



NORTHERN ELECTRIC FINANCE PLC

(incorporated in England with limited liability under the Companies Act 1985 with registered number 03070482)

£150,000,000

2.750 per cent Guaranteed Bonds due 2049

guaranteed by

NORTHERN POWERGRID (NORTHEAST) LIMITED

(incorporated in England with limited liability under the Companies Act 1985 with registered number 02906593)

Issue Price: 98.967 per cent

The £150,000,000 2.750 per cent Guaranteed Bonds due 2049 (the "**Bonds**") of Northern Electric Finance plc (the "**Issuer**") will be issued pursuant to the bond trust deed to be dated 24 May 2019 (the "**Trust Deed**") between the Issuer, Northern Powergrid (Northeast) Limited (the "**Guarantor**") and HSBC Corporate Trustee Company (UK) Limited as bond trustee (the "**Trustee**", which expression includes the trustee or trustees for the time being of the Trust Deed). The Guarantor will unconditionally and irrevocably guarantee the due and timely payment of all amounts at any time becoming due and payable in respect of the Bonds.

The Bonds will bear interest from 24 May 2019 at the rate of 2.750 per cent per annum payable annually in arrear on 24 May in each year.

The Bonds mature on 24 May 2049. The Issuer may, at its option, redeem all or (as the case may be) some only of the Bonds at any time in accordance with Condition 7(b) (*Redemption at the option of the Issuer*) at the higher of their principal amount and an amount calculated by reference to yields on United Kingdom government stock together with accrued interest (other than in the case of any date fixed for redemption which falls in the period from but excluding the date falling three months prior to the scheduled maturity date of the Bonds to but excluding the scheduled maturity date, in which case the Issuer may redeem the Bonds at their principal amount together with accrued interest). The Issuer may also, at its option, redeem all (but not some only) of the Bonds at any time at their principal amount together with accrued interest in the event of certain tax changes as described in Condition 7(c) (*Redemption for tax reasons*). Upon the occurrence of certain events the holders of the Bonds may require the Issuer to redeem the Bonds at their principal amount together with accrued interest — see "*Terms and Conditions of the Bonds — Restructuring Event*".

An investment in the Bonds involves certain risks. For a discussion of these risks, see "Risk Factors".

An application has been made to the United Kingdom Financial Conduct Authority ("**FCA**") in its capacity as competent authority (the "**UK Listing Authority**") under the Financial Services and Markets Act 2000, as amended for the Bonds to be admitted to listing on the Official List of the UK Listing Authority (the "**Official List**") and to the London Stock Exchange plc (the "**London Stock Exchange**") for the Bonds to be admitted to trading on the London Stock Exchange's Regulated Market. The London Stock Exchange's Regulated Market is a regulated market for the purposes of Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments (as amended, "**MiFID II**").

This Prospectus comprises a prospectus for the purposes of Article 5.4 of Directive 2003/71/EC, as amended by Directive 2010/73/EU, (the "**Prospectus Directive**") and relevant implementing measures in the United Kingdom.

The Bonds are expected to be rated upon issue A by S&P Global Ratings Europe Limited, a division of The McGraw-Hill Companies, Inc. ("**S&P**") and A by Fitch Ratings Limited ("**Fitch**"). A rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal at any time by the assigning rating organisation. Each of S&P and Fitch is established in the European Union ("**EU**") and is registered in accordance with Regulation (EC) No. 1060/2009, as amended, of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (the "**CRA Regulation**") and are included in the list of registered credit rating agencies published at the website of the European Securities and Markets Authority ("**ESMA**"). A rating is not a recommendation to buy, sell or hold Bonds and may be subject to suspension, reduction or withdrawal at any time by the assigning rating agency.

MiFID II professionals/ECPs-only/No PRIIPs KID: Manufacturer target market (MiFID II product governance) is eligible counterparties and professional clients only (all distribution channels). No PRIIPs key information document (KID) has been prepared as not available to retail in EEA.

The Bonds will be in bearer form and in the denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000. The Bonds will initially be represented by a temporary global bond (the "**Temporary Global Bond**"), without interest coupons, which will be deposited on or around 24 May 2019 (the "**Closing Date**") with a common depository for Euroclear Bank SA/NV ("**Euroclear**") and Clearstream Banking, S.A. ("**Clearstream, Luxembourg**"). The Temporary Global Bond will be exchangeable, in whole or in part, for interests in a permanent global bond (the "**Permanent Global Bond**"), without interest coupons, not earlier than 40 days after the Closing Date upon certification as to non-U.S. beneficial ownership. Interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership. The Permanent Global Bond will be exchangeable in certain limited circumstances in whole, but not in part, for Bonds in definitive form with interest coupons attached.

Joint Lead Managers

Lloyds Bank Corporate Markets

NatWest Markets

**Santander Corporate Investment
Banking**

MIFID II product governance / Professional investors and ECPs only target market

Solely for the purposes of each manufacturer's product approval process, the target market assessment in respect of the Bonds has led to the conclusion that: (i) the target market for the Bonds is eligible counterparties and professional clients only, each as defined in MiFID II; and (ii) all channels for distribution of the Bonds to eligible counterparties and professional clients are appropriate. Any person subsequently offering, selling or recommending the Bonds (a "**distributor**") should take into consideration the manufacturers' target market assessment; however, a distributor subject to MiFID II is responsible for undertaking its own target market assessment in respect of the Bonds (by either adopting or refining the manufacturers' target market assessment) and determining appropriate distribution channels.

PRIIPs Regulation / Prohibition of sales to EEA retail investors

The Bonds are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the European Economic Area ("**EEA**"). For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of MiFID II; or (ii) a customer within the meaning of Directive 2002/92/EC (as amended or superseded, the "**Insurance Mediation Directive**"), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II. Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the "**PRIIPs Regulation**") for offering or selling the Bonds or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Bonds or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation.

Each of the Issuer and the Guarantor accepts responsibility for the information contained in this Prospectus. Having taken all reasonable care to ensure that such is the case, the information contained in this Prospectus is, to the best of the knowledge of each of the Issuer and the Guarantor, in accordance with the facts and contains no omission likely to affect its import.

This Prospectus is to be read in conjunction with all documents which are deemed to be incorporated herein by reference (see "*Documents Incorporated by Reference*"). This Prospectus should be read and construed on the basis that such documents are incorporated and form part of the Prospectus.

No person has been authorised to give any information or to make representations, other than those contained in this Prospectus, in connection with the offering of the Bonds and, if given or made, any such information or representations must not be relied upon as having been authorised by the Issuer, the Guarantor, the Joint Lead Managers (as defined under "*Subscription and Sale*" below) or the Trustee.

Neither the delivery of this Prospectus nor any sale made in connection herewith shall under any circumstances constitute a representation, or create any implication that there has been no change since the date hereof in the affairs of the Issuer or that information contained herein has remained accurate and complete.

This Prospectus does not constitute an offer to sell, or an invitation by or on behalf of the Issuer, the Guarantor or the Joint Lead Managers to subscribe for or purchase, any of the Bonds. This Prospectus does not constitute an offer, and may not be used for the purpose of an offer to, or a solicitation by, anyone in any jurisdiction or in any circumstances in which such an offer or solicitation is not authorised or is unlawful.

The Joint Lead Managers and the Trustee have not separately verified the information contained herein. Accordingly, no representation, warranty or undertaking, express or implied, is made and no responsibility or liability (whether arising in tort or contract or otherwise) is accepted by the Joint Lead Managers, the Trustee or any of them as to the accuracy or completeness of the information contained in this Prospectus or any other information provided by the Issuer or the Guarantor in connection with the Bonds or their distribution.

This Prospectus is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by the Issuer, the Guarantor or the Joint Lead Managers that any recipient of this Prospectus should purchase any of the Bonds. Each investor contemplating purchasing Bonds should make its own independent investigation of the financial condition and affairs, and its own appraisal of the creditworthiness, of the Issuer and the Guarantor.

The Bonds have not been and will not be registered under the United States Securities Act of 1933 (as amended) (the "**Securities Act**"), or under any relevant securities laws of any state or other jurisdiction of the United States, and are subject to U.S. tax law requirements. The Bonds may not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S under the Securities Act ("**Regulation S**")) except pursuant to an applicable exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in accordance with applicable U.S. state securities laws. For a description of certain restrictions on the offer, sale and delivery of the Bonds and on the distribution of this Prospectus, see "*Subscription and Sale*".

The distribution of this Prospectus and the offering of the Bonds in certain jurisdictions may be restricted by law. Persons into whose possession this Prospectus comes are required by the Issuer, the Guarantor and the Joint Lead Managers to inform themselves about and to observe any such restrictions. For a description of certain restrictions on offers and sales of the Bonds and on the distribution of this Prospectus and other offering material relating to the Bonds, see "*Subscription and Sale*" below.

Each potential investor in any Bond must determine the suitability of that investment in light of its own circumstances. In particular, each potential investor should: (i) have sufficient knowledge and experience to make a meaningful evaluation of the Bonds, the merits and risks of investing in the Bonds and the information contained or incorporated by reference in this Prospectus or any applicable supplement; (ii) have access to, and knowledge of, appropriate analytical tools to evaluate, in the context of its particular financial situation, an investment in the relevant Bonds and the impact such investment will have on its overall investment portfolio; (iii) have sufficient financial resources and liquidity to bear all of the risks of an investment in the Bonds; (iv) understand thoroughly the terms of the Bonds and be familiar with the behaviour of any relevant markets; and (v) be able to evaluate (either alone or with the help of a financial adviser) possible scenarios for economic, interest rate and other factors that may affect its investment and its ability to bear the applicable risks.

All references herein to "**pounds**", "**sterling**", "**Sterling**" or "**£**" are to the currency of the United Kingdom.

In connection with the issue of the Bonds, NatWest Markets Plc (the "Stabilising Manager") (or any person acting on behalf of the Stabilising Manager) may over-allot Bonds or effect transactions with a view to supporting the market price of the Bonds at a level higher than that which might otherwise prevail. However stabilisation may not necessarily occur. Any stabilisation action may begin on or after the date on which

adequate public disclosure of the terms of the offer of the Bonds is made and, if begun, may cease at any time, but it must end no later than the earlier of 30 days after the Closing Date and 60 days after the date of allotment of the Bonds. Any stabilisation action or over-allotment must be conducted by the Stabilising Manager (or persons acting on behalf of the Stabilising Manager) in accordance with all applicable laws and rules.

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RISK FACTORS

The Issuer and the Guarantor believe that the following factors may affect their ability to fulfil their obligations under the Bonds and the Guarantee, respectively. All of these factors are contingencies which may or may not occur and the Issuer and the Guarantor are not in a position to express a view on the likelihood of any such contingency occurring.

In addition, factors which are material for the purpose of assessing the market risks associated with the Bonds are described below.

The Issuer and the Guarantor believe that the factors described below represent the principal risks inherent in investing in the Bonds, but the Issuer may be unable to pay interest, principal or other amounts on or in connection with the Bonds and the Guarantor may be unable to fulfil its obligations under the Guarantee for other reasons which may not be considered significant risks by the Issuer and the Guarantor based on information currently available to them or which they may not currently be able to anticipate. Prospective investors should also read the detailed information set out elsewhere in this Prospectus and reach their own views prior to making any investment decision.

Words and expressions defined in "Terms and Conditions of the Bonds" below or elsewhere in this Prospectus have the same meaning in this section.

Factors that may affect the Issuer's and the Guarantor's ability to fulfil their obligations under the Bonds and the Guarantee

Regulatory price controls

The Guarantor is regulated by the Gas and Electricity Markets Authority for Great Britain (commonly referred to as "**Ofgem**"). The Guarantor is subject to price controls, set and enforced by Ofgem, that limit the revenue that may be recovered and retained from its electricity distribution activities. The current electricity distribution price control, RIIO-ED1 (Revenue=Incentives+Innovation+Outputs) became effective on 1 April 2015 and runs for a period of eight years until 31 March 2023, with provision for a mid-period review (although Ofgem announced in April 2018 that it did not intend to launch a mid-period review). Ofgem published its Final Determination in November 2014 under RIIO-ED1. The Guarantor and Northern Powergrid (Yorkshire) plc appealed Ofgem's proposals for the resetting of the formula that commenced 1 April 2015, as did one other party, and the Competition and Markets Authority ("**CMA**") subsequently revised aspects of Ofgem's decision. Please refer to "*Description of the Guarantor – Regulatory Framework*" for more information on this. Ofgem published its RIIO-2 sector methodology consultation on December 18, 2018, continuing the process of developing the next set of price control arrangements that will be implemented for transmission and gas distribution networks in the UK. The consultation does not set out proposals for the Guarantor's next price control, which will run from April 2023. However, some of the proposals may be capable of application to that price control. The Guarantor is actively involved in consultations on the RIIO-2 price controls.

There can be no assurance that future price controls will permit the generation of sufficient revenues by the Guarantor to enable the Issuer and the Guarantor to meet their respective payment obligations under the Bonds and the Guarantee. There can also be no assurance that net operating revenues generated by the Issuer and the Guarantor will be sufficient to meet such payment obligations.

Distribution licence

Failure by the Guarantor to comply with the conditions of its distribution licence or certain statutory conditions may lead to Ofgem making an enforcement order and/or imposing a financial penalty. Financial penalties may also be imposed for failure to achieve a satisfactory performance in relation to individual standards of performance. Ofgem has the power to levy penalties of up to 10 per cent of the Guarantor's turnover.

While the distribution licence may be terminated immediately in exceptional circumstances, such as in the event of insolvency proceedings, it otherwise continues indefinitely until revoked following no less than 25 years' written notice.

Ofgem has formal powers to modify each distribution licence. The Guarantor may appeal against any modifications to its distribution licence on one or more specified grounds. Ofgem routinely makes minor modifications to the Guarantor's distribution licence. The last material modification was made to give effect to the RIIO-ED1 price control. While the Guarantor is not aware of any proposed further material modifications to its distribution licence, there can be no assurance that a modification will not be introduced in the future which could have an adverse effect on the operations and financial condition of the Guarantor.

Health and safety

Failure to comply with legislation, or a health and safety incident, could lead to prosecution by the Health and Safety Executive (the "HSE"). While the Guarantor places the highest priority on health and safety, and invests in robust training and auditing of all its employees, no assurance can be given that the Guarantor will not be subject to HSE action in the future. Any HSE action could adversely affect the Issuer's and/or the Guarantor's financial performance, the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Environmental laws and regulations

The Guarantor's activities, including the operation of the distribution network and the distribution of electricity, are potentially dangerous. The Guarantor is subject to laws and regulations relating to pollution, the protection of the environment and the use and disposal of hazardous substances and waste materials. These laws and regulations expose the Guarantor to costs and liabilities relating to its operations and properties whether current, including those inherited from predecessor bodies, or formerly owned by the Guarantor and sites used for the disposal of its waste.

Significant resources are committed towards ensuring compliance with these laws and regulations. Nevertheless, a major environmental impact incident could expose employees, contractors and third parties to the risk of injury, therefore exposing the Guarantor to potential liability and/or loss of reputation. In addition, breaches of applicable environmental laws or regulations could expose the Guarantor to penalties, claims for financial compensation and/or adverse regulatory consequences. Furthermore, there can be no assurance that costs of compliance with applicable environmental standards and regulations will not increase, and any such increased costs could adversely affect the Issuer's and/or the Guarantor's financial performance, the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Ofgem requirements

The Guarantor's activities are regulated by Ofgem. The Ofgem price control regime includes a number of incentive schemes which encourage DNOs to provide an appropriate quality of service to end users with penalty payments made by DNOs to end users where guaranteed standards of service have not been met. Failure to operate the network properly could lead to compensation payments, financial penalties or loss of incentive revenues under these incentive arrangements. Failure to invest capital expenditure in line with agreed programmes could also lead to deterioration of the network and regulatory penalties if specified outputs are not met.

While the Guarantor's investment programme is targeted to maintain asset condition and meet the prescribed outputs over the price control period and improve customer interruptions and customer minutes lost over the period, no guarantee can be given that these regulatory requirements will be met. Any failure to meet these regulatory requirements could adversely affect the Issuer's and/or the Guarantor's financial position, the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Network or IT Systems failure or interruption

The Guarantor's business is heavily reliant on information technology ("IT") systems and the network infrastructure. The Guarantor may suffer a major network failure or interruption, or may not be able to carry out critical non-network operations. Operational performance could be materially adversely affected by a failure to maintain the health of the system or network, inadequate forecasting of demand, inadequate record keeping or failure of information systems and supporting technology. This could cause the Guarantor to fail to meet the standards of service with which it is bound to comply, requiring the payment of specific penalties for default, or it could cause the Guarantor to be in breach of a licence, approval, regulatory requirement or contractual obligation, which could result in adverse regulatory and financial consequences.

Technology and Sustainability

As the UK aims to make significant reductions in its carbon emissions, the way in which electricity is produced and used is expected to have a substantial impact on the electricity network over time. This has already been evidenced through the number of low-carbon technology installations such as photovoltaic solar panels, electric vehicles and heat pumps. The volume and total capacity of decentralised energy generation has also been growing steadily and, given the greater range of load and generation technologies now connected to the network, the Guarantor is taking action to develop innovative solutions that will reduce the need for traditional and potentially expensive reinforcement of the network.

Within the regulatory framework for innovation, the Guarantor is running a portfolio of projects in the priority areas of smart meters, digital-enabled customer service and affordability.

The Guarantor recognises that failure to invest sufficiently in technology and innovation may lead to failure to operate efficiently and may adversely affect the Guarantor's financial performance, the Issuer's ability to repay principal on the Bonds, and the Guarantor's ability to meet its obligations under the Guarantee.

Electricity Supplier Credit Risk

The six largest UK energy suppliers consisting of British Gas, EDF, E.ON, RWE Npower, Scottish Power and SSE, known as the Big Six still dominate the energy supply sector. The principal electricity suppliers that use the Guarantor's network are RWE Npower and certain of its affiliates and British Gas Trading Limited.

The Guarantor has in place credit control, billing and collection processes in line with best practice guidelines as determined by market rules and by Ofgem. Supplier failure is administered in the interests of customers by Ofgem, through the appointment of a supplier of last resort. As part of this process, the Guarantor's bad debts arising from an electricity supplier default may be recovered through an increase in future allowed income. Please refer to "*Description of the Guarantor – Customer Information*" for more information on this. The average credit period on the Guarantor's receivables is 30 days.

As the bad debt losses will not be recovered until future periods, the failure of any of the Guarantor's principal electricity suppliers may have an impact on the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Events beyond Issuer's and Guarantor's control

Damage to infrastructure

The Issuer and/or the Guarantor may be affected by potential events that are largely outside their control such as the impact of weather, unlawful or unintentional acts of third parties or force majeure. Terrorist attacks, sabotage or other intentional acts may also damage their assets or otherwise significantly affect corporate activities.

Cybercrime is an increasing risk and the introduction of the General Data Protection Regulation (GDPR) during 2018 places additional duties on the Issuer and the Guarantor which could lead to penalties for breaches.

Whilst the Issuer and the Guarantor have in place measures to manage the risk that they sustain an adverse financial impact through inability to carry on their respective operations and have in place business continuity and IT disaster recovery plans, the risk remains that any failure or interruption could cause the Guarantor to fail to meet agreed standards of service or be in breach of a licence, approval, regulatory requirement or contractual obligation and could result in adverse regulatory and financial consequences and therefore adversely affect the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Retail prices index movements and cost-base variations

The annual revenues of the Guarantor are adjusted by the published Retail Prices Index ("**RPI**") in the UK. Ofgem is proposing to move away from RPI for the purposes of indexing RAV and allowed returns from RIIO-2 onwards and to use the Consumer Prices Index Including Owner Occupiers' Housing Costs ("**CPIH**"). The Consumer Price Index ("**CPI**") differs from RPI in that it does not measure changes in housing costs and mortgage interest repayments. CPIH is similar to CPI but includes a measure of owner-occupiers' housing costs. There is therefore a risk that the Guarantor's cost base may change at a different rate than its revenues due to changes in the RPI (or, when relevant, CPIH) affecting components of the Guarantor's cost base or RAV. If that were to happen, its profitability could be reduced and, if the differential between RPI-linked (or, when relevant CPIH-linked) inflation and

experienced operating cost inflation was sufficiently large, it could adversely affect the Guarantor's business, financial position and results of operations and therefore the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Financing

The Issuer's and the Guarantor's financial position could be affected by significant changes in interest rates and financial market conditions. Restrictions imposed by regulators may also limit the manner in which the Issuer and the Guarantor services the financial requirements of their business.

As evidenced during the global financial crisis and following the 2016 UK referendum vote to leave the European Union, financial markets can be subject to periods of volatility and shortages of liquidity. The stability of the global economy and financial institutions remains uncertain and if the Issuer and Guarantor were unable to access the capital markets or other sources of finance at competitive rates for a prolonged period, the Issuer's and Guarantor's cost of financing may increase and the discretionary and uncommitted elements of the Guarantor's proposed capital investment programme may need to be reconsidered. The occurrence of any such events could have a material adverse impact on the Guarantor's business, results of operations and prospects on the Issuer's ability to pay interest and repay principal on the Bonds and on the Guarantor's ability to meet its obligations under the Guarantee.

Insurance

The Guarantor seeks to maintain insurance cover on all its key property and liability exposures to a level consistent with sound business practice, using appropriate insurance products and providers, including self-insurance where applicable. No assurance can be given that the insurance cover acquired by the Guarantor provides adequate or sufficient cover for all events or incidents. The insurance market is volatile and therefore there can be no guarantee that existing cover will remain available or will be available at commercially acceptable premia. If events or incidents were to occur which are not covered by the Guarantor's insurance and/or adequate insurance were not to be available at commercially acceptable premia, this could adversely affect its financial position, the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Procurement risk

In order to support its core business activities, it is necessary for the Guarantor to purchase significant quantities of resources and enter into contracts for the supply of other products and services. Although the Guarantor routinely enters into long-term contracts to protect its commercial position, significant price rises and/or failure to secure key materials could have a significant adverse effect on the operations and/or financial position of the Guarantor and could adversely affect the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Whilst the Guarantor receives protection from inflation through its price controls being linked to the RPI, it will be exposed to any changes relative to inflation, either as a result of commodity prices or issues around supply and demand for plant and equipment or with its contractors. To the extent it purchases equipment from overseas, this exposure would also extend to exchange rate fluctuations.

Pensions

The Guarantor is a participating employer in the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "**DB Scheme**"), a defined benefit pension scheme. Further details of the DB Scheme are set out in "*Description of the Guarantor*" below.

In common with many other defined benefit schemes, the DB Scheme is currently in deficit due to low gilt rates that are used for valuing liabilities. The deficit as at the last valuation date of 31 March 2016, was £195m and a deficit recovery plan has been agreed with the Trustees that aims to repay the deficit by 2025. The scheme is subject to triennial valuations and the most recent valuation date was 31 March 2019, and the approval of the pension valuation is expected to be delivered by 30 June 2020.

Under the electricity regulatory framework, the deficit repair payments relating to regulated distribution businesses are treated as pass-through for pre-2010 liabilities and for post-2010 these are treated as total employment costs which are subject to efficiency reviews.

Similarly, cash contributions payable in respect of new benefit accrual in defined benefit pension schemes along with cash contributions payable to any defined contribution arrangements will be benchmarked as part of total employment costs and will only be funded to the extent that they are deemed to be efficient.

Ofgem performs regular efficiency reviews of the DB Scheme and the deficit contributions payable to defined benefit pension schemes. If Ofgem deems that any cash contributions have not been efficiently incurred, it may restrict the amount that can be recovered from customers in the future which could adversely affect the Guarantor's financial position, the Issuer's ability to pay interest and repay principal on the Bonds and the Guarantor's ability to meet its obligations under the Guarantee.

Ofgem undertook an efficiency review of the DB Scheme in 2017. This review confirmed that the established deficit for the DB Scheme would continue to be funded through the price control mechanism.

Special Administration Regime for electricity distribution network operators ("DNO")

The Energy Act 2004 provides for a special administration regime for the holders of electricity distribution licences. This regime makes provisions for energy administration orders and is designed to ensure the uninterrupted operation of electricity networks essential to secure supply of electricity in the event of actual or threatened insolvency of such a licence holder. The making of an application for an administration order in respect of the Guarantor would give rise to a moratorium on the enforcement of debts against the Guarantor, including enforcement of its obligations under the Guarantee.

The objective of an energy administrator appointed pursuant to an energy administration order is to ensure that a DNO's distribution network is maintained and developed efficiently and economically, and that it becomes unnecessary for the administration order to remain in place. The energy administrator may achieve this objective by preserving the DNO as a going concern or by transferring its undertaking as a going concern to one or more other companies. This objective takes precedence over the protection of the respective interests of members and creditors of the DNO and could thus adversely affect the interests of the holders of the Bonds.

An application for an energy administration order can only be made by the Secretary of State, or by Ofgem with the consent of the Secretary of State. Upon application, a court can only make an energy administration order if it is satisfied that the DNO is or is likely to be unable

to pay its debts or that, on a petition from the Secretary of State under the Insolvency Act 1986, it would be just and equitable (aside from the objective of energy administration) to wind up the DNO in the public interest.

Changes in government, government policy or political structure could lead to changes in the regulatory environment which may have an impact on the business of the Issuer and the Guarantor

Due to the UK vote in 2016 to leave the European Union ("**Brexit**"), there are uncertainties in respect of the UK's future relationship with the European Union ("**EU**") which may have an impact on the applicability of EU legislation in the UK. Until the terms and timing of Brexit are clearer, it is not possible to determine the impact if any, that Brexit and/or any other related matter may have on the regulatory framework applicable to the Issuer and the Guarantor. The Issuer and the Guarantor, as a DNO, operate entirely within the UK with only immaterial exposure to cross-border transactions, as such Brexit is not expected to have any impact on the business of the Issuer or the Guarantor

Factors which are material for the purpose of assessing the market risks associated with the Bonds

Early redemption by the Issuer at its option

The Issuer may, in the limited circumstances set out in Condition 7 (*Redemption and Purchase*) of the Terms and Conditions of the Bonds (the "**Terms and Conditions**") and subject to the provisions of that Condition, including as to minimum redemption price, redeem the Bonds prior to their stated maturity date. This early redemption feature may limit the market value of the Bonds. The market value of the Bonds is unlikely to rise substantially above the price at which they can be redeemed. In addition, depending on prevailing market conditions at the time, an investor receiving the proceeds of an early redemption of the Bonds may not be able to reinvest those proceeds in a comparable security at an effective interest rate as high as that of the Bonds.

Redemption prior to maturity for tax reasons

If the Issuer were to be obliged to increase the amounts payable in respect of the Bonds due to any change in or amendment to the laws or regulations of the United Kingdom or any political sub-division thereof or of any authority therein or thereof having the power to tax or in the application or official interpretation thereof, the Issuer may redeem all outstanding Bonds in accordance with the Terms and Conditions. It may not be possible for an investor to reinvest the redemption proceeds at an effective interest rate as high as the interest rate on the Bonds and this may only be possible at a significantly lower rate.

Modification and waivers and substitution

The Trust Deed contains provisions for calling meetings of Bondholders (as defined in the Terms and Conditions) to consider matters affecting their interests generally. These provisions permit defined majorities to bind all Bondholders including Bondholders who did not attend and vote at the relevant meeting and Bondholders who voted in a manner contrary to the majority.

The Trust Deed also provides that, subject to certain exceptions, the Trustee may, without the consent of Bondholders or Couponholders, (i) agree to any modification, waiver or authorisation of any breach, or proposed breach, of the Terms and Conditions or the provisions of the Trust Deed or (ii) determine that any event, condition or act which would

otherwise be an Event of Default, Potential Event of Default or Restructuring Event shall not be treated as such or (iii) agree with the Issuer to the substitution of the Guarantor or any wholly-owned subsidiary of the Issuer or the Guarantor as principal debtor under the Bonds in place of the Issuer, in the circumstances described in Condition 16 of the Terms and Conditions, provided that, in each case, it is not, in the opinion of the Trustee, materially prejudicial to the interests of the Bondholders.

Change of law

The Terms and Conditions are based on English law in effect as at the date of this Prospectus. No assurance can be given as to the impact of any possible judicial decision or change to English law or administrative practice after the date of this Prospectus.

Absence of prior public markets

The Bonds constitute a new issue of securities by the Issuer. Prior to the issue, there will have been no public market for the Bonds. Although an application has been made for the Bonds to be admitted to trading on the Regulated Market of the London Stock Exchange, there can be no assurance that an active public market for the Bonds will develop and, if such a market were to develop, none of the Joint Lead Managers (as defined in "*Subscription and Sale*") and any other person is under any obligation to maintain such a market. The liquidity and the market price of the Bonds can be expected to vary with changes in market and economic conditions, the financial condition and prospects of the Issuer and/or the Guarantor and other factors that generally influence the market price of securities.

Interest rate risks

Investment in the Bonds, which are fixed rate obligations, involves the risk that subsequent changes in market interest rates may adversely affect the value of the Bonds.

Credit ratings may not reflect all risks

The Bonds are expected to be rated upon issue A by S&P and A by Fitch. The ratings assigned to the Bonds may not reflect the potential impact of all risks that may affect the value of the Bonds. A credit rating is not a recommendation to buy, sell or hold securities and may be revised or withdrawn by the rating agency at any time. Any adverse change in an applicable credit rating could affect the trading price for the Bonds.

In general, European regulated investors are restricted under the CRA Regulation from using credit ratings for regulatory purposes, unless such ratings are issued by a credit rating agency established in the EU and registered under the CRA Regulation (and such registration has not been withdrawn or suspended), subject to transitional provisions that apply in certain circumstances whilst the registration application is pending. This general restriction will also apply in the case of credit ratings issued by non-EU credit rating agencies, unless the relevant credit ratings are endorsed by an EU-registered credit rating agency or the relevant non-EU rating agency is certified in accordance with the CRA Regulation (and such endorsement action or certification, as the case may be, has not been withdrawn or suspended). The list of registered and certified rating agencies published by ESMA on its website in accordance with the CRA Regulation is not conclusive evidence of the status of the relevant rating agency included in such list, as there may be delays between certain supervisory measures being taken against a relevant rating agency and the publication of the updated ESMA list. Certain information with respect to the credit rating agencies and ratings is set out on the cover of this Prospectus.

Global Bonds held by or on behalf of Euroclear and Clearstream, Luxembourg

The Bonds will be represented by the Temporary Global Bond and/or the Permanent Global Bond (together the "**Global Bonds**") and, except in certain limited circumstances described in the Permanent Global Bond, investors will not be entitled to receive definitive Bonds. The Global Bonds will be delivered to a common depository for Euroclear and Clearstream, Luxembourg. Euroclear and Clearstream, Luxembourg will maintain records of the beneficial interests in the Global Bonds. While the Bonds are represented by the Global Bonds, investors will be able to trade their beneficial interests only through Euroclear and Clearstream, Luxembourg.

The Issuer will discharge its payment obligations under the Bonds by making payments to the common depository for Euroclear and Clearstream, Luxembourg for distribution to their account holders. A holder of a beneficial interest in a Global Bond must rely on the procedures of Euroclear and Clearstream, Luxembourg to receive payments under the Bonds. The Issuer has no responsibility or liability for the records relating to, or payments made in respect of, beneficial interests in the Global Bonds.

Holders of beneficial interests in the Global Bonds will not have a direct right to vote in respect of the Bonds. Instead, such holders will be permitted to act only to the extent that they are enabled by Euroclear and Clearstream, Luxembourg to appoint appropriate proxies.

Integral multiples of less than £100,000

Although the Bonds will be admitted to trading on a regulated market within the European Economic Area and will only be issued with a minimum specified denomination of £100,000 it is possible that the Bonds may be traded in the clearing systems in amounts in excess of £100,000 that are not integral multiples of £100,000. In such a case, should Definitive Bonds (as defined below) be required to be issued, holders of the Bonds who, as a result of trading such amounts, hold Bonds in the relevant clearing system in amounts that are not integral multiples of £100,000 may need to purchase or sell, on or before the date of exchange of the Permanent Global Bond for Definitive Bonds, a principal amount of Bonds such that their holding is equal to or an integral multiple of £100,000, otherwise such Bondholders may not receive all of their entitlements in Definitive Bonds.

DOCUMENTS INCORPORATED BY REFERENCE AND FINANCIAL STATEMENTS

The following documents (or parts thereof) which have previously been published and have been filed with the Financial Conduct Authority, shall be incorporated in, and form part of, this Prospectus:

- (a) the auditor's report and audited financial statements of the Issuer for the year ended 31 December 2017 (which appear on pages 6 to 23 of the Issuer's Strategic Report, Report of the Directors and Financial Statements for the year ended 31 December 2017); and
- (b) the auditor's report and audited financial statements of the Issuer for the year ended 31 December 2018 (which appear on pages 6 to 32 of the Issuer's Strategic Report, Report of the Directors and Financial Statements for the year ended 31 December 2018).

Any documents themselves incorporated by reference in the documents incorporated by reference in this Prospectus shall not form part of this Prospectus.

Any information contained in any of the documents specified above which is not expressly incorporated by references in this Prospectus does not form part of this Prospectus and is either not relevant to investors or is covered elsewhere in this Prospectus. Any information contained in any website referred to in any of the documents specified above does not form part of this Prospectus.

Copies of the documents incorporated by reference in this Prospectus can be obtained (without charge) from the registered office of the Issuer and the specified office of the Paying Agent for the time being in London and from the website of the Regulatory News Service operated by the London Stock Exchange at <http://www.londonstockexchange.com/exchange/news/market-news/market-news-home.html>.

The following documents are included in this Prospectus at Appendix 1 and Appendix 2, respectively:

- (a) the auditor's report and audited financial statements of the Guarantor for the year ended 31 December 2017; and
- (b) the auditor's report and audited financial statements of the Guarantor for the year ended 31 December 2018.

TERMS AND CONDITIONS OF THE BONDS

The following is the text of the terms and conditions of the Bonds which, subject to amendment, will be endorsed on each definitive Bond. Bonds in definitive form will only be issued in certain limited circumstances. For a summary of the provisions relating to the Bonds in global form, see "Summary of provisions relating to the Bonds in global form" below.

The £150,000,000 2.750 per cent Guaranteed Bonds due 2049 (the "**Bonds**", which expression shall, unless the context otherwise requires, include any Further Bonds (as defined in Condition 3 (*Definitions*)) of Northern Electric Finance plc (the "**Issuer**") are constituted by and subject to a trust deed dated 24 May 2019 (as the same may be amended and/or supplemented from time to time, the "**Trust Deed**") between the Issuer, Northern Powergrid (Northeast) Limited in its capacity as guarantor of the Bonds (the "**Guarantor**") and HSBC Corporate Trustee Company (UK) Limited (the "**Trustee**", which expression shall, wherever the context so admits, include its successors as trustee under the Trust Deed) as trustee for the holders of the Bonds (the "**Bondholders**"). The statements in these Terms and Conditions include summaries of and are subject to, the detailed provisions of the Trust Deed. Copies of the Trust Deed and the Paying Agency Agreement dated 24 May 2019 (the "**Paying Agency Agreement**") between the Issuer, the Guarantor, HSBC Bank plc (the "**Principal Paying Agent**") and any paying agent appointed thereunder (each a "**Paying Agent**" and together with the Principal Paying Agent, the "**Paying Agents**") and the Trustee will be available for inspection by Bondholders and the holders of the interest coupons appertaining to the Bonds (respectively, the "**Couponholders**" and the "**Coupons**") at the specified office(s) of each of the Paying Agents. The Bondholders and the Couponholders are entitled to the benefit of, are bound by, and are deemed to have notice of, all the provisions of the Trust Deed and the provisions of the Paying Agency Agreement applicable to them.

1. **Form, Denomination and Title**

The Bonds are serially numbered and in bearer form in the denominations of £100,000 and integral multiples of £1,000 in excess thereof up to and including £199,000, each with Coupons attached on issue. No definitive Bonds will be issued with a denomination above £199,000. Title to the Bonds and to the Coupons will pass by delivery. Bonds of one denomination may not be exchanged for Bonds of the other denomination. The holder of any Bond or Coupon will (except as otherwise required by law) be treated as its absolute owner for all purposes (whether or not it is overdue and regardless of any notice of ownership, trust, or any interest in it, any writing on it, or its theft or loss) and no person will be liable for so treating the holder. No person shall have any right to enforce any term or condition of the Bonds or the Trust Deed under the Contracts (Rights of Third Parties) Act 1999.

2. **Status of the Bonds and the Guarantee**

- (a) *Status of the Bonds:* The Bonds and Coupons constitute direct, unconditional and (subject to the provisions of Condition 4(a) (*Negative Pledge*)) unsecured obligations of the Issuer and rank *pari passu* and without any preference among themselves. The payment obligations of the Issuer under the Bonds and the Coupons shall, subject as aforesaid and save for such obligations as may be preferred by laws that are both mandatory and of general application, at all times rank at least equally with all its present and future unsecured and unsubordinated obligations.

- (b) *Guarantee of the Bonds*: The Guarantor has in the Trust Deed unconditionally and irrevocably guaranteed the due and punctual payment of all sums from time to time payable by the Issuer in respect of the Bonds. This guarantee (the "**Guarantee**") constitutes a direct, unconditional and (subject to the provisions of Condition 4 (*Negative Pledge*)) unsecured obligation of the Guarantor. The payment obligations of the Guarantor under the Guarantee shall, subject as aforesaid and save for certain obligations required to be preferred by laws that are both mandatory and of general application, at all times rank at least equally with all its present and future unsecured and unsubordinated obligations.

3. **Definitions**

"**Business Day**" means any day (other than a Saturday or Sunday) on which banks and other financial institutions are open for business in London.

"**Companies Act**" means the Companies Act 2006 as amended or re-enacted from time to time and all subordinate legislation made pursuant thereto.

"**Electricity Act**" means the Electricity Act 1989 as amended or re-enacted from time to time and all subordinate legislation made pursuant thereto.

"**Electricity Distribution Licence**" means the electricity distribution licence granted or treated as granted to the Guarantor under section 6(1)(c) of the Electricity Act.

"**Energy Act**" means the Energy Act 2004 as amended or re-enacted from time to time and all subordinate legislation made pursuant thereto.

"**Energy Administrator**" means an energy administrator appointed pursuant to Part 3 of the Energy Act.

"**Event of Default**" means any of the events set out in Condition 10 (*Events of Default*).

"**Final Determination**" means the final determination document published by Ofgem for each electricity distribution price control review.

"**Fitch**" means Fitch Ratings Limited.

"**Further Bonds**" means all further bonds created and issued by the Issuer and guaranteed by the Guarantor in accordance with Condition 17 (*Further Bonds*) and/or for the time being outstanding or, as the context may require, a specific proportion thereof.

"**Indebtedness For Borrowed Money**" means any indebtedness (whether being principal, premium, interest or other amounts) for (i) money borrowed, (ii) payment obligations under or in respect of any acceptance or acceptance credit, or (iii) any notes, bonds, debentures, debenture stock, loan stock or other debt securities offered, issued or distributed whether by way of public offer, private placing, acquisition consideration or otherwise and whether issued for cash or in whole or in part for a consideration other than cash.

"**Investment Grade Rating**" means a credit rating assigned by a Rating Agency of BBB- (in the case of such ratings assigned by S&P and/or Fitch) or Baa3 (in the case of such ratings assigned by Moody's) or the equivalents of such ratings for the time being, or better.

"**Issue Date**" means 24 May 2019.

"**Moody's**" means Moody's Investors Service Limited.

A "**Negative Rating Event**" shall be deemed to have occurred if (i) the Issuer or the Guarantor does not, either prior to or no later than 14 days after the date of a Negative Certification (as defined in Condition 11 (*Restructuring Event*)) in respect of the relevant Restructuring Event, seek, and thereupon use all reasonable endeavours to obtain, from a Rating Agency, a rating of the Reference Rated Securities or these Bonds or any other unsecured and unsubordinated debt of the Guarantor, or of the Issuer which is guaranteed on an unsecured and unsubordinated basis by the Guarantor, and in each case having an initial maturity of five years or more or (ii) if it does so seek and use such endeavours, it is unable, as a result of such Restructuring Event, to obtain such a rating which is an Investment Grade Rating.

"**Ofgem**" means the Gas and Electricity Markets Authority and/or the Office of Gas and Electricity Markets, including their successor office or body, as appropriate.

"**Potential Event of Default**" means an event or circumstance which would with the giving of notice and/or lapse of time and/or the issuing of a certificate become an Event of Default.

A "**Put Event**" occurs on the date of the last to occur of (i) a Restructuring Event, (ii) either a Rating Downgrade or, as the case may be, a Negative Rating Event, and (iii) the relevant Negative Certification.

"**Rating Agencies**" means S&P and Fitch, and "**Rating Agency**" means any one of them.

A "**Rating Downgrade**" shall be deemed to have occurred (i) if the then current rating assigned to any Reference Rated Securities by any Rating Agency (whether provided by a Rating Agency at the invitation of the Issuer or the Guarantor or by its own volition) is withdrawn or reduced from an Investment Grade Rating to a non-Investment Grade Rating (BB+/Ba1, or their respective equivalents for the time being, or worse) or, (ii) if any Rating Agency shall then have already assigned a non-Investment Grade Rating (as described above) to the Reference Rated Securities, such rating is lowered one full rating category, provided that, in the case of (i) or (ii), if during the Restructuring Period the Reference Rated Securities have at least one Investment Grade Rating then it shall be deemed that no Rating Downgrade shall have occurred.

"**Reference Gilt**" means the 4.25 per cent Treasury Stock due December 2049 or such other conventional (i.e. not index linked) UK Government Stock as the Issuer (with the advice of an independent financial institution of international repute appointed by the Issuer) may determine to be the most appropriate benchmark conventional UK Government Stock.

"**Reference Rated Securities**" means the Bonds for so long as they have a rating from a Rating Agency, and otherwise any other unsecured and unsubordinated debt securities of the Guarantor or of the Issuer which are guaranteed on an unsecured and unsubordinated basis by the Guarantor and in each case having an initial maturity of five years or more which are rated by a Rating Agency.

"**Regulated Asset Value**" means the regulatory asset value of the Guarantor as set out in the most recent Final Determination or, if any electricity distribution price control financial model has been published on Ofgem's website since the most recent Final Determination, the regulatory asset value of the Guarantor as set out in such financial model, in each case, adjusted for inflation, as of the 31 March nearest to the date of determination, *provided that* if at any time Ofgem alters its methodology of

determining Regulated Asset Value in a manner which results in a change in Regulated Asset Value, appropriate adjustments to this definition (and to other terms defined or described herein solely for the purposes of this definition) so as to preserve the original intent of Condition 10(c) (*Events of Default*) shall be determined by an independent accountant experienced in the regulated electricity distribution market selected by the Guarantor.

"Relevant Indebtedness" means any indebtedness (whether being principal, premium, interest or other amounts) in the form of or represented by notes, bonds, debentures, debenture stock, loan stock or other securities, whether issued for cash or in whole or in part for a consideration other than cash, and which, with the agreement of the person issuing the same, are quoted, listed or ordinarily dealt in on any stock exchange or recognised over-the-counter or other securities market.

"Restructuring Event" means the occurrence of any one or more of the following events:

- (i) (a) written notice being given to the Guarantor of revocation of its Electricity Distribution Licence which is requisite to the conduct of the Guarantor's business at the relevant time or (b) the Guarantor agreeing in writing to any revocation or surrender of its Electricity Distribution Licence which is requisite to the conduct of the Guarantor's business at the relevant time or (c) any legislation (whether primary or subordinate) being enacted terminating or revoking its Electricity Distribution Licence which is requisite to the conduct of the Guarantor's business at the relevant time, except in any such case in circumstances where a licence or licences is or are granted to the Guarantor or a Subsidiary of the Guarantor 100 per cent of the ordinary share capital of which is owned directly or indirectly by the Guarantor (the "**Relevant Transferee**") and *provided that* the terms of such licence or licences are substantially no less favourable than the Electricity Distribution Licence in which event all references in these Terms and Conditions to the Electricity Distribution Licence and the Guarantor in its capacity as holder of the Electricity Distribution Licence shall hereafter be deemed to be references to the licence or licences on substantially no less favourable terms and the Relevant Transferee respectively; or
- (ii) any modification (other than a modification which is of a formal, minor or technical nature) being made to the terms and conditions of the Electricity Distribution Licence on or after the Issue Date unless two Directors of the Guarantor have certified in good faith to the Trustee (and the Trustee may rely absolutely on such certification) that the modified terms and conditions are not materially less favourable to the business of the Guarantor. For the purposes of this paragraph (ii) a modification which (a) results in a licence or licences being granted to the Guarantor or a Subsidiary of the Guarantor 100 per cent of the ordinary share capital of which is owned directly or indirectly by the Guarantor (collectively, the "**Applicable Transferees**") and *provided that* the terms of such licence or licences are substantially no less favourable than the terms of the Electricity Distribution Licence or (b) results in a licence or licences being granted to an Applicable Transferee *provided that* the terms of such licence or licences are substantially no less favourable than the terms of the Electricity Distribution Licence, shall not be deemed to be a modification within this paragraph (ii). In the event of such a modification as is referred to

in (a) or (b), all references in these Terms and Conditions to the Electricity Distribution Licence and the Guarantor in its capacity as holder of the Electricity Distribution Licence shall thereafter be deemed to be references to the licence or licences granted to the Applicable Transferee and to the Applicable Transferee, respectively; or

- (iii) any legislation (whether primary or subordinate) is enacted which removes, qualifies or amends (other than an amendment which is of a formal, minor or technical nature) the duties of the Secretary of State (or any successor) and/or Ofgem under the Electricity Act as in force on the Issue Date, unless two Directors of the Guarantor have certified in good faith to the Trustee (and the Trustee may rely absolutely on such certification) that such removal, qualification or amendment does not have a materially adverse effect on the financial condition of the Guarantor.

"Restructuring Period" means:

- (i) if at the time a Restructuring Event occurs there are Reference Rated Securities, the period of 90 days starting from and including the day on which the Restructuring Event occurs; or
- (ii) if at the time a Restructuring Event occurs there are not Reference Rated Securities, the period starting from and including the day on which the Restructuring Event occurs and ending on the day 90 days following the later of (a) the date on which the Issuer shall seek to obtain a rating pursuant to the definition of Negative Rating Event prior to the expiry of the 14 days referred to in the definition of Negative Rating Event and (b) the date on which a Negative Certification shall have been given to the Issuer in respect of the Restructuring Event.

"S&P" means S&P Global Ratings Europe Limited, a division of The McGraw-Hill Companies, Inc.

"Security Interest" means a mortgage, charge, lien, pledge or other security interest.

"Subsidiary" means a subsidiary or subsidiary undertaking within the meaning of the Companies Act.

4. **Negative Pledge**

So long as any of the Bonds remain outstanding (as defined in the Trust Deed), each of the Issuer and the Guarantor will ensure that none of its Relevant Indebtedness or the Relevant Indebtedness of any of their respective Subsidiaries nor any guarantee given by it or by any such Subsidiary of the Relevant Indebtedness of any other person will be secured by a Security Interest upon, or with respect to, any of the present or future business, undertaking, assets or revenues (including any uncalled capital) of the Issuer, the Guarantor or any such Subsidiary unless the Issuer or, as applicable, the Guarantor shall, before or at the same time as the creation of the Security Interest, take any and all action necessary to ensure that:

- (a) all amounts payable by the Issuer under the Bonds, the Coupons and the Trust Deed or, as the case may be, all amounts payable by the Guarantor under the Guarantee and the Trust Deed are secured to the satisfaction of the Trustee equally and rateably with the Relevant Indebtedness or guarantee of Relevant Indebtedness, as the case may be, by such Security Interest; or

- (b) such other Security Interest or guarantee or other arrangement (whether or not including the giving of a Security Interest) is provided in respect of all amounts payable by the Issuer under the Bonds, the Coupons and the Trust Deed or, as the case may be, all amounts payable by the Guarantor under the Guarantee and the Trust Deed either (i) as the Trustee shall in its absolute discretion deem not materially less beneficial to the interests of the Bondholders, or (ii) as shall be approved by an Extraordinary Resolution (as defined in the Trust Deed) of the Bondholders.

5. **Interest**

The Bonds bear interest from (and including) the Issue Date at the rate of 2.750 per cent per annum payable annually in arrear on 24 May in each year (each, an "**Interest Payment Date**"). Each Bond will cease to bear interest from the due date for redemption thereof, unless upon due presentation, payment of principal or premium (if any) is improperly withheld or refused. In such event, each Bond shall continue to bear interest at such rate (both before and after judgment) until whichever is the earlier of (i) the day on which all sums due in respect of such Bond up to that day are received by or on behalf of the relevant holder and (ii) the day falling seven days after the Trustee or the Principal Paying Agent has notified Bondholders in accordance with Condition 14 (*Notices*) of receipt of all sums then due in respect of all the Bonds up to that seventh day (except to the extent that there is failure in the subsequent payment to the relevant holder under these Terms and Conditions). In these Conditions, the period beginning on and including 24 May 2019 and ending on but excluding the first Interest Payment Date and each successive period beginning on and including an Interest Payment Date and ending on but excluding the next succeeding Interest Payment Date is called an "**Interest Period**". Where interest is to be calculated in respect of a period which is equal to or shorter than an Interest Period the day-count fraction used will be the number of days in the relevant period, from and including the date from which interest begins to accrue to but excluding the date on which it falls due, divided by the number of days in the Interest Period in which the relevant period falls (including the first such day but excluding the last). Interest in respect of each £1,000 in principal amount of the Bonds (the "**Calculation Amount**") for any period shall be equal to the product of 2.750 per cent, the Calculation Amount and the day-count fraction for the relevant period, rounding the resulting figure to the nearest pence (half a pence being rounded upwards).

6. **Payments**

Payments of principal, premium (if any) or interest in respect of the Bonds will be made against surrender of Bonds or, in the case of payments of interest due on an Interest Payment Date, against surrender of Coupons, at the specified office of any Paying Agent by a sterling cheque drawn on, or at the option of the holder, by transfer to a sterling account maintained by the payee with a branch of a bank in the City of London, subject in all cases to (i) any fiscal or other laws and regulations applicable thereto in the place of payment, but without prejudice to the provisions of Condition 8 (*Taxation*) and (ii) any withholding or deduction required pursuant to an agreement described in Section 1471(b) of the U.S. Internal Revenue Code of 1986 (the "**Code**") or otherwise imposed pursuant to Sections 1471 through 1474 of the Code, any regulations or agreements thereunder, any official interpretations thereof, or (without prejudice to the provisions of Condition 8 (*Taxation*)) any law implementing an intergovernmental approach thereto.

Upon the due date for redemption of any Bond, all unmatured Coupons relating to such Bond (whether or not attached) shall become void and no payment shall be made in respect of them. Where any Bond is presented for redemption without all unmatured Coupons relating to it, redemption shall be made only against the provision of such indemnity as the Issuer or the Guarantor may require.

If the due date for redemption of any Bond is not 24 May in any year, interest accrued in respect of such Bond from (and including) the last preceding 24 May will be paid only against presentation and surrender of such Bond.

If the due date for payment of any amount in respect of any Bond or Coupon is not a business day, then the holder thereof shall not be entitled to payment of the amount due until the next following business day nor to any further interest or other payment in respect of such delay. The expression "**business day**" in this Condition means a day other than a Saturday or Sunday on which banks are open for business in the place where the Bond or Coupon is presented and, in the case of payment by transfer to a sterling account as referred to above, in the City of London.

The names of the initial Principal Paying Agent and the other initial Paying Agents and their initial specified offices are set out at the end of these Terms and Conditions. The Issuer and the Guarantor reserve the right, subject to the prior written approval of the Trustee, at any time to vary or terminate the appointment of any Paying Agent and to appoint additional or other Paying Agents *provided that* the Issuer and the Guarantor will at all times maintain a principal paying agent. Notice of any such termination or appointment and of any changes in the specified offices of the Paying Agents will be given to the Bondholders in accordance with Condition 14 (*Notices*) as soon as practicable thereafter. Under no circumstances will interest be payable in the United States of America or any possession of the United States of America.

7. **Redemption and Purchase**

- (a) *Scheduled redemption:* Unless previously redeemed, or purchased and cancelled, the Issuer will redeem the Bonds on 24 May 2049 (the "**Maturity Date**") at their outstanding principal amount.
- (b) *Redemption at the option of the Issuer:* The Issuer may, having given not less than 30 nor more than 45 days' notice in accordance with Condition 14 (*Notices*) (which notice shall be irrevocable), redeem the whole or part (in principal amount of £5,000,000 or integral multiples thereof) of the Bonds at

any time prior to the Maturity Date at a price equal to the Redemption Price together with interest accrued up to and including the date of redemption.

In this Condition, "**Redemption Price**" means:

- (i) in relation to any date fixed for redemption which falls in the period up to and including the date falling three months prior to the Maturity Date, the higher of the following:
 - (1) par; and
 - (2) that price, expressed as a percentage (rounded to three decimal places, 0.0005 being rounded upwards), at which the Gross Real Redemption Yield (calculated as described below) on the Bonds, if they were to be purchased at such price on the third dealing day prior to the publication of the notice of redemption, would be equal to the Gross Real Redemption Yield on such dealing day of the Reference Gilt, on the basis of the middle market price of the Reference Gilt prevailing at 11:00 a.m. on such dealing day, as determined by NatWest Markets Plc (or such other investment bank of international repute as the Trustee may approve); and
- (ii) in relation to any date fixed for redemption which falls in the period from but excluding the date falling three months prior to the Maturity Date to but excluding the Maturity Date, par.

Any reference in these Terms and Conditions to principal shall be deemed to include any sum payable as the Redemption Price.

Notices of redemption will specify the date fixed for redemption, the applicable Redemption Price and, in the case of partial redemption, the aggregate principal amount of the Bonds to be redeemed, the serial numbers of the Bonds called for redemption, the serial numbers of the Bonds previously called for redemption and not presented for payment and the aggregate principal amount of the Bonds to remain outstanding after the redemption. No such notice of redemption may be given by the Issuer unless it shall have presented to the Trustee a certificate signed by two Directors of the Issuer (upon which the Trustee may rely absolutely) that it will have the funds, not subject to the interest of any other person, required to redeem the Bonds at the Redemption Price plus accrued interest on the date specified for redemption. Upon the expiry of any notice of redemption the Issuer shall be bound to redeem the Bonds called for redemption at the applicable Redemption Price. Any partial redemption of the Bonds shall be on the basis of selection by drawings (the method of such drawings to be approved by the Trustee in its absolute discretion).

"**Gross Real Redemption Yield**" means a yield expressed as a percentage and calculated on a basis consistent with the basis indicated by the United Kingdom Debt Management Office publication "Formulae for calculating Gilt Prices from Yields" published on 8 June 1998 with effect from 1 November 1998, page 5 and updated on 15 January 2002 and 16 March 2005 and as further updated or amended from time to time.

- (c) *Redemption for tax reasons:* If, as a result of any change in, or amendment to, the laws or regulations of the United Kingdom or any political sub-division of, or any authority in, or of, the United Kingdom having power to tax, or any change in the application or official interpretation of such laws or regulations, which change or amendment becomes effective after 22 May 2019, the Issuer or the Guarantor (if a demand were made under the Guarantee) has or will become obliged to pay additional amounts as provided or referred to in Condition 8 (*Taxation*) (and such amendment or change has been evidenced by the delivery by the Issuer or, as applicable, the Guarantor to the Trustee (who shall accept such certificate as sufficient evidence thereof) of a certificate signed by two Directors of the Issuer or, as applicable, the Guarantor stating that such amendment or change has occurred (irrespective of whether such amendment or change is then effective), describing the facts leading thereto and stating that such obligation cannot be avoided by the Issuer or, as applicable, the Guarantor taking reasonable measures available to it) the Issuer may at its option, having given not less than 30 nor more than 60 days' notice to the Bondholders in accordance with Condition 14 (*Notices*) (which notice shall be irrevocable), redeem all the Bonds (other than Bonds in respect of which the Issuer shall have given a notice of redemption pursuant to Condition 7(b) (*Redemption at the option of the Issuer*) prior to any notice being given under this Condition 7(c)), but not some only, at their outstanding principal amount together with interest accrued to (but excluding) the date of redemption, *provided that* no notice of redemption shall be given earlier than 90 days before the earliest date on which the Issuer or the Guarantor would be required to pay the additional amounts were a payment in respect of the Bonds (or, as the case may be, the Guarantee) then due and *provided further that* no notice of redemption may be given by the Issuer unless two Directors of the Issuer shall have certified to the Trustee that it will have the funds, not subject to the interest of any other person, required to redeem the Bonds at their principal amounts outstanding plus accrued interest on the date specified for redemption (the Trustee being able to rely on such certificate absolutely).
- (d) *Purchase:* The Issuer, the Guarantor or any of their respective Subsidiaries may at any time purchase or otherwise acquire Bonds (provided that all unmatured Coupons are attached thereto or are surrendered therewith) at any price in the open market or otherwise.
- (e) *Cancellation:* All Bonds which are redeemed pursuant to this Condition by the Issuer shall be cancelled (together with all relative unmatured Coupons attached thereto or surrendered therewith) and accordingly may not be reissued or resold. Bonds purchased by or on behalf of the Issuer, the Guarantor or any of their respective Subsidiaries may be held or reissued or resold or surrendered for cancellation.

8. **Taxation**

- (a) All payments in respect of the Bonds and Coupons by or on behalf of the Issuer or the Guarantor shall be made without withholding or deduction for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature ("**Taxes**") imposed or levied by or on behalf of the United Kingdom, or any political subdivision of, or authority in, or of, the United Kingdom having power to tax, unless the withholding or deduction of

the Taxes is required by law. In that event, the Issuer or (as the case may be) the Guarantor will pay such additional amounts as may be necessary in order that the net amounts received by the Bondholders and Couponholders after the withholding or deduction shall equal the respective amounts which would have been receivable in respect of the Bonds or, as the case may be, Coupons in the absence of the withholding or deduction; except that no additional amounts shall be payable in relation to any payment in respect of any Bond or Coupon:

- (i) to, or to a third party on behalf of, a holder who is liable to the Taxes in respect of the Bond or Coupon by reason of such holder having some connection with the United Kingdom other than the mere holding of the Bond or Coupon; or
 - (ii) to, or to a third party on behalf of, a holder who would not be liable or subject to the withholding or deduction by making a declaration of non-residence or other similar claim for exemption to the relevant tax authority; or
 - (iii) presented for payment more than 30 days after the Relevant Date except to the extent that the holder would have been entitled to additional amounts on presenting the same for payment on the last day of the period of 30 days.
- (b) In these Terms and Conditions, "**Relevant Date**" means the date on which the payment first becomes due, but if the full amount of the money payable has not been received in London by the Principal Paying Agent or the Trustee on or before the due date, it means the date on which, the full amount of the money having been so received, notice to that effect shall have been duly given to the Bondholders by the Issuer in accordance with Condition 14 (*Notices*).
- (c) Any reference in these Terms and Conditions to any amounts in respect of the Bonds shall be deemed also to refer to any additional amounts which may be payable under this Condition or under any undertakings given in addition to, or in substitution for, this Condition 8 pursuant to the Trust Deed.

9. **Prescription**

Bonds and Coupons will become void unless presented for payment within periods of ten years and five years, respectively, from the Relevant Date for payment in respect thereof, subject to the provisions of Condition 6 (*Payments*).

10. **Events of Default**

If:

- (a) default is made in the payment of any principal or premium (if any) in respect of any Bond pursuant to Condition 7 (*Redemption and Purchase*), or for a period of 14 days or more in the payment of any interest due in respect of the Bonds; or
- (b) the Issuer or the Guarantor, as the case may be, fails to perform or observe any of its other obligations, covenants, conditions or provisions under the Bonds or the Trust Deed and (except where the Trustee shall have certified to the Issuer or the Guarantor, as applicable, in writing that it considers such failure to be

incapable of remedy in which case no such notice or continuation as is hereinafter mentioned will be required) such failure continues for the period of 60 days (or such longer period as the Trustee may permit) following the service by the Trustee on the Issuer or the Guarantor, as applicable, of notice requiring the same to be remedied; or

- (c) (i) any other Indebtedness For Borrowed Money of the Issuer, the Guarantor or any of their respective Subsidiaries becomes due and repayable prior to its stated maturity by reason of an event of default (however described) or (ii) any such Indebtedness For Borrowed Money is not paid when due or (iii) the Issuer, the Guarantor or any of their respective Subsidiaries fails to pay when due any amount payable by it under any present or future guarantee for, or indemnity in respect of any Indebtedness For Borrowed Money of any person or (iv) any security given by the Issuer, the Guarantor or any of their respective Subsidiaries for any Indebtedness For Borrowed Money of any person or any guarantee or indemnity of Indebtedness For Borrowed Money of any person becomes enforceable by reason of default in relation thereto and steps are taken to enforce such security save in any such case referred to in (i), (ii), (iii) or (iv) where there is a *bona fide* dispute as to whether the relevant Indebtedness For Borrowed Money or any such guarantee or indemnity as aforesaid shall be due and payable, and *provided that* the aggregate amount of the relevant Indebtedness For Borrowed Money in respect of which any one or more of the events mentioned above in this sub-paragraph (c) has or have occurred equals or exceeds 5 per cent of Regulated Asset Value and such event shall continue unremedied or unwaived for more than 14 days (or such longer grace period as may have been originally provided in the applicable instrument) and the time for payment of such amount has not been expressly extended (until such time as any payment default is remedied, cured or waived); or
- (d) any order shall be made by any competent court or any resolution shall be passed for the winding up or dissolution of the Issuer or the Guarantor, save for the purposes of amalgamation, merger, consolidation, reorganisation, reconstruction or other similar arrangement on terms previously approved by an Extraordinary Resolution of the Bondholders; or
- (e) the Issuer, the Guarantor or any of their respective Subsidiaries shall cease to carry on the whole or substantially the whole of its business, save in each case for the purposes of amalgamation, merger, consolidation, reorganisation, reconstruction or other arrangement (i) not involving or arising out of the insolvency of the Issuer, the Guarantor or such Subsidiary and under which all or substantially all of its assets are transferred, in the case of the Issuer, to a Subsidiary of the Issuer or the Guarantor, in the case of the Guarantor, to a Subsidiary of the Guarantor or, in the case of a Subsidiary, to the Issuer, the Guarantor or another Subsidiary of either of them or to a transferee which is, or immediately upon such transfer becomes such a Subsidiary or (ii) under which all or substantially all of its assets are transferred to a third party or parties (whether a Subsidiary or Subsidiaries of the Issuer or the Guarantor or not) for full consideration by the Issuer, the Guarantor or any such Subsidiary on an arm's length basis or (iii) the terms of which have previously been approved by an Extraordinary Resolution of the Bondholders *provided that* if the Guarantor shall cease to hold or shall transfer the Electricity Distribution

Licence (other than where the Electricity Distribution Licence is revoked, terminated or surrendered in the circumstances envisaged by paragraph (i)(a), (b) or (c) of the definition of Restructuring Event in Condition 3 (*Definitions*) and such revocation, termination or surrender does not constitute a Restructuring Event pursuant to paragraph (i) of such definition) the Guarantor shall be deemed to have ceased to carry on the whole or substantially the whole of its business (and neither of exceptions (i) and (ii) above shall apply) unless the transferee of the Electricity Distribution Licence is the Issuer or a Subsidiary of the Guarantor, at least 51 per cent of the ordinary share capital of which is owned directly or indirectly by the Guarantor (the "**NE Transferee**") and in such event all references in these Terms and Conditions to the Guarantor in its capacity as holder of the Electricity Distribution Licence shall thereafter be deemed to be references to the NE Transferee; or

- (f) the Issuer, the Guarantor or any of their respective Subsidiaries shall suspend or shall threaten to suspend payment of its debts generally or shall be declared or adjudicated by a competent court to be unable, or shall admit in writing its inability, to pay its debts (within the meaning of Section 123(1) or (2) of the Insolvency Act 1986) as they fall due, or shall be adjudicated or found insolvent by a competent court or shall enter into any composition or other similar arrangement with its creditors under Part I of the Insolvency Act 1986; or
- (g) a receiver, administrative receiver, Energy Administrator, administrator or other similar official shall be appointed in relation to the Issuer, the Guarantor or any of their respective Subsidiaries or in relation to the whole or a substantial part of the undertaking or assets of any of them or a distress, execution or other process shall be levied or enforced upon or sued out against, or any encumbrancer shall take possession of, the whole or a substantial part of the assets of any of them and in any of the foregoing cases it or he shall not be paid out or discharged within 120 days (or such longer period as the Trustee may in its absolute discretion permit); or
- (h) the Guarantee of the Bonds is not (or is claimed by the Guarantor not to be) in full force and effect;

and, in the case of sub-paragraphs (b), (c) and (e) to (g) (inclusive) the Trustee shall have certified in writing that the relevant event is in its opinion materially prejudicial to the interests of the Bondholders, the Trustee may at its discretion (and the Trustee shall on the request in writing of the holders of at least one quarter in principal amount of the Bonds then outstanding or upon being so directed by an Extraordinary Resolution of the Bondholders), by notice in writing to the Issuer and the Guarantor declare that the Bonds are, and they shall accordingly thereby forthwith become, immediately due and repayable at their principal amount together with accrued interest (as provided in the Trust Deed), *provided always that* the giving of any notice in relation to any Event of Default shall not operate as a waiver of any of the Trustee's rights (including the right to give a further notice) or prevent the Trustee from giving a further notice in the manner referred to above in relation to that Event of Default at any time thereafter.

So long as any of the Bonds remain outstanding the Issuer or the Guarantor will, forthwith upon becoming aware of any Event of Default or Potential Event of Default, give notice in writing thereof to the Trustee.

For the purpose of sub-paragraph (f) above, Section 123(1)(a) of the Insolvency Act 1986 shall have effect as if for "£750" there was substituted "£250,000" or such higher figure as Ofgem may from time to time determine by notice in writing to the Guarantor for the purposes of Schedule 2 (Revocation) of its Electricity Distribution Licence.

Neither the Issuer, the Guarantor nor any Subsidiary shall be deemed to be unable to pay its debts for the purposes of sub-paragraph (f) above if any such demand as is mentioned in Section 123(1)(a) of the Insolvency Act 1986 is being contested in good faith by the Issuer, the Guarantor or the relevant Subsidiary with recourse to all appropriate measures and procedures.

11. **Restructuring Event**

(a)

- (i) If, at any time while any of the Bonds remains outstanding, a Restructuring Event occurs and during the Restructuring Period an Independent Financial Adviser (as defined below) shall have certified in writing to the Trustee that such Restructuring Event is not, in its opinion, materially prejudicial to the interests of the Bondholders, the following provisions of this Condition shall cease to have any further effect in relation to such Restructuring Event.
- (ii) If, at any time while any of the Bonds remains outstanding, a Restructuring Event occurs and (subject to paragraph (a)(i) above):
 - (1) within the Restructuring Period, either:
 - (A) if at the time such Restructuring Event occurs there are Reference Rated Securities, a Rating Downgrade in respect of such Restructuring Event also occurs; or
 - (B) if at such time there are not Reference Rated Securities, a Negative Rating Event in respect of such Restructuring Event also occurs; and
 - (2) an Independent Financial Adviser shall have certified in writing to the Trustee that such Restructuring Event is, in its opinion, materially prejudicial to the interests of the Bondholders (a "**Negative Certification**"),

then, unless at any time the Issuer shall have given a notice under Condition 7(b) (*Redemption at the option of the Issuer*) or Condition 7(c) (*Redemption for tax reasons*), in each case expiring prior to the Put Date (as defined below), the holder of each Bond will, upon the giving of a Put Event Notice (as defined below), have the option (the "**Put Option**") to require the Issuer to redeem or, at the option of the Issuer, purchase (or procure the purchase of) that Bond on the Put Date at its principal amount together with (or, where purchased, together with an amount equal to) interest (if any) accrued to (but excluding) the Put Date.

Notwithstanding the occurrence of a Rating Downgrade or a Negative Rating Event, no Bondholder shall be entitled to exercise the Put Option and to serve a Put Notice if the rating assigned to the Reference Rated Securities or these Bonds by any Rating Agency is subsequently increased to, or, as the case may

be, there is assigned to the Reference Rated Securities or these Bonds by any Rating Agency an Investment Grade Rating or, in the event that the rating assigned to the Reference Rated Securities immediately prior to the occurrence of the Rating Downgrade or Negative Rating Event was not an Investment Grade Rating, if such rating is restored, in either case prior to any Negative Certification being issued.

Any certification by an Independent Financial Adviser as aforesaid as to whether or not, in its opinion, any Restructuring Event is materially prejudicial to the interest of the Bondholders shall, in the absence of manifest error, be conclusive and binding on the Trustee, the Issuer, the Guarantor and the Bondholders. For the purposes of this Condition, an "**Independent Financial Adviser**" means a financial adviser appointed by the Issuer or the Guarantor and approved by the Trustee or, if neither the Issuer nor the Guarantor shall have appointed such an adviser within 21 days after either the Issuer or Guarantor becoming aware of the occurrence of such Restructuring Event and the Trustee is indemnified and/or prefunded and/or secured to its satisfaction against the costs of such adviser, appointed by the Trustee.

A Rating Downgrade or a Negative Rating Event or a non-Investment Grade Rating shall be deemed not to have occurred as a result of or in respect of a Restructuring Event if the Rating Agency making the relevant reduction in rating or, where applicable, declining to assign an Investment Grade Rating as provided in this Condition does not announce or publicly confirm or inform the Trustee in writing at its request that the reduction or, where applicable, declining to assign a rating of at least investment grade was the result, in whole or in part, of any event or circumstance comprised in or arising as a result of the applicable Restructuring Event.

The Trust Deed provides that the Trustee is under no obligation to ascertain whether a Restructuring Event, a Negative Rating Event, a Rating Downgrade or any event which could lead to the occurrence of or could constitute a Restructuring Event, a Negative Rating Event or a Rating Downgrade has occurred and until it shall have actual knowledge or express notice pursuant to the Trust Deed to the contrary the Trustee may assume that no Restructuring Event, Negative Rating Event, Rating Downgrade or other such event has occurred.

- (b) Promptly upon the Issuer or the Guarantor becoming aware that a Put Event (as defined in Condition 3 (*Definitions*)) has occurred, and in any event not later than 14 days after the occurrence of a Put Event, the Issuer or the Guarantor (as the case may be) shall, and at any time upon the Trustee becoming similarly so aware the Trustee may, and (subject to it being indemnified and/or prefunded and/or secured to its satisfaction) if so requested by the holders of at least one-quarter in principal amount of the Bonds then outstanding shall, give notice (a "**Put Event Notice**") to the Bondholders in accordance with Condition 14 (*Notices*) specifying the nature of the Put Event and the procedure for exercising the Put Option.
- (c) To exercise the Put Option, the holder of a Bond must deliver such Bond to the specified office of any Paying Agent, on a day which is a business day (as defined in Condition 6 (*Payments*)) in London and in the place of such specified office falling within the period (the "**Put Period**") of 45 days after

that on which a Put Event Notice is given, accompanied by a duly completed and signed notice of exercise in the form (for the time being current) obtainable from any specified office of any Paying Agent (a "**Put Notice**") and in which the holder may specify a bank account complying with the requirements of Condition 6 (*Payments*) to which payment is to be made under this Condition. Each Bond should be delivered together with all Coupons appertaining thereto maturing after the day (the "**Put Date**") being the fifteenth day after the date of expiry of the Put Period, failing which any such missing Coupon will become void and no payment shall be made in respect of it. The Paying Agent to which such Bond and Put Notices are delivered shall issue to the Bondholder concerned a non-transferable receipt in respect of the Bond so delivered. Payment in respect of any Bond so delivered shall be made, if the holder duly specifies a bank account in the Put Notice to which payment is to be made on the Put Date, by transfer to that bank account and, in every other case, on or after the Put Date, in each case against presentation and surrender or (as the case may be) endorsement of such receipt at any specified office of any Paying Agent, subject in any such case as provided in Condition 6 (*Payments*). A Put Notice, once given, shall be irrevocable. For the purposes of Conditions 9 (*Prescription*), 10 (*Events of Default*), 12 (*Enforcement*), 13 (*Replacement of Bonds and Coupons*) and 15 (*Meetings of Bondholders, Modification and Waiver*) receipts issued pursuant to this Condition shall be treated as if they were Bonds. The Issuer shall redeem or, at the option of the Issuer, purchase (or procure the purchase of) the relevant Bond on the applicable Put Date unless previously redeemed or purchased.

12. **Enforcement**

- (a) *Limitation on Bondholders:* Only the Trustee may pursue the remedies available under general law or under the Trust Deed to enforce the rights of the Bondholders and Couponholders and no such holder will be entitled to proceed against the Issuer or the Guarantor unless the Trustee, having become bound to act in accordance with the terms of the Trust Deed, fails to do so within a reasonable amount of time and such failure is continuing.
- (b) *Enforcement Proceedings:* At any time after amounts in respect of principal of and interest on the Bonds shall have become due and payable but are unpaid, the Trustee may, at its discretion, and without further notice but subject as mentioned below, take such proceedings against the Issuer and/or the Guarantor as it may think fit to enforce the provisions of the Trust Deed in accordance with the terms thereof.

The Trustee shall only be bound to take proceedings pursuant to this Condition 12(b) if it has been indemnified and/or prefunded and/or secured to its satisfaction by the Bondholders and if it has been so requested in writing by the holders of not less than 25 per cent of the principal amount outstanding (as defined in the Trust Deed) of the Bonds or has been so directed by an Extraordinary Resolution (as defined in the Trust Deed)).

13. **Replacement of Bonds and Coupons**

Should any Bond or Coupon be lost, stolen, mutilated, defaced or destroyed it may, subject to all applicable laws and stock exchange requirements, be replaced at the specified office of the Principal Paying Agent (or such other Paying Agent as may be

approved by the Trustee for such purpose) upon payment by the claimant of the expenses, taxes and duties incurred in connection therewith and on such terms as to evidence and indemnity as the Issuer may reasonably require. Mutilated or defaced Bonds or Coupons must be surrendered before replacements will be issued.

14. **Notices**

All notices to Bondholders shall be valid if published in a leading English language national daily newspaper (which is expected to be the *Financial Times*) or, if this is not practicable, in a leading English language daily newspaper with a circulation in Europe. Such notices shall be deemed to have been given on the date of such publication or, if published more than once or on different dates, on the date of the first such publication. If publication is not practicable, notice shall be given in such other manner, and shall be deemed to have been given on such date, as the Trustee may approve.

Couponholders will be deemed for all purposes to have notice of the contents of any notice given to the Bondholders in accordance with this Condition.

15. **Meetings of Bondholders, Modification and Waiver**

(a) The Trust Deed contains provisions for convening meetings of the Bondholders to consider any matter affecting their interests, including modification by Extraordinary Resolution of these Terms and Conditions or the provisions of the Trust Deed. The quorum at any such meeting for passing an Extraordinary Resolution shall be two or more persons holding or representing more than half in principal amount of the Bonds for the time being outstanding, or at any adjourned such meeting two or more persons being or representing Bondholders whatever the principal amount of the Bonds so held or represented, except that, at any meeting the business of which includes the modification of certain of these Terms and Conditions and certain of the provisions of the Trust Deed (including altering the currency of payment of the Bonds or Coupons), the necessary quorum for passing an Extraordinary Resolution will be two or more persons holding or representing not less than two-thirds, or at any adjourned such meeting not less than one-third, in principal amount of the Bonds for the time being outstanding. An Extraordinary Resolution passed at any meeting of Bondholders shall be binding on all Bondholders, whether or not they are present or represented at the meeting, and on all Couponholders.

(b) The Trustee may, without the consent of the Bondholders or Couponholders, agree (i) other than in respect of Reserved Matters (as specified and defined in Schedule 5 to the Trust Deed), to any modification to these Terms and Conditions or to any of the provisions of the Trust Deed or to any waiver or authorisation of any breach or proposed breach by the Issuer or the Guarantor of these Terms and Conditions or of any of the provisions of the Trust Deed or determine that any event, condition or act which would otherwise be an Event of Default, Potential Event of Default or Restructuring Event shall not be so treated provided that, in the opinion of the Trustee, so to do would not be materially prejudicial to the interests of the Bondholders, and provided further that the Trustee will not do so in contravention of any express direction given by any Extraordinary Resolution or a written request made pursuant to Condition 10 (*Events of Default*) but no such direction or request will affect

any previous waiver, authorisation or determination, or (ii) to any modification to these Terms and Conditions or to any of the provisions of the Trust Deed which is made to correct a manifest error or which is of a formal, minor or technical nature.

- (c) In connection with the exercise of its trusts, powers, authorities or discretions (including, but not limited to, any modification, waiver, authorisation or substitution) the Trustee shall have regard to the interests of Bondholders as a class and, in particular, but without limitation, shall not have regard to the consequences of the exercise of its trusts, powers or discretions for individual Bondholders and Couponholders resulting from their being for any purpose domiciled or resident in, or otherwise connected with, or subject to the jurisdiction of, any particular territory and the Trustee shall not be entitled to require, nor shall any Bondholder or Couponholder be entitled to claim, from the Issuer, the Guarantor or any other person any indemnification or payment in respect of any tax consequence of any such exercise upon individual Bondholders or Couponholders, except to the extent already provided for in Condition 8 (*Taxation*) and/or any undertaking given to, or in substitution for, Condition 8 (*Taxation*) pursuant to the Trust Deed.
- (d) Any modification to these Terms and Conditions or to any of the provisions of the Trust Deed or any waiver or authorisation of any breach or proposed breach by the Issuer or the Guarantor of these Terms and Conditions or any of the provisions of the Trust Deed shall be binding on the Bondholders and the Couponholders and, unless the Trustee agrees otherwise, any modification shall be notified by the Issuer to the Bondholders as soon as practicable thereafter in accordance with Condition 14 (*Notices*).

16. **Substitution**

The Trustee may, without the consent of the Bondholders or Couponholders, agree with the Issuer and the Guarantor to the substitution of the Guarantor or any wholly-owned Subsidiary of the Issuer or the Guarantor in place of the Issuer (or of any previous substitute under this Condition) as the principal debtor under the Bonds, the Coupons and the Trust Deed, subject to the Trustee being of the opinion that the interests of the Bondholders will not be materially prejudiced thereby and certain other conditions set out in the Trust Deed (including, in the case of a Substitution of the Issuer with a company other than the Guarantor, a requirement that the Guarantee of the Bonds is fully effective in relation to the obligations of the new principal debtor under the Trust Deed) being complied with.

17. **Further Bonds**

- (a) Subject as mentioned below, power will be reserved to the Issuer to create and issue Further Bonds forming (or so as to form after the first payment of interest thereon) a single series with the Bonds *provided that*:
 - (i) the Trustee is satisfied that the rating granted in respect of the Bonds by S&P and Fitch will not thereby be adversely affected; and
 - (ii) such issue shall be constituted by a deed supplemental to the Trust Deed (in such form as the Trustee may approve) and guaranteed by the Guarantor.

- (b) The Issuer shall not be entitled to exercise the power reserved in this Condition 17 (*Further Bonds*) while any default exists in relation to any payment by the Issuer of any amounts due under the Trust Deed.

18. **Trustee**

The Trust Deed contains provisions governing the responsibility of the Trustee and providing for its indemnification and relief from responsibility in certain circumstances, (including provisions relieving it from taking proceedings against the Issuer and/or the Guarantor unless indemnified and/or secured and/or prefunded to its satisfaction) and to be paid its costs and expenses in priority to the claims of the Bondholders. The Trustee may not resign its appointment unless a successor, willing to act in such capacity, has been appointed by the Issuer and the Guarantor (acting together) and the Bondholders by Extraordinary Resolution, *provided that* the Trustee shall not be prevented from resigning its appointment if, having given notice in writing to the Issuer and the Guarantor of its intention to so resign its appointment, a successor is not appointed within the period of three months from the date of such notice.

19. **Governing Law**

The Trust Deed, the Bonds and the Guarantee and any non-contractual obligations arising out of or in connection with the Trust Deed, the Bonds and the Guarantee are governed by, and shall be construed in accordance with, English law.

There will appear at the foot of the Terms and Conditions endorsed on each Bond in definitive form the names and Specified Offices of the Paying Agents as set out at the end of this Prospectus.

SUMMARY OF PROVISIONS RELATING TO THE BONDS IN GLOBAL FORM

The Bonds will initially be in the form of the Temporary Global Bond which will be deposited on or around the Closing Date with a common depositary for Euroclear and Clearstream, Luxembourg. The Temporary Global Bond will be exchangeable in whole or in part for interests in the Permanent Global Bond not earlier than 40 days after the Closing Date upon certification as to non-U.S. beneficial ownership. No payments will be made under the Temporary Global Bond unless exchange for interests in the Permanent Global Bond is improperly withheld or refused. In addition, interest payments in respect of the Bonds cannot be collected without such certification of non-U.S. beneficial ownership.

The Permanent Global Bond will become exchangeable in whole, but not in part, for Bonds in definitive form ("**Definitive Bonds**") at the request of the bearer of the Permanent Global Bond against presentation and surrender of the Permanent Global Bond to the Principal Paying Agent if any of the following events (each, an "**Exchange Event**") occurs: (a) an Event of Default, or (b) Euroclear or Clearstream, Luxembourg is closed for business for a continuous period of 14 days (other than by reason of holiday, statutory or otherwise) or announces an intention permanently to cease business, or (c) as a result of any change in, or amendment to, the laws or regulations of the United Kingdom or of any political sub-division of, or any authority in, the United Kingdom having power to tax or any change in the application or official interpretation of such laws or regulations which becomes effective on or after 22 May 2019, the Issuer or any Paying Agent is or will be required to make any withholding or deduction from any payment in respect of the Bonds which would not be required if the Bonds were in definitive form.

Whenever the Permanent Global Bond is to be exchanged for Definitive Bonds, the Issuer shall procure the prompt delivery (free of charge to the bearer) of such Definitive Bonds, duly authenticated and with Coupons attached, in an aggregate principal amount equal to the principal amount of the Permanent Global Bond to the bearer of the Permanent Global Bond against the surrender of the Permanent Global Bond at the Specified Office of the Principal Paying Agent within 30 days of the occurrence of the relevant Exchange Event.

In addition, the Temporary Global Bond and the Permanent Global Bond will contain provisions which modify the Terms and Conditions as they apply to the Temporary Global Bond and the Permanent Global Bond. The following is a summary of certain of those provisions:

Payments: All payments in respect of the Temporary Global Bond and the Permanent Global Bond will be made against presentation and (in the case of payment of principal in full with all interest accrued thereon) surrender of the Temporary Global Bond or (as the case may be) the Permanent Global Bond at the Specified Office of any Paying Agent and will be effective to satisfy and discharge the corresponding liabilities of the Issuer in respect of the Bonds. On each occasion on which a payment of principal or interest is made in respect of the Temporary Global Bond or (as the case may be) the Permanent Global Bond, the Issuer shall procure that the same is noted in a schedule thereto.

Exercise of put option: In order to exercise the option contained in Condition 11 (*Restructuring Event*) the bearer of the Permanent Global Bond must, within the period specified in the Conditions for the deposit of the relevant Bond and put notice, give written notice (or electronic notice in accordance with the rules and procedures of Euroclear and Clearstream, Luxembourg) of such exercise to the Principal Paying Agent specifying the principal amount of Bonds in respect of which such option is being exercised. Any such notice will be irrevocable and may not be withdrawn.

Partial exercise of call option: In connection with an exercise of the option contained in Condition 7(b) (*Redemption at the option of the Issuer*) in relation to some only of the Bonds, (a) the Permanent Global Bond may be redeemed in part in the principal amount specified by the Issuer in accordance with the Terms and Conditions and the Bonds to be redeemed will not be selected as provided in the Terms and Conditions but in accordance with the rules and procedures of Euroclear and Clearstream, Luxembourg and (b) the notice of redemption will not specify the serial numbers of the Bonds called for redemption or the serial numbers of the Bonds previously called for redemption and not presented for payment. The rules and procedures of Euroclear and Clearstream, Luxembourg provide that a partial redemption will be reflected in the records of Euroclear and Clearstream, Luxembourg as either a pool factor or a reduction in nominal amount, at their discretion.

Notices: Notwithstanding Condition 14 (*Notices*), while all the Bonds are represented by the Permanent Global Bond (or by the Permanent Global Bond and/or the Temporary Global Bond) and the Permanent Global Bond is (or the Permanent Global Bond and/or the Temporary Global Bond are) deposited with a common depository for Euroclear and Clearstream, Luxembourg, notices to Bondholders may be given by delivery of the relevant notice to Euroclear and Clearstream, Luxembourg and, in any case, such notices shall be deemed to have been given to the Bondholders in accordance with Condition 14 (*Notices*) on the date of delivery to Euroclear and Clearstream, Luxembourg.

Quorum: So long as the outstanding Bonds are represented by the Temporary Global Bond and/or the Permanent Global Bond, a single voter appointed in relation thereto or being the holder of the Bonds represented thereby shall be deemed to be two voters for the purpose of forming a quorum.

USE OF PROCEEDS

The net proceeds from the issue of Bonds will be on-lent by the Issuer to the Guarantor and used by the Guarantor for general corporate purposes.

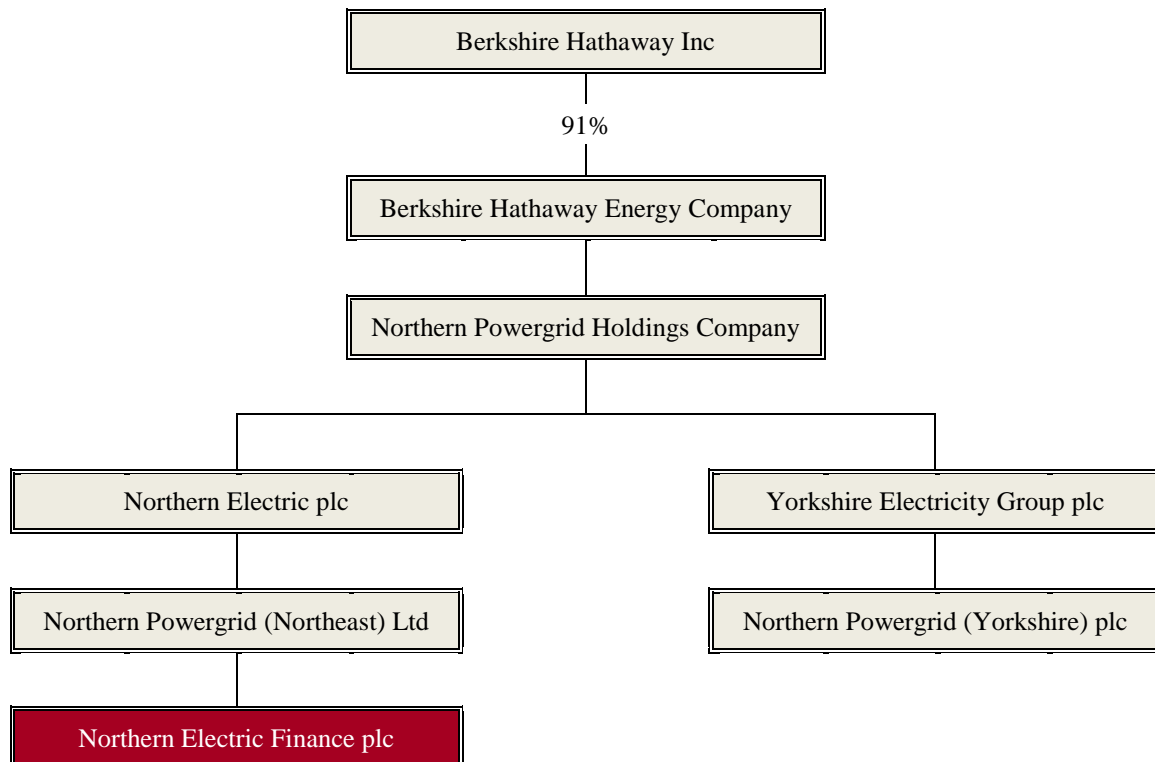
DESCRIPTION OF THE ISSUER

Background

Northern Electric Finance plc (the "**Issuer**") was incorporated on 20 June 1995 as a limited company with registered number 03070482. The registered office of the Issuer is Lloyds Court, 78 Grey Street, Newcastle Upon Tyne, NE1 6AF and its telephone number is +44 (0) 191 223 5151.

The Issuer is a wholly-owned subsidiary of the Guarantor, which in turn is a wholly-owned subsidiary of Northern Electric plc. The Issuer was established to raise finance on behalf of Northern Electric plc and its subsidiaries, including by the issue of long term bonds. Since incorporation, the Issuer has not engaged in any activities other than those that are incidental to its incorporation and raising of finance. During the year ended 31 December 2018, the Issuer's sole activity was to meet its obligations to make interest payments under its £100m 8.875% bonds due 2020 and its £150m 5.125% bonds due 2035. The Issuer lends the proceeds of its bond issues to the Guarantor.

The table below is a summary of the organisational structure showing certain holding companies and affiliated companies of the Issuer in the Northern Powergrid regulated business. Certain intermediate holding companies and affiliates of the Issuer carrying out non-regulated activities, such as engineering contracting and gas exploration, are not included.



Directors of the Issuer

The Issuer is managed by a Board of Directors comprising the following individuals:

Name	Position	Principal non-Group activities
T.E. Fielden	Finance Director, Northern Powergrid	None
T.H. France	General Counsel, Northern Powergrid	None
P.A. Jones	President and Chief Executive Officer, Northern Powergrid	None
S.J. Lockwood	Group Financial Controller, Northern Powergrid	None

The business address of each of the Directors is Lloyds Court, 78 Grey Street, Newcastle Upon Tyne, NE1 6AF. No Director has any actual or potential conflict of interest between their duties to the Issuer and their private interests and/or other duties.

DESCRIPTION OF THE GUARANTOR

Background

Northern Powergrid (Northeast) Limited (the "**Guarantor**") was incorporated on 9 March 1994 as a limited company with registered number 02906593. The registered office of the Guarantor is Lloyds Court, 78 Grey Street, Newcastle Upon Tyne, NE1 6AF and its telephone number is +44 (0) 191 223 5151. The Guarantor changed its name from Northern Electric Distribution Limited to Northern Powergrid (Northeast) Limited with effect from 31 October 2011.

The Guarantor is a regulated electricity distribution network operator ("**DNO**"). It is a wholly-owned subsidiary of Northern Electric plc, and an indirect wholly-owned subsidiary of Northern Powergrid Holdings Company ("**Northern Powergrid**", and, together with its subsidiaries, the "**Northern Powergrid Group**"). Northern Powergrid was formerly known as CE Electric UK Funding Company. The Guarantor's ultimate parent company is Berkshire Hathaway, Inc. a company incorporated in the United States of America.

Northern Powergrid also indirectly wholly-owns the share capital of Northern Powergrid (Yorkshire) plc ("**Northern Powergrid (Yorkshire)**"), which is also a DNO. The Guarantor and Northern Powergrid (Yorkshire) operate together as a single commercial entity under the brand "Northern Powergrid". As required by Ofgem (as defined below) in its regulation of DNOs, the Guarantor and Northern Powergrid (Yorkshire) are separate legal entities, which are subject to financial ring-fencing and which hold separate distribution licences. The Guarantor and Northern Powergrid (Yorkshire) are separately assessed by the Gas and Electricity Markets Authority (commonly referred to as "**Ofgem**") and undergo separate distribution price control review processes. On a management and commercial level, the Guarantor and Northern Powergrid (Yorkshire) are operated on a combined basis through shared divisional management. The costs of shared services, employees and operations are allocated back to the Guarantor and Northern Powergrid (Yorkshire) as appropriate.

Subsidiaries

The Guarantor holds 49,999 Ordinary shares in the Issuer which constitutes 100% of the issued share capital of the Issuer.

Distribution Business

The Guarantor is one of the fourteen DNOs in England, Wales and Scotland. Its distribution service area is in the northeast of England which extends from North Northumberland, south to York and west to the Pennines. The electricity distribution network includes over 41,000 kilometres of overhead and underground cables and over 27,000 substations.

The principal function of the Guarantor is to build, maintain and operate the electricity network through which end-users receive a supply of electricity. The Guarantor receives electricity from National Grid's transmission network (which connects the larger power stations) and from smaller generators (such as windfarms) that are directly connected to the Guarantor's network. This electricity is distributed by the Guarantor on behalf of suppliers to approximately 1.6 million customers connected to its electricity distribution network of transformers, switchgear, overhead power lines and underground cables, at voltages of up to 132kV. Some 14,313 gigawatt-hours of electricity was distributed to those customers during the year ended 31 December 2018.

The Guarantor holds an electricity distribution licence granted by the Secretary of State under the Electricity Act 1989 authorising it to distribute electricity for the purpose of supply to premises. The Guarantor is regulated by Ofgem.

The Guarantor Distribution Service Area Map



Regulatory Framework

Each of the fourteen licensed DNOs distributes electricity within their respective distribution service areas.

The Guarantor as a DNO is subject to regulation by Ofgem under the terms of the Electricity Act 1989 and its distribution licence. Ofgem has a duty to ensure that DNOs can finance their regulated activities and DNOs have a duty to maintain an investment grade credit rating.

DNOs are subject to price controls, set and enforced by Ofgem, which limit the revenue that may be recovered and retained from their electricity distribution activities. The regulatory regime that has been applied to DNOs encourages companies to look for efficiency gains in order to improve profits.

The distribution price control formula adjusts the revenue received by DNOs to reflect a number of factors, including, but not limited to, the rate of inflation as measured by the Retail Price Index ("**RPI**") and the quality of service delivered by the DNO's distribution system. The price control formula has been, and may be, reviewed at Ofgem's discretion. The current price control has been set for a period of eight years, with provision for mid-period review (although Ofgem announced in April 2018 that it did not intend to launch a mid-period review). The procedure and methodology adopted at a price control review are at the reasonable discretion of Ofgem. Ofgem's judgment of the future allowed revenue of DNOs has been based upon, among other things:

- actual operating and capital costs;
- operating and capital costs which each of the DNOs would incur if it were as efficient, in Ofgem's judgment, as the most efficient DNO;
- actual value of certain costs which are judged to be beyond the control of the DNO;
- expected taxes;
- the value ascribed by Ofgem to the capital employed in the regulated business ("**RAV**"), which takes account of network expenditure allowed by Ofgem;
- rate of return to be allowed on the RAV;
- financial ratios and licence requirements to maintain investment grade status;
- allowances in respect of the repair of the pension deficits in the defined benefit pension schemes sponsored by the DNO; and
- under / over-recoveries of revenues, relative to allowed revenues, in the previous price control period.

The price control formula determines the maximum revenue that the DNO is entitled to charge. There is a common charging regime for all the DNOs, approved by Ofgem, which reasonably recovers the allowed revenue from customers. Changes to the common methodology are governed by the Distribution Connection and Use of System Agreement ("**DCUSA**"). Parties to DCUSA and parties authorised by Ofgem can propose changes to the common methodology.

A number of incentive schemes also operate within the price control period to encourage DNOs to provide an appropriate quality of service to end users with penalty payments made by DNOs to end users where guaranteed standards of service have not been met. The aggregate of these guaranteed standards payments is uncapped, but may be excused in certain prescribed circumstances that are generally beyond the control of the DNO.

Changes to the price controls can be made by Ofgem without the consent of the DNO, but this is subject to a right of appeal by the DNO to the Competition and Markets Authority ("**CMA**") on specified grounds. Certain other interested parties also have the same right.

Any application for permission to appeal must be made within 20 working days of Ofgem's decision to modify the DNO's licence conditions to implement the new price control. If the CMA grants permission to appeal, the applicable legislation requires that the CMA determines the appeal within six months or in some exceptional circumstances seven months. The Guarantor and Northern Powergrid (Yorkshire) appealed Ofgem's proposals for the resetting of the formula that commenced April 1, 2015, as did one other party, and the CMA subsequently revised aspects of Ofgem's price control decision.

The current electricity distribution price control, known as RIIO-ED1 (Revenue=Incentives+Innovation+Outputs) became effective on 1 April 2015 and runs until 31 March 2023. This price control was the first to be set for electricity distribution since Ofgem completed its review of network regulation (known as the RPI-X @ 20 project). The key changes to the price control calculations, compared to those used in previous price controls, are that:

- the period over which new regulatory assets are depreciated is being gradually lengthened, from 20 years to 45 years, with the change being phased over eight years;

- some adjustments to allowed revenues will take effect during the price control period, rather than at the next price control review, including adjustments to partially reflect cost variances relative to cost allowances;
- the allowed cost of debt will be updated within the price control period by reference to a long-run trailing average based on external benchmarks of utility debt costs;
- allowed revenues will be adjusted in relation to some new service standard incentives, principally relating to new connections to the network; and
- there is scope for a mid-period review and adjustment to revenues in the latter half of the period for any changes in the outputs required of DNOs for certain specified reasons. Ofgem announced in April 2018 that it did not intend to launch a mid-period review.

Ofgem published its Final Determination in November 2014 under RIIO-ED1. Under Ofgem's determination, as revised by the CMA, and excluding the effects of incentive schemes and any deferred revenues from the prior price control, the base allowed revenue of the Guarantor remains constant throughout the period of the RIIO-ED1 price control before the addition of inflation. Nominal base allowed revenues will increase in line with inflation.

Ofgem monitors compliance by DNOs with their licence conditions. As well as imposing price controls, licence conditions governing terms of service, financial ring-fencing and the financial strength of the DNO, the provision of information to Ofgem and the public, as well as maintaining transparency, non-discrimination and avoidance of cross-subsidy in the provision of regulated services. Ofgem also monitors and enforces DNO compliance with certain statutory duties set out in the Electricity Act 1989, including the duty to develop and maintain an efficient, coordinated and economical system of electricity distribution.

Ofgem is able to issue enforcement orders to and/or impose financial penalties on DNOs that contravene any licence condition, any of certain statutory duties under the Electricity Act 1989 (as amended) or which are failing to achieve a satisfactory performance in relation to the individual standards of performance. Any penalty imposed must be reasonable and may not exceed 10% of the DNO's revenue.

RAV

The latest RAV values for the RIIO-ED1 price control review period beginning on 1 April 2015 as outlined by Ofgem in its electricity distribution price control financial model published in November 2018 are shown in the following table, all values are expressed in 2012/13 prices. The base RPI index for the 2012/13 prices is based on average RPI and is 244.675.

Annual Values as at March (£m, 2012/2013 prices)								
	2016	2017	2018	2019	2020	2021	2022	2023
Opening RAV	1129	1154	1175	1184	1193	1201	1209	1211
Net additions (after disposals)	127	124	114	115	114	105	98	96
Depreciation	(-) 102	(-) 104	(-) 105	(-) 106	(-) 106	(-) 97	(-) 96	(-) 94
Closing RAV	1,154	1,175	1,184	1,193	1,201	1,209	1,211	1,213

The above values are subject to adjustment to reflect the rate of inflation as measured by RPI.

Strategy

In common with the Northern Powergrid Group, the Guarantor's long-term financial strategy is to operate the business with a simple and conservative funding structure which maintains a good investment grade credit rating.

The Guarantor operates a business model and strategy based on its six core principles, which are:

Core Principle	Strategic objective	Key Performance Indicators (“KPI”)
Financial strength	Strong finances that enable improvement and growth.	<ul style="list-style-type: none"> - Operating profit - Maintenance of investment grade credit ratings - Cash flow
Customer service	Delivering exceptional customer service.	<ul style="list-style-type: none"> - Broad measure of customer satisfaction - Stakeholder Engagement rank
Operational excellence	High-quality, efficient operators running a smart reliable energy system.	<ul style="list-style-type: none"> - Customer Minutes Lost - Customer Interruptions - Network investment - High voltage restoration time
Employee commitment	High-performing people doing rewarding jobs in a safe and secure workplace.	<ul style="list-style-type: none"> - Occupational Safety and Health Administration Rate - Preventable Vehicle Accidents - Lost time accidents - Restricted duty accidents - Medical treatment accidents - Operational incidents - Absence rate
Environmental respect	Leaders in environmental respect and low carbon technologies.	<ul style="list-style-type: none"> - Total Oil/Fluid Lost - SF6 Gas discharges - Environmental Incidents - Carbon Footprint
Regulatory integrity	Trustworthy, fair and balanced, creating win-win outcomes.	<ul style="list-style-type: none"> - Quarterly certification

Customer Information

Substantially all of the end-users in the Guarantor's distribution service area are connected to the Guarantor's network and electricity can only be delivered to these end-users through its distribution systems, thus providing the Guarantor with distribution volumes that are relatively stable from year to year. The Guarantor charges fees for the use of its distribution systems to suppliers of electricity and to generators that are connected to the Guarantor's network.

Suppliers purchase electricity from generators, sell the electricity to end-user customers and use the Guarantor's distribution network pursuant to an industry standard DCUSA. The principal electricity suppliers that use the Guarantor's network are RWE Npower and certain of its affiliates and British Gas Trading Limited. The industry operates in accordance with a framework which sets credit limits for each supply business based on its credit rating or

payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or security deposit. Ofgem has indicated that, provided the Guarantor has implemented credit control, billing and collection in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any bad debt losses arising from supplier default will be recovered through an increase in future allowed income.

Variations in demand from end-users can affect the revenues that are received by the Guarantor in any year, but such variations have no effect on the total revenue that the Guarantor is allowed to recover in a price control period as under or over recoveries against price-controlled revenues are carried forward into prices for future years.

The Guarantor's service territory features a diverse economy with no dominant sector. The mix of rural, agricultural, urban and industrial areas cover a broad customer base concentrated around the principal centres of Newcastle and Middlesbrough.

Nearly all of the revenue generated by the Guarantor is from regulated activities. The table below shows that in each of 2016, 2017 and 2018, approximately 92% of the Guarantor's revenue came from regulated activities for Distribution Use of System charges ("DUoS") offset by generation DUoS ("GDUoS"). Most of the Guarantor's unregulated revenue was generated from trading with affiliates. In addition to increased revenue from affiliates during 2018, unregulated external revenues increased due to assessment and design fees.

<i>Revenue segmental analysis</i>	2018	2017	2016	<i>Variance (%)</i>	
	£m	£m	£m	2018 v 2017	2017 v 2016
Regulated – DUoS	287	285	291	1%	(-)2%
Regulated – GDUoS	(-)3	(-)3	(-)3	0%	0%
Unregulated - Other	29	25	24	16%	4%
Total reported revenue	313	307	312	2%	(-)2%

Almost all of the revenues from regulated activities come from the relatively stable market sectors of residential, commercial and industrial customers. The tables below indicate that residential and commercial customers represented approximately 48% of electricity distributed and approximately 61% of revenues received in 2018.

<i>GWh distributed segmental analysis</i>	2018	2017	2016	<i>Variance (%)</i>	
	GWh	GWh	GWh	2018 v 2017	2017 v 2016
Residential	5,104	5,125	5,227	0%	(-)2%
Commercial	1,741	1,782	2,222	(-)2%	(-)20%
Industrial	7,296	7,134	6,963	2%	2%
Unmetered	172	198	214	(-)13%	(-)7%
Total GWh distributed	14,313	14,239	14,626	1%	(-)3%

Demand for electricity is heavily influenced by underlying customer behaviour and a drive for energy efficiency reflecting higher retail energy prices, and increased local small-scale generation (e.g. photovoltaic cells). Reductions in electricity distributed generally reflect

warmer temperatures and downward pressure on demand created by higher retail energy prices between the years.

The increase in industrial and decrease in commercial is largely due to customer reclassifications (as a result of Ofgem approved industry changes) negatively impacting commercial volumes, with circa 400GWh reclassified between 2016 and 2017, and circa 40GWh reclassified between 2017 and 2018. The decrease in unmetered is most likely due to a combination of lower recorded council inventories and energy saving council initiatives such as active replacement of bulbs with LED equivalents.

<i>DUoS revenue segmental analysis</i>	2018	2017	2016	Variance (%)	
	£m	£m	£m	2018 v 2017	2017 v 2016
Residential	136	142	151	(-)4%	(-)6%
Commercial	39	42	49	(-)7%	(-)14%
Industrial	108	96	86	13%	12%
Unmetered	4	5	5	(-)20%	0%
Total revenue	287	285	291	1%	(-)2%

The decrease in residential revenue for a negligible decrease in units is due to an increase in the connection of new customers on lower value embedded networks, offset by decreases in higher value residential units connected directly to the Guarantor's network. The large percentage increase in industrial revenue compared to a relatively modest increase in units is due to average tariffs for industrial sites being high compared to those for residential, commercial or unmetered sites. In addition there was an average tariff increase across all market sectors of 2% between 2017 and 2018, compared to a decrease of 2% between 2016 and 2017.

Pensions

The Guarantor contributes to two pension schemes, which are operated by Northern Electric plc on its behalf. The pension schemes are:

- The Northern Powergrid Group of the Electricity Supply Pension Scheme (the "**DB Scheme**"); and
- The Northern Powergrid Pension Scheme (the "**DC Scheme**").

The DC Scheme was introduced for new employees of the Northern Powergrid Group from July 1997 and is a money purchase arrangement.

The DB Scheme is a defined benefit scheme for directors and employees, which provides pension and other related benefits based on final pensionable pay. The DB Scheme, was closed to staff commencing employment on or after 23 July 1997, but members who joined before this date continue to build up future pension benefits. The DB Scheme is administered by a board of trustees which is legally separate from the Guarantor and the assets are held in a separate trustee-administered fund.

The last actuarial valuation of the DB Scheme was carried out by the DB Scheme Trustees' actuarial advisors, Aon Hewitt, as at 31 March 2016. Such valuations are required by law to take place at intervals of no more than three years. The total market value of the assets of the DB Scheme at the date of that actuarial valuation was £1,597.5m. The valuation showed that the value of the assets represented approximately 89% of the actuarial value of the accrued benefits. This represents a shortfall of assets compared to the value of accrued benefits of

£194.9m. The accrued benefits include all benefits for pensioners and other members, as well as benefits based on service completed to date for active members, and allows for an estimate of future salary increases.

Agreement was reached during August 2017 with the DB Scheme Trustees to repair the total funding deficit over the period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2016 being borne out in practice. In determining the deficit contributions, it was agreed to reflect a partial allowance of £36m of the deterioration in the funding position due to market movements since the valuation date over the period to 31 December 2016. Pension deficit funding contributions are considered in the price control settlement and therefore the costs of these contributions are recovered via allowed revenues in line with Ofgem's assessments.

The agreed schedule of contributions to recover the total deficit is as follows:

1 April 2016 to 31 March 2017 £19.0m p.a. (of which £12.6m is borne by the Guarantor)

1 April 2017 to 31 March 2025 £27.4m p.a. (of which £17.4m is borne by the Guarantor)

The contributions above that are payable from 1 April 2017 onwards are shown in 2017/18 prices and will be altered on 1 April 2018 and on each 1 April thereafter in line with changes in RPI. The most recent valuation was 31 March 2019, and the approval of the pension valuation is expected to be delivered by 30 June 2020.

The DB Scheme is a defined benefit plan that shares the risk between various entities under common control. There is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole to individual companies within the Northern Powergrid Group and accordingly the Guarantor accounts for the DB Scheme as if it were a defined contribution scheme. The Guarantor does not provide any other post-retirement benefits to members of the DB Scheme.

Directors of the Guarantor

The Guarantor is managed by a Board of Directors comprising the following individuals:

Name	Position	Principal non-Group activities
T.E. Fielden	Finance Director, Northern Powergrid	None
T.H. France	General Counsel, Northern Powergrid	None
P.A. Jones	President and Chief Executive Officer, Northern Powergrid	None
A.J. Maclennan	Commercial Director, Northern Powergrid	None
A.R. Marshall	Non-Executive Director	None
P.C. Taylor	Non-Executive Director	Head of the School of Engineering, Director of the National Centre for Energy Systems Integration and

Siemens Professor of Energy
Systems at Newcastle
University

The business address of each of the Directors is Lloyds Court, 78 Grey Street, Newcastle Upon Tyne, NE1 6AF. No Director has any actual or potential conflict of interest between their duties to the Guarantor and their private interests and/or other duties.

TAXATION

UK Taxation

The following is a summary of the Issuer's understanding of current law and practice in the United Kingdom relating to the taxation treatment of the Bonds as at the date of this Prospectus. This is subject to any change in law or practice that may occur after such date and which may occur without notice and in some cases retrospectively. It does not purport to be a complete analysis of all United Kingdom tax considerations relating to the Bonds and is a general guide and should be treated with appropriate caution. It is not intended as tax advice and it does not purport to describe all of the tax considerations that may be relevant to a prospective purchaser. It does not necessarily apply where income is deemed for tax purposes to be the income of any other person. It relates only to the position of persons who are the absolute beneficial owners of the Bonds. Some aspects do not apply to certain classes of taxpayer (such as collective investment schemes, financial traders or dealers or persons who are connected with the Issuer). Prospective Bondholders who may be subject to tax in jurisdictions other than the United Kingdom or who may be unsure as to their tax position should seek their own professional advice. In particular, Bondholders should be aware that they may be liable to taxation under the laws of other jurisdictions in relation to payments in respect of the Bonds even if such payments may be made without withholding or deduction for or on account of taxation under the laws of the United Kingdom.

Payment of Interest on the Bonds

Payments of interest on the Bonds may be made without deduction of or withholding on account of United Kingdom income tax provided that the Bonds continue to be listed on a "recognised stock exchange" within the meaning of section 1005 of the Income Tax Act 2007 (the "**Act**") or admitted to trading on a "multilateral trading facility" operated by an EEA-regulated recognised stock exchange within the meaning of section 987 of the Act. The London Stock Exchange is a recognised stock exchange. The Bonds will be treated as listed on the London Stock Exchange if they are included in the Official List of the United Kingdom Listing Authority and admitted to trading on the London Stock Exchange. Provided, therefore, that the Bonds remain so listed, interest on the Bonds will be payable without withholding or deduction on account of United Kingdom tax.

Interest on the Bonds may also be paid without withholding or deduction on account of United Kingdom income tax where interest on the Bonds is paid by a company and, at the time the payment is made, the Issuer reasonably believes (and any person by or through whom interest on the Bonds is paid reasonably believes) that the beneficial owner is a company within the charge to United Kingdom corporation tax as regards the payment of interest, provided that HM Revenue and Customs has not given a direction (in circumstances where it has reasonable grounds to believe that it is likely that the above exemption is not available in respect of such payment of interest at the time the payment is made) that the interest should be paid under deduction of tax.

In other cases, an amount must generally be withheld from payments of interest on the Bonds on account of United Kingdom income tax at the basic rate (currently 20 per cent), subject to such relief as may be available following a direction from HM Revenue and Customs pursuant to the provisions of any applicable double taxation treaty (a "**Treaty**") or to any other exemption which may apply.

If the Guarantor makes any payments in respect of interest on the Bonds (or other amounts due under the Bonds other than the repayment of amounts subscribed for the Bonds) such payments may be subject to UK withholding tax at the basic rate (currently 20 per cent),

subject to such relief as may be available following a direction from HM Revenue and Customs pursuant to the provisions of any applicable Treaty or to any other exemption which may apply. It may, however, not in practice be possible for the Bondholder to obtain a direction for the Guarantee payments to be made free from withholding tax. Such payments by the Guarantor may not be eligible for any of the other exemptions described above.

The Bonds are issued at an issue price of less than 100 per cent of their principal amount. This discount element will not generally be subject to any United Kingdom withholding tax pursuant to the provisions outlined above, but may be subject to reporting requirements outlined below.

Any premium payable on a redemption of the Bonds may constitute a payment of interest. Payments of interest are subject to United Kingdom withholding tax provisions as outlined above and reporting requirements as outlined below.

Where interest has been paid under deduction of United Kingdom income tax, Bondholders who are not resident in the United Kingdom may be able to recover all or part of the tax deducted if there is an appropriate provision in any applicable double taxation treaty.

The references to "interest" above mean "interest" as understood in United Kingdom tax law. The statements above do not take any account of any different definitions of "interest" or "principal" which may prevail under any other law or which may be created by the Terms and Conditions or any related documentation

HM Revenue and Customs has power to obtain information (including the name and address of the beneficial owner of the interest) from any person in the United Kingdom who either pays interest to or receives interest for the benefit of an individual. Information so obtained may, in certain circumstances, be exchanged by HM Revenue and Customs with tax authorities in other countries.

Certain other tax considerations

The proposed financial transactions tax ("FTT")

On 14 February 2013, the European Commission published a proposal (the "**Commission's Proposal**") for a Directive for a common FTT in Belgium, Germany, Estonia, Greece, Spain, France, Italy, Austria, Portugal, Slovenia and Slovakia (the "**participating Member States**"). However, Estonia has since stated that it will not participate.

The Commission's Proposal has very broad scope and could, if introduced, apply to certain dealings in Bonds (including secondary market transactions) in certain circumstances. Primary market transactions referred to in Article (5)(c) of Regulation (EC) No 1287/2006 are expected to be exempt.

Under the Commission's Proposal the FTT could apply in certain circumstances to persons both within and outside of the participating Member States. Generally, it would apply to certain dealings in Bonds where at least one party is a financial institution, and at least one party is established in a participating Member State. A financial institution may be, or be deemed to be, "established" in a participating Member State in a broad range of circumstances, including (a) by transacting with a person established in a participating Member State or (b) where the financial instrument which is subject to the dealings is issued in a participating Member State.

However, the FTT proposal remains subject to negotiation between participating Member States. It may therefore be altered prior to any implementation, the timing of which remains

unclear. Additional EU Member States may decide to participate. Prospective holders of Bonds are advised to seek their own professional advice in relation to the FTT.

U.S. Foreign Account Tax Compliance Act Withholding

Pursuant to certain provisions of the U.S. Internal Revenue Code of 1986, commonly known as "**FATCA**", a "foreign financial institution" (as defined by (FATCA) may be required to withhold on certain payments it makes ("**foreign passthru payments**") to persons that fail to meet certain certification, reporting, or related requirements. The issuer may be a foreign financial institution for these purposes. A number of jurisdictions (including the United Kingdom) have entered into, or have agreed in substance to, intergovernmental agreements with the United States to implement FATCA ("**IGAs**"), which modify the way in which FATCA applies in their jurisdictions. Under the provisions of IGAs as currently in effect, a foreign financial institution in an IGA jurisdiction would generally not be required to withhold under FATCA or an IGA from payments that it makes. Certain aspects of the application of the FATCA provisions and IGAs to instruments such as the Bonds, including whether withholding would ever be required pursuant to FATCA or an IGA with respect to payments on instruments such as the Bonds, are uncertain and may be subject to change. Even if withholding would be required pursuant to FATCA or an IGA with respect to payments on instruments such as the Bonds, such withholding would not apply to foreign passthru payments made prior to the date that is two years after the date on which final regulations defining foreign passthru payments are published in the U.S. Federal Register, and Bonds characterised as debt (or which are not otherwise characterised as equity and have a fixed term) for U.S. federal tax purposes that are issued on or prior to the date that is six months after the date on which final regulations defining foreign passthru payments are filed with the U.S. Federal Register generally would be grandfathered for purposes of FATCA withholding, in either case unless materially modified after such date (including by reason of a substitution of the Issuer). Bondholders should consult their own tax advisors regarding how these rules may apply to their investment in the Bonds.

SUBSCRIPTION AND SALE

Banco Santander, S.A., Lloyds Bank Corporate Markets Plc and NatWest Markets Plc (together the "**Joint Lead Managers**") have, in a subscription agreement dated 22 May 2019 (the "**Subscription Agreement**") and made between the Issuer, the Guarantor and the Joint Lead Managers upon the terms and subject to the conditions contained therein, jointly and severally agreed to subscribe for the Bonds. The Joint Lead Managers are entitled in certain circumstances to be released and discharged from their obligations under the Subscription Agreement prior to the closing of the issue of the Bonds.

United States of America

The Bonds have not been and will not be registered under the Securities Act or with any securities regulatory authority or under any relevant securities laws of any state or other jurisdiction of the United States. The Bonds may not be offered, sold or delivered within the United States or to, or for the account or benefit of, U.S. persons (as defined in Regulation S), except pursuant to an applicable exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and in accordance with applicable U.S. state securities laws.

Each Joint Lead Manager has agreed that it will not offer, sell or deliver the Bonds, (i) as part of its distribution at any time or (ii) otherwise until 40 days after the later of the commencement of the offering of the Bonds and the date of issue of the Bonds (the "**Distribution Compliance Period**") within the United States or to, or for the account or benefit of, U.S. persons, and, at or prior to confirmation of sale of the Bonds, it will have sent to each distributor, dealer or other person to which it sells Bonds during the Distribution Compliance Period a confirmation or other notice setting forth the restrictions on offers and sales of the Bonds within the United States or to, or for the account or benefit of, U.S. persons. In addition, until 40 days after the commencement of the offering of the Bonds, an offer or sale of Bonds within the United States by any dealer (whether or not participating in the offering of such Bonds) may violate the requirements of the Securities Act.

The Bonds are subject to U.S. tax law requirements and may not be offered, sold or delivered within the United States or its possessions or to a U.S. person, except in certain transactions permitted by U.S. tax regulations. Terms used in this paragraph have the meanings given to them by U.S. Internal Revenue Code of 1986, as amended and regulations thereunder.

United Kingdom

Each Joint Lead Manager has represented and agreed, *inter alia*, that:

- (a) it has complied and will comply with all applicable provisions of the Financial Services and Markets Act 2000 (the "**FSMA**") with respect to anything done by it in relation to the Bonds in, from or otherwise involving the United Kingdom; and
- (b) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of the Bonds in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Guarantor.

Prohibition of Sales to EEA Retail Investors

Each Joint Lead Manager has represented and agreed that it has not offered, sold or otherwise made available and will not offer, sell or otherwise make available any Bonds to any retail

investor in the European Economic Area. For the purposes of this provision, the expression "retail investor" means a person who is one (or more) of the following:

- (a) a retail client as defined in point (11) of Article 4(1) of MiFID II; or
- (b) a customer within the meaning of the Insurance Mediation Directive, where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II.

General

Each of the Joint Lead Managers has acknowledged that no action has been taken by the Issuer, the Guarantor or any Joint Lead Manager which would or is intended to permit a public offer of Bonds in any country or jurisdiction where action for that purpose is required. Accordingly, each Joint Lead Manager has undertaken that it will not, directly or indirectly, offer or sell any Bonds in any country or jurisdiction where action for that purpose is required and neither this Prospectus nor any other circular, prospectus, form of application, advertisement or other material may be distributed in or from or published in any country or jurisdiction, except under circumstances which will, to the best of its knowledge and belief, result in compliance with applicable laws and regulations.

GENERAL INFORMATION

1. The creation and issue of the Bonds has been authorised by a resolution of the Board of Directors of the Issuer dated 26 April 2019. The giving of the Guarantee has been authorised by a resolution of the Board of Directors of the Guarantor dated 26 April 2019.
2. It is expected that official listing will be granted on or about 24 May 2019 subject only to the issue of the Temporary Global Bond. Prior to official listing, dealings will be permitted by the London Stock Exchange in accordance with its rules. The Issuer estimates that the total expenses related to the admission to trading of the Bonds will be approximately £5,250.
3. At the Closing Date, the yield on the Bonds will be 2.801 per cent per annum. The yield is calculated at the Closing Date on the basis of the issue price. It is not an indication of future yield.
4. There are no governmental, legal or arbitration proceedings (including any proceedings which are pending or threatened of which the Issuer or the Guarantor is aware) in the 12 months preceding the date of this Prospectus which may have or have had a significant effect on the financial position or profitability of the Issuer, the Guarantor or the Northern Powergrid Group.
5. There has been no significant change in the financial or trading position of the Issuer, the Guarantor or the Northern Powergrid Group since 31 December 2018. There has been no material adverse change in the prospects of the Issuer or the Guarantor since 31 December 2018.
6. The auditors of the Issuer and the Guarantor are Deloitte LLP, which is registered to carry out audit work in the UK and Ireland by the Institute of Chartered Accountants in England and Wales, and which have audited, without qualification, the financial statements of the Issuer and the Guarantor for the financial years ended 31 December 2017 and 31 December 2018. The address of Deloitte LLP is One Trinity Gardens, Broad Chare, Newcastle-upon-Tyne, NE1 2HF.
7. The financial information included in this Prospectus (other than the Issuer's financial statements which are incorporated by reference in this Prospectus and the Guarantor's financial statements which are included in this Prospectus) does not constitute the statutory accounts of the Issuer or the Guarantor as the case may be, within the meaning of Section 435(1) and (2) of the Companies Act 2006 for any period presented. The auditors have made a report under Chapter 3 of Part 16 Of the Companies Act 2006 on the statutory accounts of each of the Issuer and the Guarantor for each of the years ended 31 December 2017 and 31 December 2018, which reports were unqualified and did not contain any statement as is described in Sections 498(2) or (3) of the Companies Act 2006. Statutory accounts of the Issuer and of the Guarantor have been delivered to the Registrar of Companies in England and Wales for each of the years ended 31 December 2017 and 31 December 2018.
8. Copies of the following documents may be inspected and collected during normal business hours at the offices of the Principal Paying Agent:
 - (a) the Memorandum and Articles of Association of each of the Issuer and the Guarantor;
 - (b) the Paying Agency Agreement and the Trust Deed (which includes the Guarantee);

- (c) the audited financial statements of the Issuer for the years ended 31 December 2017 and 2018; and
 - (d) the audited financial statements of the Guarantor for the years ended 31 December 2017 and 2018.
9. The Bonds and any Coupons appertaining thereto will bear a legend to the following effect:
- "Any United States person who holds this obligation will be subject to limitations under the United States income tax laws, including the limitations provided in Sections 165(j) and 1287(a) of the Internal Revenue Code." The sections referred to in such legend provide that a United States person who holds a Bond or Coupon will generally not be allowed to deduct any loss realised on the sale, exchange or redemption of such Bond or Coupon and any gain (which might otherwise be characterised as capital gain) recognised on such sale, exchange or redemption will be treated as ordinary income.
10. The Bonds have been accepted for clearance through Euroclear and Clearstream, Luxembourg. The ISIN for the Bonds is XS1999869370 and the Common Code is 199986937.
- The address of Euroclear is Euroclear Bank SA/NV, 1 Boulevard du Roi Albert II, B-1210 Brussels, Belgium and the address of Clearstream, Luxembourg is Clearstream Banking, 42 Avenue JF Kennedy, L-1855 Luxembourg.
11. Each of the Joint Lead Managers and their respective affiliates have engaged, and may in the future engage, in investment banking and/or commercial banking transactions with, and may perform services for the Issuer, the Guarantor and their affiliates in the ordinary course of business. They may have positions, deal or make markets in the Bonds, related derivatives and reference obligations, including (but not limited to) entering into hedging strategies on behalf of the Issuer, the Guarantor and their affiliates, investor clients, or as principal in order to manage their exposure, their general market risk, or other trading activities.

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**APPENDIX 1 – FINANCIAL STATEMENTS OF NORTHERN POWERGRID
(NORTHEAST) LIMITED FOR THE YEAR ENDED 31 DECEMBER 2017**

(Pages 1-15 (inclusive) are deliberately omitted)

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHERN POWERGRID (NORTHEAST) LIMITED

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Northern Powergrid (Northeast) Limited (the 'company') which comprise:

- the statement of profit and loss;
- the statement of profit or loss and other comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the cash flow statement;
- the related accounting policies; and
- the related notes 1 to 25.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF NORTHERN POWERGRID (NORTHEAST) LIMITED

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:


- the information given in the Strategic Report and Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Report of the Directors have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Report of the Directors.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or
- returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit


David M Johnson FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Statutory Auditor
Newcastle upon Tyne
United Kingdom
25 April 2018

NORTHERN POWERGRID (NORTHEAST) LIMITED

**STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Notes	2017 £'000	2016 £'000
CONTINUING OPERATIONS			
Revenue	3	328,300	333,012
Cost of sales		<u>(12,856)</u>	<u>(13,982)</u>
GROSS PROFIT		315,444	319,030
Operating expenses		<u>(181,869)</u>	<u>(169,449)</u>
OPERATING PROFIT		133,575	149,581
Other gains		331	400
Finance costs	5	(28,944)	(29,082)
Finance income	5	<u>93</u>	<u>482</u>
PROFIT BEFORE INCOME TAX	6	105,055	121,381
Income tax	7	<u>(19,469)</u>	<u>(5,090)</u>
PROFIT FOR THE YEAR		<u>85,586</u>	<u>116,291</u>

The notes on pages 23 to 53 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017**

	2017 £'000	2016 £'000
PROFIT FOR THE YEAR	85,586	116,291
OTHER COMPREHENSIVE INCOME	<u>-</u>	<u>-</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>85,586</u>	<u>116,291</u>


The notes on pages 23 to 53 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED (REGISTERED NUMBER: 02906593)

**STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2017**

	Notes	2017 £'000	2016 £'000
ASSETS			
NON-CURRENT ASSETS			
Intangible assets	10	47,568	40,857
Property, plant and equipment	11	2,346,759	2,232,507
Investments	12	50	50
		<u>2,394,377</u>	<u>2,273,414</u>
CURRENT ASSETS			
Inventories	13	13,080	12,085
Trade and other receivables	14	54,972	55,194
		<u>68,052</u>	<u>67,279</u>
TOTAL ASSETS		<u><u>2,462,429</u></u>	<u><u>2,340,693</u></u>
EQUITY			
SHAREHOLDERS' EQUITY			
Called up share capital	15	200,000	200,000
Retained earnings	16	775,708	712,822
TOTAL EQUITY		<u>975,708</u>	<u>912,822</u>
LIABILITIES			
NON-CURRENT LIABILITIES			
Trade and other payables	17	584,348	562,308
Interest bearing loans and borrowings	18	547,049	586,949
Deferred tax	21	91,210	89,519
Provisions	20	88	98
		<u>1,222,695</u>	<u>1,238,874</u>
CURRENT LIABILITIES			
Trade and other payables	17	108,735	103,568
Interest bearing loans and borrowings	18	147,079	75,217
Tax payable		7,112	9,582
Provisions	20	1,100	630
		<u>264,026</u>	<u>188,997</u>
TOTAL LIABILITIES		<u>1,486,721</u>	<u>1,427,871</u>
TOTAL EQUITY AND LIABILITIES		<u><u>2,462,429</u></u>	<u><u>2,340,693</u></u>

The financial statements were approved by the Board of Directors on 24 April 2018 and were signed on its behalf by:



P A Jones
Director.

The notes on pages 23 to 53 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED

**STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Called up share capital £'000	Retained earnings £'000	Total equity £'000
Balance at 1 January 2016	200,000	618,331	818,331
Changes in equity			
Dividends	-	(21,800)	(21,800)
Total comprehensive income	-	<u>116,291</u>	<u>116,291</u>
Balance at 31 December 2016	<u>200,000</u>	<u>712,822</u>	<u>912,822</u>
Changes in equity			
Dividends	-	(22,700)	(22,700)
Total comprehensive income	-	<u>85,586</u>	<u>85,586</u>
Balance at 31 December 2017	<u>200,000</u>	<u>775,708</u>	<u>975,708</u>

The notes on pages 23 to 53 form part of these financial statements

NORTHERN POWERGRID (NORTHEAST) LIMITED

**STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Notes	2017 £'000	2016 £'000
Cash flows from operating activities			
Cash generated from operations	24	194,188	208,634
Finance costs paid		(31,351)	(31,533)
Dividends received		46	37
Interest received		47	445
Tax paid		<u>(20,248)</u>	<u>(4,600)</u>
Net cash from operating activities		<u>142,682</u>	<u>172,983</u>
Cash flows from investing activities			
Purchase of intangible fixed assets		(11,417)	(12,964)
Purchase of tangible fixed assets		(193,133)	(186,633)
Sale of tangible fixed assets		331	488
Receipt of customer contributions		<u>52,376</u>	<u>45,063</u>
Net cash used in investing activities		<u>(151,843)</u>	<u>(154,046)</u>
Cash flows from financing activities			
Movements in loans from Group		31,861	2,863
Equity dividends paid		<u>(22,700)</u>	<u>(21,800)</u>
Net cash from/(used in) financing activities		<u>9,161</u>	<u>(18,937)</u>
Movement in cash and cash equivalents		-	-
Cash and cash equivalents at beginning of year		-	-
Cash and cash equivalents at end of year		<u>-</u>	<u>-</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

1. GENERAL INFORMATION

Northern Powergrid (Northeast) Limited (the "Company") is a company limited by shares incorporated in England and Wales and is part of the Northern Powergrid Holdings Company group of companies (the "Northern Powergrid Group"). The address of the registered office is Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.

The nature of the Company's business model, strategic objectives, operations and activities are set out in the Strategic Report.

2. ACCOUNTING POLICIES

Accounting convention and basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements have also been prepared in accordance with IFRSs as adopted by the European Union and with those parts of the Companies Act 2006 (the "Act") that are applicable to companies reporting under IFRS.

The Company is exempt from preparing group financial statements as it is a wholly owned subsidiary of a parent undertaking preparing group financial statements. Further details of the registered address and parent company are available in note 25.

The financial statements have been prepared under the historical cost convention.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis, except for leasing transactions which are within the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The principal accounting policies are set out below.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES- continued

Application of new and revised IFRS

In the current year, the Company has a number of amendments to IFRS issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for an accounting period that begins on or after 1 January 2017:

- Amendments to IAS 12 The amendments to IAS 12 Income Taxes clarify when a deferred tax asset should be recognised for unrealised losses. The application of the amendments has not resulted in any impact on the financial performance or financial position of the Company.
- Amendments to IAS 7 The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The directors of the Company do not anticipate the application of these amendments has had no material impact on the Company's financial statements.
- Annual Improvements to IFRSs 2014-2016 Cycle The annual improvements to IFRSs 2014-2016 Cycle include a number of amendments to IFRSs. The application of these amendments has had no effect on the Company's financial statement.

New and revised standards in issue but not yet effective

The Company has not applied the following new and revised IFRS that have been issued but are not yet effective for the year ended 31 December 2017:

- IFRS 9 - Financial Instruments (1 January 2018). A revised version of IFRS 9, Financial Instruments, was issued in July 2014 mainly to include: a) impairment requirements for financial assets; and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' ("FVTOCI") measurement category for certain simple debt instruments. The directors of the Company anticipate that the application of IFRS 9 in the future is unlikely to have a material impact on amounts reported in respect of the Company's financial assets and financial liabilities.
- IFRS 15 - Revenue from Contracts with Customers (1 January 2018). In May 2014, IFRS 15, Revenue from Contracts with Customers, was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 11 Construction Contracts, IAS 18 Revenue and the related Interpretations. The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15. On the whole the directors anticipate that the application of IFRS 15 will not have a material impact on the Company's financial statements, however there is ongoing discussion in the industry and amongst the accounting professions to consider the appropriate accounting treatment for customer contributions towards distribution system assets. We continue to engage in these conversations and will evaluate and conclude prior to the application of the standard.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

2. ACCOUNTING POLICIES- continued

- IFRS 16 - Leases (1 January 2019)

IFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective. IFRS 16 distinguishes between leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions between operating leases and finance leases are removed for lessee accounting, and is replaced by a model where right-of-use asset and a corresponding liability have to be recognised for all leases by lessees except for short term leases and leases of low-value assets. As of 31 December 2017, the Company has non-cancellable operating lease commitments of £7.6 million, IAS 17 does not require recognition of any right-of-use asset or liability for future payments for these leases. A preliminary assessment indicates that these arrangements will meet the definition of a lease under IFRS 16, and hence the Company will recognise a right-of-use asset and corresponding liability in respect of all these leases unless they qualify for low-value or short-term leases upon the application of IFRS 16.

Critical judgements in applying accounting policies

The following are the critical judgements, apart from those involving estimations, that the directors have made in the process of applying the Group's accounting policies and that have the most significant effect on amounts recognised in the consolidated financial statements:

- The split of operating and capital expenditure and the allocation of overheads to property, plant and equipment:

Costs are capitalised where it is probable that future economic benefits associated with the asset will flow to the enterprise; and the cost of the item can be reliably measured.

The allocation of overheads to capital is derived from a detailed analysis of the costs and their relevant cost drivers, which is reviewed on annual basis.

The amount of overheads capitalised in the year was £40.0m (2016: £38.3m)

Key sources of estimation uncertainty

In the preparation of financial statements in conformity with IFRS the Directors did not identify any key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Revenue

Revenue is only recognised when the risks and rewards of ownership have been transferred to a third party. No revenue is recognised where there are significant uncertainties regarding the consideration to be received or the costs associated with the transaction.

Revenue is measured at the fair value of consideration received or receivable.

Revenue represents charges for the use of the Company's distribution network, amortisation of customer contributions, recharge of costs incurred on behalf of related parties and the invoiced value of other goods sold and services provided, exclusive of value added tax.

Revenues from charges to end customers for the use of the Company's distribution network include estimates of the units distributed. The estimated usage is based on historic data, judgement and assumptions. Revenues are gradually adjusted to reflect actual usage in the period during which actual meter readings are obtained.

Any under or over-recovery of allowed distribution network revenues as prescribed by Ofgem is not provided for in the financial statements and will be recovered/repaid through future tariffs.

Customer contributions towards distribution system assets are included in deferred revenue. The Company's policy is to credit the customer contribution to revenue on a straight-line basis, in line with the useful life of the distribution system assets.

Interest income from a financial asset is recognised when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

Software development costs

Costs in respect of major developments are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over the estimated useful life of the software of up to 10 years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognised in profit or loss in the period which they are incurred.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes the purchase price of the asset and any costs, including internal employee and other costs, directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Depreciation is recognised so as to write off the cost of assets less their residual values over their useful lives, using the straight-line method:

Distribution system:

Distribution system assets	45 years
Distributed generation assets	15 years
Metering equipment included in distribution system assets	up to 5 years
Information technology equipment included in distribution system assets	up to 10 years

Non-operational land & buildings:

Buildings - freehold	up to 60 years
Buildings - leasehold	lower of lease period or 60 years

Fixtures and equipment:

up to 10 years

Software development costs:

up to 10 years

Freehold land is not depreciated.

The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any material changes in those estimates accounted for on a prospective basis. Due to the significance of the Company's investment in property, plant and equipment, variations in estimates could impact operating results both positively and negatively although, historically, few changes have been required.

Assets in the course of construction are carried at cost, less any recognised impairment loss. Costs include professional fees, and, for qualifying assets, borrowing costs capitalised in accordance with the Company's accounting policy. Such assets are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation on these assets, on the same basis as other assets, commences when the assets are commissioned. Assets are derecognised when they are disposed of profit or loss on disposal is recognised in other gains on the statement of profit or loss.

Internally-generated intangible assets

An internally generated intangible asset arising from development is recognised if the conditions set out in IAS 38 relating to the recognition of intangible assets are met. The amount initially recognised for internally-generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria. Amortisation is recognised on a straight-line basis over their estimated useful lives.

Impairment of tangible and intangible assets

At the balance sheet date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

An intangible asset with an indefinite useful life is tested for impairment at least annually and whenever there is an indication that the asset may be impaired.

Where the recoverable amount is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Financial instruments

Financial assets and financial liabilities are recognised on the statement of financial position when the Company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

Inventories

Inventories are stated at the lower of cost and net realisable value. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale. Raw materials and goods for resale are valued at purchase cost on an average price basis. Work in progress is valued at the cost of direct materials and labour plus attributable overheads based on the normal level of activity less progress payments.

Taxation

The income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from 'profit before tax' as reported in the statement of profit or loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from the initial recognition of assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit. In addition, deferred tax liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill.

Deferred tax liabilities recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting period and reduced to the extent that that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Foreign currencies

Transactions in foreign currencies are recognised at the rate of exchange prevailing at the date of the transaction. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at that date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Leases

Leases are classified as finance leases wherever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Operating lease rentals are recognised in the statement of profit or loss or in property, plant and equipment on a straight-line basis over the lease term.

Provisions

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

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Pensions

The Company contributes to the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "Northern Powergrid Group of the ESPS"), a defined benefit scheme. There is no contractual agreement or policy to allow for accounting for the company's share of the defined benefit scheme's liabilities and assets therefore the scheme has been accounted for as a defined contribution scheme.

The company's share of the net defined benefit cost is allocated between employers contribution and deficit payments. The contribution is determined by the number of current employees in the Company in the pension scheme. The deficit payments are agreed by the Group with the Trustees, these deficit payments are allocated by the group according to the liability relating to previous and current employees on the scheme within Northern Electric plc, Northern Powergrid (Yorkshire) plc, and Northern Powergrid (Northeast) Ltd. The estimated amount of contributions expected to be paid to the pension scheme by the company during the next financial year is £28.6m (2016: £24.7m).

The Group also participates in a defined contribution scheme. Contributions payable to the defined contribution scheme are charged to the statement of profit or loss in the year or capitalised as appropriate when employees have rendered service entitling them to the contributions.

A liability is recognised for benefits accruing to employees in respect of wages and salaries, annual leave and sick leave in the period in which the related service is rendered at the undiscounted amount of the benefits expected to be paid in exchange for that service. Liabilities recognised in respect of short-term employee benefits are measured at the undiscounted amount of the benefits expected to be paid in exchange for the related service. Liabilities recognised in respect of other long-term employee benefits are measured at the present value of the estimated future cash outflows expected to be made by the Company in respect of services provided by employees up to the reporting date.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Financial assets

Financial assets, including trade and other receivables and cash and cash equivalents, are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment.

The effective interest method is a method of calculating the amortised cost of an instrument and of allocating income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the instrument to the net carrying amount on initial recognition.

Interest income is recognised by applying the effective interest rate, except for short-term receivables when the effect of discounting is immaterial.

Cash and cash equivalents (which are presented as a single class of assets on the face of the statement of financial position) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For certain categories of financial assets, such as trade receivables, assets are assessed for impairment on a collective basis even if they were assessed not to be impaired individually. Objective evidence of impairment for a portfolio of receivables could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period of 30 days, as well as observable changes in national or local economic conditions that correlate with default on receivables.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the statement of profit or loss. The financial asset is derecognised when the contractual rights to the cash flows from the asset expire, on derecognition the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised in other comprehensive income and accumulated in equity is recognised in the profit or loss.

Going concern

The directors have, at the time of approving the financial statements, a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the financial statements. Further detail is contained within the Going Concern Statement in the Report of the Directors.

Capital management

The Group manages its capital centrally to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from 2016.

The capital structure of the Company consists of net debt (borrowings as detailed in note 18 offset by equity of the Company (comprising issued capital, reserves and retained earnings as detailed in notes 15 and 16).

The Company is subject to externally imposed capital requirements as detailed in note 18. Further details of the financial risk management is available on page 11 of the strategic report.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

3. SEGMENTAL REPORTING

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Company that are regularly reviewed by the President and Chief Executive Officer of the Northern Powergrid Group in order to allocate resources to these segments and to assess their performance.

In practice, the President and Chief Executive Officer allocates resources and assesses performance based upon the aggregate results of the Company and Northern Powergrid (Yorkshire) plc, another distribution network operator in the Northern Powergrid Group, suggesting that no segmental reporting is required.

Revenue, profit before tax and net assets are attributable to electricity distribution. Revenue is all in respect of sales to United Kingdom customers.

Revenue represents charges made to customers for use of the distribution system, the recharge of costs incurred on behalf of related parties, amortisation of customer contributions and other services and is included net of value added tax.

4. EMPLOYEES AND DIRECTORS

	2017	2016
	£'000	£'000
Salaries	49,569	50,354
Social security costs	5,521	5,543
Defined benefit pension costs	24,714	23,004
Defined contribution pension costs	<u>1,928</u>	<u>1,574</u>
	81,732	80,475
Less charged to property, plant and equipment	<u>(41,372)</u>	<u>(42,130)</u>
	<u><u>40,360</u></u>	<u><u>38,345</u></u>

A large proportion of the Company's employees are members of the Northern Powergrid Group of the ESPS, most of the remaining employees are members of the Northern Powergrid Pension Scheme, details of both are given in the employee benefits note (note 22).

The average monthly number of employees during the year was:

	2017	2016
Technical	336	329
Industrial	437	440
Administration	188	198
Other	<u>111</u>	<u>98</u>
	<u><u>1,072</u></u>	<u><u>1,065</u></u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

4. EMPLOYEES AND DIRECTORS - continued

DIRECTORS' REMUNERATION

	2017 £'000	2016 £'000
Highest Paid:		
Short-term employee benefits	375	319
Post-employment benefits	-	10
Other long-term benefits	<u>435</u>	<u>370</u>
	<u>810</u>	<u>699</u>
	2017 £'000	2016 £'000
Total:		
Short-term employee benefits	805	667
Post-employment benefits	40	52
Other long-term benefits	<u>682</u>	<u>612</u>
	<u>1,527</u>	<u>1,331</u>
Directors who are a member of the defined benefit scheme	<u>1</u>	<u>3</u>
Directors who are a member of the defined contribution scheme	<u>2</u>	<u>3</u>

OTHER KEY PERSONNEL REMUNERATION

	2017 £'000	2016 £'000
Total:		
Short-term employee benefits	439	424
Post-employment benefits	97	81
Other long-term benefits	<u>233</u>	<u>250</u>
	<u>769</u>	<u>755</u>

Other key personnel includes a number of senior functional managers who, whilst not board directors, have authority and responsibility for planning, directing and controlling the activities of the Company.

The directors and key personnel are remunerated for their services to the Northern Powergrid Group, of which the Company is a subsidiary. The figures above represent the share of the costs borne by the Company.

Other long-term benefits relate to deferred bonus plan accrued over the period of the plan.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

5. NET FINANCE COSTS

	2017 £'000	2016 £'000
Finance income:		
Dividends received	46	37
Interest on tax refund	-	388
Deposit account interest	<u>47</u>	<u>57</u>
	<u>93</u>	<u>482</u>
Finance costs:		
Bank interest	101	105
Interest payable on other loans	8,284	8,284
Interest payable on loans from Group undertakings	23,347	23,353
Borrowing costs capitalised	<u>(2,788)</u>	<u>(2,660)</u>
	<u>28,944</u>	<u>29,082</u>
Net finance costs	<u>28,851</u>	<u>28,600</u>

Borrowing costs were capitalised at a rate of 4.86% per annum (2016: 5.53%) on eligible expenditure.

6. PROFIT BEFORE INCOME TAX

The profit before income tax is stated after charging:

	2017 £'000	2016 £'000
Depreciation - owned assets	77,313	74,186
Software development costs amortisation	4,706	3,730
Research and development costs	1,479	830
Amortisation of deferred revenue	(21,210)	(19,342)
Impairment of trade and other receivables	361	440
Profit on disposal of property, plant and equipment	<u>(331)</u>	<u>(400)</u>

Analysis of auditor's remuneration is as follows:

	2017 £'000	2016 £'000
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	121	125
Other assurance services	<u>45</u>	<u>45</u>
Total fees payable to the Company's auditor	<u>166</u>	<u>170</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

7. INCOME TAX

Analysis of tax expense

	2017 £'000	2016 £'000
Current tax	17,778	8,168
Deferred tax	<u>1,691</u>	<u>(3,078)</u>
Total tax expense in statement of profit or loss	<u>19,469</u>	<u>5,090</u>

Factors affecting the tax expense

The tax assessed for the year is lower (2016: lower) than the standard rate of corporation tax in the UK. The difference is explained below:

	2017 £'000	2016 £'000
Profit before income tax	<u>105,055</u>	<u>121,381</u>
Profit multiplied by the standard rate of corporation tax in the UK of 19.25% (2016 – 20.00%)	20,223	24,276
Effects of:		
Changes in legislation	(358)	(5,043)
Current tax over provision for prior years	(396)	(14,390)
Tax free income and disallowable costs	(148)	(130)
Profits at deferred tax rate	(228)	-
Deferred tax under provision for prior years	332	369
Other	<u>44</u>	<u>8</u>
Tax expense	<u>19,469</u>	<u>5,090</u>

	2017 £'000	2016 £'000
Tax expense comprises:		
Current tax expense:		
Corporation tax charge for the year	18,174	22,588
Over provision for prior years	<u>(396)</u>	<u>(14,390)</u>
Total current tax charge	17,778	8,168
Deferred tax:		
Deferred tax expenses relating to the origination and reversal of temporary differences	1,717	1,596
Under provision for prior years	332	369
Effect of changes in legislation	<u>(358)</u>	<u>(5,043)</u>
Total deferred tax charge	<u>1,691</u>	<u>(3,078)</u>
Tax on profit before tax	<u>19,469</u>	<u>5,090</u>

Finance Act No.2 2015 included provisions to reduce the corporation tax to 19% with effect from 1 April 2017 and Finance Act 2016 introduced a further reduction in the main rate of corporation tax to 17% from 1 April 2020. Accordingly deferred tax assets and liabilities have been calculated at the tax rates which will be in force when the underlying temporary differences are expected to reverse.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

8. DIVIDENDS

	2017 £'000	2016 £'000
Interim dividend at 11.3p per share (2016: 10.9p per share)	<u>22,700</u>	<u>21,800</u>

9. OPERATING EXPENSES

	2017 £'000	2016 £'000
Operating expenses comprise		
Distribution costs	107,931	101,879
Administrative expenses	<u>73,938</u>	<u>67,570</u>
	<u>181,869</u>	<u>169,449</u>

10. INTANGIBLE ASSETS

	Software development costs £'000
COST	
At 1 January 2017	68,667
Additions	<u>11,417</u>
At 31 December 2017	<u>80,084</u>
AMORTISATION	
At 1 January 2017	27,810
Amortisation for year	<u>4,706</u>
At 31 December 2017	<u>32,516</u>
NET BOOK VALUE	
At 31 December 2017	<u>47,568</u>

	Software development costs £'000
COST	
At 1 January 2016	55,703
Additions	<u>12,964</u>
At 31 December 2016	<u>68,667</u>
AMORTISATION	
At 1 January 2016	24,080
Amortisation for year	<u>3,730</u>
At 31 December 2016	<u>27,810</u>
NET BOOK VALUE	
At 31 December 2016	<u>40,857</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

11. PROPERTY, PLANT AND EQUIPMENT

	Non operational land & buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST				
At 1 January 2017	4,191	2,797,074	40,983	2,842,248
Additions	-	188,871	2,694	191,565
Disposals	-	(7,024)	(423)	(7,447)
At 31 December 2017	<u>4,191</u>	<u>2,978,921</u>	<u>43,254</u>	<u>3,026,366</u>
DEPRECIATION				
At 1 January 2017	2,163	579,199	28,379	609,741
Charge for year	252	73,141	3,920	77,313
Eliminated on disposal	-	(7,024)	(423)	(7,447)
At 31 December 2017	<u>2,415</u>	<u>645,316</u>	<u>31,876</u>	<u>679,607</u>
NET BOOK VALUE At 31 December 2017	<u>1,776</u>	<u>2,333,605</u>	<u>11,378</u>	<u>2,346,759</u>
	Non operational land & buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST				
At 1 January 2016	4,191	2,626,332	35,964	2,666,487
Additions	-	181,503	5,236	186,739
Disposals	-	(10,761)	(217)	(10,978)
At 31 December 2016	<u>4,191</u>	<u>2,797,074</u>	<u>40,983</u>	<u>2,842,248</u>
DEPRECIATION				
At 1 January 2016	1,871	519,357	25,182	546,410
Charge for year	292	70,480	3,414	74,186
Eliminated on disposal	-	(10,638)	(217)	(10,855)
At 31 December 2016	<u>2,163</u>	<u>579,199</u>	<u>28,379</u>	<u>609,741</u>
NET BOOK VALUE At 31 December 2016	<u>2,028</u>	<u>2,217,875</u>	<u>12,604</u>	<u>2,232,507</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

11. PROPERTY, PLANT AND EQUIPMENT - continued

Assets in the course of construction included above:

	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
At 1 January 2017	162,715	-	162,715
Additions	181,503	5,236	186,739
Available for use	<u>(173,551)</u>	<u>(5,236)</u>	<u>(178,787)</u>
At 1 January 2017	<u>170,667</u>	<u>-</u>	<u>170,667</u>
Additions	188,871	2,694	191,565
Available for use	<u>(148,049)</u>	<u>(2,694)</u>	<u>(150,743)</u>
At 31 December 2017	<u><u>211,489</u></u>	<u><u>-</u></u>	<u><u>211,489</u></u>

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £19.4m (2016: £32.8m).

The net book value of non-operating land and buildings comprise:

	2017 £'000	2016 £'000
Freehold	1,345	1,534
Long leasehold	<u>431</u>	<u>494</u>
	<u><u>1,776</u></u>	<u><u>2,028</u></u>

12. INVESTMENTS

	Shares in group undertakings £'000
COST	
At 1 January 2017 and 31 December 2017	<u>50</u>
NET BOOK VALUE	
At 31 December 2017	<u><u>50</u></u>
	Shares in group undertakings £'000
COST	
At 1 January 2016 and 31 December 2016	<u>50</u>
NET BOOK VALUE	
At 31 December 2016	<u><u>50</u></u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

12. INVESTMENTS - continued

Details of the principal investments of the Company at 31 December 2017 are listed below:

Name of Company	Registered Office	Country of Registration	Holding of Ordinary Shares	Proportion	Nature of Business
Electralink Limited	Northumberland House, 303 - 306 High Holborn, WC1V 7JZ	England and Wales	619 at 10p	6.7%	Data transfer network operator
MRA Service Company Limited	8 Fenchurch Place, London, EC3M 4AJ	England and Wales	1 at £1	1.0%	Governance of the electricity industry's Master Registration Agreement
DCUSA Limited	Northumberland House, 303 - 306 High Holborn, WC1V 7JZ	England and Wales	1 at £1	1.0%	Management and governance of the Distribution Connection and Use of System Agreement
Northern Electric Finance plc	Lloyds Court, 78 Grey Street, Newcastle Upon Tyne, NE1 6AF	England and Wales	50,000 at £1	100%	Finance company

The above investments are unlisted.

13. INVENTORIES

	2017 £'000	2016 £'000
Inventory	12,283	11,853
Work-in-progress	797	232
	<u>13,080</u>	<u>12,085</u>

14. TRADE AND OTHER RECEIVABLES

	2017 £'000	2016 £'000
Current:		
Distribution use of system receivables	49,140	50,524
Prepayments and accrued income	4,020	2,290
Other receivables	2,424	2,784
Amounts receivable provided for in bad debts	(612)	(404)
	<u>54,972</u>	<u>55,194</u>

The directors consider that the carrying amount of trade and other receivables approximates their fair value calculated by discounting the future cash flows at the market rate at the end of the reporting period. The fair valuation of the assets is based on Level 1 inputs. The maximum exposure to risk to the Company is the book value of these receivables less any provisions for impairment.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

14. TRADE AND OTHER RECEIVABLES - continued

Distribution use of system receivables

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 21% of distribution revenues in 2017 (2016: 22%) and British Gas plc accounting for approximately 14% of distribution revenues in 2017 (2016: 15%). Ofgem has determined a framework which sets credit limits for each supply business based on its credit rating or payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or an escrow account. Included within other payables are customer deposits of £0.9 million as at 31 December 2017 (2016: £0.4 million).

Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any bad debt losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material. Included in the Company's use of system ("UoS") receivables are debtors with a carrying value of £0.4 million, which have been placed into administration and have therefore been provided in full at the year-end (2016: £0.2 million)

Amounts receivable from sale of goods and services

Sales of goods and services comprise all income streams which are not classified as UoS income. Examples of non-UoS income streams would be meter rentals and amortisation of customer contributions in relation to distribution system assets and recovery of amounts for damage caused by third parties to the distribution system.

The average credit period on sales of goods and services is 30 days. Interest is not generally charged on the trade receivables paid after the due date. An allowance for doubtful debts is made for debts past their due date based on estimated irrecoverable amounts from the sale of goods and services, determined by reference to past default experience.

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £1.6 million (2016: £1.1 million) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £0.2 million (2016: £0.2 million) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 114 days (2016: 207 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.3 million (2016: £0.2 million). These amounts are past due at the reporting date and the Company has not provided for any amounts as not being recoverable, because there has not been a significant change in credit quality and the amounts are still considered recoverable. The Company does not hold any collateral over these balances. The average age of these receivables is 69 days (2016: 66 days).

Ageing of past due but not impaired receivables

	2017 £'000	2016 £'000
30-60 days	194	116
60-120 days	119	66
120-210 days	17	7
Total	<u>330</u>	<u>189</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

14. TRADE AND OTHER RECEIVABLES - continued

Movement in the allowance for doubtful debts

	2017 £'000	2016 £'000
At 1 January	404	192
Amounts utilised/written off in the year	(153)	(228)
Amounts recognised in statement of profit or loss	<u>361</u>	<u>440</u>
At 31 December	<u><u>612</u></u>	<u><u>404</u></u>

In determining the recoverability of the trade and other receivables, the Company considers any change in the credit quality of the trade and other receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk, other than in relation to UoS receivables, is limited due to the customer base being large and unrelated. Accordingly, the directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Included in the allowance for doubtful debts are specific trade receivables, with a balance of £0.2 million (2016: £0.3 million), which have been placed in administration. The impairment represents the differences between the carrying amount of the specific trade receivable and the present value of the expected liquidation dividend.

Categories of financial assets

	2017 £'000	2016 £'000
Cash and bank balances	-	-
Loans and receivables at amortised cost	<u>52,763</u>	<u>52,465</u>
Total financial assets	<u><u>52,763</u></u>	<u><u>52,465</u></u>
Non-current assets	2,394,377	2,273,414
Inventories	13,080	12,085
Prepayments and accrued income	<u>2,209</u>	<u>2,729</u>
Total non-financial assets	<u><u>2,409,666</u></u>	<u><u>2,288,228</u></u>
Total assets	<u><u>2,462,429</u></u>	<u><u>2,340,693</u></u>

15. CALLED UP SHARE CAPITAL

Allotted, authorised, issued and fully paid:			2017	2016
Number:	Class:	Nominal value:	£'000	£'000
200,000,100	Ordinary share capital	£1	<u><u>200,000</u></u>	<u><u>200,000</u></u>

There is no right to fixed income.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

16. RESERVES

	Retained earnings £'000
At 1 January 2017	712,822
Profit for the year	85,586
Dividends	<u>(22,700)</u>
At 31 December 2017	<u>775,708</u>
	Retained earnings £'000
At 1 January 2016	618,331
Profit for the year	116,291
Dividends	<u>(21,800)</u>
At 31 December 2016	<u>712,822</u>

17. TRADE AND OTHER PAYABLES

	2017 £'000	2016 £'000
Current:		
Payments on account	44,726	37,203
Trade creditors	8,368	3,985
Amounts owed to group undertakings	495	583
Social security and other taxes	3,836	5,304
Other payables	5,203	2,436
Deferred revenue	22,450	20,920
Accrued expenses	<u>23,657</u>	<u>33,137</u>
	<u>108,735</u>	<u>103,568</u>
Non-current:		
Deferred revenue	<u>584,348</u>	<u>562,308</u>
Aggregate amounts	<u>693,083</u>	<u>665,876</u>

The directors consider that the carrying amount of other financial liabilities approximates their fair value, calculated by discounting future cash flows at market rate at the end of the reporting period. The valuation of liabilities set out above is based on Level 1 inputs. Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. Invoices are paid at the end of the month following the date of the invoice. The Company has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

17. TRADE AND OTHER PAYABLES - continued

The following tables detail the remaining contractual maturities for the non-derivative financial liabilities. The tables have been drawn up based on the discounted cash flows of financial liabilities based on the earliest possible date on which the Company can be required to pay. The tables include both interest and principal cash flows. The standard supplier payment terms are net monthly.

	Less than 3 months £'000	3 months to 1 year £'000	1 to 5 years £'000	5+ years £'000	Total £'000
2017:					
Non-interest bearing	41,559	-	-	-	41,559
Variable interest rate liability	98,857	-	-	-	98,857
Fixed interest rate liability	45,031	25,539	299,810	595,096	965,476
	<u>185,447</u>	<u>25,539</u>	<u>299,810</u>	<u>595,096</u>	<u>1,105,892</u>
2016:					
Non-interest bearing	45,445	-	-	-	45,445
Variable interest rate liability	66,639	-	-	-	66,639
Fixed interest rate liability	5,031	25,539	325,057	600,736	956,363
	<u>117,115</u>	<u>25,539</u>	<u>325,057</u>	<u>600,736</u>	<u>1,068,447</u>

Categories of financial liabilities

	2017 £'000	2016 £'000
Loans and payables at amortised cost	<u>708,153</u>	<u>669,170</u>
Total financial liabilities	<u>708,153</u>	<u>669,170</u>
Payments received on account	44,726	37,203
Income tax liabilities	98,322	99,101
Other taxes and social security	3,836	5,304
Accruals	23,698	33,137
Deferred Revenue	606,798	583,228
Provisions	<u>1,188</u>	<u>728</u>
Total non-financial liabilities	<u>778,568</u>	<u>758,701</u>
Total liabilities	<u>1,486,721</u>	<u>1,427,871</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

17. TRADE AND OTHER PAYABLES - continued

Deferred Revenue

	2017 £'000	2016 £'000
At 1 January	583,228	546,590
Additions	44,780	55,980
Amortisation	<u>(21,210)</u>	<u>(19,342)</u>
At 31 December	<u>606,798</u>	<u>583,228</u>

Deferred revenue represents contributions from customers made in advance towards distribution system assets. This income is released to the statement of profit or loss over 45 years on a straight line basis (except for distribution generation which is released over 15 years on a straight line basis), in line with the useful economic life of the distribution system assets.

18. BORROWINGS

The directors' consideration of liquidity, interest rate and foreign currency risk are described in the Strategic Report.

	Book Value		Fair Value	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Loans	243,564	243,534	257,176	261,338
Amounts owed to Group undertakings	<u>450,564</u>	<u>418,632</u>	<u>578,448</u>	<u>554,770</u>
	<u>694,128</u>	<u>662,166</u>	<u>835,624</u>	<u>816,158</u>
The borrowings are repayable as follows:				
On demand or within one year	147,079	75,217	147,055	75,217
Between one and five years	178,949	218,925	204,378	256,576
After five years	<u>368,100</u>	<u>368,024</u>	<u>484,191</u>	<u>484,365</u>
	<u>694,128</u>	<u>662,166</u>	<u>835,624</u>	<u>816,158</u>
Analysis of borrowings:				
Short-term loan	10	11	10	11
Inter-company short-term loan	98,898	67,042	98,898	67,042
Northern Electric Finance plc 2020 - 8.875%	101,849	101,849	122,795	130,276
Northern Electric Finance plc 2035 - 5.125%	49,789	49,711	69,123	69,168
Yorkshire Electricity Group plc 2037 - 5.9%	100,016	100,016	149,768	150,277
Northern Electric Finance plc 2037 - 5.125%	100,014	100,014	137,864	138,007
European Investment Bank 2018 - 4.065%*	41,429	41,419	41,444	42,974
European Investment Bank 2019 - 4.241%*	41,491	41,481	43,015	44,655
European Investment Bank 2020 - 4.386%*	40,504	40,495	43,426	44,990
European Investment Bank 2027 - 2.564%	<u>120,128</u>	<u>120,128</u>	<u>129,281</u>	<u>128,758</u>
	<u>694,128</u>	<u>662,166</u>	<u>835,624</u>	<u>816,158</u>

Average weighted interest rate: 4.17% (2016: 4.39%).

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

18. BORROWINGS - continued

The fair value is determined with reference to quoted market prices. The directors' estimates of the fair value of bank loans and internal borrowings are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions or dealer quotes for similar instruments. The fair value of short-term borrowings is equal to their book value. All loans are non-secured and are denominated in sterling.

The valuation of liabilities set out above is based on Level 1 inputs.

* The borrowings from the European Investment Bank were drawn down in twelve tranches, repayable in 2018, 2019 and 2020. The interest rates shown are average rates for those repayment dates. The spread of interest rates is as follows:

2018:	3.901% - 4.283%
2019:	4.077% - 4.455%
2020:	4.227% - 4.586%

Interest on short-term loans and inter-company short term loans is charged at a floating rate of LIBOR plus 0.35%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £0.7m per year. This is considered to be an acceptable level of risk. All other loans are at fixed interest rates and expose the Company to fair value interest rate risk.

The covenants associated with the 2035 bonds issued by Northern Electric Finance plc, a wholly-owned subsidiary of the Company, include restrictions on the issuance of new indebtedness and the making of distributions dependent on the scale of the ratio of Senior Total Net Debt to Regulatory Asset Value ("RAV"). The definition of Senior Total Net Debt excludes any subordinated debt and any debt incurred on a non-recourse basis. In addition, it excludes interest payable, any fair value adjustments and unamortised issue costs.

The Company's Senior Total Net Debt as at 31 December 2017 totalled £686.4m. Using the RAV value as at March 2018, as outlined by Ofgem in its electricity distribution price control financial model published in November 2017, and adjusting for the effects of movements in the value of the Retail Price Index gives an approximation for the RAV value as at 31 March 2018 of £1,354.8m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 50.7% (2016:50.5%).

At 31 December 2017, the Company had available £94.0m (2016: £94.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

19. LEASING AGREEMENTS

Minimum lease payments under non-cancellable operating leases fall due as follows:

	2017	2016
	£'000	£'000
Within one year	5,048	5,235
Between one and five years	15,029	14,008
In more than five years	<u>2,841</u>	<u>3,131</u>
	<u>22,918</u>	<u>22,374</u>

	2017	2016
	£'000	£'000
Minimum lease payments under operating leases recognised in the year	<u>7,674</u>	<u>7,070</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

19. LEASING AGREEMENTS - continued

Leases primarily relate to the hire of fleet vehicles and the rental of operational land. The vehicle leases have terms between 2 and 7 years. The Company does not have the option to purchase the vehicles at the end of the lease term.

The operational land lease are between 10 and 999 years, but in the majority are between 20 and 60 years. As the leases are regarded as a business tenancy, the Company has the option to renew the lease under the 1954 Landlord and Tenant Act unless a landlord is to redevelop or has grounds to recover land as prescribed under the Act, and may acquire the freehold at any time by agreement. The Company also has the ability to compulsorily purchase the freehold.

20. PROVISIONS

	2017	2016
	£'000	£'000
Other provisions	<u>1,188</u>	<u>728</u>

Analysed as follows:

Current	1,100	630
Non-current	<u>88</u>	<u>98</u>
	<u>1,188</u>	<u>728</u>

	Claims £'000	Other £'000	Total £'000
At 1 January 2017	217	511	728
Utilised/paid in the year	(619)	(443)	(1,061)
Charged to statement of profit or loss	<u>1,165</u>	<u>357</u>	<u>1,522</u>
At 31 December 2017	<u>763</u>	<u>425</u>	<u>1,188</u>

Claims: Provision has been made to cover costs arising from utility damages, public liability, and motoring third party claims, which are not externally insured. Settlement is expected substantially within 12 months.

Other: Primarily consists of a provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated Biphenyls (PCBs) and for an amount to cover claims made under Section 74 of the New Road and Street Works Act 1991. Costs are expected to be incurred over the next 15 years.

21. DEFERRED TAX

	Accelerated Tax Depreciation £'000	Other £'000	Total £'000
At 1 January 2017	89,821	(302)	89,519
Charge/(credit) to statement of profit or loss	<u>1,692</u>	<u>(1)</u>	<u>1,691</u>
At 31 December 2017	<u>91,513</u>	<u>(303)</u>	<u>91,210</u>

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

21. DEFERRED TAX - continued

	Accelerated Tax Depreciation £'000	Other £'000	Total £'000
At 1 January 2016	92,815	(218)	92,597
Charge to statement of profit or loss	<u>(2,994)</u>	<u>(84)</u>	<u>(3,078)</u>
At 31 December 2016	<u>89,821</u>	<u>(302)</u>	<u>89,519</u>

Other comprises provisions and employee expenses deductible for tax on a paid basis and claims for hold over relief.

22. EMPLOYEE BENEFIT OBLIGATIONS

Introduction

The Company contributes to two pension schemes, which it operates on behalf of the participating companies within the Northern Powergrid Group. Those pension schemes are:

- The Northern Powergrid Group of the ESPS (the "DB Scheme"); and
- The Northern Powergrid Pension Scheme.

The Northern Powergrid Pension Scheme was introduced for new employees from 23 July 1997 and is a money purchase arrangement accounted for as a defined contribution scheme in these financial statements. The disclosures in this note relate to the Group pension scheme.

The DB Scheme is a defined benefit scheme for directors and employees which provides pension and other related retirement benefits based on final pensionable pay. The DB Scheme closed to staff commencing employment with the Northern Powergrid Group on or after 23 July 1997. Members who joined before this date, including some Protected Persons under The Electricity (Protected Persons) (England and Wales) Pension Regulations 1990, continue to build up future pension benefits.

Under the DB Scheme, employees are typically entitled to annual pensions on retirement at age 63 of one-eighth of final pensionable salary for each year of service plus an additional tax-free cash lump sum at retirement of three times pension. Benefits are also payable on death and following other events such as withdrawing from active service.

No other post-retirement benefits are provided to members of the DB Scheme.

Role of Trustees

The DB Scheme is administered by a board of Trustees which is legally separate from the Company. The assets of the DB Scheme are held in a separate trustee-administered fund. The board of Trustees is made up of Trustees appointed by the Company, as the Principal Employer of the DB Scheme, Trustees elected by the membership and an independent trustee. The Trustees are required by law to act in the interests of all relevant beneficiaries and are responsible in particular for the asset investment strategy plus the day-to-day administration of the benefits payable. They also are responsible for jointly agreeing with the Principal Employer the level of contributions due to the DB Scheme.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

Funding requirements

UK legislation requires that pension schemes are funded prudently (i.e. to a level in excess of the current expected cost of providing benefits). The last actuarial valuation of the DB Scheme was carried out by the Trustee's actuarial advisors, Aon Hewitt, as at 31 March 2016. Such valuations are required by law to take place at intervals of no more than three years. Following each valuation, the Trustees and the Northern Powergrid Group must agree the contributions required (if any) to ensure the DB Scheme is fully funded over time on the basis of suitably prudent assumptions. Contributions agreed in this manner constitute a minimum funding requirement. The next funding valuation is due no later than 31 March 2019, at which progress towards full-funding will be reviewed.

Agreement was reached during August 2017 with the Trustees to repair the funding deficit of £194.9M as at 31 March 2016 over the 9 year period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2016 being borne out in practice. The agreement includes payments of £2.3m per month to be made over the remaining 8 years and 3 months of the recovery plan. This amount is in 2017/18 prices and will be updated on 1 April 2018 and on each 1 April thereafter in line with changes in RPI inflation.

The contributions payable by the Northern Powergrid Group to the DB Scheme in respect of future benefits which are accruing increased from 34.2% to 43.6% of pensionable pay from 1 April 2017. These contributions were determined as part of the 31 March 2016 actuarial valuation and are payable in addition to the deficit repair contributions mentioned above. These rates will remain in place until such a time as a new schedule of contributions is agreed between the Trustees and the Company as part of the 31 March 2019 valuation. In addition, the Company pays contributions to cover the expenses of running the DB Scheme which increased from 3.0% to 3.6% of pensionable pay from 1 September 2017.

The Northern Powergrid Group's total contributions to the DB Scheme for the next financial year are expected to be £45.4M.

Under the rules of the DB Scheme, any future surplus in the DB Scheme may, following consultation with the Group Trustees, be allocated for the benefit of the members of the DB Scheme and/or the Principal and Participating Employers.

Pensions' Regulation

The UK pensions market is regulated by the Pensions Regulator whose key statutory objectives in relation to UK defined benefit plans are to:

- protect the benefits of members;
- promote and to improve understanding of good administration;
- reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund ("PPF"); and
- minimise any adverse impact on the sustainable growth of an employer.

The Pensions Regulator has various powers including the power to:

- wind up a scheme where winding up is necessary to protect members' interests;
- appoint or remove a trustee;
- impose a schedule of company contributions or the calculation of the technical provisions where trustees and company fail to agree on appropriate contributions; and
- impose contributions where there has been a detrimental action against the scheme.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

Profile of the DB Scheme

The Defined Benefit Obligation ("DBO") includes benefits for current employees, former employees and current pensioners. The overall duration of the DB Scheme's obligation was assessed to be about 17 years based on the results of the 31 March 2016 funding valuation. This is the weighted-average time over which benefit payments are expected to be made.

Broadly, about 40% of the liabilities are attributable to current employees (duration about 24 years), 10% to former employees (duration about 25 years) and 50% to current pensioners (duration about 14 years).

Risks associated with the DB Scheme

The DB Scheme exposes the Northern Powergrid Group to a number of risks, the most significant of which are:

Risk	Description	Mitigation
Volatile asset returns	The DBO is calculated using a discount rate set with reference to corporate bond yields. If assets underperform this discount rate, this will create an element of deficit. The DB Scheme aims to hold a significant proportion (48%) of its assets in return-seeking assets (such as equities) which, although expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term.	The allocation to return-seeking assets is monitored to ensure it remains appropriate given the DB Scheme's long-term objectives. The Trustees regularly review the strategy from return-seeking assets and have diversified some return-seeking assets from equities into Reinsurance and Listed Infrastructure to reduce overall risk. To avoid concentration risk, the allocation to UK equity is restricted to 35% of the total equity allocation.
Changes in bond yields	A decrease in corporate bond yields will increase the value placed on the DBO for accounting purposes, although this will be partially offset by an increase in the value of the DB Scheme's bond holdings.	The DB Scheme also holds a substantial proportion of its assets (61%) as bonds, which provide a hedge against falling bond yields (falling yields which increase the DBO will also increase the value of the bond assets). There are some differences in the credit quality of bonds held by the DB Scheme and the bonds analysed to decide the DBO discount rate, such that there remains some risk should yields on different quality bond/swap assets diverge.
Inflation risk	A significant proportion of the DBO is indexed in line with price inflation (specifically in line with RPI) and higher inflation will lead to higher liabilities	The DB Scheme invests around 35% in LDI which provides a hedge against higher-than-expected inflation increases on the DBO (rising inflation will increase both the DBO and the value of the LDI portfolio).
Currency risk	To increase diversification, the DB Scheme invests in overseas assets. This leads to a risk that foreign currency movements negatively impact the value of assets in Sterling terms.	The DB Scheme hedges a proportion of the overseas investments currency risk for those overseas currencies that can be hedged efficiently. The DB Scheme's currency hedging ratio is currently 50% in respect of overseas developed market currencies.
Life expectancy	The majority of the DB Scheme's obligations are to provide benefits for the pensionable lifetime of the member, so increases in life expectancy will result in an increase in the liabilities.	The DB Scheme regularly reviews actual experience of its membership against the actuarial assumptions underlying the future benefit projections and carries out detailed analysis when setting an appropriate scheme specific mortality assumption.

NORTHERN POWERGRID (NORTHEAST) LIMITED

NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2017

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

The Company and Trustees have agreed a long-term strategy for reducing investment risk as and when appropriate. This includes the use of Liability Driven Investment (LDI) from October 2016 to more closely match the nature and duration of the DB Scheme's liabilities through the use of derivatives such as swaps and repurchase agreements. The portfolio is designed to hedge a proportion of the interest rate and inflation risk inherent in the Scheme's liabilities. The target hedging level is currently 75% (2016: 60%) of the DB Scheme's liabilities as measured on the basis used for the funding valuation.

The Trustees insure certain benefits payable on death before retirement.

Other risks

There are a number of other risks associated with the DB Scheme including operational risks (such as paying out the wrong benefits), legislative risks (such as the government increasing the burden on pension schemes through new legislation) and other demographic risks (such as a higher proportion members dying than assumed with a dependant eligible to receive a survivor's pension from the DB Scheme).

A particular legislative risk exists in relation to the equalisation of the Guaranteed Minimum Pension ("GMP"), a quasi-state benefit accrued by many UK plans over the period 1978 to 1997 as a result of a UK government programme allowing pension plans to "contract out" of the State Second Pension. The UK Government has announced its intention to ensure that these benefits, which currently pay out at different levels for men and women, are gender-equalised in accordance with sex-discrimination legislation. This would increase the DBO but it is not possible to fully quantify the impact of this change at this stage. However, it could lead to an increase in the order of 2% to the DBO for a typical scheme.

Reporting at 31 December 2017

For the purposes of this disclosure, the current and future pension costs of the Northern Powergrid Group have been assessed by Aon Hewitt, a qualified independent actuary, using the assumptions set out below, which the actuary has confirmed represent a reasonable best estimate of those costs. This review has been based on the same membership and other data as at 31 March 2016. The directors of Northern Powergrid Holdings Company has accepted the advice of the actuary and formally approved the use of these assumptions for the purpose of calculating the pension cost of the Northern Powergrid Group.

The results of the latest funding valuation at 31 March 2016 have been adjusted to 31 December 2017. Those adjustments take account of experience over the period since 31 March 2016, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the DBO and the related current service cost were measured using the Projected Unit Credit Method.

For schemes closed to new members, such as the DB Scheme, the current service cost calculated under the Projected Unit Credit Method is expected to increase as the members of the DB Scheme approach retirement.

The principal assumptions used to calculate the liabilities under IAS 19 are set out below:

Main financial assumptions	2017 % p.a.	2016 % p.a.
RPI Inflation	2.95	3.00
Rate of long-term increase in salaries	3.45	3.00
Pension increases	2.85	2.90
Discount rate for scheme liabilities	2.60	2.70

The financial assumptions reflect the nature and term of the DB Scheme's liabilities.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

Main demographic assumptions	2017	2016
Life expectancy for a male currently aged 60	26.7	27.1
Life expectancy for a female currently aged 60	28.8	28.8
Life expectancy at 60 for a male currently aged 45	28.1	28.6
Life expectancy at 60 for a female currently aged 45	29.9	30.6
Proportion of pension exchanged for additional cash at retirement	10%	10%

The mortality assumptions are based on recent actual mortality experience of DB Scheme members and allow for expected future improvements in mortality rates.

The DB Scheme's funds are invested in the following assets:

Asset allocation	2017 £m	2016 £m
Developed market equity	187.9	338.6
Emerging market equity	7.4	12.9
Property	164.7	91.4
Reinsurance	83.0	71.3
Listed infrastructure	112.7	99.2
Investment grade corporate bonds	423.5	366.9
Other debt	43.4	30.3
Fixed interest gilts	28.2	52.4
Index-linked gilts	-	3.1
Liability driven investments	644.2	581.2
Cash	51.0	107.1
Total	1,746.0	1,754.4

The fair values of the above equity and debt instruments are determined based on quoted market prices in active markets whereas the fair values of properties are not based on quoted prices in active markets.

As at 31 December 2017, the fair value of the DB Scheme's assets, which related to self-investment, amounted to £nil (2016: £nil).

Changes to the present value of the DBO during the year	2017 £m	2016 £m
Opening DBO	1,722.9	1,453.2
Current service cost	17.9	14.9
Interest expense on defined benefit obligation	45.1	53.0
Contributions by DB Scheme participants	0.9	1.0
Actuarial gains on DB Scheme liabilities arising from changes in demographic assumptions	(33.3)	-
Actuarial losses on DB Scheme liabilities arising from changes in financial assumptions	49.7	311.5
Actuarial gains on DB Scheme liabilities arising from experience	(19.8)	(25.9)
Benefits paid	(52.5)	(84.8)
Liabilities extinguished on settlements	(101.8)	-
Closing DBO	1,629.1	1,722.9

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

22. EMPLOYEE BENEFIT OBLIGATIONS - continued

Changes in the fair value of DB Scheme assets during the year	2017 £m	2016 £m
Opening fair value of DB Scheme assets	1,754.4	1,541.3
Interest income on DB Scheme assets	46.9	56.7
Re-measurement gains on DB Scheme assets	64.7	200.9
Contributions by the employer	45.0	40.5
Contributions by DB Scheme participants	0.9	1.0
Net benefits paid out	(52.5)	(84.8)
Administration costs incurred	(1.3)	(1.2)
Assets distributed on settlements	<u>(112.1)</u>	<u>-</u>
Closing fair value of DB Scheme assets	<u>1,746.0</u>	<u>1,754.4</u>

Actual return on DB Scheme assets	2017 £m	2016 £m
Interest income on DB Scheme assets	46.9	56.7
Re-measurement gain on DB Scheme assets	<u>64.7</u>	<u>200.9</u>
Actual return on DB Scheme assets	<u>111.6</u>	<u>257.6</u>

Sensitivity to key assumptions

The key assumptions used for IAS 19 are discount rate, inflation and mortality. If different assumptions were used, it could have a material effect on the results of the Group. The sensitivity of the results to these assumptions is as follows.

	Changes in DBO £m	Revised DBO £m
Current Figures	1,629.1	
Following a 10 bps decrease in the discount rate	31.9	1,661.0
Following a 10 bps increase in the discount rate	(31.5)	1,597.6
Following a 10 bps increase in the inflation assumption	27.0	1,656.1
Following a 10 bps decrease in the inflation assumption	(26.7)	1,602.4
Following a 1 year increase in life expectancy	68.5	1,697.6
Following a 1 year decrease in life expectancy	(67.1)	1,562.0

The sensitivity information shown above has been prepared using the same method as adopted when adjusting the results of the latest funding valuation to the statement of financial position date. This is the same approach as has been adopted in previous periods.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

23. RELATED PARTY DISCLOSURES

The Company entered into transactions, in the ordinary course of business, with affiliated companies. Transactions entered into and trading balances outstanding at the year-end were as follows:

	Sales to related parties £'000	Purchases from related parties £'000	Amounts owed to related parties £'000	Finance (cost/Income to related parties) £'000	Borrowings from related parties £'000
Related Party					
2017					
Integrated Utility Services Limited	326	3,606	-	-	-
Integrated Utility Services Limited (registered in Eire)	1,286	9	-	-	-
Northern Electric plc	25	3,565	-	-	-
Northern Electric Finance plc	-	-	-	17,028	251,831
Northern Powergrid Metering Limited	28	-	-	-	-
Northern Powergrid (Yorkshire) plc	19,065	12,620	-	-	-
Vehicle Lease and Service Limited	23	3,372	495	-	-
Yorkshire Electricity Group	-	-	-	6,319	193,341
	<u>20,753</u>	<u>23,172</u>	<u>495</u>	<u>23,347</u>	<u>445,172</u>
2016					
Integrated Utility Services Limited	402	2,112	-	-	-
Integrated Utility Services Limited (registered in Eire)	7	1,387	165	-	-
Northern Electric plc	35	3,885	-	-	-
Northern Electric Finance plc	-	-	-	17,027	251,574
Northern Powergrid Metering Limited	94	-	-	-	-
Northern Powergrid (Yorkshire) plc	17,348	10,841	-	-	-
Vehicle Lease and Service Limited	37	3,895	418	-	-
Yorkshire Electricity Group plc	-	-	-	6,326	167,058
	<u>17,923</u>	<u>22,120</u>	<u>583</u>	<u>23,253</u>	<u>418,632</u>

Sales and purchases from related parties were made at commercial prices. Interest on loans from Northern Powergrid Group companies is charged at a commercial rate. The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of amounts owed by related parties.

There are no transactions with key management personnel apart from remuneration that is disclosed in note 4.

NORTHERN POWERGRID (NORTHEAST) LIMITED

**NOTES TO THE FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

24. RECONCILIATION OF PROFIT BEFORE INCOME TAX TO CASH GENERATED FROM OPERATIONS

	2017	2016
	£'000	£'000
Profit before income tax	105,055	121,381
Depreciation/amortisation charges	82,019	77,916
Profit on disposal of property, plant and equipment	(331)	(400)
Amortisation of deferred revenue	(21,210)	(19,342)
Increase/(decrease) in provisions	460	(401)
Finance costs	28,944	29,082
Finance income	<u>(93)</u>	<u>(482)</u>
	194,844	207,754
(Increase)/decrease in inventories	(995)	721
Increase in trade and other receivables	(598)	(1,487)
Increase in trade and other payables	<u>937</u>	<u>1,646</u>
Cash generated from operations	<u>194,188</u>	<u>208,634</u>

25. ULTIMATE CONTROLLING PARTY

The immediate parent undertaking of the Company is Northern Electric plc (Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF). The ultimate controlling party and ultimate parent undertaking of Northern Electric plc is Berkshire Hathaway, Inc., a company incorporated in the United States of America.

Copies of the group financial statements of Berkshire Hathaway, Inc. (3555 Farnam Street, Omaha, Nebraska 68131) (the parent undertaking of the largest group preparing group financial statements) which include the Company and the group financial statements of Northern Electric plc, the smallest parent undertaking to prepare group financial statements in the UK, can both be obtained from the Company Secretary, Northern Powergrid Holdings Company, Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.

**APPENDIX 2 – FINANCIAL STATEMENTS OF NORTHERN POWERGRID
(NORTHEAST) LIMITED FOR THE YEAR ENDED 31 DECEMBER 2018**

(Pages 1-14 (inclusive) are deliberately omitted)

Northern Powergrid (Northeast) Limited

Independent Auditor's Report to the Members of Northern Powergrid (Northeast) Limited

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRS; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements of Northern Powergrid (Northeast) Limited (the 'company') which comprise:

- the statement of profit or loss;
- the statement of other comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of cash flows;
- the related accounting policies; and
- the related notes 1 to 30.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs(UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Northern Powergrid (Northeast) Limited
Independent Auditor's Report to the Members of Northern Powergrid (Northeast) Limited
(continued)

Responsibilities of directors

As explained more fully in the Statement of Directors' Responsibilities (set out on page 13), the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of our knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified material misstatements in the Strategic Report and the Report of the Directors.

Northern Powergrid (Northeast) Limited
Independent Auditor's Report to the Members of Northern Powergrid (Northeast) Limited
(continued)

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.



David M Johnson FCA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP, Statutory Auditor
Newcastle upon Tyne
United Kingdom

26 April 2019

Northern Powergrid (Northeast) Limited
Statement of Profit or Loss for the Year Ended 31 December 2018

	Note	2018 £ 000	2017 £ 000
Revenue	4	335,253	328,300
Cost of sales		<u>(14,767)</u>	<u>(12,856)</u>
Gross profit		320,486	315,444
Distribution costs		(116,627)	(107,931)
Administrative expenses		<u>(80,660)</u>	<u>(73,938)</u>
Operating profit	6	123,199	133,575
Other gains	5	466	331
Finance costs	7	(28,782)	(28,944)
Finance income	7	<u>147</u>	<u>93</u>
Profit before tax		95,030	105,055
Income tax expense	11	<u>(17,571)</u>	<u>(19,469)</u>
Profit for the year		<u><u>77,459</u></u>	<u><u>85,586</u></u>

Northern Powergrid (Northeast) Limited
Statement of Comprehensive Income for the Year Ended 31 December 2018

	2018	2017
	£ 000	£ 000
Profit for the year	<u>77,459</u>	<u>85,586</u>
Total comprehensive income for the year	<u><u>77,459</u></u>	<u><u>85,586</u></u>

Northern Powergrid (Northeast) Limited
(Registration number: 02906593)
Statement of Financial Position as at 31 December 2018

	Note	31 December 2018 £ 000	31 December 2017 £ 000
Assets			
Non-current assets			
Property, plant and equipment	12	2,439,107	2,346,759
Intangible assets	13	50,638	47,568
Investments in subsidiaries, joint ventures and associates	14	50	50
		<u>2,489,795</u>	<u>2,394,377</u>
Current assets			
Inventories	15	12,869	13,080
Trade and other receivables	16	51,530	54,972
		<u>64,399</u>	<u>68,052</u>
Total assets		<u>2,554,194</u>	<u>2,462,429</u>
Equity and liabilities			
Equity			
Share capital	17	(200,000)	(200,000)
Retained earnings		<u>(829,467)</u>	<u>(775,708)</u>
Total equity		<u>(1,029,467)</u>	<u>(975,708)</u>
Non-current liabilities			
Loans and borrowings	19	(507,152)	(547,049)
Provisions	21	(87)	(88)
Deferred revenue	23	(597,215)	(584,348)
Deferred tax liabilities	11	<u>(92,358)</u>	<u>(91,210)</u>
		<u>(1,196,812)</u>	<u>(1,222,695)</u>
Current liabilities			
Trade and other payables	22	(84,860)	(86,285)
Loans and borrowings	19	(214,566)	(147,079)
Income tax liability		(4,833)	(7,112)
Deferred revenue	23	(22,780)	(22,450)
Provisions	21	<u>(876)</u>	<u>(1,100)</u>
		<u>(327,915)</u>	<u>(264,026)</u>
Total liabilities		<u>(1,524,727)</u>	<u>(1,486,721)</u>
Total equity and liabilities		<u>(2,554,194)</u>	<u>(2,462,429)</u>

Approved by the Board of Directors on 15 April 2019 and signed on its behalf by:



P A Jones
Director

Northern Powergrid (Northeast) Limited
Statement of Changes in Equity for the Year Ended 31 December 2018

	Note	Share capital £ 000	Retained earnings £ 000	Total £ 000
At 1 January 2018		200,000	775,708	975,708
Profit for the year		-	77,459	77,459
Total comprehensive income		-	77,459	77,459
Dividends	25	-	(23,700)	(23,700)
At 31 December 2018		200,000	829,467	1,029,467
		Share capital £ 000	Retained earnings £ 000	Total £ 000
At 1 January 2017		200,000	712,822	912,822
Profit for the year		-	85,586	85,586
Total comprehensive income		-	85,586	85,586
Dividends	25	-	(22,700)	(22,700)
At 31 December 2017		200,000	775,708	975,708

Northern Powergrid (Northeast) Limited
Statement of Cash Flows for the Year Ended 31 December 2018

	Note	2018 £ 000	2017 £ 000
Cash flows from operating activities			
Profit for the year		77,459	85,586
Adjustments to cash flows from non-cash items			
Depreciation and amortisation	6	88,619	82,019
Amortisation of deferred revenue		(22,355)	(21,210)
Profit on disposal of property plant and equipment	5	(466)	(331)
Finance income	7	(147)	(93)
Finance costs	7	28,782	28,944
Income tax expense	11	17,571	19,469
		189,463	194,384
Decrease/(increase) in inventories	15	211	(995)
Decrease/(increase) in trade and other receivables	16	2,564	(574)
Increase in trade and other payables	22	655	337
(Decrease)/increase in provisions	21	(225)	460
Cash generated from operations		192,668	193,612
Income taxes paid	11	(18,702)	(20,248)
Net cash flow from operating activities		173,966	173,364
Cash flows used in investing activities			
Acquisitions of property plant and equipment		(172,384)	(192,405)
Proceeds from sale of property plant and equipment		466	331
Acquisition of intangible assets	13	(10,357)	(11,417)
Receipt of customer contributions		35,143	52,352
Interest received		85	47
Dividend income	7	62	46
Net cash flows used in investing activities		(146,985)	(151,046)
Cash flows used in financing activities			
Movement in intercompany loans		24,940	31,861
Proceeds from short-term borrowing		44,000	-
Repayment of long-term external borrowings		(40,000)	-
Interest paid		(32,221)	(31,479)
Dividends paid	25	(23,700)	(22,700)
Net cash flows used in financing activities		(26,981)	(22,318)
Net movement in cash and cash equivalents		-	-
Cash and cash equivalents at 1 January		-	-
Cash and cash equivalents at 31 December		-	-

The notes on pages 23 to 60 form an integral part of these financial statements.

Northern Powergrid (Northeast) Limited

Notes to the Financial Statements for the Year Ended 31 December 2018

1 General information

The company is a private company limited by share capital, incorporated under the Companies Act and domiciled in England and Wales.

The address of its registered office is Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.

2 Accounting policies

Statement of compliance

The Company financial statements have been prepared in accordance with International Financial Reporting Standards and its interpretations adopted by the EU ("adopted IFRSs").

Summary of significant accounting policies and key accounting estimates

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

The financial statements have been prepared in accordance with adopted IFRSs and under historical cost accounting rules. The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies.

The nature of the Company's business model, strategic objectives, operations and activities are set out in the Strategic Report.

The Company is exempt from preparing group financial statements as it is a wholly owned subsidiary of a parent undertaking preparing group financial statements. Further details of the registered address and parent company are available in note 30. Further details on the Company's accounting policies in relation to investments are available on page 30.

Going Concern

A review of the Company's business activities during the year, together with details regarding its future development, performance and position, its objectives, policies and processes for managing its capital, its financial risk management objectives and details of its exposures to trading risk, credit risk and liquidity risk are set out in the Strategic Report, the Report of the Directors and the appropriate notes to the financial statements.

When considering continuing to adopt the going concern basis in preparing the annual reports and financial statements, the directors have taken into account a number of factors, including the following:

- The Company is a stable electricity distribution business operating an essential public service and is regulated by GEMA. In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance the activities, which are the subject of obligations under Part 1 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;
- The Company is profitable with strong underlying cash flows and holds investment grade credit ratings;
- The Company is financed by long-term borrowings with an average maturity of 11 years and has access to borrowing facilities provided by Lloyds Bank plc, Royal Bank of Scotland plc and Abbey National Treasury Services plc;
- The Northern Powergrid Group plans to issue long-term borrowings within the next 12 months and early indications from our relationship banks suggest there is an active market with appetite to invest; and
- The Company has prepared forecasts which taking into account reasonable possible changes in trading performance, show that the company has sufficient resources to settle its liabilities as they fall due. The directors have had discussions with the bank who have indicated that they would continue to provide the short term facilities to the Northern Powergrid Group for the foreseeable future on acceptable terms.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Changes in accounting policy

New standards, interpretations and amendments effective

The following have been applied for the first time from 1 January 2018 and have had an effect on the financial statements:

IFRS 9 - Financial Instruments

In the current year, the Company has applied IFRS 9 Financial Instruments (as revised in July 2014) and the related consequential amendments to other IFRSs in advance of their effective dates. IFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting. Details of these new requirements as well as their impact on the Company's financial statements are described below.

The Company has applied IFRS 9 in accordance with the transition provisions set out in IFRS 9.

(a) Classifications and measurement of financial assets

The date of initial application (i.e. the date on which the Company has assessed its existing financial assets and financial liabilities in terms of the requirements of IFRS 9) is 1 January 2018. Accordingly, the Company has applied the requirements of IFRS 9 to instruments that have not been derecognised as at 1 January 2018 and has not applied the requirements to instruments that have already been derecognised as at 1 January 2018. Comparative amounts in relation to instruments that have not been derecognised as at 1 January 2018 have been restated where appropriate.

All recognised financial assets that are within the scope of IFRS 9 are required to be subsequently measured at amortised cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets, specifically:

- debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, are subsequently measured at amortised cost;
- debt investments that are held within a business model whose objective is both to collect the contractual cash flows and to sell the debt instruments, and that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, are subsequently measured at fair value through other comprehensive income (FVTOCI); and
- all other debt investments and equity investments are subsequently measured at fair value through profit or loss (FVTPL).

Despite the foregoing, the Company may make the following irrevocable election / designation at initial recognition of a financial asset:

- the Company may irrevocably elect to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies in other comprehensive income; and
- the Company may irrevocably designate a debt investment that meets the amortised cost or FVTOCI criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch.

In the current year, the Company has not designated any debt investments that meet the amortised cost or FVTOCI criteria as measured at FVTPL.

When a debt investment measured at FVTOCI is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment. In contrast, for an equity investment designated as measured at FVTOCI, the cumulative gain or loss previously recognised in other comprehensive income is not subsequently reclassified to profit or loss.

Debt instruments that are subsequently measured at amortised cost or at FVTOCI are subject to impairment. See (b) below.

Northern Powergrid (Northeast) Limited

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

The directors of the Company reviewed and assessed the Company's existing financial assets as at 1 January 2018 based on the facts and circumstances that existed at that date and concluded that the initial application of IFRS 9 has had the following impact on the Company's financial assets as regards their classification and measurement:

- financial assets classified as held-to-maturity and loans and receivables under IAS 39 that were measured at amortised cost continue to be measured at amortised cost under IFRS 9 as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding; and
- financial assets that were measured at FVTPL under IAS 39 continue to be measured as such under IFRS 9.

Note (e) below tabulates the change in classification of the Company's financial assets upon application of IFRS 9. None of the reclassifications of financial assets have had any impact on the Company's financial position, profit or loss, other comprehensive income or total comprehensive income for both years.

(b) Impairment of financial assets

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires the Company to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

Specifically, IFRS 9 requires the Company to recognise a loss allowance for expected credit losses on i) debt investments subsequently measured at amortised cost or at FVTOCI, ii) lease receivables, iii) contract assets and iv) loan commitments and financial guarantee contracts to which the impairment requirements of IFRS 9 apply. In particular, IFRS 9 requires the Company to measure the loss allowance for a financial instrument at an amount equal to the lifetime ECL if the credit risk on that financial instrument has increased significantly since initial recognition, or if the financial instrument is a purchased or originated credit-impaired financial asset. On the other hand, if the credit risk on a financial instrument has not increased significantly since initial recognition (except for a purchased or originated credit-impaired financial asset), the Company is required to measure the loss allowance for that financial instrument at an amount equal to 12m ECL. IFRS 9 also provides a simplified approach for measuring the loss allowance at an amount equal to lifetime ECL for trade receivables, contract assets and lease receivables in certain circumstances.

As at 1 January 2018, the directors of the Company reviewed and assessed the Company's existing financial assets, amounts due from customers and financial guarantee contracts for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of IFRS 9 to determine the credit risk of the respective items at the date they were initially recognised, and compared that to the credit risk as at 1 January 2018 and 1 January 2017. The result of the assessment is as follows:

- Trade and other receivables: The Company applies the simplified approach and recognises lifetime ECL for these assets.
- Cash and bank balances: All bank balances are assessed to have low credit risk at each reporting date as they are held with reputable international banking institutions.

(c) Classification and measurement of financial liabilities

One major change introduced by IFRS 9 in the classification and measurement of financial liabilities relates to the accounting for changes in the fair value of a financial liability designated as at FVTPL attributable to changes in the credit risk of the issuer.

The application of the IFRS 9 impairment requirements has not resulted in additional loss allowance to be recognised in the current year (2017: £nil).

Specifically, IFRS 9 requires that the changes in the fair value of the financial liability that is attributable to changes in the credit risk of that liability be presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss, but are instead transferred to retained earnings when the financial liability is derecognised. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at FVTPL was presented in profit or loss.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

This change in accounting policy has not affected the Company.

Profit and other comprehensive income reported for 2018 and 2017 have not been affected as the Company did not have any financial liabilities designated as at FVTPL in the prior year.

(d) General hedge accounting

The new general hedge accounting requirements retain the three types of hedge accounting. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about the Company's risk management activities have also been introduced. The Company does not have any hedged instruments.

(e) Disclosures in relation to the initial application of IFRS 9

The below illustrates the classification and measurement of financial assets and financial liabilities under IFRS 9 and IAS 39 at the date of initial application, 1 January 2018.

- Trade receivables (note 16) - basic loans and receivables where the objective of the entity's business model for realising these assets is collecting contractual cash flows are recognised at amortised cost under both IFRS 9 and as loans and receivables under IAS 39, there was no change in carrying value;
- Cash and bank balances - these were classified as financial assets at amortised cost under IFRS 9 and loans and receivables under IAS 39, there has been no change in carrying value.
- Investments in equity instruments (note 14) - Investments in equity instruments are designated as at FVTPL under IFRS 9 and IAS 39, there has been no change in carrying value.
- Intercompany treasury account - the objective of the entity's business model for realising these assets is collecting contractual cash flows, as such they are recognised at amortised cost under IFRS 9 and as loans and receivables under IAS 39, there has been no change in carrying value; and
- Trade and other payables (note 22) - were recognised as financial liabilities at amortised cost under both IFRS 9 and IAS 39, there has been no change in carrying value.
- Borrowings (note 19) - were recognised as financial liabilities at amortised cost under both IFRS 9 and IAS 39, there has been no change in carrying value.

There were no financial assets or financial liabilities which the Company had previously designated as at FVTPL under IAS 39 that were subject to reclassification, or which the Company has elected to reclassify upon the application of IFRS 9. There were no financial assets or financial liabilities which the Company has elected to designate as at FVTPL at the date of initial application of IFRS 9.

(f) Financial impact of initial application of IFRS 9

There has been no adjustment to financial statement line items because of the application of IFRS 9 for the current and prior years.

Amendments to IFRS 7

The consequential amendments to IFRS 7 have had no impact to the comparatives and therefore no restatement is required, they have resulted in more extensive disclosures in relation to the Company's exposure to credit risk in the financial risk review note 28.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

IFRS 15 - Revenue from contracts with customers

Revenue from Contracts with Customers establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 supersedes the current revenue recognition guidance including IAS 11 Construction Contracts, IAS 18 Revenue and the related interpretations. The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied. Apart from providing more extensive disclosures, the application of IFRS 15 has not had a significant impact on the financial position or performance of the Company.

None of the other standards, interpretations and amendments effective for the first time from 1 January 2018 have had a material effect on the financial statements.

New standards, interpretations and amendments not yet effective

The following newly issued but not yet effective standards, interpretations and amendments, which have not been applied in these financial statements, will or may have an effect on the company financial statements in future:

IFRS 16 - Leases (1 January 2019)

IFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective. IFRS 16 distinguishes between leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions between operating leases and finance leases are removed for lessee accounting, and are replaced by a model where right-of-use asset and a corresponding liability have to be recognised for all leases by lessees except for short term leases and leases of low-value assets. As of 31 December 2018, the Company has non-cancellable operating lease commitments of £24.5 million, IAS 17 does not require recognition of any right-of-use asset or liability for future payments for these leases. A preliminary assessment indicates that these arrangements will meet the definition of a lease under IFRS 16, and hence the Company will recognise a right-of-use asset and corresponding liability in respect of all these leases unless they qualify for low-value or short-term leases upon the application of IFRS 16.

None of the other standards, interpretations and amendments that are listed below, which are effective for periods beginning after 1 January 2019 and which have not been adopted early, are expected to have a material effect on the financial statements:

Effective for periods beginning or after 1 January 2019

- Amendments to IAS 28 - Long-term interests in associates and joint ventures;
- Amendments to IAS 19 - Plan amendment, curtailment or settlement;
- Annual improvements to IFRS 2015-2017 cycle

Effective for periods beginning or after 1 January 2020

- Amendments to IFRS 3 - Definition of a business;
- Amendments to IAS 1 and IAS 8 - Definition of material; and
- Amendments to References to the Conceptual Framework in IFRS Standards.

Northern Powergrid (Northeast) Limited

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Revenue recognition

Recognition

The company earns revenue from the provision of services relating to Revenue from a contract to provide services is recognised by the following means:

- Distribution use of system income is recognised on a per GWh basis;
- Customer contributions for connections are amortised over the life of the corresponding asset;
- Meter asset provision are recognised over time;
- Intercompany recharges for services provided are based on costs incurred; and
- Other revenue includes assessment and design fees and disconnections from the network, these are recognised by reference to the proportion of total costs of providing the service.

This revenue is recognised in the accounting period when the services are rendered at an amount that reflects the consideration to which the entity expects to be entitled in exchange for fulfilling its performance obligations to customers.

The principles in IFRS are applied to revenue recognition criteria using the following 5 step model:

1. Identify the contracts with the customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue when or as the entity satisfies its performance obligations

Fee arrangements

Below are details of fee arrangements and how these are measured and recognised, for revenue from the provision of services:

- For regulated fees the revenue for the service is recognised on the basis of agreed charging methodologies on a per GWh basis.
- For fixed fee for connection the revenue is recognised over the life of the corresponding asset.
- For fixed fee arrangements from services revenue is recognised based on the stage of completion and performance obligations met for actual services provided as a proportion of the total fixed fee agreed in the contract.
- For fee for service (time) revenue is recognised by time performed on the contract to the year end date using contractual rates specified in the contract.

Performance obligations

The main performance obligations in contracts consist of the provision of a distribution network to electricity suppliers. For these contracts, through the distribution and connection use of system agreement (DCUSA) the delivery of performance obligations are measured at the balance sheet date by the number of GWh distributed by the system.

Finance income and costs policy

Finance income from a financial asset is recognised when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

Finance costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognised in profit or loss in the period which they are incurred.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except when a change attributable to an item of income or expense recognised as other comprehensive income is also recognised directly in other comprehensive income.

The current income tax charge is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the reporting date in the countries where the company operates and generates taxable income.

Deferred income tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements and on unused tax losses or tax credits in the company. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the reporting date.

The carrying amount of deferred tax assets are reviewed at each reporting date and a valuation allowance is set up against deferred tax assets so that the net carrying amount equals the highest amount that is more likely than not to be recovered based on current or future taxable profit.

Property, plant and equipment

Property, plant and equipment is stated in the statement of financial position at cost, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The cost of property, plant and equipment includes directly attributable incremental costs incurred in their acquisition and installation.

Assets in the course of construction are carried at cost, less any recognised impairment loss. Costs include professional fees, and, for qualifying assets, borrowing costs capitalised in accordance with the Company's accounting policy. Such assets are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation on these assets, on the same basis as other assets, commences when the assets are commissioned. Assets are derecognised when they are disposed of profit or loss on disposal is recognised in other gains on the statement of profit or loss.

Depreciation

Depreciation is charged so as to write off the cost of assets, other than land and properties under construction over their estimated useful lives. Depreciation is recognised on a straight line basis as follows:

<i>Asset class</i>	<i>Depreciation rate</i>
Distribution system assets	45 years
Distribution generation assets	15 year
Metering equipment included in distribution system assets	up to 5 years
Information technology equipment included in distribution system assets	up to 10 years
Buildings - freehold	up to 60 years
Buildings - leasehold	lower of lease period or 60 years
Fixtures and fittings	up to 10 years

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Intangible assets

An internally generated intangible asset arising from development is recognised if the conditions set out in IAS 38 relating to the recognition of intangible assets are met. The amount initially recognised for internally-generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria. Amortisation is recognised on a straight-line basis over their estimated useful lives.

Amortisation

Amortisation is provided on intangible assets so as to write off the cost, less any estimated residual value, over their expected useful economic life as follows:

<i>Asset class</i>	<i>Amortisation method and rate</i>
Software development costs	up to 10 years

Derecognition

An intangible asset is derecognised on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognised in the profit or loss when the asset is derecognised.

Investments

Investments in securities are classified on initial recognition as available-for-sale and are carried at fair value, except where their fair value cannot be measured reliably, in which case they are carried at cost, less any impairment.

Unrealised holding gains and losses other than impairments are recognised in other comprehensive income. On maturity or disposal, net gains and losses previously deferred in accumulated other comprehensive income are recognised in income.

Interest income on debt securities, where applicable, is recognised in income using the effective interest method. Dividends on equity securities are recognised in income when receivable.

Cash and cash equivalents

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

Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at the transaction price. They are subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for the impairment of trade receivables is established when there is objective evidence that the company will not be able to collect all amounts due according to the original terms of the receivables.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using a weighted average method.

At each reporting date, inventories are assessed for impairment. If inventory is impaired, the carrying amount is reduced to its selling price less costs to complete and sell; the impairment loss is recognised immediately in profit or loss.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised initially at the transaction price and subsequently measured at amortised cost using the effective interest method.

Borrowings

All borrowings are initially recorded at the amount of proceeds received, net of transaction costs. Borrowings are subsequently carried at amortised cost, with the difference between the proceeds, net of transaction costs, and the amount due on redemption being recognised as a charge to the income statement over the period of the relevant borrowing.

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

Provisions

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

Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the reporting date and are discounted to present value where the effect is material.

Leases

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

Impairment of non-financial assets

At the balance sheet date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

An intangible asset with an indefinite useful life is tested for impairment at least annually and whenever there is an indication that the asset may be impaired.

Where the recoverable amount is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Share capital

Ordinary shares are classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable, net of the direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement is on a present value basis.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Dividends

Dividend distribution to the Company's shareholders is recognised as a liability in the company's financial statements in the period in which the dividends are approved by the Company's shareholders.

Defined benefit pension obligation

The Company contributes to the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "DB Scheme"), a defined benefit scheme that shares risk between various entities under common control. There is no contractual agreement or stated policy for charging the net defined benefit cost for the plan as a whole to individual group entities and accordingly the Company financial statements account for the Northern Powergrid Group of the ESPS as if it were a defined contribution scheme.

Contributions to the Northern Powergrid Group of the ESPS are charged to the statement of profit or loss. The capital costs of ex-gratia and supplementary pensions are normally charged to the statement of profit or loss in the period in which they are granted.

The Company also participates in a defined contribution scheme. Contributions payable to the defined contribution scheme are charged to the statement of profit or loss in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the statement of financial position.

Financial instruments

Initial recognition

Financial assets and financial liabilities comprise all assets and liabilities reflected in the statement of financial position, although excluding property, plant and equipment, investment properties, intangible assets, deferred tax assets, prepayments, deferred tax liabilities and employee benefits plan.

The Company recognises financial assets and financial liabilities in the statement of financial position when, and only when, the company becomes party to the contractual provisions of the financial instrument.

Financial assets are initially recognised at fair value. Financial liabilities are initially recognised at fair value, representing the proceeds received net of premiums, discounts and transaction costs that are directly attributable to the financial liability.

All regular way purchases and sales of financial assets and financial liabilities classified as fair value through profit or loss ("FVTPL") are recognised on the trade date, i.e. the date on which the Company commits to purchase or sell the financial assets or financial liabilities. All regular way purchases and sales of other financial assets and financial liabilities are recognised on the settlement date, i.e. the date on which the asset or liability is received from or delivered to the counterparty. Regular way purchases or sales are purchases or sales of financial assets that require delivery within the time frame generally established by regulation or convention in the market place.

Subsequent to initial measurement, financial assets and financial liabilities are measured at either amortised cost or fair value.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Classification and measurement

Financial instruments are classified at inception into one of the following categories, which then determine the subsequent measurement methodology:-

Financial assets are classified into one of the following three categories:-

- financial assets at amortised cost;
- financial assets at fair value through other comprehensive income (FVTOCI); or
- financial assets at fair value through the profit or loss (FVTPL).

Financial liabilities are classified into one of the following two categories:-

- financial liabilities at amortised cost; or
- financial liabilities at fair value through the profit or loss (FVTPL).

The classification and the basis for measurement are subject to the Company's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets, as detailed below:-

Financial assets at amortised cost

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:-

- the assets are held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

If either of the above two criteria is not met, the financial assets are classified and measured at fair value through the profit or loss (FVTPL).

If a financial asset meets the amortised cost criteria, the Company may choose to designate the financial asset at FVTPL. Such an election is irrevocable and applicable only if the FVTPL classification significantly reduces a measurement or recognition inconsistency.

Financial assets at fair value through other comprehensive income (FVTOCI)

A financial asset is measured at FVTOCI only if it meets both of the following conditions and is not designated as at FVTPL:-

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investments that is not held for trading, the Company may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

If an equity investment is designated as FVTOCI, all gains and losses, except for dividend income, are recognised in other comprehensive income and are not subsequently included in the statement of income.

Financial assets at fair value through the profit or loss (FVTPL)

Financial assets not otherwise classified above are classified and measured as FVTPL.

Financial liabilities at amortised cost

All financial liabilities, other than those classified as financial liabilities at FVTPL, are measured at amortised cost using the effective interest rate method.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Financial liabilities at fair value through the profit or loss

Financial liabilities not measured at amortised cost are classified and measured at FVTPL. This classification includes derivative liabilities.

Derecognition

Financial assets

The Company derecognises a financial asset when;

- the contractual rights to the cash flows from the financial asset expire,
- it transfers the right to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred; or
- the Company neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset and the sum of the consideration received is recognised as a gain or loss in the profit or loss.

Any cumulative gain or loss recognised in OCI in respect of equity investment securities designated as FVTOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Company is recognised as a separate asset or liability.

The Company enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised.

When the Company derecognises transferred financial assets in their entirety, but has continuing involvement in them then the entity should disclose for each type of continuing involvement at the reporting date:

- (a) The carrying amount of the assets and liabilities that are recognised in the entity's statement of financial position and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which those assets and liabilities are recognised.
- (b) The fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets;
- (c) The amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and how the maximum exposure to loss is determined; and
- (d) The undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee for the transferred assets.

Financial liabilities

The Company derecognises a financial liability when its contractual obligations are discharged, cancelled, or expire.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Modification of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, the Company evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to the cash flows from the original financial asset are deemed to expire. In this case the original financial asset is derecognised and a new financial asset is recognised at either amortised cost or fair value.

If the cash flows are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the company recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the statement of income.

Financial liabilities

If the terms of a financial liabilities are modified, the Company evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual obligations from the cash flows from the original financial liabilities are deemed to expire. In this case the original financial liabilities are derecognised and new financial liabilities are recognised at either amortised cost or fair value.

If the cash flows are not substantially different, then the modification does not result in derecognition of the financial liabilities. In this case, the company recalculates the gross carrying amount of the financial liabilities and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the statement of income.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Impairment of financial assets

Measurement of Expected Credit Losses

The Company recognises loss allowances for expected credit losses (ECL) on financial instruments that are not measured at FVPTL, namely:

- Financial assets that are debt instruments
- Accounts and other receivables
- Financial guarantee contracts issued; and
- Loan commitments issued.

The Company classifies its financial instruments into stage 1, stage 2 and stage 3, based on the applied impairment methodology, as described below:

Stage 1: for financial instruments where there has not been a significant increase in credit risk since initial recognition and that are not credit-impaired on origination, the company recognises an allowance based on the 12-month ECL.

Stage 2: for financial instruments where there has been a significant increase in credit risk since initial recognition but they are not credit-impaired, the Company recognises an allowance for the lifetime ECL.

Stage 3: for credit-impaired financial instruments, the Company recognises the lifetime ECL.

The Company measures loss allowances at an amount equal to the lifetime ECL, except for the following, for which they are measured as a 12-month ECL:

- debt securities that are determined to have a low credit risk (equivalent to investment grade rating) at the reporting date; and
- other financial instruments on which the credit risk has not increased significantly since their initial recognition.

The Company considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade'.

A 12-month ECL is the portion of the ECL that results from default events on a financial instrument that are probable within 12 months from the reporting date.

Provisions for credit-impairment are recognised in the statement of income and are reflected in accumulated provision balances against each relevant financial instruments balance.

Evidence that the financial asset is credit-impaired include the following;

- Significant financial difficulties of the borrower or issuer;
- A breach of contract such as default or past due event;
- The restructuring of the loan or advance by the Company on terms that the Company would not consider otherwise;
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- The disappearance of an active market for the security because of financial difficulties; or
- There is other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the Company, or economic conditions that correlate with defaults in the Company.

Northern Powergrid (Northeast) Limited

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

For trade receivables, the Company applies the simplified approach, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. The contract assets relate to unbilled work in progress and have substantially the same risk characteristics as the trade receivables for the same types of contracts. The Company has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

The expected loss rates are based on the payment profiles of sales over a period of 36 month before 31 December 2018 and the corresponding historical credit losses experienced within this period. The historical loss rates are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of the customers to settle the receivables. The company has identified the GDP and the unemployment rate of the countries in which it sells its goods and services to be the most relevant factors, and accordingly adjusts the historical loss rates based on expected changes in these factors.

Definition of default

The Company considers the following as constituting an event of default for internal credit risk management purposes as historical experience indicates that financial assets that meet either of the following criteria are not recoverable:

- when there is a breach of financial covenants by the debtor; and
- information developed internally or obtained from external sources indicates that the debtor is unlikely to pay its creditors, including the Company, in full.

Accounting estimates and assumptions

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of certain financial assets, liabilities, income and expenses.

The use of estimates and assumptions is principally limited to the determination of provisions for impairment, the valuation of financial instruments as explained in more detail below:

Provisions for impairment

In determining impairment of financial assets, judgement is required in the estimation of the amount and timing of future cash flows as well as an assessment of whether the credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of ECL.

Fair value of financial assets and liabilities

Where the fair value of financial assets and liabilities cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is derived from observable markets where available, but where this is not feasible, a degree of judgement is required in determining assumptions used in the models. Changes in assumptions used in the models could affect the reported fair value of financial assets and liabilities.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

3 Critical accounting judgements and key sources of estimation uncertainty

Critical judgements in applying accounting policies

The following are the critical judgements, apart from those involving estimations, that the directors have made in the process of applying the Group's accounting policies and that have the most significant effect on amounts recognised in the consolidated financial statements:

Split of operating and capital expenditure and the allocation of overheads to property, plant and equipment

The allocation of overheads to property, plant and equipment which results in higher capital expenditure and a reduction in operating costs. Costs are capitalised where it is probable that future economic benefits associated with the asset will flow to the enterprise; and the cost of the item can be reliably measured.

The allocation of overheads to capital is derived from a detailed analysis of the costs and their relevant cost drivers, which is reviewed on an annual basis. There has been no change in the methodology since the prior year.

The amount of overheads capitalised in the year was £38.3m (2017: £40.0m)

Key sources of estimation uncertainty

In the preparation of financial statements in conformity with IFRS the Directors did not identify any key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

4 Revenue

The analysis of the Company's revenue for the year from continuing operations is as follows:

	2018	2017
	£ 000	£ 000
Distribution use of system revenue	284,226	281,893
Amortisation of deferred revenue	22,355	21,210
Work for related parties	21,543	19,181
Other revenue	7,129	6,016
	<u>335,253</u>	<u>328,300</u>

Segmental analysis

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Company that are regularly reviewed by the President and Chief Executive Officer of the Northern Powergrid Group in order to allocate resources to these segments and to assess their performance.

In practice, the President and Chief Executive Officer allocates resources and assesses performance based upon the aggregate results of the Company and Northern Powergrid (Yorkshire) plc, another distribution network operator in the Northern Powergrid Group, suggesting that no segmental reporting is required.

Revenue, profit before tax and net assets are attributable to electricity distribution. Revenue is all in respect of sales to United Kingdom customers.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

5 Other gains and losses

The analysis of the Company's other gains and losses for the year is as follows:

	2018	2017
	£ 000	£ 000
Gain on disposal of property, plant and equipment	<u>466</u>	<u>331</u>

6 Operating profit

Arrived at after charging/(crediting)

	2018	2017
	£ 000	£ 000
Depreciation expense	81,332	77,313
Amortisation expense	7,287	4,706
Amortisation of deferred revenue	(22,355)	(21,210)
Research and development cost	2,437	1,479
Operating lease expense - other	7,929	7,674
Loss allowance on trade and other receivables	<u>874</u>	<u>361</u>

Amortisation expense is included in administration costs in the statement of profit or loss on page 18.

7 Finance income and costs

	2018	2017
	£ 000	£ 000
Finance income		
Interest income on financial assets measured at amortised cost	85	47
Dividend income from equity investments designated at FVTPL	<u>62</u>	<u>46</u>
Total finance income	<u>147</u>	<u>93</u>
Finance costs		
Interest on bank overdrafts and borrowings	(7,020)	(8,385)
Interest paid to group undertakings	(24,002)	(23,347)
Borrowing costs included in cost of qualifying asset	<u>2,240</u>	<u>2,788</u>
Total finance costs	<u>(28,782)</u>	<u>(28,944)</u>
Net finance costs	<u>(28,635)</u>	<u>(28,851)</u>

Borrowing costs included in the costs of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 5.33% (2017: 5.26%) to expenditure on such assets.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

8 Staff costs

	2018	2017
	£ 000	£ 000
Salaries	51,632	49,569
Social security costs	5,744	5,521
Defined benefit pension costs	25,934	24,714
Defined contribution pension costs	2,462	1,928
	<u>85,772</u>	<u>81,732</u>
Less charged to plant, property and equipment	<u>(40,784)</u>	<u>(41,372)</u>
	<u><u>44,988</u></u>	<u><u>40,360</u></u>

A large proportion of the Company's employees are members of the DB Scheme, most of the remaining employees are members of the Northern Powergrid Pension Scheme, details of both are given in the employee benefits note 24.

The average number of persons employed by the company (including directors) during the year, analysed by category was as follows:

	2018	2017
	No.	No.
Production	782	773
Administration and support	204	188
Other departments	123	111
	<u>1,109</u>	<u>1,072</u>

9 Directors and other key personnel remuneration

The directors' remuneration for the year was as follows:

	2018	2017
	£ 000	£ 000
Remuneration	<u>1,452</u>	<u>1,519</u>

During the year the number of directors who were receiving retirement benefits was as follows:

	2018	2017
	No.	No.
Accruing benefits under defined benefit pension scheme	1	1
Accruing benefits under money purchase pension scheme	<u>2</u>	<u>2</u>

In respect of the highest paid director:

	2018	2017
	£ 000	£ 000
Short-term employee benefits	365	368
Long-term benefits	475	435
	<u>840</u>	<u>803</u>

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

9 Directors and other key personnel remuneration (continued)

In respect of other key personnel:

	2018	2017
	£ 000	£ 000
Short-term employee benefits	407	439
Post retirement benefits - defined benefit	31	45
Post retirement benefits - defined contribution	40	52
Long-term benefits	<u>206</u>	<u>233</u>
	<u><u>684</u></u>	<u><u>769</u></u>

Other key personnel includes a number of senior functional managers who, whilst not board directors, have authority and responsibility for planning, directing and controlling the activities of the Company.

The directors and key personnel are remunerated for their services to the Northern Powergrid Group, of which the Company is a subsidiary. The figures above represent the share of the costs borne by the Company.

Long-term benefits relate to deferred bonus plan vested over the period of the plan.

10 Auditor's remuneration

	2018	2017
	£ 000	£ 000
Audit of the financial statements	121	121
Other audit services	<u>45</u>	<u>45</u>
Total fees payable to the Company's auditor	<u><u>166</u></u>	<u><u>166</u></u>

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

11 Income tax

Tax charged/(credited) in the income statement

	2018	2017
	£ 000	£ 000
Current taxation		
UK corporation tax	17,109	18,174
UK corporation tax adjustment to prior periods	(686)	(396)
	<u>16,423</u>	<u>17,778</u>
Deferred taxation		
Arising from origination and reversal of temporary differences	783	1,587
Deferred tax adjustment to prior periods	718	332
Effect of changes in legislation	(353)	(228)
Total deferred taxation	<u>1,148</u>	<u>1,691</u>
Tax expense in the income statement	<u><u>17,571</u></u>	<u><u>19,469</u></u>

The tax on profit before tax for the year is lower than the standard rate of corporation tax in the UK (2017 - lower than the standard rate of corporation tax in the UK) of 19% (2017 - 19.25%).

The differences are reconciled below:

	2018	2017
	£ 000	£ 000
Profit before tax	<u>95,030</u>	<u>105,055</u>
Corporation tax at standard rate	18,056	20,223
Decrease in current tax from adjustment for prior periods	(686)	(396)
Deferred tax expense due to under provision for prior years	718	332
Effect of income and expenses not deductible in determining taxable profit	(68)	(148)
Deferred tax credit relating to lower tax rates	(176)	(358)
Decrease in deferred tax due to changes to legislation	(353)	(228)
Other	81	44
Total tax charge	<u><u>17,572</u></u>	<u><u>19,469</u></u>

Finance Act No.2 2015 included provisions to reduce the corporation tax to 19% with effect from 1 April 2017 and Finance Act 2016 introduced a further reduction in the main rate of corporation tax to 17% from 1 April 2020. Accordingly deferred tax assets and liabilities have been calculated at the tax rates which will be in force when the underlying temporary differences are expected to reverse.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

11 Income tax (continued)

Deferred tax

Deferred tax assets and liabilities

Deferred tax movement during the year:

	At 1 January 2018 £ 000	Recognised in income £ 000	At 31 December 2018 £ 000
Accelerated tax depreciation	91,513	1,213	92,726
Other	(303)	(65)	(368)
Net tax liabilities	<u>91,210</u>	<u>1,148</u>	<u>92,358</u>

Deferred tax movement during the prior year:

	At 1 January 2017 £ 000	Recognised in income £ 000	At 31 December 2017 £ 000
Accelerated tax depreciation	89,821	1,692	91,513
Other	(302)	(1)	(303)
Net tax liabilities	<u>89,519</u>	<u>1,691</u>	<u>91,210</u>

Other comprises provisions and employee expenses deductible for tax on a paid basis and claims for hold over relief.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

12 Property, plant and equipment

	Land and buildings £ 000	Distribution system £ 000	Furniture, fittings and equipment £ 000	Total £ 000
Cost or valuation				
At 1 January 2017	4,191	2,797,074	40,983	2,842,248
Additions	-	188,871	2,694	191,565
Disposals	-	(7,024)	(423)	(7,447)
At 31 December 2017	4,191	2,978,921	43,254	3,026,366
At 1 January 2018	4,191	2,978,921	43,254	3,026,366
Additions	-	171,921	1,759	173,680
Disposals	-	(13,590)	(390)	(13,980)
At 31 December 2018	4,191	3,137,252	44,623	3,186,066
Depreciation				
At 1 January 2017	2,163	579,199	28,379	609,741
Charge for year	252	73,141	3,920	77,313
Eliminated on disposal	-	(7,024)	(423)	(7,447)
At 31 December 2017	2,415	645,316	31,876	679,607
At 1 January 2018	2,415	645,316	31,876	679,607
Charge for the year	252	76,975	4,105	81,332
Eliminated on disposal	-	(13,590)	(390)	(13,980)
At 31 December 2018	2,667	708,701	35,591	746,959
Carrying amount				
At 31 December 2017	1,776	2,333,605	11,378	2,346,759
At 31 December 2018	1,524	2,428,551	9,032	2,439,107

Included within the net book value of land and buildings above is £1,156,000 (2017 - £1,345,000) in respect of freehold land and buildings and £368,000 (2017 - £431,000) in respect of long leasehold land and buildings.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

12 Property, plant and equipment (continued)

Expenditure recognised in the carrying amount of property, plant and equipment in the course of construction:

	31 December 2018 £ 000	31 December 2017 £ 000
Distribution system	<u>211,655</u>	<u>211,489</u>

Contractual commitments for the acquisition of property, plant and equipment:

	31 December 2018 £ 000	31 December 2017 £ 000
Distribution system	<u>20,500</u>	<u>19,400</u>

13 Intangible assets

	Internally generated software development costs £ 000
Cost or valuation	
At 1 January 2017	68,667
Additions	<u>11,417</u>
At 31 December 2017	<u>80,084</u>
At 1 January 2018	80,084
Additions	<u>10,357</u>
At 31 December 2018	<u>90,441</u>
Amortisation	
At 1 January 2017	27,810
Amortisation charge	<u>4,706</u>
At 31 December 2017	<u>32,516</u>
At 1 January 2018	32,516
Amortisation charge	<u>7,287</u>
At 31 December 2018	<u>39,803</u>
Carrying amount	
At 1 January 2017	<u>40,857</u>
At 31 December 2017	<u>47,568</u>
At 31 December 2018	<u>50,638</u>

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

14 Investments

Subsidiaries	£ 000
Cost or valuation	
At 1 January 2017	50
At 31 December 2017	50
At 1 January 2018	50
At 31 December 2018	50
Carrying amount	
At 31 December 2018	50
At 1 January 2017	50

Details of the subsidiaries as at 31 December 2018 are as follows:

Name of subsidiary	Principal activity	Registered office	Ownership interest and voting rights held	
			2018	2017
Northern Electric Finance plc	Finance company	Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF England and Wales	100%	100%

Associates

Cost or valuation

Details of the associates as at 31 December 2018 are as follows:

Name of associate	Principal activity	Registered office	Ownership interest and voting rights held	
			2018	2017
Electralink Limited +	Data transfer network operator	Northumberland House, 303 - 306 Holborn, WC1V 7JZ England and Wales	6.7%	6.7%
MRA Service Company Limited +	Governance of the electricity industry's Master Registration Agreement	8 Fenchurch Place, London, EC3M 4AJ England and Wales	1%	1%
DCUSA Limited +	Governance of Distribution Connection and Use of System Agreement	Northumberland House, 303 - 306 High Holborn, WC1V 7JZ England and Wales	1%	1%

+ indicates accounted for using the equity method

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

15 Inventories

	31 December	31 December
	2018	2017
	£ 000	£ 000
Inventory	12,422	12,283
Work in progress	447	797
	<u>12,869</u>	<u>13,080</u>

16 Trade and other receivables

	31 December	31 December
	2018	2017
	£ 000	£ 000
Distribution use of system receivables	48,039	48,898
Trade receivables	3,495	4,409
Loss allowance	<u>(1,465)</u>	<u>(613)</u>
Net trade receivables	50,069	52,694
Accrued income	(22)	705
Prepayments	<u>1,483</u>	<u>1,573</u>
	<u>51,530</u>	<u>54,972</u>

The average credit period on receivables is 30 days. No interest is charged on outstanding trade receivables.

The Company always measures the loss allowance for trade receivables at an amount equal to lifetime expected credit loss. The expected credit losses on trade receivables are estimated using a provision matrix by reference to past default experience of the debtor and an analysis of the debtor's current financial position, adjusted for factors that are specific to the debtors, general economic conditions of the industry in which the debtors operate and an assessment of both the current as well as the forecast direction of conditions at the reporting date.

There has been no change in the estimation techniques or significant assumptions made during the current reporting period.

The Group writes off a trade receivable when there is information indicating that the debtor is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the debtor has been placed under liquidation or has entered into bankruptcy proceedings, or when the trade receivables are over two years past due, whichever occurs earlier. None of the trade receivables that have been written off is subject to enforcement activities.

As the Company's historical credit loss experience does shows significantly different loss patterns for different customer segments, the provision for loss allowance based on past due status is not distinguished between DUoS receivables, non-damages receivables, and damages receivables.

Movement in the loss allowance

	31 December	31 December
	2018	2017
	£ 000	£ 000
At 1 January	613	404
Amounts utilised/written off in the year	(22)	(152)
Amounts recognised in the statement of profit or loss	<u>874</u>	<u>361</u>
At 31 December	<u>1,465</u>	<u>613</u>

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

16 Trade and other receivables (continued)

Distribution use of system receivables

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 19% of distribution revenues in 2018 (2017: 21%) and British Gas plc accounting for approximately 12% of distribution revenues in 2018 (2017: 14%). Ofgem has determined a framework which sets credit limits for each supply business based on its credit rating or payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or an escrow account.

Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material therefore no ECL has been made on DUoS balances.

The following table details the age of DUoS receivables:

2018	Not due £ 000	Current £ 000	1-3 months £ 000	3-6 months £ 000
Total balance	26,392	21,219	34	394
Less specific provisions	-	(190)	(4)	(387)
Balance on which ECL made	<u>26,392</u>	<u>21,029</u>	<u>30</u>	<u>7</u>
Expected credit loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
2017	Not due £ 000	Current £ 000	1-3 months £ 000	3-6 months £ 000
Total balance	25,536	23,115	-	246
Less specific provisions	-	-	-	(242)
Balance on which ECL made	<u>25,536</u>	<u>23,115</u>	<u>-</u>	<u>4</u>
Expected credit loss	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>

Other trade receivables

Sales of goods and services comprise all income streams which are not classified as UoS income. Examples of non-UoS income streams would be service alterations/disconnections, assessment and design fees, and recovery of amounts for damage caused by third parties to the distribution system. The average credit period on sales of goods and services is 30 days. Interest is not generally charged on the tradereceivables paid after the due date.

In determining the recoverability of the trade and other receivables, the Company considers any change in the credit quality of the trade and other receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk, other than in relation to UoS receivables, is limited due to the customer base being large and unrelated. Accordingly, the directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Included in the allowance for doubtful debts are specific trade receivables, with a balance of £1.2m (2017: £0.5m), which have been placed in administration. The impairment represents the difference between the carrying amount of the specific trade receivable and the present value of the expected liquidation dividend.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

16 Trade and other receivables (continued)

Non-damages

2018	Not due £ 000	Current £ 000	1-6 months £ 000	6-12 months £ 000	Over 1 year £ 000
Total balance	1,960	1,018	2,247	1,058	273
Less other balances	(1,681)	(810)	(1,991)	(1,010)	(192)
Balance on which ECL made	279	208	256	48	81
Lifetime ECL	0%	0%	0%	15%	20%
Expected credit loss	-	-	-	7	16
2017	Not due £ 000	Current £ 000	1-6 months £ 000	6-12 months £ 000	Over 1 year £ 000
Total balance	1,231	945	984	509	474
Less other balances	(1,212)	(751)	(849)	(490)	(440)
Balance on which ECL made	19	194	135	19	34
Lifetime ECL	0%	0%	0%	15%	20%
Expected credit loss	-	-	-	3	7

Damages

2018	1-6 months £ 000	6-12 months £ 000	1-2 years £ 000	2-3 years £ 000	Over 3 years £ 000
Total balance	871	788	525	186	19
Less specific provisions	-	(47)	(11)	(133)	-
Balance on which ECL made	871	741	514	53	19
Lifetime ECL	10%	10%	15%	30%	60%
Expected credit loss	87	74	77	16	11
2017	1-6 months £ 000	6-12 months £ 000	1-2 years £ 000	2-3 years £ 000	Over 3 years £ 000
Total balance	675	536	280	31	6
Less specific provisions	-	(70)	(145)	-	-
Balance on which ECL made	675	466	135	31	6
Lifetime ECL	10%	10%	15%	30%	60%
Expected credit loss	68	47	20	9	4

There has been no significant change in the gross amounts of trade receivables that has affected the estimation of loss allowance.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

16 Trade and other receivables (continued)

Significant increase in credit risk

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Company compares the risk of a default occurring on a financial instrument at the reporting date with the risk of a default occurring on the financial instrument at the date of initial recognition. In making this assessment the Company considers historical experience as well as forward-looking information that is available without undue cost or effort. Forward-looking information includes the future prospects of the industries in which the Company's debtors operate obtained from economic expert reports, financial analysts, government bodies, relevant think-tanks and other similar organisations. In particular the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor's ability to meet its debt obligations;
- an actual or expected significant deterioration in the operating results of the debtor;
- significant increases in credit risk on other financial instruments of the same debtor; and
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the debtor that results in a significant decrease in the debtor's ability to meet its debt obligations.

17 Share capital

Allotted, called up and fully paid shares

	31 December 2018		31 December 2017	
	No.	£	No.	£
Ordinary Share Capital of £1 each	<u>200,000,100</u>	<u>200,000,100</u>	<u>200,000,100</u>	<u>200,000,100</u>

18 Reserves

	Retained earnings £ 000
At 1 January 2018	775,708
Profit for the year	<u>77,459</u>
Total comprehensive income	77,459
Dividends	<u>(23,700)</u>
At 31 December 2018	<u><u>829,467</u></u>

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

18 Reserves (continued)

	Retained earnings £ 000
At 1 January 2017	712,822
Profit for the year	<u>85,586</u>
Total comprehensive income	85,586
Dividends	<u>(22,700)</u>
At 31 December 2017	<u><u>775,708</u></u>

19 Loans and borrowings

	31 December 2018 £ 000	31 December 2017 £ 000
Non-current loans and borrowings	507,152	547,049
Current loans and borrowings	<u>214,566</u>	<u>147,079</u>
	<u><u>721,718</u></u>	<u><u>694,128</u></u>

	Book value		Fair value	
	31 December 2018 £ 000	31 December 2017 £ 000	31 December 2018 £ 000	31 December 2017 £ 000
Short-term loan	44,008	10	44,008	10
Intercompany loan	123,838	98,898	123,838	98,898
Northern Electric Finance plc 2020 - 8.875%	101,849	101,849	114,338	122,795
Northern Electric Finance plc 2035 - 5.125%	49,865	49,789	65,757	69,123
Yorkshire Electricity Group plc 2037 - 5.9%	-	100,016	-	149,768
Northern Powergrid Holdings Company 2037 - 5.9%	100,016	-	141,879	-
Northern Electric Finance plc 2037 - 5.125%	100,014	100,014	130,759	137,864
European Investment Bank 2018 - 4.065%	-	41,429	-	41,444
European Investment Bank 2019 - 4.241%	41,493	41,491	41,506	43,015
European Investment Bank 2020 - 4.386%	40,507	40,504	41,796	43,426
European Investment Bank 2027 - 2.564%	<u>120,128</u>	<u>120,128</u>	<u>126,761</u>	<u>129,281</u>
	<u><u>721,718</u></u>	<u><u>694,128</u></u>	<u><u>830,642</u></u>	<u><u>835,624</u></u>

The fair value of liabilities set out above is based on Level 1 inputs.

The fair value of the bonds is determined with reference to quoted market prices. The directors' estimates of the fair value of bank loans and internal borrowings are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions or dealer quotes for similar instruments. The fair value of short-term borrowings is equal to their book value. All loans are non-secured and are denominated in sterling.

The company's exposure to market and liquidity risk; including maturity analysis, in respect of loans and borrowings is disclosed in financial risk review note 28.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

20 Obligations under leases and hire purchase contracts

Operating leases

Leases primarily relate to the hire of fleet vehicles and the rental of operational land. The vehicle leases have terms between 2 and 7 years. The Company does not have the option to purchase the vehicles at the end of the lease term.

The operational land lease are between 10 and 999 years, but in the majority are between 20 and 60 years. As the leases are regarded as a business tenancy, the Company has the option to renew the lease under the 1954 Landlord and Tenant Act unless a landlord is to redevelop or has grounds to recover land as prescribed under the Act, and may acquire the freehold at any time by agreement. The Company also has the ability to compulsorily purchase the freehold.

The total future value of minimum lease payments is as follows:

	31 December 2018 £ 000	31 December 2017 £ 000
Within one year	5,381	5,048
In two to five years	17,039	15,029
In over five years	<u>2,116</u>	<u>2,841</u>
	<u><u>24,536</u></u>	<u><u>22,918</u></u>

The amount of non-cancellable operating lease payments recognised as an expense during the year was £7,929,000 (2017 - £7,674,000).

21 Other provisions

	Claims £ 000	Other provisions £ 000	Total £ 000
At 1 January 2018	763	425	1,188
Additional provisions	945	401	1,346
Provisions used	<u>(1,209)</u>	<u>(362)</u>	<u>(1,571)</u>
At 31 December 2018	<u>499</u>	<u>464</u>	<u>963</u>
Non-current liabilities	<u>-</u>	<u>87</u>	<u>87</u>
Current liabilities	<u>499</u>	<u>377</u>	<u>876</u>

Claims: Provision has been made to cover costs arising from utility damages, public liability, and motoring third party claims, which are not externally insured. Settlement is expected substantially within 12 months.

Other: Primarily consists of a provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated Biphenyls (PCBs) and for an amount to cover claims made under Section 74 of the New Road and Street Works Act 1991. Costs are expected to be incurred over the next 15 years.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

22 Trade and other payables

	31 December	31 December
	2018	2017
	£ 000	£ 000
Payments on Account	43,492	44,726
Trade payables	1,701	4,269
Accrued expenses	6,808	6,720
Capital Accruals	22,888	23,832
Amounts due to related parties	-	495
Social security and other taxes	6,850	3,836
Other payables	3,121	2,407
	<u>84,860</u>	<u>86,285</u>

The Company's exposure to market and liquidity risks, including maturity analysis, related to trade and other payables is disclosed in note 28 "Financial risk review".

23 Deferred revenue

	31 December	31 December
	2018	2017
	£ 000	£ 000
Current	22,780	22,450
Non-current	597,215	584,348
	<u>619,995</u>	<u>606,798</u>

Deferred revenue relates to customer contributions towards distribution system assets. The Company's policy is to credit the customer contribution to revenue on a straight-line basis, in line with the useful life of the distribution system assets.

24 Pension and other schemes

Defined contribution pension scheme

The Company operates a defined contribution pension scheme. The pension cost charge for the year represents contributions payable by the Company to the scheme and amounted to £2.5m (2017 - £1.9m). The pension cost for 2019 is expected to be £2.8m.

Defined benefit pension scheme

The Company operates a defined benefit pension scheme. The pension cost charge for the year represents contributions payable by the Company to the scheme and amounted to £25.9m (2017 - £24.7m). The pension cost for 2019 is expected to be £26.9m.

Detailed information on the Northern Powergrid pension schemes is available in the Northern Powergrid Holdings Company financial statements, available from Lloyds Court, 78 Grey Street, Newcastle upon Tyne, Tyne and Wear, NE1 6AF.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Dividends

	31 December 2018 £ 000	31 December 2017 £ 000
Interim dividend of 11.3p (2017 - 10.9p) per ordinary share	<u>23,700</u>	<u>22,700</u>

26 Reconciliation of liabilities arising from financing activities

	At 1 January 2018 £ 000	Financing cash flows £ 000	Other changes £ 000	At 31 December 2018 £ 000
Long-term borrowings	595,220	(40,000)	(1,348)	553,872
Short-term borrowings	<u>98,908</u>	<u>68,940</u>	<u>(2)</u>	<u>167,846</u>
	<u>694,128</u>	<u>28,940</u>	<u>(1,350)</u>	<u>721,718</u>
	At 1 January 2017 £ 000	Financing cash flows £ 000	Other changes £ 000	At 31 December 2017 £ 000
Long term borrowings	595,113	-	107	595,220
Short term borrowings	<u>67,053</u>	<u>31,856</u>	<u>(1)</u>	<u>98,908</u>
	<u>662,166</u>	<u>31,856</u>	<u>106</u>	<u>694,128</u>

Other changes relate to amortisation of financing fees and discounts.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

27 Classification of financial and non-financial assets and financial and non-financial liabilities

The classification of financial assets and financial liabilities by accounting categorisation for the period ending 31 December 2018 was as follows:

	Financial assets at amortised cost £ 000	Financial assets & liabilities at FVTPL £ 000	Financial liabilities at amortised cost £ 000	Non-financial assets & liabilities £ 000
Assets				
Non-current assets				
Property, plant and equipment	-	-	-	2,439,107
Intangible assets	-	-	-	50,638
Investments in subsidiaries, joint ventures and associates	-	50	-	-
	<u>-</u>	<u>50</u>	<u>-</u>	<u>2,489,745</u>
Current assets				
Inventories	-	-	-	12,869
Trade and other receivables	50,323	-	-	1,207
	<u>50,323</u>	<u>-</u>	<u>-</u>	<u>14,076</u>
Total assets	<u><u>50,323</u></u>	<u><u>50</u></u>	<u><u>-</u></u>	<u><u>2,503,821</u></u>
Liabilities				
Non-current liabilities				
Loans and borrowings	-	-	(507,152)	-
Provisions	-	-	-	(87)
Deferred revenue	-	-	-	(597,215)
Deferred tax liabilities	-	-	-	(92,358)
	<u>-</u>	<u>-</u>	<u>(507,152)</u>	<u>(689,660)</u>
Current liabilities				
Trade and other payables	-	-	(84,860)	-
Loans and borrowings	-	-	(214,566)	-
Income tax liability	-	-	(4,833)	-
Deferred revenue	-	-	-	(22,780)
Provisions	-	-	-	(876)
	<u>-</u>	<u>-</u>	<u>(304,259)</u>	<u>(23,656)</u>
Total liabilities	<u><u>-</u></u>	<u><u>-</u></u>	<u><u>(811,411)</u></u>	<u><u>(713,316)</u></u>

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

27 Classification of financial and non-financial assets and financial and non-financial liabilities (continued)

The classification of financial assets and financial liabilities by accounting categorisation for the period ending 31 December 2017 was as follows:

	Financial assets at amortised cost £ 000	Financial assets & liabilities at FVTPL £ 000	Financial liabilities at amortised cost £ 000	Non-financial assets & liabilities £ 000
Assets				
Non-current assets				
Property, plant and equipment	-	-	-	2,346,759
Intangible assets	-	-	-	47,568
Investments in subsidiaries, joint ventures and associates	-	50	-	-
	<u>-</u>	<u>50</u>	<u>-</u>	<u>2,394,327</u>
Current assets				
Inventories	-	-	-	13,080
Trade and other receivables	53,827	-	-	1,145
	<u>53,827</u>	<u>-</u>	<u>-</u>	<u>14,225</u>
Total assets	<u><u>53,827</u></u>	<u><u>50</u></u>	<u><u>-</u></u>	<u><u>2,408,552</u></u>
Liabilities				
Non-current liabilities				
Loans and borrowings	-	-	(547,049)	-
Provisions	-	-	-	(88)
Deferred revenue	-	-	-	(584,348)
Deferred tax liabilities	-	-	-	(91,210)
	<u>-</u>	<u>-</u>	<u>(547,049)</u>	<u>(675,646)</u>
Current liabilities				
Trade and other payables	-	-	(86,285)	-
Loans and borrowings	-	-	(147,079)	-
Income tax liability	-	-	(7,112)	-
Deferred revenue	-	-	-	(22,450)
Provisions	-	-	-	(1,100)
	<u>-</u>	<u>-</u>	<u>(240,476)</u>	<u>(23,550)</u>
Total liabilities	<u><u>-</u></u>	<u><u>-</u></u>	<u><u>(787,525)</u></u>	<u><u>(699,196)</u></u>

The fair value of assets classified as fair value through profit or loss are valued using level 3 inputs.

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

28 Financial risk review

This note presents information about the Company's exposure to financial risks and the company's management of capital.

Capital management

The Group manages its capital centrally to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from 2017.

The capital structure of the Company consists of net debt (borrowings as detailed in note 19 offset by equity of the Company (comprising issued capital, reserves and retained earnings as detailed in notes 17 and 18).

The covenants associated with the 2035 bonds issued by Northern Electric Finance plc, a wholly-owned subsidiary of the Company, include restrictions on the issuance of new indebtedness and the making of distributions dependent on the scale of the ratio of Senior Total Net Debt to Regulatory Asset Value ("RAV"). The definition of Senior Total Net Debt excludes any subordinated debt and any debt incurred on a non-recourse basis. In addition, it excludes interest payable, any fair value adjustments and unamortised issue costs.

The Company's Senior Total Net Debt as at 31 December 2018 totalled £715.4m. Using the RAV value as at March 2019, as outlined by Ofgem in its electricity distribution price control financial model published in November 2018, and adjusting for the effects of movements in the value of the Retail Price Index gives an approximation for the RAV value as at 31 March 2019 of £1,406.5m. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 50.9% (2017: 50.7%).

Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Company. The Company has adopted a policy of only dealing with creditworthy counterparties. The Company's exposure and the credit ratings of its counterparties are continuously monitored and the aggregate value of transactions concluded is spread amongst approved counterparties. The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Company's maximum exposure to credit risk as no collateral or other credit enhancements are held.

The Company's income is primarily generated from use of system revenue from electricity suppliers; suppliers are credit checked by independent ratings agencies. Impaired income from DUoS will be recovered in future periods through system charges and is therefore of no material risk to the Company..

		Gross carrying amount £ 000	Loss allowance £ 000	Net carrying amount £ 000
2018	Notes			
Trade and other receivables	16	52,995	(1,465)	51,530
Equity investments at FVTPL	14	<u>50</u>	<u>-</u>	<u>50</u>
2017				
Trade and other receivables	16	55,585	(613)	54,972
Equity investments at FVTPL	14	<u>50</u>	<u>-</u>	<u>50</u>

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

28 Financial risk review (continued)

For trade receivables the Company has applied the simplified approach in IFRS 9 to measure the loss allowance at lifetime ECL. The Company determines the expected credit losses on these items by using a provision matrix, estimated based on historical credit loss experience based on the past due status of the debtors, adjusted as appropriate to reflect current conditions and estimates of future economic conditions. Accordingly, the credit risk profile of these assets is presented based on their past due status in terms of the provision matrix. Note 16 includes further details on the loss allowance for these assets.

The carrying amount of the Company's financial assets at FVTPL as disclosed in note 27 best represents their respective maximum exposure to credit risk. The Company holds no collateral over any of these balances.

Liquidity risk

Ultimate responsibility of liquidity risk management rests with the board of directors, which has established an appropriate liquidity risk management framework for the management of the Company's short, medium, and long-term funding and liquidity management requirements. The Company manages liquidity by maintaining adequate reserves, banking facilities and reserve borrowing facilities, by continuously monitoring forecast and actual cash flows, and by matching the maturity profiles of financial assets and liabilities.

The Company has access to £75 million under a five-year committed revolving credit facility provided by Lloyds Bank plc, The Royal Bank of Scotland plc and Abbey National Treasury Services plc., which expires on 30 April 2020. In addition, the Company has access to further short-term borrowing facilities provided by YEG and to a £19 million overdraft facility provided by Lloyds Bank plc, which is reviewed annually, these borrowings are repayable on demand. At 31 December 2018, the Company had available £50.0m (2017: £94.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

Maturity analysis for financial liabilities

The following tables set out the remaining contractual maturities of the company's financial liabilities by type.

	Less than 3 month £ 000	3 months - 1 year £ 000	1-5 years £ 000	More than 5 years £ 000	Total £ 000
2018					
Non-derivative liabilities					
Non-interest bearing	41,368	-	-	-	41,368
Variable interest rate liabilities	167,838	-	-	-	167,838
Fixed interest rate liabilities	43,405	25,539	216,239	567,407	852,590
Total	252,611	25,539	216,239	567,407	1,061,796

	Less than 3 month £ 000	3 months - 1 year £ 000	1-5 years £ 000	More than 5 years £ 000	Total £ 000
2017					
Non-derivative liabilities					
Non-interest bearing	41,559	-	-	-	41,559
Variable interest rate liabilities	98,857	-	-	-	98,857
Fixed interest rate liabilities	45,031	25,539	299,810	595,096	965,476
Total	185,447	25,539	299,810	595,096	1,105,892

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

28 Financial risk review (continued)

Market risk

The Company's activities do not expose it to significant financial risks of changes in foreign currency exchange rates and interest rates. Materially all income and expenses are denominated in pound sterling. Short-term loans and inter-company short term loans is charged at a floating rate of LIBOR plus 0.35%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would subject the Company to an approximate change in interest costs of £1.3m per year. This is considered to be an acceptable level of risk. All other loans are at fixed interest rates and expose the Company to fair value interest rate risk.

29 Related party transactions

Summary of transactions with joint ventures

Vehicle Lease and Service Limited is a joint venture of Northern Electric plc and provides vehicle fleet and servicing for the Northern Powergrid Group. Income constitutes recharges for use of management personnel and purchases are lease and servicing payments for fleet vehicles.

Summary of transactions with other related parties

Other subsidiaries of the Northern Powergrid Group. Included within these amounts are:

- Integrated Utility Services and Integrated Utility Services (Eire) that provide engineering contracting resource;
- Northern Powergrid (Yorkshire) plc that provides and receives mutual support through use of staff and resources which are then recharged;
- Northern Powergrid Metering that is recharged for the use of staff;
- Northern Electric Finance Limited that provides loan financing;
- Northern Powergrid Holdings Company that provides loan financing; and
- Yorkshire Electricity Group plc that operates the group intercompany treasury account.

Income and receivables from related parties

	Parent	Joint ventures	Other related parties
	£ 000	£ 000	£ 000
2018			
Sale of goods	15	16	23,257
	Parent	Joint ventures	Other related parties
	£ 000	£ 000	£ 000
2017			
Sale of goods	25	23	20,705

Expenditure with and payables to related parties

	Parent	Joint ventures	Other related parties
	£ 000	£ 000	£ 000
2018			
Purchase of goods	2,476	4,998	14,872
	Parent	Joint ventures	Other related parties
	£ 000	£ 000	£ 000
2017			
Purchase of goods	3,565	3,372	16,235
Amounts payable to related party	-	495	-

Northern Powergrid (Northeast) Limited
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

29 Related party transactions (continued)

Loans from related parties

	Subsidiary £ 000	Other related parties £ 000
2018		
At start of period	251,650	198,914
Advanced	-	24,930
Interest charged	17,030	6,972
Interest paid	<u>(16,952)</u>	<u>(6,972)</u>
At end of period	<u>251,728</u>	<u>223,844</u>
	Subsidiary £ 000	Other related parties £ 000
2017		
At start of period	251,574	167,053
Advanced	-	31,861
Interest charged	17,028	6,319
Interest paid	<u>(16,952)</u>	<u>(6,319)</u>
At end of period	<u>251,650</u>	<u>198,914</u>

Details of loans from related parties

Loans from related parties are details in the loans and borrowings note 19 on page 51.

30 Parent and ultimate parent undertaking

The Company's immediate parent is Northern Electric plc.

The ultimate parent is Berkshire Hathaway, Inc. These financial statements are available upon request from 3555 Farnam Street, Omaha, Nebraska 68131.

Relationship between entity and parents

The parent of the largest group in which these financial statements are consolidated and the ultimate controlling party is Berkshire Hathaway, Inc, incorporated in United States.

The address of Berkshire Hathaway, Inc is:
3555 Farnam Street, Omaha, Nebraska 68131.

The parent of the smallest group in which these financial statements are consolidated is Northern Electric plc, incorporated in United Kingdom.

The address of Northern Electric plc is:
Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.

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