

**Northern Gas Networks Limited**

Annual Report and accounts  
for the year ended 31 December 2010

Registered number: 5167070

## Directors' report

For the year ended 31 December 2010

The directors present their Annual Report on the affairs of the company, together with the accounts and auditor's report, for the year ended 31 December 2010.

### Principal activity

The principal activity of the company throughout the year was the distribution of gas through the North of England network.

### Business review

The company previously operated an operating model, referred to as strategic asset management, whereby the asset management and ownership responsibilities of the network were separated from the delivery of operational activity. This operating model ceased on 31 October 2010 following the acquisition of the entire issued share capital of United Utilities Operations Limited ("UUOL"). The company name was subsequently changed to Northern Gas Networks Operations Limited ("NGNOL"), the company which had been contracted to undertake the operational activity, and Northern Gas Networks Pensions Trustee Limited ("NGNPT") from United Utilities plc. These acquisitions have brought the operation and maintenance of the network in house and should promote operational efficiencies in the future. Detail of the acquisition is included in note 12.

The company's financial results for the year are lower than the prior year due to a combination of factors including the timing of price changes and expenditure across the regulatory cycle, but are above expectations. Total revenue for the year was £341.0m (2009 - £343.5m) and operating profit for the year was £84.1m (2009 - £87.3m).

Following the successful debt refinancing of £197.0m in March 2010, the company has debt before financing costs of £1,119.5m (2009 - £1,066.7m) at the year end. This comprises:

- bank loans of £45.0m (2009 - £314.2m) which carry interest at LIBOR plus a margin of 2.01%;
- an intercompany loan of £198.2m (2009 - £198.2) which carries interest at 5.875% and is repayable in 2019;
- an intercompany loan of £197.0m (2009 - £nil) which carries interest at 5.625% and is repayable in 2040;
- an intercompany loan of £505.0m (2009 - £505.0m) which carries interest at 4.875%, with £250.0m repayable in 2027 and £255.0m in 2035;
- an interest free intercompany loan of £24.3m (2009 - £24.3m); and
- loans of £150.0m (2009 - £25.0m) carrying interest at 3 month LIBOR plus a margin which varies by facility and is set out in detail in note 15 to the accounts, £25.0m of which is repayable in 2023 and £125.0m in 2024.

This debt structure has given rise to interest payable and similar charges of £59.6m (2009 - £62.9m).

The tax charge for the year was £9.0m (2009 - £13.7m) which represents an effective tax rate of 35% (2009 - 54%). The tax charge and effective tax rate are lower than expected due to a £4.2m deferred tax credit as a result of the adjustment of the opening deferred tax liability to reflect the change in corporation tax rate from 28% to 27%. Excluding the one off benefit, the effective tax rate would have been 50%.

Capital expenditure ("Capex") for the year was £40.3m (2009 - £49.9m) principally focused on investment in network assets and new IT systems used to support many of the company's operational business activities.

## Directors' report (continued)

At the end of the year, the company's undrawn borrowing facilities available for use amounted to £155.0m (2009 - £368.6m).

### *Business strategy*

The company's purpose is to provide safe and secure gas supplies to the people and the businesses within the distribution network. The company's vision of success is to be consistently benchmarked by the regulators, Ofgem and the Health and Safety Executive ("HSE") as being in the top two comparable utilities in safety management, efficiency and customer service.

### *Key performance indicators (KPIs)*

The key financial and non-financial performance indicators used by the Board of Directors in their monitoring of the company, focus on the areas of safety management, efficiency and customer service. Key financial and non-financial performance indicators include:

	2010	2009
<b>Financial performance</b>		
EBITDA*	£129.3m	£130.0m
Dividends paid	£65.0m	£30.0m
Post maintenance interest coverage ratio	1.9	1.9
EBITDA interest coverage ratio	2.2	2.1
Senior net debt/Regulatory asset value	68.5%	69.4%
*Profit before interest, tax, depreciation and amortisation		
<b>Customer services</b>		
Quarterly customer satisfaction survey for repair, replacement and connections	8.0 out of 10.0	7.5 out of 10.0
<b>Safety management</b>		
Number of lost time injuries to employees and contractors	6	5
Reported injuries to members of the general public	4	4

### *Environment*

The company recognises the importance of its environmental responsibilities and undertakes its operations in an environmentally sensitive manner, complying with all relevant legislative requirements and higher standards where possible. The company is committed to the protection of the environment in the region it serves. The company's environmental management systems are certified under ISO14001. This helps the directors deal proactively with future environmental issues and legislation and assist in the development of environmentally beneficial projects.

## Directors' report (continued)

### *Principal risks and uncertainties*

The company's principal risks and uncertainties are set out below.

#### Regulatory environment, revenue and costs

The gas industry is subject to extensive legal and regulatory obligations and controls which the company must comply with. The application and possible changes of these laws, regulations and regulatory standards could have an adverse affect on the operations and financial position of the company or in the case of financial misreporting, a potential fine.

#### Health and safety

There is a risk that an incident within the network leads to injury to an employee, contractor or a member of the general public. Any such incident could have an adverse affect on the reputation of the company, or lead to potential prosecution and reduced productivity.

#### Price Control

The current price control runs to 31 March 2013 and the process to determine the next price control has now commenced. The company could be unsuccessful in negotiating what is deemed an acceptable outcome resulting in lower than expected revenue.

#### Network performance

If the network assets were to fail it could result in a loss in supply of gas to customers and associated adverse publicity and an unexpected increase in costs.

#### Employees

The success of the company depends to a significant extent on the contribution of its employees and the employees of operational contractors. Fair and effective recruitment, training and employee development are critical to the successful functioning and progression of the business. The ability to adapt in a climate of change is dependent on the appointment and retention of a high calibre, competent, flexible, quality conscious and customer focused workforce all of whom are committed to business success and are given appropriate training. Appropriate succession planning strategies mean that development of existing staff is crucial. Effective resourcing and selection processes also play a positive role in improving the image of the company in the community it serves.

The company, as an equal opportunities employer, ensures that no job applicant receives less favourable treatment because of his or her age, colour, disability, ethnic or national origin, gender, marital status or sexuality or is disadvantaged by conditions or requirements which are irrelevant to performance and the company's needs.

#### *Outlook*

The directors expect the general level of activity to remain stable given the certainty provided by the price control outcome which runs to 2013.

## Directors' report (continued)

### **Financial risk management objectives and policies**

The company's financial instruments, other than derivatives, comprise borrowings, cash, overdrafts, and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial instruments is to finance the company's operations.

The company also enters into derivative transactions, principally interest rate swaps. The purpose of such transactions is to manage the interest rate risks arising from the company's sources of finance.

The main risks arising from the company's financial instruments are interest rate risk, currency risk and liquidity risk. The Board of Directors reviews and agrees policies for managing each of these risks and they are summarised below.

#### *Interest rate risk*

The long term approach adopted in minimising interest rate exposures on debt is as follows:

- To have a balanced debt portfolio comprising a mixture of fixed rate, floating rate and index-linked debt aiming to achieve a degree of symmetry with the Regulator's broad approach to setting cost of debt allowances (each class of debt held should comprise between 20% and 50% of total debt beyond the end of the current price control period);
- To maintain a debt portfolio consistent with those of comparable utility companies; and
- To synchronise the maturities of fixed rate interest hedges on floating rate debt with the timing of the Regulator's price control reviews.

#### *Currency risk*

No exposures are currently identified. Regular monitoring procedures will identify material risks as they arise. Currency risk management is only used to hedge underlying commercial exposures. Therefore trading in currency is prohibited and if an underlying exposure ceases to exist then the corresponding hedge is closed out immediately.

All non-sterling borrowings and associated service costs are hedged into sterling at the time the commitment to draw down is made.

#### *Liquidity risk*

The maturities of required committed debt facilities are managed such that at any one time all have a time to maturity of more than one year and that at least 50% by value have a time to maturity of more than two years.

Facilities are staggered to maturity to avoid excessive concentrations in any twelve month period as well as removing refinancing risk if such timeframes coincide with a regulatory reset date. Non-facility debt maturities are also staggered where practicable.

## Directors' report (continued)

### Going concern

The company's business activities, performance and position, together with its principal risks and uncertainties likely to affect its future development and performance are set out on pages 1 to 4. In addition note 15 to the accounts includes further details of the company's net debt position and details of its financial instruments.

The directors have made enquiries and reviewed the forecasts, including sensitivity analysis, and in light of the facilities available, have 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 Annual Report and accounts.

### Dividends

The directors do not recommend payment of a final dividend. Interim dividends of £142,500 per share were paid on 24 June 2010 and of £507,500 per share were paid on 29 December 2010 making a total of £650,000 per share for the year (2009 – £300,000).

### Directors

The directors, who served throughout the year except as noted, were as follows:

W Shurniak	(Chairman)
B Scarsella	(Chief Executive Officer, resigned 4 January 2011)
M J Horsley	(Chief Executive Officer, appointed 4 January 2011)
F R Frame	
H L Kam	
K S Tso	
N McGee	
A Hunter	
M Robinson	
C Cornish	(resigned 13 January 2010)

### The Board of Directors

The daily operations of the business are managed by the Senior Management Team ("SMT") and the Chief Executive Officer ("CEO"). All significant decisions are referred to the Board of Directors ("the Board").

## Directors' report (continued)

### The Board of Directors (continued)

The Board meets at least six times a year. The number of Board meetings held during the year and attendees (including alternates) at the Board meetings are detailed below:

2010		2009	
Date	Attendees	Date	Attendees
11 January	8 out of 9	12 January	9 out of 9
15 March	6 out of 8	2 March	9 out of 9
17 May	8 out of 8	6 May	9 out of 9
28 June	8 out of 8	6 July	9 out of 9
17 September	6 out of 8	14 September	9 out of 9
22 November	8 out of 8	16 November	9 out of 9

The effectiveness of systems and internal controls are reviewed on an ongoing basis by the SMT who formally report to the CEO bi-annually. The Board is ultimately responsible for the system of internal controls and for the review of their overall effectiveness.

### Supplier payment policy

The company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the company at 31 December 2010 were equivalent to 21 (2009 – 22) days' purchases, based on the average daily amount invoiced by suppliers during the year.

### Charitable and political contributions

During the year the company made charitable donations of £79,704 (2009 - £77,428), principally to local charities serving the communities in which the company operates. Charitable donations included a project called Northern Green Networks which provided £60,000 (2009 - £60,000) to local community groups within the network region to support environmental schemes. No political donations were made (2009 – £nil).

### Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of employees becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of all other employees.

### Employee consultation

The company places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the company. This is achieved through both formal and informal meetings. Employees are consulted regularly on a wide range of matters affecting their current and future interests. Employees are eligible to receive an annual bonus related to the overall financial and operational performance of the company.

## Directors' report (continued)

### **Auditor**

Each of the directors at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware; and
- the director has taken all the steps that he ought to have taken as a director to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

The directors will place a resolution before the annual general meeting to reappoint Deloitte LLP as auditor for the ensuing year.

1100 Century Way  
Thorpe Park Business Park  
Colton  
Leeds  
LS15 8TU

By order of the Board,

M J Horsley

24 March 2011

Director

## Directors' responsibilities

The directors are responsible for preparing the Annual Report and accounts in accordance with applicable law and regulations.

Company law requires the directors to prepare accounts for each financial year. Under that law the directors have elected to prepare the accounts in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

## Independent auditor's report

### **To the Members of Northern Gas Networks Limited**

We have audited the accounts of Northern Gas Networks Limited for the year ended 31 December 2010 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet, the statement of accounting policies and the related notes 1 to 23. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards ("United Kingdom Generally Accepted Accounting Practice").

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

### **Respective responsibilities of directors and auditor**

As explained more fully in the Directors' Responsibilities statement, the directors are responsible for the preparation of the accounts and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's ("APB's") Ethical Standards for Auditors.

Through management, the directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of accounts may differ from legislation in other jurisdictions.

### **Scope of the audit of the accounts**

An audit involves obtaining evidence about the amounts and disclosures in the accounts sufficient to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the accounts.

### **Opinion on accounts**

In our opinion the accounts:

- give a true and fair view of the state of the company's affairs as at 31 December 2010 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

## Independent auditor's report (continued)

### **Opinion on other matters prescribed by the Companies Act 2006**

In our opinion the information given in the Directors' report for the financial year for which the accounts are prepared is consistent with the accounts.

### **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 accounts 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.

**Christopher Powell FCA (Senior Statutory Auditor)**

**For and on behalf of Deloitte LLP**

**Chartered Accountants and Statutory Auditor**

**Leeds, England**

24 March 2011

## Profit and loss account

For the year ended 31 December 2010

	Notes	2010 £'000	2009 £'000
<b>Turnover</b>	1	340,959	343,497
Cost of sales		(8,102)	(7,136)
<b>Gross profit</b>		332,857	336,361
Other operating expenses	2	(248,791)	(249,032)
<b>Operating profit</b>		84,066	87,329
Other income	12	1,818	-
Finance charges (net)	3	(59,800)	(62,023)
<b>Profit on ordinary activities before taxation</b>	4	26,084	25,306
Tax on profit on ordinary activities	7	(9,001)	(13,726)
<b>Profit for the financial year</b>	19	17,083	11,580

The above results arise from continuing operations.

The accompanying notes are an integral part of this profit and loss account.

## Statement of total recognised gains and losses

For the year ended 31 December 2010

	Notes	2010 £'000	2009 £'000
Profit for the financial year		17,083	11,580
Actuarial loss relating to the pension scheme	22	(8,141)	(8,293)
Deferred tax attributable to actuarial loss		1,904	2,322
<b>Total recognised gains and losses relating to the year</b>		<b>10,846</b>	<b>5,609</b>

The accompanying notes are an integral part of this statement of total recognised gains and losses.

## Balance sheet

31 December 2010

	Notes	2010 £'000	2009 £'000
<b>Fixed assets</b>			
Intangible assets - goodwill	9	141,502	145,613
Tangible assets	10	1,398,747	1,399,521
Investments	11	2,203	154
		<u>1,542,452</u>	<u>1,545,288</u>
<b>Current assets</b>			
Debtors - due within one year	13	38,365	39,626
Cash at bank and in hand		-	1,465
		<u>38,365</u>	<u>41,091</u>
<b>Creditors: Amounts falling due within one year</b>	14	<u>(124,043)</u>	<u>(403,495)</u>
<b>Net current liabilities</b>		<u>(85,678)</u>	<u>(362,404)</u>
<b>Total assets less current liabilities</b>		1,456,774	1,182,884
<b>Creditors: Amounts falling due after more than one year</b>	15	(1,114,568)	(787,492)
<b>Provisions for liabilities excluding pension liability</b>	17	<u>(128,295)</u>	<u>(129,196)</u>
<b>Net assets excluding pension liability</b>		<u>213,911</u>	<u>266,196</u>
<b>Pension liability</b>	22	<u>(19,225)</u>	<u>(17,356)</u>
<b>Net assets including pension liability</b>		<u>194,686</u>	<u>248,840</u>
<b>Capital and reserves</b>			
Called-up share capital	18	-	-
Profit and loss account	19	<u>194,686</u>	<u>248,840</u>
<b>Shareholders' funds</b>	20	<u>194,686</u>	<u>248,840</u>

The accompanying notes are an integral part of this balance sheet.

The accounts of Northern Gas Networks Limited, Registered number 5167070, were approved by the Board of Directors and authorised for issue on 14 March 2011 and signed on its behalf by:

M J Horsley

Director

24 March 2011

## Statement of accounting policies

31 December 2010

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

### **Basis of accounting**

The accounts have been prepared under the historical cost convention and in accordance with applicable United Kingdom ("UK") accounting standards.

The company is exempt from the requirement of FRS1 (revised) "Cash flow statements" to present a cash flow statement as it is a wholly owned subsidiary of Northern Gas Networks Holdings Limited, which prepares consolidated accounts which are publicly available.

The company is not required to prepare group accounts as it is a wholly owned subsidiary of Northern Gas Networks Holdings Limited which prepares consolidated accounts which are publicly available.

### **Going concern**

The Directors' report includes a note on page 5 stating that the directors consider the business to be a going concern at the time of the approval of the Annual Report and accounts.

### **Intangible assets – goodwill**

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is estimated to be 40 years in line with the acquired asset base. Provision is made for any impairment.

### **Tangible fixed assets**

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Cost includes internal labour costs and finance costs incurred which are directly attributable to the construction of tangible fixed assets. Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the estimated economic lives of the assets. Depreciation is provided on all tangible fixed assets, other than freehold land and assets in the course of construction, at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Gas mains & services	55 to 65 years
Gas storage	40 years
Plant & machinery	10 to 50 years
Freehold buildings	50 years
Leasehold land and buildings	Lesser of lease period and 50 years
Motor vehicles and office equipment	3 to 10 years

## Statement of accounting policies (continued)

### **Investments**

Fixed asset investments are shown at cost less provision for impairment. Current asset investments are stated at the lower of cost and net realisable value.

### **Replacement expenditure**

Replacement expenditure represents the cost of planned maintenance of the gas mains and services assets by replacing sections of pipe. This expenditure is principally undertaken to maintain the safety of the network and is expensed as incurred. Expenditure that enhances the performance of the mains and services assets is treated as an addition to tangible fixed assets.

### **Taxation**

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

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

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the accounts. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is measured at the average tax rates that are expected to apply in the years in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

### **Decommissioning and environmental costs**

Decommissioning and environmental costs, based on discounted future estimated expenditures, are provided for in full and where appropriate a corresponding tangible fixed asset is also recognised. The unwinding of the discount is included within the profit and loss account as a financing charge.

### **Turnover**

Turnover represents income receivable for the distribution of gas and provision of other services in the normal course of business net of Value Added Tax. Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end.

## Statement of accounting policies (continued)

### **Pension costs**

The company has obligations for a defined benefit scheme. The amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments which are included within operating costs. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs. The interest cost and the expected return on assets are shown as a net amount of other finance costs or credits adjacent to interest. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

The defined benefit scheme is funded with the assets of the scheme held separately from those of the company, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet.

The company also operates defined contribution schemes. The amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

### **Leases**

Assets held under finance leases and other similar contracts, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful economic lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the leases to produce a constant rate of charge on the balance of capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful economic lives.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

### **Finance costs**

Finance costs of debt are recognised in the profit and loss account over the term of the instrument at a constant rate on the carrying amount.

Finance costs which are directly attributable to the construction of tangible fixed assets are capitalised as part of the cost of those assets. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress.

## Statement of accounting policies (continued)

### **Finance costs (continued)**

Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete.

### **Debt**

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the accounting year and reduced by payments made in the year.

### **Derivative financial instruments**

The company only holds or issues derivative financial instruments to manage interest rate exposures or commodity price risks in respect of expected gas usage. The principal derivatives used are interest rate swaps. The company does not hold or issue any derivative financial instruments for speculative purposes.

Interest rate swaps are entered into for the purpose of matching or eliminating risk from potential movements in interest rates associated with the borrowing requirements of the company. Amounts payable or receivable in respect of the interest rate swaps are recognised within net interest payable in the profit and loss account over the life of the financial instrument.

## Notes to the accounts

31 December 2010

### 1 Segment information

The directors consider that the company has only one class of business. The company's turnover is generated wholly from within the UK.

### 2 Other operating expenses

	2010 £'000	2009 £'000
Distribution costs	228,573	236,453
Administrative expenses	20,218	12,579
	<u>248,791</u>	<u>249,032</u>

### 3 Finance charges (net)

	2010 £'000	2009 £'000
Interest payable and similar charges	59,648	62,851
Less: investment income	(376)	(362)
Other finance charges (income)	528	(466)
	<u>59,800</u>	<u>62,023</u>

#### *Interest payable and similar charges*

	2010 £'000	2009 £'000
Bank loans and overdrafts	15,106	32,976
Intercompany interest payable	46,056	31,001
Finance leases and hire purchase contracts	-	85
	<u>61,162</u>	<u>64,062</u>
Finance costs capitalised	(1,514)	(1,211)
	<u>59,648</u>	<u>62,851</u>

Finance costs have been capitalised based on a capitalisation rate of 5.99% (2009 – 5.99%).

## Notes to the accounts (continued)

### 3 Finance charges (net) (continued)

#### *Investment income*

	2010 £'000	2009 £'000
Income from fixed asset investments	271	225
Interest receivable and similar income	105	137
	<u>376</u>	<u>362</u>

#### *Other finance charges (income)*

	2010 £'000	2009 £'000
Unwinding of discount on provisions (see note 17)	663	(880)
Net (return) cost on pension scheme (see note 22)	(135)	414
	<u>528</u>	<u>(466)</u>

### 4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging (crediting):

	2010 £'000	2009 £'000
Depreciation and amounts written off tangible fixed assets		
- owned	41,026	38,444
- held under finance leases and hire purchase contracts	49	75
Amortisation of goodwill	4,111	4,112
Profit on disposal of fixed assets	(4)	(205)
Operating lease rentals - other	231	198
Fees payable to the company's auditor for the audit of the company's annual accounts	<u>62</u>	<u>60</u>

Fees payable to Deloitte LLP and their associates for non-audit services to the company are not required to be disclosed because the consolidated accounts of the parent company are required to disclose such fees on a consolidated basis.

## Notes to the accounts (continued)

### 5 Staff costs

The average monthly number of employees (including executive directors) was:

	2010 Number	2009 Number
Administration	72	63
	<u>72</u>	<u>63</u>

	2010 £'000	2009 £'000
Their aggregate remuneration comprised:		
Wages and salaries	4,646	4,200
Social security costs	603	462
Other pension costs	474	295
	<u>5,723</u>	<u>4,957</u>

### 6 Directors' remuneration and transactions

#### *Remuneration*

The remuneration of the directors was as follows:

	2010 £'000	2009 £'000
Emoluments	640	700
Amounts receivable (other than shares) under long-term incentive schemes	127	21
Company contributions to money purchase pension schemes	55	40
	<u>822</u>	<u>761</u>

## Notes to the accounts (continued)

### 6 Directors' remuneration and transactions (continued)

#### *Pensions*

The number of directors who were members of pension schemes was as follows:

	2010 Number	2009 Number
Money purchase schemes	<u>1</u>	<u>1</u>

#### *Highest-paid director*

The above amounts for remuneration include the following in respect of the highest paid director:

	2010 £'000	2009 £'000
Emoluments	767	721
Company contributions to money purchase schemes	<u>55</u>	<u>40</u>
	<u>822</u>	<u>761</u>

#### *Transactions*

There have been no transactions with directors in the year (2009 – £nil) other than as set out above in respect of remuneration.

## Notes to the accounts (continued)

### 7 Tax on profit on ordinary activities

The tax charge comprises:

	2010 £'000	2009 £'000
<b>Current tax</b>		
UK corporation tax	9,286	7,286
Adjustments in respect of prior years	(580)	(856)
<b>Total current tax</b>	<u>8,706</u>	<u>6,430</u>
<b>Deferred tax</b>		
Current year - origination and reversal of timing differences	3,860	5,571
Adjustments in respect of prior years	605	1,725
Effects of decrease in tax rate on opening liability	(4,170)	-
<b>Total deferred tax</b>	<u>295</u>	<u>7,296</u>
<b>Total tax on profit on ordinary activities</b>	<u>9,001</u>	<u>13,726</u>

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows.

	2010 £'000	2009 £'000
<b>Profit on ordinary activities before tax</b>	<u>26,084</u>	<u>25,306</u>
Tax on profit on ordinary activities at standard UK corporation tax rate of 28% (2009 – 28%)	7,303	7,086
Effects of:		
Expenses not deductible for tax purposes	5,986	5,771
Capital allowances in excess of depreciation	(2,609)	(3,558)
Other timing differences	(1,394)	(2,013)
Adjustments in respect of prior year	(580)	(856)
<b>Current tax charge for the year</b>	<u>8,706</u>	<u>6,430</u>

The company earns its profits in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 28% (2009 – 28%).

The company's planned level of capital investment is expected to remain at similar levels as current investment. Therefore, it expects to be able to claim capital allowances in excess of depreciation in future years, at a similar level to the current year.

Notes to the accounts (continued)

**8 Dividends paid on equity shares**

	2010 £'000	2009 £'000
Equity shares		
- interim dividend paid of £142,500 (2009 - £165,500) per ordinary share	14,250	16,500
- interim dividend paid of £507,500 (2009 - £135,000) per ordinary share	50,750	13,500
	<u>65,000</u>	<u>30,000</u>

**9 Intangible fixed assets – goodwill**

£'000

**Cost**

At 1 January 2010 and 31 December 2010 164,457

**Amortisation**

At 1 January 2010 18,844

Charge for the year 4,111

At 31 December 2010 22,955

**Net book value**

At 31 December 2010 141,502

At 31 December 2009 145,613

## Notes to the accounts (continued)

### 10 Tangible fixed assets

	Land and buildings £'000	Gas distribution assets £'000	Motor vehicles £'000	Other equipment £'000	Assets in the course of construction £'000	Total £'000
<b>Cost</b>						
At 1 January 2010	2,983	1,487,381	12,764	42,343	20,959	1,566,430
Additions	-	30,757	-	255	9,335	40,347
Disposals	-	(20)	(103)	(30)	-	(153)
Transfers	-	-	-	1,723	(1,723)	-
At 31 December 2010	<u>2,983</u>	<u>1,518,118</u>	<u>12,661</u>	<u>44,291</u>	<u>28,571</u>	<u>1,606,624</u>
<b>Depreciation</b>						
At 1 January 2010	1,197	146,465	4,065	15,182	-	166,909
Charge for the year	189	33,466	1,992	5,428	-	41,075
Disposals	-	(7)	(70)	(30)	-	(107)
At 31 December 2010	<u>1,386</u>	<u>179,924</u>	<u>5,987</u>	<u>20,580</u>	<u>-</u>	<u>207,877</u>
<b>Net book value</b>						
At 31 December 2010	<u>1,597</u>	<u>1,338,194</u>	<u>6,674</u>	<u>23,711</u>	<u>28,571</u>	<u>1,398,747</u>
At 31 December 2009	<u>1,786</u>	<u>1,340,916</u>	<u>8,699</u>	<u>27,161</u>	<u>20,959</u>	<u>1,399,521</u>
Leased assets included above:						
<b>Net book value</b>						
At 31 December 2010	<u>243</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>243</u>
At 31 December 2009	<u>283</u>	<u>-</u>	<u>10</u>	<u>-</u>	<u>-</u>	<u>293</u>

Short leasehold assets included within land and buildings above have a cost of £442,000 (2009 - £442,000), depreciation charge in the year of £40,000 (2009 - £42,000), accumulated depreciation of £199,000 (2009 - £159,000) and a net book value of £243,000 (2009 - £283,000).

Leased assets included within motor vehicles above have a cost of £160,000 (2009 - £231,000), depreciation charge in the year of £9,000 (2009 - £33,000), accumulated depreciation of £160,000 (2009 - £221,000) and a net book value of £nil (2009 - £10,000).

Cumulative finance costs capitalised included in the cost of tangible fixed assets amount to £4,974,000 (2009 - £3,460,000).

## Notes to the accounts (continued)

### 11 Fixed asset investments

	2010 £'000	2009 £'000
Subsidiary undertakings	2,099	50
Other investments	104	104
	<u>2,203</u>	<u>154</u>

The company has an investment in the following subsidiary undertakings:

Subsidiary undertaking	Country of incorporation	Principal activity	Holding	%
Northern Gas Networks Finance Plc ("NGNF")	England & Wales	Financing	49,999 ordinary shares of £1	100
Northern Gas Networks Operations Limited ("NGNOL")	England & Wales	Gas networks operations	2 ordinary shares of £1	100
Northern Gas Networks Pensions Trustee Limited ("NGNPT")	England & Wales	Pension scheme trustee	1 ordinary share of £1	100

The other investment represents a 10.38% holding in xoserve Limited, which provides information, data processing, invoicing and supply point administration services to the company. xoserve Limited is registered in England & Wales.

#### *Subsidiary undertakings*

	£'000
<b>Cost and net book value</b>	
At 1 January 2010	50
Capital contribution	1,818
Fees on acquisition	231
	<u>2,099</u>
At 31 December 2010	<u>2,099</u>

#### *Other investments*

	£'000
<b>Cost and net book value</b>	
At 1 January 2010 and 31 December 2010	<u>104</u>

## Notes to the accounts (continued)

### 12 Acquisition of subsidiary undertaking

On 31 October 2010 the company acquired the entire issued share capital of NGNOL and NGNPT. NGNPT was acquired for £1 cash being the book value and fair value of the assets at acquisition. NGNOL was acquired for cash consideration of £231,000 with deferred consideration due to the company with a fair value of £1,818,000 which is provisional until the completion accounts process is finalised. The following table sets out the book and fair values of the identifiable assets and liabilities acquired:

	Book and fair value to company £'000
<b>Current assets</b>	
Cash at bank acquired	30
Stocks	901
<b>Total assets</b>	<u>931</u>
<b>Creditors</b>	
Bank overdraft	(1,085)
Other creditors & accruals	(630)
<b>Provisions</b>	
Other	(1,034)
<b>Total liabilities</b>	<u>(2,749)</u>
<b>Net liabilities</b>	(1,818)
Goodwill	231
	<u>(1,587)</u>
<b>Satisfied by</b>	
Cash consideration paid or payable	231
Deferred consideration receivable	(1,818)
	<u>(1,587)</u>

The directors do not believe that any fair value adjustments are required on acquisition.

The deferred consideration receivable has been recognised as other income.

## Notes to the accounts (continued)

### 12 Acquisition of subsidiary undertaking (continued)

Net cash outflows in respect of the acquisitions comprised:

	£'000
Cash consideration	151
Cash at bank and in hand acquired	(30)
Bank overdrafts acquired	1,085
	<u>1,206</u>

NGNPT is a non trading company with £nil profits in the nine month period ended 31 December 2010 (year to 31 March 2010 - £nil). NGNOL earned a loss after taxation of £1.2m in the nine month period ended 31 December 2010 (year ended 31 March 2010 as restated – £0.4m), of which a loss of £1.2m arose in the period from 1 April 2010 to 31 October 2010.

### 13 Debtors – due within one year

	2010	2009
	£'000	£'000
Trade debtors	522	2,593
Prepayments and accrued income	36,025	37,033
Other debtors	1,818	-
	<u>38,365</u>	<u>39,626</u>

## Notes to the accounts (continued)

### 14 Creditors: Amounts falling due within one year

	2010 £'000	2009 £'000
Bank overdrafts	2,634	-
Bank loans	43,850	314,057
Obligations under finance leases and hire purchase contracts	-	218
Payments received on account	10,925	9,822
Trade creditors	526	3,578
Amounts owed to group undertakings	38,705	9,619
Other taxation and social security	1,872	2,288
Accruals and deferred income	16,472	59,598
Defined contribution pension scheme accrual	30	33
UK corporation tax	9,029	4,282
	<u>124,043</u>	<u>403,495</u>

Bank loans comprise a working capital facility of £25.0m and a revolving credit facility of £20.0m both repayable on 31 January 2011. These facilities are available to be re-drawn until 30 August 2012 and carry interest at LIBOR plus a margin of 2.01%.

### 15 Creditors: Amounts falling due after more than one year

	2010 £'000	2009 £'000
Bank loans	149,978	24,977
Amounts owed to group undertakings	924,458	727,572
Deferred income	40,132	34,943
	<u>1,114,568</u>	<u>787,492</u>

The bank loans comprise £25.0m which carries interest at 3 month LIBOR plus a margin of 0.36% repayable on 23 January 2023, £25.0m which carries interest at 3 month LIBOR plus a margin of 0.55% repayable on 24 June 2024 and £100.0m which carries interest at 3 month LIBOR plus a margin of 0.62% repayable on 30 March 2024.

## Notes to the accounts (continued)

### **15 Creditors: Amounts falling due after more than one year (continued)**

The amounts owed to group undertakings is an interest free loan of £24.3m which has no repayment date, an interest bearing loan of £505.0m, with £250.0m repayable in 2027 and £255.0m repayable in 2035 with interest of 4.875% plus a margin to cover related costs, an interest bearing loan of £198.2m repayable in 2019 with interest of 5.875% plus a margin to cover related costs and an interest bearing loan of £197.0m repayable in 2040 with interest of 5.625% plus a margin to cover related costs.

### **16 Derivatives and other financial instruments**

Page 4 of the Directors' report provides an explanation of the role that financial instruments have had during the year in creating or changing the risks the company faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS 13"). Certain financial assets such as investments in subsidiary undertakings are excluded from the scope of these disclosures.

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures. The directors believe that the fair values are not materially different from the balance sheet values.

#### *Interest rate profile*

The company has no financial assets (2009 – sterling cash deposits of £1,465,000) which are part of the financing arrangements of the company. The sterling cash deposits comprise monies held in bank accounts.

After taking into account interest rate swap contracts entered into by the company, the interest rate profile of the company's financial liabilities at 31 December 2010 was as follows:

## Notes to the accounts (continued)

### 16 Derivatives and other financial instruments (continued)

	Floating rate 2010 £'000	Fixed rate 2010 £'000	Interest free 2010 £'000	Total 2010 £'000
Borrowings	149,978	943,980	24,328	1,118,286
Total	<u>149,978</u>	<u>943,980</u>	<u>24,328</u>	<u>1,118,286</u>

The profile at 31 December 2009 for comparison purposes was as follows:

	Floating rate 2009 £'000	Fixed rate 2009 £'000	Interest free 2009 £'000	Total 2009 £'000
Borrowings	169,034	873,244	24,328	1,066,606
Finance leases	-	218	-	218
Total	<u>169,034</u>	<u>873,462</u>	<u>24,328</u>	<u>1,066,824</u>

Further analysis of the interest rate profile at 31 December 2010 and 31 December 2009 is as follows:

	2010		
	Floating rate	Fixed rate	
	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings - Bank Loans	1.3	2.6	0.1
Borrowings - Intercompany Loans	-	5.3	19.9
	2009		
	Floating rate	Fixed rate	
	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings - Bank Loans	1.0	0.9	0.1
Borrowings - Intercompany Loans	-	5.2	17.7
Finance leases	-	15.0	1.0

Further details of interest rates on long term borrowings are given in note 15.

## Notes to the accounts (continued)

### 16 Derivatives and other financial instruments (continued)

#### *Maturity of financial liabilities*

The maturity profile of the company's financial liabilities at 31 December was as follows:

	2010 £'000	2009 £'000
In one year or less	43,850	314,275
In more than five years	1,074,436	752,549
	<u>1,118,286</u>	<u>1,066,824</u>

#### *Borrowing facilities*

The company had undrawn committed borrowing facilities at 31 December, in respect of which all conditions precedent had been met, as follows:

	2010 £'000	2009 £'000
Expiring in one year or less	-	43,564
Expiring in more than one year but not more than two years	155,000	-
Expiring in more than two years	-	325,000
	<u>155,000</u>	<u>368,564</u>

#### *Fair values*

Set out below is a comparison by category of book values and fair values of the company's financial assets and liabilities at 31 December.

	2010		2009	
	Book value £'000	Fair value £'000	Book value £'000	Fair value £'000
Liabilities				
<b>Primary financial instruments held or issued to finance the company's operations</b>				
Short term borrowings	43,850	45,000	314,057	314,166
Long term borrowings	149,978	150,513	24,977	25,060
Intercompany loans	924,458	916,865	727,572	679,729
<b>Derivative financial instruments held to manage the interest rate and currency profile</b>				
Interest rate swaps	-	44,319	-	62,000

## Notes to the accounts (continued)

### 16 Derivatives and other financial instruments (continued)

#### *Fair values (continued)*

The fair value of the intercompany loans has been determined by reference to the underlying bonds market price. The fair values of the interest rate swaps have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

#### *Gains and losses on hedges*

The company enters into interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the accounts until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

	2010			2009		
	Gains £'000	Losses £'000	Net £'000	Gains £'000	Losses £'000	Net £'000
<b>Unrecognised gains and losses on hedges at 1 January</b>	39,068	(101,068)	(62,000)	69,210	(128,691)	(59,481)
Gains and losses arising in previous years that were recognised in the year	-	-	-	-	-	-
<b>Gains and losses arising before 1 January that were not recognised in the year</b>	39,068	(101,068)	(62,000)	69,210	(128,691)	(59,481)
Gains and losses arising in the year that were not recognised in the year	38,691	(21,010)	17,681	(30,142)	27,623	(2,519)
<b>Unrecognised gains and losses on hedges at 31 December</b>	<u>77,759</u>	<u>(122,078)</u>	<u>(44,319)</u>	<u>39,068</u>	<u>(101,068)</u>	<u>(62,000)</u>
Of which:						
Gains and losses expected to be recognised in 2011	-	-	-	-	-	-
Gains and losses expected to be recognised in 2012 or later	<u>77,759</u>	<u>(122,078)</u>	<u>(44,319)</u>	<u>39,068</u>	<u>(101,068)</u>	<u>(62,000)</u>

## Notes to the accounts (continued)

### 17 Provisions for liabilities excluding pension liability

	Deferred tax £'000	Environmental restoration £'000	Other £'000	Total £'000
At 1 January 2010	114,372	5,951	8,873	129,196
Charged to profit and loss account	2,838	-	649	3,487
Utilised in the year	-	-	(966)	(966)
Adjustment arising from the decrease in tax rate	(4,085)	-	-	(4,085)
Adjustment arising from discounting	-	526	137	663
At 31 December 2010	<u>113,125</u>	<u>6,477</u>	<u>8,693</u>	<u>128,295</u>

#### *Deferred tax*

Deferred tax is provided as follows:

	2010 £'000	2009 £'000
Accelerated capital allowances	111,258	112,141
Other timing differences	1,867	2,231
<b>Provision for deferred tax</b>	<u>113,125</u>	<u>114,372</u>

Deferred tax in respect of the company's defined benefit pension scheme is disclosed in note 22.

#### *Environmental restoration*

Estimated environmental restoration costs are provided where the company has a legal obligation to restore sites at the balance sheet date. The provision represents the estimated net present value for statutory decontamination of old gas manufacturing sites. It also reflects the obligations associated with other environmental damage.

#### *Other*

Other provisions relate to the estimated net present value of future claims in relation to past public and employer's liability events.

The timing of the utilisation of the environmental and other provisions is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date.

## Notes to the accounts (continued)

### 18 Called-up share capital

	2010 £	2009 £
<i>Allotted, called-up and fully-paid</i>		
100 ordinary shares of £1 each	<u>100</u>	<u>100</u>

### 19 Reserves

	Profit and loss account £'000
At 1 January 2010	248,840
Profit for the financial year	17,083
Actuarial loss relating to the pension scheme	(8,141)
Deferred tax attributable to the actuarial loss	1,904
Dividends paid on equity shares	<u>(65,000)</u>
At 31 December 2010	<u>194,686</u>

## Notes to the accounts (continued)

### 20 Reconciliation of movements in shareholders' funds

	2010 £'000	2009 £'000
Profit for the financial year	17,083	11,580
Other recognised gains and losses relating to the year (net)	(6,237)	(5,971)
Dividends paid on equity shares	(65,000)	(30,000)
Net movement in shareholders' funds	(54,154)	(24,391)
Opening shareholders' funds	248,840	273,231
Closing shareholders' funds	<u>194,686</u>	<u>248,840</u>

### 21 Financial commitments

Capital commitments are as follows:

	2010 £'000	2009 £'000
Contracted for but not provided for	4,823	2,687
	<u>4,823</u>	<u>2,687</u>

Annual commitments under non-cancellable operating leases are as follows:

	<u>Land and Buildings</u>	
	2010 £'000	2009 £'000
Expiry date		
- between two and five years	53	53
- after five years	386	386
	<u>439</u>	<u>439</u>

The company has entered into a Guarantee and Reimbursement Agreement with FGIC UK Limited ("FGIC") in conjunction with its subsidiary Northern Gas Networks Finance Plc ("the Issuer") in relation to the bonds issued by that company in November 2005 of £505.0m. The company guarantees the punctual payment of any and all sums and fees due to FGIC and undertakes to pay any amount due from the Issuer but not paid by it. The company also indemnifies FGIC against any loss or liability suffered, if any obligation guaranteed by FGIC is, or becomes, unenforceable, invalid or illegal. The amount of the loss or liability under the indemnity is equal to the amount FGIC would otherwise have been entitled to recover.

## Notes to the accounts (continued)

### 22 Pension arrangements

The company has obligations for a defined benefit pension scheme.

The amounts recognised in the balance sheet are as follows:

	2010 £'000	2009 £'000
Present value of funded obligations	267,116	233,924
Fair value of plan assets	(240,781)	(209,819)
Deficit	26,335	24,105
Related deferred tax asset	(7,110)	(6,749)
Net liability	19,225	17,356
Amounts in the balance sheet		
- Liabilities	19,225	17,356

The amounts recognised in the profit and loss account are as follows:

	2010 £'000	2009 £'000
<i>Amount charged to operating profit</i>		
Current service costs	6,033	5,561
<i>Amount credited to net finance charges</i>		
Interest costs	14,016	11,818
Expected return on plan assets	(14,151)	(11,404)
Net (return) cost on pension scheme	(135)	414
Total	5,898	5,975

The total amounts recognised in the statement of total recognised gains and losses are as follows:

	2010 £'000	2009 £'000
Actuarial losses	8,141	8,293

The cumulative amount of actuarial gains and losses recognised in the statement of total recognised gains and losses is as follows:

	2010 £'000	2009 £'000
Actuarial losses	22,614	14,473

## Notes to the accounts (continued)

### 22 Pension arrangements (continued)

Changes in the present value of the defined benefit obligation are as follows:

	2010 £'000	2009 £'000
Opening defined benefit obligation	233,924	195,262
Service cost	6,033	5,561
Interest cost	14,016	11,818
Member contributions	742	805
Actuarial losses	16,614	28,867
Benefits paid	(4,213)	(8,389)
Closing defined benefit obligation	<u>267,116</u>	<u>233,924</u>

Changes in the fair value of plan assets are as follows:

	2010 £'000	2009 £'000
Opening fair value of plan assets	209,819	174,517
Expected return	14,151	11,404
Actuarial gains	8,473	20,574
Employer contributions	11,809	10,908
Member contributions	742	805
Benefits paid	(4,213)	(8,389)
	<u>240,781</u>	<u>209,819</u>

The company expects to contribute £11.6m to its defined benefit pension plan in 2011.

The major categories of plan assets as a percentage of the total plan assets and the expected rate of return on plan assets are as follows:

	2010		2009	
	Percentage of plan assets %	Expected return on plan assets %	Percentage of plan assets %	Expected return on plan assets %
Equity securities	41.80	7.30	46.90	7.70
Bond securities	45.20	4.30	45.10	4.70
Property	12.40	7.30	6.90	7.70
Other	0.60	0.30	1.10	0.30

To determine the overall expected rate of return on plan assets the company considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the assets are invested and the expectations for future returns of each asset class in the plan. The expected return for each asset class was then weighted, based on the asset allocation in the plan to develop the assumption for the expected rate of return on plan assets.

## Notes to the accounts (continued)

### 22 Pension arrangements (continued)

The actual return on plan assets is as follows:

	2010 £'000	2009 £'000
Actual return on plan assets	<u>22,624</u>	<u>31,978</u>

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages) are:

	2010	2009
Discount rate	5.30%	5.70%
Expected return on plan assets	6.30%	6.20%
Future salary increases	3.90%	4.00%
Future pension increases	3.40%	3.50%
Inflation	3.40%	3.50%
Life expectancy - member aged 65	21.7 years	21.6 years
- member aged 40	24.1 years	24.0 years

Amounts for the current and previous four periods are as follows:

	31 December 2010 £'000	31 December 2009 £'000	31 December 2008 £'000	31 December 2007 £'000	31 December 2006 £'000
Defined benefit obligation	(267,116)	(233,924)	(195,262)	(218,356)	(214,907)
Plan assets	<u>240,781</u>	<u>209,819</u>	<u>174,517</u>	<u>205,014</u>	<u>186,930</u>
Deficit	<u>(26,335)</u>	<u>(24,105)</u>	<u>(20,745)</u>	<u>(13,342)</u>	<u>(27,977)</u>

Experience adjustments for the current and previous four periods are as follows:

	31 December 2010	31 December 2009	31 December 2008	31 December 2007	31 December 2006
<b>Plan assets:</b>					
Amount (£'000)	8,473	20,574	(49,202)	(5,065)	1,000
Percentage of plan assets	3%	10%	(28%)	(2%)	1%
<b>Plan liabilities:</b>					
Amount (£'000)	-	3,019	4,800	4,052	-
Percentage of the present value of plan liabilities	-	1%	2%	2%	-

The company also operates defined contribution schemes for which the pension charge for the year amounted to £474,000 (2009 - £295,000).

## Notes to the accounts (continued)

### **23 Ultimate controlling party**

The directors regard Northern Gas Networks Holdings Limited, a company incorporated in England and Wales, as the ultimate parent company and the ultimate controlling party.

Northern Gas Networks Holdings Limited is the parent company of the largest and smallest group of which the company is a member and for which group accounts are drawn up. Copies of the accounts are available from 1100 Century Way, Thorpe Park Business Park, Colton, Leeds, LS15 8TU.

The Shareholders of Northern Gas Networks Holdings Limited are a consortium comprising of:

PG (April) Limited (47.1%)

Beta Central Profits Limited (41.3%)

SAS Trustee Corporation (11.6%)

As a subsidiary undertaking of Northern Gas Networks Holdings Limited, the company has taken advantage of the exemption in FRS 8 "Related party disclosures" from disclosing transactions with other members of the group headed by Northern Gas Networks Holdings Limited.

The company had no transactions with PG (April) Limited during the year. In 2007, the company paid legal expenses on behalf of PG (April) Limited in the amount of £15,000. The debtor with PG (April) Limited remains outstanding at both the current and prior year end.