,006.6</b>
<b>Net assets</b>	<b>5,200.8</b>	<b>3,121.0</b>
<b>Equity:</b>		
Share capital	468.4	461.5
Share premium	859.8	857.5
Capital redemption reserve	22.0	22.0
Hedge reserve	(1.2)	(16.2)
Translation reserve	38.2	113.4
Retained earnings	2,652.2	1,686.6
Hybrid capital	1,161.4	-
<b>Total equity attributable to equity holders of the parent</b>	<b>5,200.8</b>	<b>3,124.8</b>
Non-controlling interest	-	(3.8)
<b>Total Equity</b>	<b>5,200.8</b>	<b>3,121.0</b>

## Statement of Changes in Equity as at 31 March 2011

### Consolidated

Reconciliation of movement in reserves	Share capital £m	Share premium account £m	Capital redemption reserve £m	Hedge reserve £m	Translation reserve £m	Retained earnings £m	Non-controlling interest £m	Hybrid Capital £m	Total £m
At 1 April 2010	461.5	857.5	22.0	(16.2)	113.4	1,686.6	(3.8)	-	3,121.0
Profit for the year	-	-	-	-	-	1,504.5	-	-	1,504.5
Effective portion of changes in fair value of cash flow hedges (net of tax)	-	-	-	26.4	-	-	-	-	26.4
Transferred to balance sheet on cash flow hedges (net of tax)	-	-	-	(7.0)	-	-	-	-	(7.0)
Effective net investment hedge (net of tax)	-	-	-	-	3.1	-	-	-	3.1
Exchange differences on translation of foreign operation	-	-	-	-	(78.3)	-	-	-	(78.3)
Actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	(16.7)	-	-	(16.7)
Jointly controlled entities and associates:									
Share of change in fair value of effective cash flow hedges	-	-	-	(4.4)	-	-	-	-	(4.4)
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	(9.8)	-	-	(9.8)
<b>Total comprehensive income for the year</b>	-	-	-	15.0	(75.2)	1,478.0	-	-	1,417.8
Dividends to shareholders	-	-	-	-	-	(659.8)	-	-	(659.8)
Scrip dividend related share issue	6.4	(6.4)	-	-	-	146.1	-	-	146.1
Issue of hybrid capital	-	-	-	-	-	-	-	1,161.4	1,161.4
Issue of shares	0.5	8.7	-	-	-	-	-	-	9.2
Credit in respect of employee share awards	-	-	-	-	-	9.9	-	-	9.9
Transactions with shareholders	-	-	-	-	-	-	3.8	-	3.8
Investment in own shares	-	-	-	-	-	(9.2)	-	-	(9.2)
Current and deferred tax recognised in equity in respect of employee share awards	-	-	-	-	-	0.6	-	-	0.6
<b>At 31 March 2011</b>	<b>468.4</b>	<b>859.8</b>	<b>22.0</b>	<b>(1.2)</b>	<b>38.2</b>	<b>2,652.2</b>	<b>-</b>	<b>1,161.4</b>	<b>5,200.8</b>

### Consolidated

Reconciliation of movement in reserves	Share capital £m	Share premium account £m	Capital redemption reserve £m	Equity reserve £m	Hedge reserve £m	Translation reserve £m	Retained earnings £m	Non-controlling interest £m	Total £m
At 1 April 2009	460.2	835.3	22.0	0.8	19.6	146.6	1,492.7	(2.3)	2,974.9
Profit for the year	-	-	-	-	-	-	1,235.3	0.2	1,235.5
Effective portion of changes in fair value of cash flow hedges (net of tax)	-	-	-	-	(24.5)	-	-	-	(24.5)
Effective net investment hedge (net of tax)	-	-	-	-	-	(34.0)	-	-	(34.0)
Exchange differences on translation of foreign operation	-	-	-	-	(0.4)	0.8	-	-	0.4
Actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	-	(366.3)	-	(366.3)
Jointly controlled entities and associates:									
Share of change in fair value of effective cash flow hedges	-	-	-	-	(10.9)	-	-	-	(10.9)
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	-	(59.1)	-	(59.1)
<b>Total comprehensive income for the year</b>	-	-	-	-	(35.8)	(33.2)	809.9	0.2	741.1
Dividends to shareholders	-	-	-	-	-	-	(618.5)	(1.7)	(620.2)
Convertible bond converted to equity	0.9	15.8	-	(0.8)	-	-	-	-	15.9
Issue of shares	0.4	6.4	-	-	-	-	-	-	6.8
Credit in respect of employee share awards	-	-	-	-	-	-	17.9	-	17.9
Investment in own shares	-	-	-	-	-	-	(15.8)	-	(15.8)
Current and deferred tax recognised in equity in respect of employee share awards	-	-	-	-	-	-	0.4	-	0.4
<b>At 31 March 2010</b>	<b>461.5</b>	<b>857.5</b>	<b>22.0</b>	<b>-</b>	<b>(16.2)</b>	<b>113.4</b>	<b>1,686.6</b>	<b>(3.8)</b>	<b>3,121.0</b>

The capital redemption reserve comprises the value of shares redeemed or purchased from distributable profits.

The hedge reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedge derivative instruments related to hedged transactions that have not yet occurred.

The equity reserve comprised the equity component of the Group's convertible bond.

The translation reserve comprises exchange translation differences on foreign currency net investments offset by exchange translation differences on borrowings and derivatives classified as net investment hedges under IAS 39.

**Consolidated Cash Flow Statement**  
for the year ended 31 March 2011

	2011	2010
	£m	Restated £m
<b>Cash flows from operating activities</b>		
Profit for the year after tax	1,504.5	1,235.5
Taxation	607.2	403.1
Movement on financing and operating derivatives	(1,417.4)	(395.7)
Finance costs	453.1	432.0
Finance income	(250.2)	(203.2)
Share of jointly controlled entities and associates	(64.9)	(109.8)
Pension service charges less contributions paid	(68.9)	(88.8)
Exceptional impairment of assets	521.8	-
Depreciation and impairment of assets	496.7	394.9
Amortisation and impairment of intangible assets	21.5	22.2
Impairment of inventories	6.6	3.0
Release of provisions	(6.0)	(7.1)
Release of deferred income	(19.6)	(15.2)
Decrease in inventories	48.4	97.2
(Increase) / decrease in receivables	(95.4)	914.3
Increase / (decrease) in payables	371.3	(486.8)
Increase in provisions	6.2	5.9
Charge in respect of employee share awards (before tax)	9.9	17.9
(Profit) on disposal of property, plant and equipment	(5.8)	(5.7)
Loss on disposal of fixed asset investment	-	0.1
(Profit) on disposal of business and subsidiaries	(10.2)	-
<b>Cash generated from operations</b>	<b>2,108.8</b>	<b>2,213.8</b>
Dividends received from jointly controlled entities	81.7	23.7
Dividends paid to minority investment holders	-	(1.7)
Interest income	109.7	102.5
Interest costs	(387.1)	(341.4)
Income taxes paid	(172.6)	(307.7)
Payment for consortium relief	(21.2)	-
<b>Net cash from operating activities</b>	<b>1,719.3</b>	<b>1,689.2</b>
<b>Cash flows from investing activities</b>		
Purchase of property, plant and equipment	(1,079.0)	(1,033.5)
Purchase of other intangible assets	(40.3)	(4.2)
Deferred income received	28.5	18.7
Proceeds from sale of property, plant and equipment	7.9	40.2
Proceeds from sale of fixed asset investment	-	0.9
Proceeds from sale of business and subsidiaries	31.9	-
Loans to jointly controlled entities and associates	(204.4)	(336.4)
Purchase of businesses and subsidiaries	(241.3)	(67.8)
Cash acquired in purchases	-	9.7
Cash included in disposals	(5.5)	-
Cash included in assets held for sale	(23.0)	-
Investment in jointly controlled entities and associates	(176.3)	(61.8)
Loans and equity repaid by jointly controlled entities	13.3	34.5
Increase in other investments	(30.4)	(1.1)
<b>Net cash from investing activities</b>	<b>(1,718.6)</b>	<b>(1,400.8)</b>
<b>Cash flows from financing activities</b>		
Proceeds from issue of share capital	9.2	6.8
Dividends paid to Company's equity holders	(513.7)	(618.5)
Issue of hybrid capital	1,161.4	-
Employee share awards share purchase	(9.2)	(15.8)
New borrowings	765.1	1,338.3
Repayment of borrowings	(1,187.1)	(1,035.3)
<b>Net cash from financing activities</b>	<b>225.7</b>	<b>(324.5)</b>
<b>Net increase / (decrease) in cash and cash equivalents</b>	<b>226.4</b>	<b>(36.1)</b>
Cash and cash equivalents at the start of year	252.5	293.6
Net increase / (decrease) in cash and cash equivalents	226.4	(36.1)
Effect of foreign exchange rate changes	(7.3)	(5.0)
<b>Cash and cash equivalents at the end of year</b>	<b>471.6</b>	<b>252.5</b>
Cash and cash equivalents as above	471.6	252.5
Bank overdraft (i)	5.3	9.2
<b>Cash and cash equivalents per balance sheet</b>	<b>476.9</b>	<b>261.7</b>

(i) Bank overdrafts are reported on the balance sheet as part of current loans and borrowings. For cash flow purposes, these have been included as cash and cash equivalents.

## **Notes to the Preliminary Statement**

### **For the year ended 31 March 2011**

#### **1. Financial Information**

The financial information set out in this announcement does not constitute the Group's statutory accounts for the years ended 31 March 2011 or 2010 but is derived from those accounts. Statutory accounts for 2010 have been delivered to the Registrar of Companies, and those for 2011 will be delivered in due course. The auditors have reported on those accounts; their reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for 2011. This preliminary announcement was authorised by the Board on 19 May 2011.

#### **2. Basis of preparation**

The financial information set out in this announcement has been prepared under the historical cost convention excepting certain assets and liabilities stated at fair value and in accordance with International Financial Reporting Standards and their interpretations as adopted by the European Union (adopted IFRS). The accounting policies adopted by the Group in this financial information are consistent with those used in the financial statements for the year ended 31 March 2011. The Directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future. The financial information has therefore been prepared on a going concern basis. Certain items have been reclassified to enhance understanding of the prior year results and to aid comparability with the current year presentation. The financial statements are presented in pounds sterling.

#### **3. Basis of consolidation of the Group**

The financial information consolidates the results and net assets of Scottish and Southern Energy plc and its subsidiaries together with the Group's share of the results and net assets of its jointly controlled entities and associates.

The results of subsidiary undertakings acquired or sold are consolidated from the date that control commences until the date control ceases using the purchase method of accounting.

The Group's share of the total recognised gains and losses of associates are included on an equity accounted basis from the date that significant influence commences until the date significant influence ceases.

Investments in jointly controlled entities are accounted for under the equity method of accounting from the date that joint control commences until the date joint control ceases. Jointly controlled operations are businesses which use assets and liabilities that are separable from the rest of the Group. In these arrangements, the Group accounts for its own share of property, plant and equipment, carries its own inventories, incurs its own expenses and liabilities and raises its own finance.

#### **4. Reclassification of Comparative Amounts**

The Group's Investments in Jointly Controlled Entities and Associates were previously disclosed including the value of long-term shareholder loans. While this represents the substance of the Group's net investment in its Jointly Controlled Entities and Associates, such interests are not recorded under the equity method of accounting under IAS 27 and 31 but instead are recorded initially at fair value under IAS 39 and are subsequently measured at amortised cost. To align with emerging consensus practice, all such long-term shareholder loans are now shown separately as non-current financial assets and not as part of the equity investment in Jointly Controlled Entities and Associates. In addition to this, the Group holds interest-bearing long-term commercial loans with certain Jointly Controlled Entities (Greater Gabbard Offshore Winds Limited and Marchwood Power Limited) which were previously recorded as part of current other receivables. These have been reclassified as non-current financial assets. No further restatement has been considered necessary to aid understanding of the Group's financial position.

The impact of these changes are as follows:

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### i. Reclassification of long-term shareholder loans

	Reported 31 March 2010 £m	Restated 31 March 2010 £m
Equity investment in associates and jointly controlled entities	1,037.3	635.2
Loans to associates and jointly controlled entities	-	402.1
	<b>1,037.3</b>	<b>1,037.3</b>

### ii. Reclassification of long-term commercial loans

	Reported 31 March 2010 £m	Restated 31 March 2010 £m
Current other receivables	857.5	289.1
Loans to associates and jointly controlled entities	-	568.4
	<b>857.5</b>	<b>857.5</b>

Following the adoption of IFRIC 18, the Group has restated the income statement of the prior year to recognise an increase in the depreciation of property, plant and equipment of £38.5m and a corresponding reduction in cost of sales. This has also had an impact on certain cash flow statement classifications.

## 5. Segmental information

The Group's operating segments are the distribution and transmission of electricity in the North of Scotland, the distribution of electricity in the South of England (together referred to as Power Systems), the generation and supply of electricity and sale of gas in Great Britain and Ireland (Generation and Supply) and other businesses. In addition to this the Group's 50% equity share in Scotia Gas Networks Limited, a business which distributes gas in Scotland and the South of England, is included as a separate segment where appropriate due to its significance. The types of products and services from which each reportable segment derives its revenues are:

Segment	Geographical location	Description
<b>Power Systems</b>	UK	Transmits and distributes electricity to over 3 million businesses, offices and homes.
<b>Generation and supply</b>	Great Britain, Ireland and Europe	The Group views this as a single value chain within a vertically-integrated business. It generates and supplies electricity to domestic, commercial and industrial customers in Great Britain and Ireland. In addition, it also supplies gas to customers in the same locations. Generation is provided by a portfolio of thermal power stations and from renewable sources of energy.
<b>Other businesses:</b>		
Contracting, Utility Solutions and Lighting Services	UK and Ireland	Mechanical and electrical contracting services, public and highway lighting and electrical and instrumentation engineering; electricity and gas connections for homes, offices and businesses, out-of-area electricity networks, licenced gas transportation and water and sewerage services.
Metering	UK	Supplies, installs and maintains electricity meters and provides data collection services.
Gas Storage	UK	Develops, owns and operates underground onshore gas storage facilities
Exploration & Production	UK	Production and processing of North Sea gas and oil and the development of new gas and oil fields
Telecoms	UK	Provides network capacity, data centre and bandwidth services to customers

Analysis of revenue and operating profit by segment is provided below. All revenue and profit before taxation arise from operations within Great Britain, Ireland and mainland Europe.

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### a) Revenue by segment

	Total revenue		Intra-segment revenue		External revenue	
	2011 £m	2010 £m	2011 £m	2010 £m	2011 £m	2010 £m
<b>Power Systems</b>						
Scotland	356.7	309.1	111.0	105.5	245.7	203.6
England	517.2	473.5	214.1	212.2	303.1	261.3
	<b>873.9</b>	<b>782.6</b>	<b>325.1</b>	<b>317.7</b>	<b>548.8</b>	<b>464.9</b>
<b>Generation and Supply</b>						
Retail	8,044.4	8,234.4	-	-	8,044.4	8,234.4
Wholesale and Trading	18,899.9	12,000.3	17.1	12.0	18,882.8	11,988.3
Other businesses	222.9	216.4	15.8	7.8	207.1	208.6
	<b>27,167.2</b>	<b>20,451.1</b>	<b>32.9</b>	<b>19.8</b>	<b>27,134.3</b>	<b>20,431.3</b>
<b>Other businesses</b>	<b>1,219.9</b>	<b>1,173.9</b>	<b>568.8</b>	<b>519.7</b>	<b>651.1</b>	<b>654.2</b>
	<b>29,261.0</b>	<b>22,407.6</b>	<b>926.8</b>	<b>857.2</b>	<b>28,334.2</b>	<b>21,550.4</b>

Revenue within Generation and Supply includes retail sales from energy supply customers, wholesale and trading revenue and other sales. Wholesale and Trading revenue includes revenues from generation plant output and the gross value of all wholesale power and gas sales including settled physical and financial trades. These are entered into to optimise the performance of the generation plants and to support the energy supply business. Purchase trades are included in cost of sales.

Revenue from the Group's investment in Scotia Gas Networks (SSE share being 2011 – £392.5m; 2010 – £373.5m) is not recorded in the revenue line in the income statement.

### b) Operating profit by segment

	2011				Total £m
	Adjusted £m	JCE / Associate share of interest and tax (i) £m	Before exceptional items and certain re- measurements £m	Exceptional items and certain re- measurements £m	
<b>Power Systems</b>					
Scotland	168.1	-	168.1	-	168.1
England	287.4	-	287.4	-	287.4
	<b>455.5</b>	<b>-</b>	<b>455.5</b>	<b>-</b>	<b>455.5</b>
Scotia Gas Networks	186.8	(150.7)	36.1	38.4	74.5
<b>Energy Systems</b>	<b>642.3</b>	<b>(150.7)</b>	<b>491.6</b>	<b>38.4</b>	<b>530.0</b>
<b>Generation and Supply</b>	<b>882.8</b>	<b>(47.1)</b>	<b>835.7</b>	<b>874.6</b>	<b>1,710.3</b>
<b>Other businesses</b>	<b>136.8</b>	<b>(0.3)</b>	<b>136.5</b>	<b>-</b>	<b>136.5</b>
	<b>1,661.9</b>	<b>(198.1)</b>	<b>1,463.8</b>	<b>913.0</b>	<b>2,376.8</b>
Unallocated expenses (ii)	(9.0)	-	(9.0)	-	(9.0)
	<b>1,652.9</b>	<b>(198.1)</b>	<b>1,454.8</b>	<b>913.0</b>	<b>2,367.8</b>

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### 5. Segmental information (continued)

#### b) Operating profit by segment (continued)

	Adjusted	JCE / Associate share of interest and tax (i)	2010		Total
			Before exceptional items and certain re- measurements	Exceptional items and certain re- measurements	
	£m	£m	£m	£m	£m
<b>Power Systems</b>					
Scotland	158.9	-	158.9	-	158.9
England	256.9	-	256.9	-	256.9
	415.8	-	415.8	-	415.8
Scotia Gas Networks	183.7	(130.5)	53.2	2.4	55.6
<b>Energy Systems</b>	599.5	(130.5)	469.0	2.4	471.4
<b>Generation and Supply</b>	896.0	(26.5)	869.5	432.7	1,302.2
<b>Other businesses</b>	140.3	(0.2)	140.1	-	140.1
	1,635.8	(157.2)	1,478.6	435.1	1,913.7
Unallocated expenses (ii)	(9.8)	-	(9.8)	-	(9.8)
	1,626.0	(157.2)	1,468.8	435.1	1,903.9

(i) The adjusted operating profit of the Group is reported after removal of the Group's share of interest, remeasurement of derivatives and tax from jointly controlled entities and associates. The share of Scotia Gas Networks interest includes loan stock interest payable to the consortium shareholders, £33.4m (2010 - £33.8m). The Group has accounted for its 50% share of this as finance income (note 7).

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

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### 6. Exceptional items and certain re-measurements

#### i) Exceptional items

In the year to 31 March 2011 the following exceptional items have been recorded:

Impairment of thermal and renewable generation portfolio assets arising from changing market conditions. Exceptional charges have been recognised in relation to the impairment of goodwill (£42.5m), property, plant and equipment (£442.7m), development intangible assets (£39.7m) and financial assets (£7.4m). In addition, related net credits of £10.5m have been recognised, including £8.8m relating to finance costs.

These were recognised as a consequence of changing regulatory and economic conditions, in particular, (i) the impact of the Industrial Emissions Directive on station running hours and useful economic lives at certain plants including the Fiddler's Ferry and Ferrybridge power stations; (ii) the consequential impact on the ash remediation plant at Fiddler's Ferry, (iii) changes in the economic prospects of certain older, less flexible thermal plants, and, (iv) the decision to concentrate continental Europe wind generation activities on the Sweden and Netherlands markets.

Impairment of Investments in Associates. Exceptional impairment charges have been recognised in relation to the Group's investments in Barking Power Limited and Derwent Cogeneration Limited following the expiry of long-term power purchase agreements at both stations. In addition, certain other investments have been impaired. The combined impairment charges are £76.3m net of deferred tax.

Changes in UK corporation tax rates. The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate will reduce from 28% to 24% over a period of four years from 2011. The first change from 28% to 27% was substantially enacted on July 2010 and applies from 1 April 2011. The March 2011 Budget further reduced the tax rate from 1 April 2011 to 26%. This was substantively enacted on 29 March 2011. These changes will reduce the Group's future current tax charge accordingly. As this rate change has been substantively enacted it has the effect of reducing the Group's net deferred tax liabilities recognised at 31 March 2011 by £49.4m. It has not yet been possible to quantify the full anticipated effect of the announced further 3% rate reduction (the rate now being reduced to 23%) due to legislation not being enacted, although this will further reduce the company's future current tax charge and reduce the company's deferred tax liabilities/assets accordingly.

In addition, the March 2011 Budget increased the rate of supplementary corporation tax (SCT) from 20% to 32% and was also substantively enacted on 29 March 2011. This had the effect of increasing the Group's deferred tax liabilities and assets in relation to the Group's Exploration and Production (E&P) business to which this supplementary tax applies. The impact on the Group's net deferred tax liabilities was an increase of £31.7m.

#### ii) Certain re-measurements

Certain re-measurements arising from IAS 39 are disclosed separately to aid understanding of the underlying performance of the Group. This category includes the movement on derivatives as described in note 12.

#### iii) Taxation

The Group has separately recognised the tax effect of the exceptional items and certain re-measurements summarised above.

## Notes to the Preliminary Statement

for the year ended 31 March 2011

These transactions can be summarised thus:

	2011 £m	2010 £m
Exceptional items		
Impairments and other charges:		
Impairment of Generation assets arising from changing market conditions	(521.8)	-
Impairment of Investments in Associates (share of results, net of tax)	(76.3)	-
Share of effect of change in UK corporation tax on deferred tax liabilities and assets of associate and joint venture investments	36.3	-
	<u>(561.8)</u>	<u>-</u>
Certain re-measurements		
Movement on operating derivatives (note 12)	1,461.8	432.2
Movement on financing derivatives (note 12)	(44.4)	(36.5)
Share of movements on derivatives in jointly controlled entities (net of tax)	4.2	2.9
	<u>1,421.6</u>	<u>398.6</u>
<b>Profit before taxation</b>	<b>859.8</b>	<b>398.6</b>
Exceptional items		
Effect of change in UK corporation tax rate on deferred tax liabilities and assets	49.4	-
Effect of change in UK supplementary corporation tax rate	(31.7)	-
Taxation on other exceptional items	126.1	-
	<u>143.8</u>	<u>-</u>
Taxation on certain re-measurements	(396.2)	(110.9)
<b>Taxation</b>	<b>(252.4)</b>	<b>(110.9)</b>
<b>Impact on profit for the year</b>	<b>607.4</b>	<b>287.7</b>

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### 7. Net finance costs

Recognised in income statement

	Before exceptional items and certain re- measure ments £m	Exceptional items and certain re- measure ments (note 6) £m	2011 £m	Before exceptional items and certain re- measure ments £m	Exceptional items and certain re- measure ments (note 6) £m	2010 £m
<b>Finance income:</b>						
Return on pension scheme assets	141.9	-	141.9	100.7	-	100.7
Interest income from short term deposits	2.7	-	2.7	3.5	-	3.5
<b>Other interest receivable:</b>						
Scotia Gas Networks loan stock	33.4	-	33.4	33.8	-	33.8
Other jointly controlled entities and associates	23.1	-	23.1	20.1	-	20.1
Other receivable	49.1	-	49.1	35.1	-	35.1
	105.6	-	105.6	89.0	-	89.0
Foreign exchange translation of monetary assets and liabilities	-	-	-	10.0	-	10.0
<b>Total finance income</b>	<b>250.2</b>	<b>-</b>	<b>250.2</b>	<b>203.2</b>	<b>-</b>	<b>203.2</b>
<b>Finance costs:</b>						
Bank loans and overdrafts	(58.1)	-	(58.1)	(49.9)	-	(49.9)
Other loans and charges	(247.1)	(8.8)	(255.9)	(284.1)	-	(284.1)
Interest on pension scheme liabilities	(150.2)	-	(150.2)	(127.5)	-	(127.5)
Notional interest arising on discounted provisions	(4.3)	-	(4.3)	(3.5)	-	(3.5)
Finance lease charges	(39.7)	-	(39.7)	(13.2)	-	(13.2)
Foreign exchange translation of monetary assets and liabilities	(13.2)	-	(13.2)	-	-	-
Less: interest capitalised	59.5	-	59.5	46.2	-	46.2
<b>Total finance costs</b>	<b>(453.1)</b>	<b>(8.8)</b>	<b>(461.9)</b>	<b>(432.0)</b>	<b>-</b>	<b>(432.0)</b>
Changes in fair value of financing derivative assets or liabilities at fair value through profit or loss	-	(44.4)	(44.4)	-	(36.5)	(36.5)
<b>Net finance costs</b>	<b>(202.9)</b>	<b>(53.2)</b>	<b>(256.1)</b>	<b>(228.8)</b>	<b>(36.5)</b>	<b>(265.3)</b>
Finance income	250.2	-	250.2	203.2	-	203.2
Finance costs	(453.1)	(53.2)	(506.3)	(432.0)	(36.5)	(468.5)
<b>Net finance costs</b>	<b>(202.9)</b>	<b>(53.2)</b>	<b>(256.1)</b>	<b>(228.8)</b>	<b>(36.5)</b>	<b>(265.3)</b>

Adjusted net finance costs are arrived at after the following adjustments:

	2011 £m	2010 £m
Net finance costs	(256.1)	(265.3)
(add)/less:		
Share of interest from jointly controlled entities and associates:		
Scotia Gas Networks loan stock	(33.4)	(33.8)
Other jointly controlled entities and associates	(106.5)	(73.3)
	(139.9)	(107.1)
Exceptional charges	8.8	-
Movement on financing derivatives	44.4	36.5
<b>Adjusted finance income and costs</b>	<b>(342.8)</b>	<b>(335.9)</b>
(add)/less:		
Return on pension scheme assets	(141.9)	(100.7)
Interest on pension scheme liabilities	150.2	127.5
Notional interest arising on discounted provisions	4.3	3.5
Finance lease charges	39.7	13.2
Adjusted finance income and costs for interest cover calculations	(290.5)	(292.4)

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### 8. Taxation

Analysis of charge recognised in the income statement:

	Before Exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments (note 6) £m	2011 £m	Before Exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments (note 6) £m	2010 £m
<b>Current tax</b>						
UK corporation tax	270.2	-	270.2	277.4	-	277.4
Adjustments in respect of previous years	(25.0)	-	(25.0)	(19.1)	-	(19.1)
Total current tax	245.2	-	245.2	258.3	-	258.3
<b>Deferred tax</b>						
Current year	60.8	234.7	295.5	32.2	110.9	143.1
Effect of change in tax rates	-	17.7	17.7	-	-	-
Adjustments in respect of previous years	48.8	-	48.8	1.7	-	1.7
Total deferred tax	109.6	252.4	362.0	33.9	110.9	144.8
Total taxation charge	354.8	252.4	607.2	292.2	110.9	403.1

The charge for the year can be reconciled to the profit per the income statement as follows:

	2011 £m	2011 %	2010 £m	2010 %
Group profit before tax	2,111.7		1,638.6	
Less: share of results of associates and jointly controlled entities	(64.9)		(109.8)	
<b>Profit before tax</b>	<b>2,046.8</b>		<b>1,528.8</b>	
Tax on profit on ordinary activities at standard UK corporation tax rate of 28% (2010 – 28%)	573.1	28.0	428.1	28.0
Tax effect of:				
Change in rate of UK corporation tax	(49.4)	(2.4)	-	-
Change in rate of UK supplementary corporation tax	31.7	1.5	-	-
Expenses not deductible for tax purposes	27.6	1.3	7.6	0.5
Impact of supplementary corporation tax	2.2	0.1	-	-
Non taxable income	(4.3)	(0.2)	(2.3)	(0.2)
Impact of foreign tax rates and foreign dividends	6.4	0.3	(0.2)	-
Adjustments to tax charge in respect of previous years	23.8	1.2	(17.4)	(1.1)
Consortium relief not paid for	(9.0)	(0.4)	(9.8)	(0.6)
Other items	5.1	0.3	(2.9)	(0.2)
<b>Group tax charge and effective rate</b>	<b>607.2</b>	<b>29.7</b>	<b>403.1</b>	<b>26.4</b>

The adjusted current tax charge is arrived at after the following adjustments:

	2011 £m	2011 %	2010 £m	2010 %
Total taxation charge	607.2	29.7	403.1	26.4
Effect of adjusting items (see below)	-	16.6	-	4.8
Total taxation charge on adjusted basis	607.2	46.3	403.1	31.2
(add)/less:				
Share of current tax from jointly controlled entities and associates	23.0	1.8	15.8	1.2
Exceptional items	143.8	11.0	-	-
Tax on movement on derivatives	(396.2)	(30.2)	(110.9)	(8.6)
Deferred tax (excluding share of jointly controlled entities)	(109.6)	(8.4)	(33.9)	(2.6)
Adjusted current tax charge and effective rate	268.2	20.5	274.1	21.2

The adjusted effective rate is based on adjusted profit before tax being:

	2011 £m	2010 £m
Profit before tax	2,111.7	1,638.6
(add)/less:		
Exceptional items and certain re-measurements	(859.8)	(398.6)
Share of tax from jointly controlled entities and associates	58.2	50.1
Adjusted profit before tax	1,310.1	1,290.1

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### 9. Dividends

	Year ended 31 March 2011 Total £m	Settled via scrip £m	Pence per ordinary share	Year ended 31 March 2010 Total £m	Pence per ordinary share
Interim – year ended 31 March 2011	208.3	61.7	22.4	-	-
Final – year ended 31 March 2010	451.5	84.4	49.0	-	-
Interim – year ended 31 March 2010	-	-	-	193.4	21.0
Final – year ended 31 March 2009	-	-	-	425.1	46.2
	<u>659.8</u>	<u>146.1</u>		<u>618.5</u>	

The final dividend of 49.0p per ordinary share declared in the financial year ended 31 March 2010 (2009 – 46.2p) was approved at the Annual General Meeting on 22 July 2010 and was paid to shareholders on 24 September 2010. Shareholders were able to elect to receive ordinary shares credited as fully paid instead of the cash dividend under the terms of the Company's scrip dividend scheme.

An interim dividend of 22.4p per ordinary share (2010 – 21.0p) was declared and paid on 25 March 2011 to those shareholders on the Scottish and Southern Energy plc share register on 28 January 2011. Shareholders were able to elect to receive ordinary shares credited as fully paid instead of the interim cash dividend under the terms of the Company's scrip dividend scheme.

The proposed final dividend of 52.6p per ordinary share is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

### 10. Earnings per share

#### Basic earnings per share

The calculation of basic earnings per share at 31 March 2011 is based on the net profit attributable to ordinary shareholders and a weighted average number of ordinary shares outstanding during the year ended 31 March 2011. All earnings are from continuing operations.

#### Adjusted earnings per share

Adjusted earnings per share has been calculated by excluding the charge for deferred tax, items disclosed as exceptional and certain re-measurements.

	Year ended 31 March 2011 Earnings (i) £m	Year ended 31 March 2011 Earnings per share pence	Year ended 31 March 2010 Earnings (i) £m	Year ended 31 March 2010 Earnings per share Pence
<b>Basic</b>	<b>1,504.5</b>	<b>162.2</b>	1,235.3	134.0
Exceptional items and certain re-measurements (note 6)	(607.4)	(65.5)	(287.7)	(31.2)
Basic excluding exceptional items and certain re-measurements	<u>897.1</u>	<u>96.7</u>	947.6	102.8
Adjusted for:				
Deferred tax (note 8)	109.6	11.8	33.9	3.7
Deferred tax from share of jointly controlled entities and associates results	35.2	3.8	34.3	3.7
<b>Adjusted</b>	<u>1,041.9</u>	<u>112.3</u>	1,015.8	110.2
<b>Basic</b>	<b>1,504.5</b>	<b>162.2</b>	1,235.3	134.0
Dilutive effect of convertible debt and outstanding share options	-	(0.2)	-	(0.1)
<b>Diluted</b>	<u>1,504.5</u>	<u>162.0</u>	1,235.3	133.9
Exceptional items and certain re-measurements	(607.4)	(65.4)	(287.7)	(31.2)
Diluted excluding exceptional items and certain re-measurements	<u>897.1</u>	<u>96.6</u>	947.6	102.7

## Notes to the Preliminary Statement

for the year ended 31 March 2011

The weighted average number of shares used in each calculation is as follows:

	2011 Number of shares (millions)	2010 Number of shares (millions)
For basic and adjusted earnings per share	927.6	921.9
Effect of exercise of share options	1.1	0.4
	<u>928.7</u>	<u>922.3</u>
Effect of dilutive convertible debt	-	0.7
For diluted earnings per share	<u>928.7</u>	<u>923.0</u>

(i) Attributable to the equity holders of the parent.

### 11. Retirement Benefit Obligations

#### Valuation of combined Pension Schemes

	Long- term rate of return expected at 31 March 2011 %	Consolidated		Value at 31 March 2010 £m
		Value at 31 March 2011 £m	Long- term rate of return expected at 31 March 2010 %	
Equities	7.8	1,032.5	8.0	1,063.4
Government bonds	4.3	743.8	4.5	563.4
Corporate bonds	5.5	471.0	5.5	449.0
Other investments	4.4	216.3	4.1	222.5
Total fair value of plan assets		<u>2,463.6</u>		2,298.3
IFRIC 14 liability		(374.2)		(256.3)
Present value of defined benefit obligation		<u>(2,758.0)</u>		<u>(2,762.3)</u>
<b>Deficit in the schemes</b>		<b>(668.6)</b>		<b>(720.3)</b>
Deferred tax thereon		173.8		201.7
Net pension liability		<u>(494.8)</u>		<u>(518.6)</u>

Movements in the defined benefit obligation are as follows:

	2011 £m	2010 £m
At 1 April	(2,762.3)	(1,929.8)
Movements in the year:		
Service costs	(37.7)	(21.4)
Member contributions	(7.8)	(8.1)
Benefits paid	105.6	101.6
Interest on pension scheme liabilities	(150.2)	(127.5)
Actuarial gains / (losses)	94.4	(777.1)
<b>At 31 March</b>	<b>(2,758.0)</b>	<b>(2,762.3)</b>

Movements in scheme assets during the year:

	2011 £m	2010 £m
At 1 April	2,042.0	1,656.3
Movements in the year:		
Expected return on pension scheme assets	141.9	100.7
Assets distributed on settlement	(105.7)	(101.6)
Employer contributions	106.6	110.2
Member contributions	7.8	8.1
Actuarial gains	14.7	394.1
IFRIC 14 liability	(117.9)	(125.8)
<b>At 31 March</b>	<b>2,089.4</b>	<b>2,042.0</b>

The Scottish Hydro Electric Pension Scheme net liability of £239.8m (2010 - £251.1m) is presented after an IFRIC 14 minimum funding requirement restriction of £374.2m (2010 - £256.3m).

## Notes to the Preliminary Statement

for the year ended 31 March 2011

### 12. Derivative financial assets and liabilities

For financial reporting purposes, the Group has classified derivative financial instruments into two categories, operating derivatives and financing derivatives. Operating derivatives include all qualifying commodity contracts including those for electricity, gas, oil, coal and carbon. Financing derivatives include all fair value and cash flow interest rate hedges, non-hedge accounted (mark-to-market) interest rate derivatives, cash flow foreign exchange hedges and non-hedge accounted foreign exchange contracts. Non-hedge accounted contracts are treated as held for trading.

The net movement reflected in the Income Statement can be summarised thus:

	2011 £m	2010 £m
<b>Operating derivatives</b>		
Total result on operating derivatives (i)	887.9	(3,449.6)
Less: amounts settled in the year (ii)	573.9	3,881.8
<b>Movement in unrealised derivatives</b>	<u>1,461.8</u>	<u>432.2</u>
<b>Financing derivatives (and hedged items)</b>		
Total result on financing derivatives (i)	(935.9)	(640.6)
Less: amounts settled in the year (ii)	891.5	604.1
<b>Movement in unrealised derivatives</b>	<u>(44.4)</u>	<u>(36.5)</u>
<b>Net income statement impact</b>	<u>1,417.4</u>	<u>395.7</u>

(i) Total result on derivatives in the income statement represents the total amount (charged) or credited to the income statement in respect of operating and financing derivatives.

(ii) Amounts settled in the year represent the result on derivatives transacted which have matured or been delivered and have been included within the total result on derivatives.

Net derivative financial assets and (liabilities) are represented as follows:

	2011 £m	2010 £m
Derivative financial assets		
Non-current	990.1	466.3
Current	2,525.5	1,468.3
	<u>3,515.6</u>	<u>1,934.6</u>
Derivative financial liabilities		
Non-current	(769.3)	(899.0)
Current	(2,307.5)	(2,020.7)
Total derivative liabilities	<u>(3,076.8)</u>	<u>(2,919.7)</u>
	<u>438.8</u>	<u>(985.1)</u>

### 13. Acquisition of Exploration and Production assets

On 2 February 2011, the Group, through its subsidiary SSE E&P Limited, concluded the acquisition of joint operating interests in various North Sea natural gas and infrastructure assets in three main geographical areas (Bacton, Easington Catchment Area (ECA) and Lomond/Everest) from Hess Limited following a completion period where partner and regulatory approvals were received. The acquisition will provide the Group with a new source of primary fuel and an economic hedge for the Generation and Supply business. The acquisition will also mean the Group has involvement throughout the gas supply chain. Goodwill primarily represents deferred tax liabilities recognised. The completion period included a mechanism to adjust values for incurred and earned cash flows between the economic date of the agreement and the completion date. Cash consideration of £200.4m was paid on the date of acquisition which includes the impact of effective cash flow hedge arrangements for the transaction. At 14 April 2011 a final cash settlement of £3.2m was received in relation to the completion adjustments. Professional fees of £0.9m were incurred and expensed.

The assets and liabilities acquired can be summarised thus:

	Agreement Valuations £m	Completion Adjustments £m	Fair value adjustments £m	Total £m
Goodwill	-	-	38.1	38.1
Production and infrastructure assets	165.1	(17.0)	157.1	305.2
Exploration and evaluation assets	53.8	(4.7)	0.9	50.0
Decommissioning provision	-	-	(71.5)	(71.5)
Accruals and provisions	-	-	(11.4)	(11.4)
Deferred tax asset	-	-	22.9	22.9
Deferred tax liability	-	-	(136.1)	(136.1)
	<u>218.9</u>	<u>(21.7)</u>	<u>-</u>	<u>197.2</u>
Consideration:				
Cash				200.4
Debtor				(3.2)
				<u>197.2</u>

## **Notes to the Preliminary Statement**

for the year ended 31 March 2011

The exploration and production business recorded an operating profit of £4.6m in the period from acquisition. The majority of the revenue earned by the business was internal under arm's length trading arrangements with another Group company. Had the business been owned from 1 April 2010, the estimated operating profit before depreciation and amortisation would have been £42.6m from an estimated revenue of £68.4m.

### **14. Post balance sheet event**

On 14 April 2011, the Group disposed of three wind farms to Infinis for final cash consideration of £178.4m. The assets were part of the current assets held for sale at the balance sheet date. No profit or loss was recognised on the transaction.