



19 May 2010
Scottish and Southern Energy plc
Financial report for the year to 31 March 2010

	Mar 2010	Mar 2009	Change	Mar 2008
Full-Year Dividend	70.0p	66.0p	+6.1%	60.5p
Adjusted Profit Before Tax*	£1,290.1m	£1,253.7m	+2.9%	£1,229.2m
Adjusted Profit After Tax*	£1,016.0m	£953.3m	+6.6%	£912.0m
Adjusted Earnings Per Share*	110.2p	108.0p	+2.0%	105.6p
Investment and Capital Expenditure	£1,315.2m	£1,279.8m	+2.8%	£810.3m
Power Station Availability (Gas)	94%	76%	+24%	95%
Power Station Availability (Coal)	92%	89%	+3%	91%
Energy Supply Customers (GB and Ire)	9.35m	9.10m	+250,000	8.5m
Customer Minutes Lost (SHEPD)	74	75	- 1 min	72
Customer Minutes Lost (SEPD)	65	66	- 1 min	67
Number of Employees	20,177	18,795	+1,382	16,892
Total Recordable Injury Rate	0.14	0.16	-12%	N/A
Reportable Environmental Incidents	2	1	+1	1

Lord Smith of Kelvin, Chairman of SSE, said:

“Although it was a demanding year, SSE again delivered sound financial and operational performance in 2009/10, with solid progress being made in electricity generation, energy supply, networks, gas storage and other energy services. Customer service standards were also good, and we are working hard to make them better still.

“SSE’s market-based and economically-regulated energy businesses provide a broad platform from which to deliver sustained real growth in the dividend, through enhancing value from operations and creating value from investments. This balance, allied to solid performance, has enabled us to announce a 6.1% increase in the full-year dividend for 2009/10, to 70 pence per share.

“Our commitment to sustained real growth in the dividend is as strong as ever. Having assessed the progress made over the past few years, and the options for growth that have been developed for the next few years, the Board has concluded that SSE’s new dividend target should be an increase of at least 2% more than inflation in each of the three years to 2013, with our commitment to sustained real growth continuing thereafter. The achievement of these targets will mean SSE will have delivered 14 successive annual above-inflation dividend increases.

“The next few years will present major challenges, including evolving energy markets. Our strategy of balancing market-based and economically-regulated businesses gives SSE an in-built resilience and a breadth of opportunities to achieve the new dividend targets to 2013, as well as the scope to build on them with further real growth in the years beyond.”

* In line with SSE’s approach since September 2005, this financial report describes adjusted operating profit before exceptional items, the impact of IAS 32 and IAS 39, and after the removal of taxation and interest on profits from jointly controlled entities and associates, unless otherwise stated. In addition, it describes adjusted profit before tax before exceptional items, the impact of IAS 32 and IAS 39 and after the removal of taxation on profits from jointly-controlled entities and associates. It also describes adjusted earnings and earnings per share before exceptional items, the impact of IAS 32 and IAS 39 and deferred tax.

SUMMARY OF KEY ISSUES

Delivering sustained real growth in the dividend

- Recommended full-year dividend up 6.1% to 70 pence per share
- Dividend covered 1.57 times by adjusted profit after tax
- Dividend doubled in seven years; CAGR in that time of 10.4%
- Targeting annual dividend growth of at least 2% above inflation in each year to 2013

Achieving moderate growth in adjusted profit before tax

- 'Moderate' 2.9% increase in adjusted PBT
- Profit increases achieved in Generation and Supply and Energy Networks
- 36.9% operating profit from economically-regulated networks businesses
- 63.1% operating profit from market-based businesses

Investing for dividend growth

- Capital and investment expenditure of £1.31bn, consistent with five-year plan
- £1.1bn of net debt invested in assets still largely under construction at 31 March 2010
- Three quarters of investment programme in lower-risk technologies eg onshore wind
- Higher-risk investments carried out in partnership with other developers eg offshore wind

Financing for the long term

- Nine-year, £500m, 5% coupon Sterling bond issued and £400m EIB loan facility secured
- Strong cash flow from operations – up seven-fold
- Strong debt structure - £4.9bn in medium/long term borrowings
- Underlying interest cover 6.3 times

Expanding Generation portfolio

- Total commissioned capacity up 600MW to 11.3GW
- Marchwood commissioned in December 2009 – UK's first new CCGT for five years
- Additional 150MW of wind farm capacity operational; total now 840MW
- Good progress at Greater Gabbard - first turbine installations under way; £245m invested in 2009/10

Growing customer base

- 250,000 additional energy customer accounts in GB and Ireland
- Top customer service rankings from uSwitch.com, JD Power and Institute of Customer Service
- Package of gas price changes implemented in March 2010
- Sustained falls in energy usage saving average customers £70/year

Enhancing Regulatory Asset Value for Energy Networks

- Electricity network investment of £334.5m; SSE share of SGN capex/repex £206.4m
- Estimated total RAV of energy networks businesses increased to £4.94bn at 31 March 2010
- Agreement on electricity Distribution Price Control for 2010-15
- Ofgem approval for first transmission upgrades and consent for Beaulieu-Denny upgrade

Building other energy businesses

- New gas storage capacity (115 million cubic metres) at Aldbrough available
- Agreement to acquire North Sea natural gas assets
- Contracting Order Book still above £100m
- In-sourcing of meter reading and metering operations work completed

Developing SSE as a place to work

- Employee numbers up 1,382 to 20,177
- Over 800 people directly employed in low carbon energy jobs
- Total Recordable Injury Rate down from 0.16 to 0.14
- Working days lost from injury down from 361 to 73

STRATEGIC OVERVIEW

Purpose, Strategy and Principles

SSE's core purpose is to provide the energy people need in a reliable and sustainable way. In line with this, its strategy is to deliver sustained real growth in the dividend payable to shareholders through the efficient operation of, and investment in, a balanced range of market-based and economically-regulated businesses in energy production, storage, distribution, supply and related services, mainly in the UK and Ireland.

Implementation of this strategy continues to be founded on SSE's well-established financial principles. These principles are the:

- effective management of core businesses;
- maintenance of a strong balance sheet;
- rigorous analysis to ensure investments are well-founded and, where appropriate, innovative;
- deployment of a selective and disciplined approach to acquisitions; and
- use of purchase in the market of the Company's own shares as the benchmark against which financial decisions are taken.

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

SSE's strategy provides it with three key advantages:

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

SSE is the only energy company listed on the London Stock Exchange that owns and operates economically-regulated businesses, such as electricity networks, and market-based businesses, such as electricity generation and energy supply, in the UK. This means it is able to pursue operational, investment or acquisition opportunities throughout the electricity and gas sector to achieve consistently the levels of profitability required to support sustained real dividend growth.

It also means that SSE is able to derive stable and more predictable levels of profit from some of its activities and more variable levels from others (which, in turn, have greater potential for growth). As a result of this balance, SSE has greater resilience to risks associated with shorter-term trends or issues within its sector or the wider economy than do other companies with less diversity within their business model.

Delivery Against Purpose, Strategy and Principles

The Board is recommending a final dividend of 49p per share, making a full-year dividend of 70p, an increase of 6.1% on the previous year. The full-year dividend payment for 2009/10 is covered 1.57 times by SSE's adjusted profit after tax and is double the dividend per share paid seven years ago, in 2002/03.

The first full-year dividend was paid by SSE in 1999, so the recommended full-year dividend increase of 6.1% represents the eleventh successive above-inflation dividend increase since then. SSE is one of just seven FTSE 100 companies to have delivered better-than-inflation dividend growth every year during this period, and ranks fourth amongst that group in terms of compound annual growth rate over that time.

This real growth in the dividend, sustained since SSE was formed, has been supported by growth in SSE's main business areas, achieved as a result of operational efficiency, investment and, in some cases, acquisition:

- through investment and acquisition, the Regulated Asset Value (RAV) of SSE's energy networks businesses has doubled in five years, to over £4.9bn;

- also through investment and acquisition, the capacity of SSE's power stations has almost doubled in six years, to 11.3GW; and
- as a result of effective operation of core businesses, the number of customer accounts to which SSE supplies energy has doubled in eight years, to over 9.3 million.

This, allied to SSE's expansion in contracting, connections, metering, gas storage and other businesses makes SSE the biggest and broadest-based energy company in the UK and the fastest-growing energy company in Ireland.

Future Environment

The need to secure energy to heat and power homes, organisations and businesses, and the need to safeguard the environment for future generations, means the framework within which energy companies operate is, and will remain, a major public policy issue in the UK and Ireland and in the EU as a whole.

The context for energy policy in the UK and Ireland, SSE's principal areas of operation, is set by the EU 2020 Climate and Energy Package, adopted in April 2009, and the EU Renewable Energy Directive, which came into force in May 2009. The Directive requires Member States to deliver on average 20% of their final energy consumption by 2020 using renewable energy sources. The UK target is that 15 percent of all energy (electricity, heat and transport) should come from renewables by 2020. This target is the most challenging of any EU Member State because, to achieve it, around 30% of the electricity consumed in the UK will have to come from renewable sources, compared with just 5.5% at present; for Ireland a similar step-change in renewable energy output will be necessary.

In February 2010, the second report of the UK Industry Taskforce on Peak Oil & Energy Security, of which SSE is a member, was published. Called *The Oil Crunch*, the report said "it seems inevitable that global demand will move to a point where it consistently exceeds supply. The effect must be a structural increase in oil prices, coupled with the prospects of oil shortages and a consequent increase in market volatility. The only questions are "how soon and by how much?". At the same time, some analysis suggests that natural gas produced from shale could become an increasingly important source of energy over the next decade.

In addition, the period to 2020 will see:

- the closure of a number of coal- and oil-fired power stations by 2015, under the EU's Large Combustion Plant Directive;
- many nuclear power stations reaching the end of their design lives, with a number of advanced gas-cooled reactor (AGR) stations scheduled to close from 2014 onwards;
- the age and relative efficiency of a number of older gas-fired power stations becoming an increasingly significant issue; and
- the growing use of electricity to meet heat and transport needs so that its share of total energy demand increases significantly.

In July 2009, Ernst & Young estimated that £199bn of investment is needed by 2025 to meet the UK's energy goals. In October 2009, the UK energy regulator, Ofgem, published a comprehensive review of Britain's energy supplies which concluded that investment of up to £200bn is needed to secure energy supplies and meet carbon emissions targets (excluding UK Continental Shelf gas production). It updated its review in February 2010 and stated that 'the risks to gas security of supply remain high in the latter half of this decade'.

The coming decade will also see, in Great Britain, the installation of 'smart' meters in every home, to allow the quantity and value of electricity and gas used by the customer to be continuously monitored and to ensure that information about its use and cost is available to the customer and exchanged with the supplier through two-way electronic communications.

The new UK government has agreed to implement a programme of measures to fulfil its ambitions for a 'low-carbon and eco-friendly economy'. It has agreed to seek to increase the target for energy from renewable sources, subject to the advice of the Climate Change Committee. It also proposes to establish an emissions performance standard that will prevent coal-fired power stations being built unless they are equipped with sufficient carbon capture and storage (CCS) to meet an emissions

performance standard. SSE is confident it will be able to continue to work with MPs from all parties to ensure UK energy policy can deliver secure, affordable and lower-carbon energy.

Economic Development

Investment on the scale required demonstrates how the transition to a low carbon economy represents a substantive opportunity to create jobs in the UK and Ireland. For example, in October 2009, SSE selected Glasgow as the location for its new Centre of Engineering Excellence for Renewable Energy, in partnership with the University of Strathclyde. This will lead to the creation of around 300 skilled professional 'green' jobs being created over the next three years. Already, SSE directly employs over 800 people in the development or operation of projects or programmes to reduce the carbon dioxide impact of energy production and consumption.

The Offshore Valuation Group, an informal collaboration of government and industry organisations, concluded, in May 2010, that the rapid development of the UK's offshore resource – using fixed wind, floating wind, tidal stream, tidal range and wave technologies – could 'generate the electricity equivalent of one billion barrels of oil per year, or the same as the average annual output of UK North Sea oil and gas over the past four decades'. It estimates that the supply chain necessary to achieve this would have annual revenues of over £60bn in 2050 and could employ around 145,000 people in manufacturing, installation, operations and maintenance.

Priorities for SSE

SSE welcomes the focus on sustainability and security in energy, and believes that the EU Climate and Energy Package and Renewable Energy Directive, the prospect of an 'oil crunch', the requirement to safeguard energy supplies and the introduction of 'smart' meters will mean the following priorities will feature in its business activities:

- **Generation:** developing new capacity to produce electricity in a sustainable way that supports the transition to a lower-carbon economy;
- **Supply:** helping to keep electricity and gas bills as affordable as possible by offering ways to enable and encourage customers to be more efficient in their use of energy;
- **Fuel Production and Storage:** securing gas supplies to meet future energy needs and helping maintain dependable supplies by providing more storage capacity for the UK, as imports of gas rise;
- **Networks:** ensuring the distribution of energy remains reliable through investment in networks, as sources and use of electricity and gas change; and
- **Services:** meeting customers' requirements for energy products and services that are needed for the transition to a lower-carbon economy.

As the UK becomes increasingly dependent on imports of energy, and as the need for action to replace its ageing infrastructure and to de-carbonise its economy continues to intensify, the importance and value of efficient electricity generation and energy storage, distribution, supply and services will all increase. SSE, as the broadest-based energy company in the UK and the fastest-growing energy company in Ireland, is in a good position to help provide the services and infrastructure that energy customers in the UK and Ireland will need and thus secure continuing, sustained real dividend growth.

Outlook for 2010/11 and Beyond

The economic outlook for 2010/11 continues to be uncertain. In this context, SSE offers three key advantages, enabling it to deliver a consistent financial performance:

- its core purpose is to provide energy, which is something that people need, rather than want;
- its strategy of maintaining a balanced range of economically-regulated and market-based energy businesses reduces the risk associated with any particular business activity and provides a broad platform from which to maintain sustained real dividend growth; and
- its over-riding financial goal – sustained real dividend growth – is straightforward and moderate.

Taking account of the current and future environment and its impact on the energy sector in the UK and Ireland, SSE's operational priorities during 2010/11 are to:

- carry out all work in a safe and responsible manner, with a lower Total Recordable Injury Rate;
- deliver maximum efficiency throughout all business activities;
- maintain and build on sector-leading performance in all aspects of customer service, from energy supply to energy networks;
- increase the total number of energy supply and home services customer accounts across the Great Britain and Ireland markets, while supporting progress towards increased energy efficiency;
- ensure power stations maintain a high level of availability to generate electricity in response to customers' needs and market conditions; and
- focus on cost control and customer relationship management to sustain its energy services businesses through the current period of economic uncertainty.

Its investment priorities are to:

- deliver additional assets in renewable energy, electricity networks and gas storage which contribute to secure and lower-carbon supplies of energy;
- meet other key milestones in its investment programme in generation, electricity networks and gas storage; and
- take forward the additional options that it has identified for investment from the middle of this decade onwards.

The delivery of a strong operational performance and the achievement of its investment priorities should enable SSE to discharge its first responsibility to shareholders: to deliver its full-year dividend target.

Future Dividend

According to Capita Registrars Dividend Monitor, published in February 2010, dividend payments by UK companies fell by 15% in 2009, compared with the previous year. As Capita said: 'Dividends matter.'

Dividends have always mattered to SSE, as the delivery of above-inflation increases in every year since it was formed demonstrates. In the period to 2003, dividend growth was supported principally by efficient operations: securing the synergies arising from the original merger of Scottish Hydro Electric and Southern Electric in 1998.

In the subsequent period, it continued to be supported by efficient operations, some capital investment and principally by acquisitions which were successful because they were founded on SSE's key financial principle for deal-making: discipline. This period culminated in the acquisition of Airtricity in February 2008, one of the stated objectives of which was to 'provide SSE with a major new range of investment opportunities from which to secure dividend growth over the next decade', adding to established opportunities in renewable energy, thermal generation, electricity networks and gas storage.

Following the general decline in UK dividend payments in 2009, SSE remains acutely aware of the importance of sustained real growth in the dividend. It is also mindful of the need to ensure that any future dividend targets are realistic, attainable and consistent with financing future investment in assets which, in turn, will provide the additional cash flows to support further dividend growth.

Against this background, and taking account of the breadth of operational and investment opportunities that exist throughout its business, SSE's new target is to deliver annual increases in the dividend of at least 2% more than Retail Price Index (RPI) inflation in each of the three years to March 2013, with sustained real growth thereafter. For this purpose, inflation is defined as the average annual rate across each of the 12 months to March. SSE believes that these targets can be achieved while maintaining a dividend cover consistent with its established range.

Assuming inflation of 2.8% (the average rate in the five years to March 2010) over each of the next three years, the achievement of these above-inflation targets will mean SSE's full-year dividend per share in 2013 will reach at least 80p, which is more than three times the first dividend it paid, in 1999.

Throughout this three-year period, SSE will be undertaking a major programme of investment in assets which, in turn, will earn revenue to support sustained real dividend growth in the period from 2013 onwards.

Safety and Environment

While SSE's first responsibility to shareholders is to deliver sustained real growth in the dividend, it will only be able to achieve this if it exercises a wider corporate responsibility to others, such as customers and employees, on whom its success ultimately depends. It seeks to do this by maintaining a strong emphasis on its six core values, the 'SSE SET' of Safety, Service, Efficiency, Sustainability, Excellence and Teamwork. In particular, SSE believes that the effective management of safety issues is a barometer of effective management of all operational issues.

In 2009/10, SSE's safety performance was as follows (comparisons with the previous year):

- the Total Recordable Injury Rate, which includes lost-time, reportable and medical treatment injuries, was 0.14 per 100,000 hours worked, compared with 0.16;
- the Accident Frequency Rate (lost-time and reportable injuries) was 0.03 per 100,000 hours worked, compared with 0.07; and
- the total working days lost from injury was 73, down from 361.

SSE's target for any given year is zero environmental incidents which result in it being served with a formal statutory notice by a government environment protection agency. There were two such incidents in 2009/10, fuel spills at Havant and Tummel Bridge. In November 2009, SSE was fined £20,000 under the Water Environment (Controlled Activities) (Scotland) Regulations 2005 and the Water Environment and Services (Scotland) Act 2003 following an escape of diesel from a holding tank at its Loch Carnan power station on Uist in November 2008.

Risk Management

SSE's overall business model, and strategy and culture, is designed with risk firmly in mind. It has:

- a clear and moderate financial goal – sustained real growth in the dividend;
- a well-established strategy based on a balanced range of economically-regulated and market-based energy businesses;
- a business model which features diversity of assets within those businesses, thereby limiting the value and extent of, and exposure to, any single risk;
- a limited appetite for, and tolerance of, business risk;
- a commitment to effective identification, monitoring and management of risks; and
- a clear and transparent decision-making process.

On Board decision-making, specific findings from the independent review of SSE Board effectiveness, carried out in the autumn of 2009 by Independent Audit Ltd, included 'a remarkable consensus of opinion' on the following:

- there is 'an open, informal atmosphere which encourages everyone to contribute';
- discussion is 'rigorous'; and
- the Executive Directors 'respond positively and constructively to challenge'.

FINANCIAL OVERVIEW

Financial Results for 2009/10

These results for the year to 31 March 2010 are reported under International Financial Reporting Standards, as adopted by the EU. SSE's focus has consistently been, and remains, on profit before tax before exceptional items, the impact of International Accounting Standards IAS 32 and IAS 39, and after the removal of taxation on profits from jointly controlled entities and associates.

This 'adjusted profit before tax'* was first adopted as a key performance indicator by SSE in 2005/06, and it has been applied consistently since then. It reflects the underlying profits of SSE's business and the basis on which it is managed and avoids the volatility introduced by IAS 39. The table below reconciles SSE's reported profit before tax to its adjusted profit before tax*.

	Mar 10 £m	Mar 09 £m	Mar 08 £m
Reported Profit before Tax	1,638.6	53.3	1,083.8
Movement on derivatives (IAS 39)	(399.8)	1,262.1	162.9
Exceptional items	-	(102.7)	(32.8)
Tax on JVs and Associates	51.3	40.4	10.7
Interest on convertible debt	-	0.6	4.6
Adjusted Profit before Tax*	1,290.1	1,253.7	1,229.2
Adjusted current tax charge	(274.1)	(300.4)	(317.2)
Adjusted Profit after Tax*	1,016.0	953.3	912.0
Reported Profit after Tax	1,235.5	112.3	873.2
Number of shares for basic and adjusted EPS (million)	921.9	883.0	863.2
Adjusted EPS*	110.2p	108.0p	105.6p
Basic EPS	134.0p	12.7p	101.1p

IAS 39 requires companies to record certain forward commodity contracts that are deemed to be derivative financial instruments at 'fair value'. At 31 March 2010, there was a net derivative financial liability in SSE's balance sheet arising from IAS 39 of £985.1m, before tax, compared with a net liability of £1,423.6m, before tax, at 31 March 2009.

The liability principally relates to some forward commodity purchase contracts for gas, coal, oil, carbon and wholesale electricity that SSE, like all major energy suppliers, has to enter into to ensure that the future requirements of its customers are met. IAS 39 requires SSE to record these contracts at their 'fair value'. This involves comparing their contractual price against the prevailing forward market price at the financial year end. At 31 March 2010 the average contractual price was higher than the market price (in other words, 'out of the money'), albeit by a smaller amount than at the same time last year, leading to a smaller liability.

Thus the movement on derivatives under IAS 39 of £399.8m shown in the table above and on the face of the income statement is primarily due to a reduction in the 'out of the money' position on commodity contracts between 31 March 2009 and 31 March 2010. SSE sets out these movements in fair value separately, as re-measurements, as they do not reflect the underlying performance of the business and the extent of the actual profit or loss arising over the life of the contracts giving rise to this liability will not be determined until they unwind; for around 50% of the total energy volume, this will be over the next 12 months.

Adjusted Profit Before Tax* in 2009/10

Adjusted profit before tax* rose by 2.9%, from £1,253.7m to £1,290.1m. This is moderate growth, consistent with the objective which SSE set out in its Annual Report 2009. SSE's adjusted profit before tax reflects four key steps forward in its Generation and Supply business in 2009/10, compared with the previous year:

- The installation of flue gas desulphurisation (FGD) equipment in early 2009 meant there were no related restrictions on running hours at Fiddler's Ferry and Ferrybridge power stations;

- The return to service in June 2009 of Medway power station, following a 15-month unplanned outage, meant the availability of SSE's gas-fired power stations to generate electricity was significantly better;
- There was an increase in the number of customer accounts to which SSE supplies electricity and gas in the Great Britain and Ireland markets (600,000 more in April 2009 than in April 2008); and
- A better balance between the cost of energy procured and the cost of energy supplied was achieved, following the energy supply losses sustained during the previous financial year to protect customers from the worst effects of exceptionally high wholesale prices.

At the same time, however:

- output of renewable energy was much lower than expected because of the unusually dry, cold and still weather conditions experienced during the winter of 2009/10 and the loss of output from the Glendoe hydro electric scheme;
- the achieved price of electricity produced from renewable sources was lower; and
- although the output of electricity from gas- and coal-fired power stations was higher, the difference between the cost of the primary fuel and the price of the electricity generated from it (the 'spark' and 'dark' spread respectively) was lower.

Adjusted Profit Before Tax* for 2010/11

SSE's emphasis is on adjusted profit before tax* on a full-year, as opposed to half-year, basis and since it was formed in 1998 it has delivered 11 successive increases in adjusted profit before tax*.

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

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

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

In terms of 2010/11, SSE believes that its balanced range of market-based and economically-regulated energy businesses, and the diversity of opportunities within those businesses, will deliver a level of adjusted profit before tax* capable of supporting the achievement of its new full-year dividend target.

Adjusted Earnings Per Share*

To monitor financial performance over the medium term, SSE continues to focus on adjusted earnings per share* because it has the straightforward benefit of defining the amount of profit after tax that has been earned for each Ordinary Share and so reflects a clear view of underlying financial performance. In 2009/10, SSE's adjusted earnings per share* were 110.2p, compared with 108.0p in the previous year.

DIVIDEND

Final Dividend for 2009/10

SSE cannot emphasise enough that its first responsibility to shareholders is to deliver sustained real growth in the dividend. The Board is recommending a final dividend of 49p per share, compared with 46.2p in the previous year, an increase of 6.1%. This will make a full-year dividend of 70p, which is:

- an increase of 6.1% compared with 2008/09;
- a real-terms increase of 5.6%, based on the average annual rate of inflation in the UK between April 2009 and March 2010, which exceeds the target of 4%;
- the 11th successive real-terms above-inflation dividend increase since the first full-year dividend of 25.7p paid by SSE in 1998/99;
- double the dividend paid in 2002/03, since when there has been compound annual growth of 10.4%; and
- covered 1.57 times by SSE's adjusted profit after tax.

Dividend Target for 2010/11 and Beyond

Its newly-adopted targets mean SSE is aiming to deliver an increase in the full-year dividend of at least 2% more than inflation in 2010/11. The same target is in place for 2011/12 and 2012/13, with sustained real growth thereafter also being targeted.

Scrip Dividend Scheme

A resolution will be put to shareholders at the Annual General Meeting to propose the introduction of a Scrip Dividend Scheme. The proposed Scrip Dividend Scheme is intended to replace the current dividend reinvestment plan. It will give shareholders the option to receive new fully paid Ordinary Shares in the Company in place of their cash dividend payments.

INVESTMENT AND CAPITAL EXPENDITURE

Key Performance Indicators	Mar 10 £m	Mar 09 £m
Thermal Generation investment	146.2	216.2
Renewable Generation investment	666.6	525.6
Gas Storage investment	46.3	55.4
Power Systems investment	334.5	314.6
Other	121.6	168.0
Total investment and capital expenditure	1,315.2	1,279.8
SSE share of SGN capital/replacement expenditure	206.4	191.4

Introduction

In March 2008, SSE announced it was undertaking a five-year capital investment programme for the period to March 2013 projected to total around £6.7bn – one of the biggest currently being undertaken in the UK by a FTSE 100 company. In keeping with its financial principle that investments should be 'well-founded', SSE believes that projects within the programme will achieve returns which are greater than the cost of capital, enhance earnings and contribute to dividend growth.

The principal focus of the investment programme is renewable energy, the requirement for which is underpinned by statute at EU and Member State level. At the same time, significant investment is also taking place in thermal generation, electricity networks and in a number of other areas, such as gas storage. In addition to its core investment programme, SSE – through its 50% stake in Scotia Gas Networks (SGN) – is also making a significant investment in regulated gas networks.

All of this investment is in line with SSE's core purpose: to provide the energy people need in a reliable and sustainable way. It will support the maintenance and development of assets which are of strategic significance in the context of the energy trends identified in the EU 2020 Climate and Energy Package and Ofgem's analysis of the UK's energy supplies published in October 2009. SSE's investment programme is, therefore, well-founded, in accordance with its financial principles, and it will deliver:

- a significantly enhanced asset base in key businesses;
- additional fuel for electricity production in the form of renewable sources of energy; and
- additional cash flows and profits, which will support future dividend growth.

Investment in 2009/10

2009/10 represented the second year of SSE's five-year investment programme, and capital and investment expenditure (excluding SGN) totalled £1,315.2m, building on the expenditure of £1,279.8m in the previous year. During 2009/10:

- the investment of £146.2m in **thermal generation** included SSE's 50% share of the development of the new Combined Cycle Gas Turbine (CCGT) power station at Marchwood, which became operational in December 2009, on time and on budget at less than £500/kW.
- the investment of £666.6m in **renewable generation** included SSE's 50% share (£244.9m) of the investment at Greater Gabbard offshore wind farm, and £60m in Walney.
- the investment of £46.3m in **gas storage** included £26.6m invested in the new facility at Aldbrough, which takes the total invested by SSE in this development to £207.9m.
- the investment of £334.5m in **electricity networks** took the total for the 2005-10 Distribution Price Control period to £1.29bn.

A total of £1.1bn has been invested by SSE in assets which were still largely under construction at 31 March 2010, including its share of the cumulative investment in Greater Gabbard (£455.5m).

In addition, SSE's 50% share of SGN's capital and replacement expenditure was £206.4m, compared with £191.4m in the previous year. SGN's total capital investment in 2009/10 was £168.1m, taking the amount so far for the 2008-13 gas Distribution Price Control period to £525.3m.

Management of Investment Programme

SSE's programme of investment in major new assets got under way with the development and construction of Hadyard Hill which, in 2006, became the first wind farm in the UK to generate 100MW of electricity. Since then, SSE has developed other new assets, such as Marchwood, the UK's first new gas-fired power station for five years, and the UK's first new gas storage capacity for four years, at Aldbrough. It has also completed the installation of flue gas desulphurisation equipment at Fiddler's Ferry and Ferrybridge power stations, thereby making it possible for electricity generation to continue at those locations beyond 2015.

Nevertheless, the transition from efficient operator of energy assets to also being a developer of significant energy infrastructure has presented challenges. Some of SSE's projects took longer to complete than the original (often ambitious) timetable suggested and there have been difficulties at others, such as the Glendoe hydro electric scheme. Understanding project risk (including construction), implementing best project management practice, processes and systems, together with a rigorous 'lessons learned' programme, has helped SSE ensure the delivery of current and future projects. The development of proven contracting strategies and the selection of experienced delivery partners all form part of an integrated and carefully-governed management system, ensuring that value is delivered from the investment programme.

These features are at the heart of the way SSE takes forward its investment programme, which is managed by an experienced team, the members of which recognise that it is most important to invest sufficient time and resources during the development phase of the project.

SSE remains committed to constructing robust assets, capable of generating revenue on a reliable basis and delivering value in the long term. The management of the project portfolio will not be sacrificed in the interests of short-term concerns. SSE keeps the economic evaluation of its investment programme under continuous review and remains confident that significant value is being created, based on actual project delivery and on the most up-to-date project costs and schedules.

Future Investment Priorities in 2010/11 and Beyond

SSE expects its capital and investment expenditure will be around £1.7bn during 2010/11 as significant projects such as the Clyde, Griffin and Greater Gabbard wind farms and the Aldbrough gas storage facility continue to make progress and as other major developments, such as the replacement of the Beaully-Denny transmission line, get under way. Around 75% of SSE's 2008-13 investment programme is relatively low risk, involving well-established technologies such as onshore wind farms, thermal power stations and electricity networks.

SSE constantly monitors its five-year investment programme, to make sure that it is taking advantage of the best opportunities to invest and that the best projects are prioritised – and all at the optimum

time. This was demonstrated by its decision to delay projects previously included in its 2008-13 programme in order to include within it the 367MW Walney offshore wind farm, in which it acquired a 25.1% stake in December 2009. A significant factor in the decision to include Walney in the investment programme was the phased and performance-related nature of the total cash consideration and construction costs.

The main components of risk involved in any individual investment decision – market, technology and construction – are all very carefully considered within the investment appraisal process and risk premia are applied to the expected rate of return where appropriate. The need to maintain diversity within the programme is also a factor in investment decision-making. That part of SSE's 2008-13 investment programme which is deemed to be higher risk - around 25% - involves technologies such as offshore wind farms and gas storage and is generally undertaken in partnership with other experienced developers in order to mitigate the higher risks. This illustrates the care with which decisions are taken, to ensure they are consistent with SSE's financial principles, targeting returns which are risk-adjusted, greater than the cost of capital, enhance earnings and contribute to dividend growth.

FINANCIAL MANAGEMENT AND BALANCE SHEET

Key Performance Indicators	Mar 10	Mar 09
Adjusted net debt (£bn)	5.292	4.822
Average debt maturity (years)	11.0	11.8
Underlying interest cover (excluding SGN)	6.3	6.5
Shares in issue at 31 March	923.1	920.4
Shares in issue (weighted average)	921.9	883.0

Treasury Policy

SSE's operations are generally financed by a combination of retained profits, bank borrowings, bond issuance and commercial paper. As a matter of policy, a minimum of 50% of SSE's debt is subject to fixed or inflation-linked rates of interest. Within this policy framework, SSE borrows as required on different interest bases, with derivatives and forward rate agreements being used to achieve the desired out-turn interest rate profile. At 31 March 2010, after taking account of interest rate swaps, 75.1% of SSE's borrowings were at fixed or inflation-linked rates.

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

The United Kingdom remains SSE's main area of operation, although business activities in the Republic of Ireland are also substantial. Transactional foreign exchange risk arises in respect of procurement contracts, fuel and carbon purchasing, commodity hedging and energy trading operations, and long-term service agreements for plant.

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

Net Debt and Cash Flow

On an **unadjusted basis**, SSE's net debt was £5.4bn at 31 March 2010, compared with £5.1bn at 31 March 2009. There were outstanding liquid funds of £109m at 31 March 2010 relating to power purchase agreements and wholesale energy transactions, the majority of which was reconciled and settled in April 2010. On an **adjusted basis**, therefore, including these liquid funds, SSE's net debt was £5.29bn at 31 March 2010 compared with £4.82bn at 31 March 2009.

The adjusted net debt of £5.29bn results in a Net Debt/EBITDA ratio of around 2.9 on 31 March 2010 (excluding SGN).

Strong cash flow from operations, including effective management of working capital, has helped to keep the increase in adjusted net debt to a lower level than expected, as have the adjustments to SSE's investment programme following the acquisition of a 25.1% stake in the Walney offshore wind farm. In summary, while capital and investment expenditure was £1.3bn in 2009/10, the increase in adjusted net debt was limited to £470m.

Borrowings and Facilities

The objective for SSE is to maintain a balance between continuity of funding and flexibility, with debt maturities staggered across a broad range of dates. Its average debt maturity as at 31 March 2010 was 11.0 years, compared with 11.8 years at 31 March 2009.

SSE's debt structure remains strong, with around £4.9bn of medium- to long-term borrowings in the form of issued bonds, European Investment Bank debt and long-term project finance and other loans. Less than £100m of medium-to-long-term borrowings will mature in the year to 31 March 2011. The balance of SSE's adjusted net debt is financed with short-term commercial paper and bank debt.

Financing Investment

SSE's investment programme is supported by its carefully-maintained balance sheet, which remains one of the strongest in the utility sector, in line with its established financial principles. Its corporate credit ratings are now 'A-' (Standard & Poors) and 'A3' (Moody's). In line with the trend across the energy and utility sectors, and with the revisions to their ratings criteria which the agencies chose to make, they were both downgraded in 2009, having been on 'negative watch' following the acquisition of Airtricity in 2008. Nevertheless, they remain consistent with securing funding at a reasonable cost.

SSE's balance sheet position means it is comparatively well-placed to raise finance and in a position to pay interest at lower rates than would otherwise be the case. This is demonstrated by its success in securing new funding and facilities totalling £4.8bn between July 2008 and March 2010, despite the very difficult market conditions experienced by all borrowers during that time. This included, during 2009/10:

- new committed bank facilities totalling £1bn, which mature in June 2012, to replace an existing £650m facility which had been due to mature in November 2009;
- a nine-year, £500m sterling bond with a coupon of 5%, issued by SSE in September 2009; and
- a £400m loan facility from the European Investment Bank to help finance the development of renewable energy schemes in the UK and Ireland.

SSE's five-year investment programme for the period to March 2013 is, therefore, well-financed. It will, however, move quickly to take the right financing options, including bonds, loans and, should new investment or acquisition opportunities arise, equity.

Net Finance Costs

The table below reconciles reported net finance costs to adjusted net finance costs, which SSE believes is a more meaningful measure. In line with this, SSE's adjusted net finance costs during 2009/10 were £335.9m, compared with £287.7m in the previous year.

	Mar 10 £m	Mar 09 £m
Reported net finance costs	265.3	134.3
add/(less)		
Share of JCE*/Associate interest	107.1	128.2
Interest on convertible debt	-	(0.6)
Movement on derivatives	(36.5)	25.8
Adjusted net finance costs	335.9	287.7
Return on pension scheme assets	100.7	135.3
Interest on pension scheme liabilities	(127.5)	(130.1)
Finance lease interest	(13.2)	-
Notional interest arising on discounted provisions	(3.5)	(5.1)

Adjusted interest costs**

292.4	287.8
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*Jointly Controlled Entities **Adjusted finance income and costs for interest cover calculation

The average interest rate for SSE, excluding JCE/Associate interest, during the year was 5.35%, compared with 5.25% for the previous year. Based on adjusted interest costs, underlying interest cover for 2009/10 was 6.3 times (excluding interest related to SGN), compared with 6.5 times in 2008/09; including interest related to SGN it was 5.6 times.

Excluding shareholder loans, SGN's net debt at 31 March 2010 was £3.1bn, and within the adjusted interest costs of £292.4m, the element relating to SGN's net finance costs was £63.0m (compared with £86.5m in the previous year), after netting loan stock interest payable to SSE. Its contribution to SSE's adjusted profit before tax* was, therefore, £120.7m, compared with £94.0m in the previous years.

Convertible Bond Maturity and Authority to Purchase Own Shares

SSE's 3.75% Convertible Bond, which had an initial nominal value of £300m, matured on 24 October 2009.

During 2009/10, SSE did not purchase any of its own shares for cancellation. The Directors will, however, seek renewal of their authority to purchase in the market the Company's own shares at the Annual General Meeting on 22 July 2010, and this remains a benchmark against which financial decisions are taken.

Pensions

In line with the IAS 19 treatment of pension scheme assets, liabilities and costs, pension scheme liabilities of £720.3m are recognised in the balance sheet at 31 March 2010, gross of deferred tax. This represents an increase in net liabilities of £446.8m compared with the position at March 2009, principally due to the reduction in the discount rate applied to future liabilities.

During 2009/10, employer cash contributions amounted to:

- £44.2m for the Scottish Hydro Electric scheme; and
- £66.0m for the Southern Electric scheme.

Employer cash contributions include the deficit repair contributions for the Scottish Hydro Electric scheme and the Southern Electric scheme of £29.5m and £38.8m respectively.

As part of the electricity Distribution Price Control for 2005-2010, it was agreed that allowances equivalent to the regulated business' share of deficit repair contributions in respect of the Southern Electric scheme should be included in price controlled revenue. The Price Control for 2010-2015 maintains this commitment to fully fund the regulated business' share of deficit repair contributions for both the Southern and now the Scottish Hydro Electric pension schemes, with an incentive around ongoing pension costs.

TAX

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

	Mar 10 £m	Mar 09 £m
Reported tax charge/(credit)	403.1	(59.0)
add back:		
Share of JCE/Associate tax	51.3	40.4
less:		
Deferred tax	(69.4)	(39.5)

Tax on exceptional items and certain remeasurements	(110.9)	358.5
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Adjusted current tax charge	274.1	300.4
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The effective adjusted current tax rate, based on adjusted profit before tax*, was 21.2%, compared with 24.0% in the previous year, on the same basis. The impact of SSE's higher capital expenditure programme and the changes introduced in Budget 2007 and 2009 have had, and will continue to have, a positive impact on the effective current tax rate. The reported tax charge is £403.1m, compared with a tax credit of £59m in the previous year. This reflects the deferred tax associated with the derivatives mark-to-market position.

SSE's contribution to government revenues in the UK, including Corporation Tax, Employers' National Insurance Contributions and Business Rates, totalled £474.6m during 2009/10, compared with £484.9m in the previous year. The total includes joint ventures and associates.

Investor Timetable

Annual Report 2010 on website	12 June 2010
AGM (Bournemouth)	22 July 2010
Ex-dividend date	28 July 2010
Record date	30 July 2010
Payment date	24 September 2010
Interim results (provisional)	10 November 2010

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GENERATION AND SUPPLY

Introduction

SSE owns just over 11,300MW of capacity for generating electricity, a net increase of 600MW since 1 April 2009. The large majority (over 10,850MW) of this capacity is in Great Britain, in which total capacity is around 83,000MW, including the capacity to import from France. The remainder (450MW) is in Northern Ireland and the Republic of Ireland, where there is an all-island Single Electricity Market, of around 10,000MW, which is separate from the market in Great Britain.

SSE's total capacity includes its share of joint ventures and associates and comprises around:

- 4,590MW of gas- and oil-fired capacity;
- 4,370MW of coal-fired capacity (with biomass co-firing capability); and
- 2,370MW of renewable (hydro, wind and dedicated biomass) capacity.

This balance between coal- and gas-fired generation capacity, and the balance between fossil fuel and renewable sources of energy, avoids dependency on a single technology or commodity and gives SSE the greatest diversity in fuels for generating electricity among UK generators. As a result, SSE has significant optionality in the management of its power stations. It is this diversity and the optionality that goes with it which enable SSE to manage the risks inevitably associated with primary fuel procurement. Management of these risks is also assisted by the fact that SSE is the largest generator of electricity from renewable sources across the UK and Ireland.

SSE's diverse electricity generation assets are balanced by its electricity and gas supply customer base. As at 31 March 2010, SSE supplied energy to 9.16 million customer accounts in Great Britain and 190,000 accounts in Northern Ireland and the Republic of Ireland, making it:

- the second largest supplier within Great Britain's competitive electricity and gas supply market, which has around 51 million domestic and business accounts in total; and
- the fourth largest supplier in the Irish all-island energy market, which has around 3.1 million accounts in total.

SSE's responsibility as supplier to customers is to procure the electricity and gas they need, arrange for it to be distributed to them through the relevant networks, provide the associated services such as metering and billing and promote the efficient use of energy.

Wholesale gas and wholesale electricity are transacted like any other commodity in a competitive market. SSE purchases the gas and some of the electricity it needs to supply customers via bilateral contracts of varying lengths and through trading in the wholesale markets. To ensure customers' requirements are 'hedged', energy is sourced up to two years or more in advance of it actually being used. SSE also buys gas, coal, oil and biomass to use in the production of electricity from its power stations, as well as carbon dioxide emissions allowances.

SSE's long-term power purchase agreements with Barking Power Ltd (in which it has a 30.4% stake) and Derwent Cogeneration Ltd (in which it has a 49.5% stake) are due to expire in September 2010. The current contract, under which British Energy supplied SSE with 5TWh (terra-watt hours) of electricity during 2009/10 and will supply 5TWh during 2010/11 (arranged as part of SSE's acquisition of the Swalec energy supply business in 2000) ends in March 2011. In order to provide continuing long-term stability to the energy portfolio, further contractual arrangements have been agreed. These include the 15-year tolling agreement with Marchwood Power Ltd which commenced in 2009.

SSE's Trading and Risk Management team is responsible for its participation in wholesale markets for electricity and gas, as well as markets for coal, oil and carbon dioxide emissions allowances. Through analysis of generation plant availability, customer demand and its contractual position SSE can assess, and therefore manage, its exposure to market prices.

In summary, SSE assesses Generation and Supply as a single value chain within a vertically-integrated business. This means its power stations and fuel supply contracts are used to support performance in electricity (and, by extension, energy) supply. As the UK Treasury and Department of

Energy and Climate Change said in March 2010: 'Vertical integration offers several benefits, including lower risk from wholesale electricity price volatility, economies of scale and price smoothing.'

Against this background, SSE seeks to maintain a well-balanced portfolio of assets, contracts and customers, and over recent years its growth in power station capacity has been similar to its growth in supply customer numbers. This balanced, integrated business, featuring a diverse range of assets, has, therefore, value that goes beyond the sum of its parts – not least because its exposure to particular commodity price outcomes is reduced.

Generation and Supply Performance Overview

Operating profit* in Generation and Supply was £896.0m, compared with £832.0m in the previous year, contributing 55.1% of SSE's total operating profit* in 2009/10. The main differences between 2009/10 and the previous year are set out under 'Adjusted Profit Before Tax' above. (SSE reports the underlying financial performance of Generation and Supply excluding the impact of IAS 39 remeasurements which are unrealised as it continues to believe that this does not represent underlying business performance.)

Total revenue for Generation and Supply was £20.5bn, which accounted for 91% of SSE's total revenue in 2009/10, of which £8.2bn was in relation to sales of electricity and gas to industrial, commercial and domestic customers.

Electricity Generated and Supplied

During 2009/10, SSE generated 47.2TWh of electricity, including power stations in which it has a part-ownership or contractual interest. It also purchased 5.6TWh of electricity through long-term contracts with other generators. In the year, it supplied 32.7TWh of electricity to its domestic and small business customers and 27.0TWh was supplied under contract to industrial and commercial customers. Net balances were traded in the wholesale electricity market.

Average electricity usage per GB household customer of SSE fell from 4,748kWh in 2008/09 to 4,540kWh in 2009/10 and gas usage fell from 598 therms to 558 therms.

Consolidated Segmental Statement

Ofgem has introduced a requirement on electricity generators and suppliers to publish a Consolidated Segmental Statement showing revenue, costs and profits from electricity generation and electricity and gas supply activities. This statement must be published no later than six months after the end of the financial year (ie by 30 September 2010) and will be accompanied by a narrative on the assumptions used to determine income and cost.

This assumption-based approach is necessary, because the requirement to produce such a statement will not have any significant impact on SSE's long-standing approach of managing its generation and supply activities as a single value chain. The presentation of Generation and Supply in SSE's financial statements will not change.

From a wider point of view, companies adopting an integrated approach to generation and supply are most likely to be able to deliver the level of investment needed in generation in the UK and Ireland because the risks associated with such large-scale and long-term investments are mitigated by the income earned from supplying electricity and gas to customers.

GENERATION

Electricity Generation Key Performance Indicators	Mar 10	Mar 09
ASSETS (MEGAWATTS – MW)*		
Gas- and oil-fired generation capacity	4,590	4,510
Coal-fired generation capacity (inc biomass co-firing)	4,370	4,010
Renewable (inc pumped storage) generation capacity	2,370	2,220
- inc conventional hydro capacity	1,150	1,150
- inc wind farm capacity	840	690
- inc dedicated biomass capacity	80	80
- inc pumped storage capacity	300	300

Total electricity generation capacity (MW)	11,330	10,740
OPERATIONS (%)		
Gas power station availability	94	76
Coal power station availability	92	89
Hydro storage	52	73
Wind farm availability	97	96
OUTPUT (TWh/GWh)		
Gas- and oil-fired wholly-owned - TWh	15.4	15.3
Coal-fired (inc biomass co-firing) - TWh	11.5	7.8
Total output from thermal power stations - TWh	26.9	23.1
- inc Co-firing output qualifying for ROCs - GWh	218	267
Conventional hydro - GWh	3,016	3,316
- inc ROC-qualifying hydro) - GWh	1,456	1,656
Wind energy (UK) – GWh*	1,007	953
Wind energy (RoI) – GWh*	854	765
Dedicated biomass - GWh	136	148
Total output of renewable energy - GWh	5,013	5,182
Total output from pumped storage - GWh	413	273

* Including output from joint ventures and associates

Context

Over the next decade, around 20GW of the UK's capacity for generating electricity (largely coal, oil and nuclear) is scheduled to close because of its age or its inability to comply with higher environmental standards. In July 2009, the UK government's *Low Carbon Transition Plan* included a projection of possible shares of electricity generated from different sources in 2020, based on energy demand estimated at 370TWh:

- **renewables** – 31% (up from 6%)
- **gas** – 29% (down from 45%)
- **coal** – 22% (down from 32%)
- **nuclear** – 8% (down from 13%)
- **other sources such as CHP** – 10% (up from 3%)

All of this has five major implications for electricity generation over the next 10 years:

- a balance of fuels used within the UK's generation portfolio will remain critical in providing security of supply, through allowing diversity of primary energy sources;
- the need for the UK to maintain a reasonable margin between electricity generation capacity and electricity demand will reinforce the value of existing and available power-producing plant;
- the UK will have to provide replacement capacity for conventional and nuclear generation plant which is expected to retire;
- legally-binding targets for renewable energy and carbon dioxide emissions support the value of renewables and will require sustained major programmes of investment; and
- the growth in capacity for generating electricity from renewable sources will have an impact on how gas- and coal-fired capacity operates on a day-to-day basis. The value of established and flexible capacity is likely to be reinforced.

The extent of the investment required in electricity generation, and the high up-front costs associated with the low carbon technologies which the investment is needed to deliver, will require the public policy framework in the UK to evolve over the next few years, with interventions to support those low-carbon technologies. SSE is open-minded about the precise nature of these interventions, as long as existing low-carbon investments are safeguarded and the investment climate remains positive. It

believes that the progressive decarbonisation of its electricity generation portfolio means it is well-placed if the cost associated with carbon dioxide emissions increases.

Generation Objectives

In this context, SSE's key objectives in Generation, covering operations and investment, remain relevant and appropriate. The operational objectives are to:

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

SSE's investment objectives in Generation cover both existing and new power-producing plant. They are to:

- maintain a diverse portfolio of power stations, with the flexibility to respond to customer demand and market conditions;
- invest in developments supported by EU Member States' financial frameworks (such as the UK's Renewables Obligation) to help ensure legally-binding targets for renewable energy in 2020 can be met; and
- develop and pursue a diverse range of options for adding to its portfolio of power stations, and thus support security of supply.

In achieving these objectives, SSE's target is to reduce by 50% the carbon dioxide intensity of electricity produced at power stations in which it has an ownership or contractual interest, over the period from 2006, the first full year after it acquired coal-fired power stations, to 2020. This will be achieved through a combination of more electricity being produced from renewable sources and from cleaner fossil fuels such as gas, and less being produced from coal, the most carbon-intensive fuel.

Gas-fired Generation – Operations

SSE owns 4,590MW of gas- and oil-fired electricity generation capacity, including its share of joint ventures. Although the total installed capacity of Peterhead power station is 1,840MW, its maximum level of access to the transmission network at any one time is now 1,180MW, the same as the station's Unit One capacity, following the release of 344MW of electricity Transmission Entry Capacity (TEC) rights at the station in March 2010 to reduce Transmission Network Use of System (TNUoS) charges. Only 1,180MW has, therefore, been included in the overall capacity total for SSE's gas-fired power stations. The balance, in the station's Unit Two, allows Peterhead to provide replacement generation capacity when Unit One is undergoing outages.

Electricity generation plant remains exposed to significant operational costs. Costs include high and volatile TNUoS charges in the northern part of the country, business rates, maintenance and insurance. As the changes at Peterhead demonstrate, SSE monitors closely these costs in the context of the income which generation plant is able to earn and takes action to make sure that plant is able to operate economically over the medium term.

Good performance in Generation and Supply is dependent, first and foremost, on plant at power stations being available to generate electricity as and when required by customer demand and market conditions. During 2009/10, SSE's principal wholly-owned gas-fired power stations (Fife, Keadby, Medway and Peterhead) achieved 94% of their maximum availability to generate electricity, excluding planned outages, compared with 76% availability in the previous year. This reflected the return to service of Medway power station in June 2009, following a 15-month unplanned outage. The new power station at Marchwood (see below) achieved 100% availability between the time it became commercially available in December 2009 and the end of March 2010.

The amount of electricity generated by SSE at gas-fired power stations in which it has an ownership or contractual interest was 32.1TWh in 2009/10 (including 15.4TWh from wholly-owned stations), compared with 28TWh in the previous year (including 15.3TWh from wholly-owned stations).

During 2009, SSE's Engineering Centre completed a detailed review of the way that SSE's power-producing assets are managed. The review was supported by external engineering advisers. It confirmed that the asset management of SSE's power station plant, and the underpinning engineering judgements, are at, or above, expected industry standards. At the same time, it identified some potential improvements in the execution of maintenance.

Against this background, SSE has designed and implemented an updated model for managing its generation assets, with four key stages:

- asset scoping and monitoring;
- asset life management;
- engineering strategy development, including risk management; and
- advanced planning and execution, with detailed works and investment planning taking place prior to the implementation of any programme of planned outages.

The adoption of a consistent approach in the management of its assets, which have different characteristics and which have been developed, acquired or upgraded over a number of years, plus other steps, such as the acquisition of strategically-significant spare parts for generating plant to mitigate major failures, and the ongoing development of the Engineering Centre itself, including its Equipment Performance Centre, should help SSE ensure its generation assets deliver on a consistent basis levels of availability that meet both market and sustainability requirements.

Gas-fired Generation - Investment

Ofgem's *Project Discovery – Energy Market Scenarios*, published in October 2009, highlighted that Britain will face significant levels of gas imports, in particular for gas-fired power plants to replace lost nuclear and coal-fired generation capacity, and that this will increase the country's exposure to uncertainties in the global gas market.

To avoid over-dependence on a single fuel, SSE operates a diverse generation portfolio and actively develops a diverse range of options to add to it. At the same time, CCGT continues to be the benchmark technology in generation, making a growing contribution to meeting the UK's electricity requirements, because of its relatively low costs, short construction time and high thermal efficiency. With a carbon intensity around half that of coal-fired power stations, investment in CCGT assists in the transition to lower-carbon electricity generation.

The 840MW CCGT plant in Southampton developed by Marchwood Power Ltd, a 50:50 joint venture between SSE and ESB International, became available for full commercial operation in December 2009, making it the UK's first new gas-fired power station for five years. All of the station's output is contracted to SSE.

With a net thermal efficiency in excess of 58%, Marchwood is one of the most efficient gas-fired power stations in the UK. SSE's total investment in Marchwood was around £180m, comprising equity and debt, reflecting the fact the plant was procured before the significant increase in costs experienced in the electricity generation sector in 2007 and 2008. With a construction cost of less than £500/kW, it was a particularly well-timed and well-founded investment.

In May 2009, SSE acquired Abernedd Power Company Limited from BP Alternative Energy. Abernedd has applied for consent to construct and operate a new CCGT power station, with a capacity of over 800MW, on a brownfield site in Baglan Bay in South Wales, where there is already in place electricity transmission, gas and water infrastructure for the first phase of the power station. The total cash consideration will be determined by the progress of the development. Subject to planning consent being secured, SSE has decided to schedule construction of the new power station with a view to generation plant first becoming operational in around 2015 (which is slightly later than originally envisaged, but reflects the short-term fall in demand for electricity following the economic downturn in the UK). This demonstrates that SSE has flexibility in the timing and nature of the development.

In addition, SSE has identified other options for additional CCGT capacity. These include:

- the potential development of new capacity at Keadby power station. SSE has effective consent to develop 710MW of capacity at Keadby and in April 2009 it secured an agreement to connect a new 850MW power plant to the electricity transmission network from 2016; and
- the creation of additional capacity at Barking Power Ltd, in which SSE has a 30.4% stake. Barking has consent to develop a new 470MW CCGT, which – if constructed - would effectively add around 140MW to the portfolio of gas-fired generation assets owned by SSE.

In April 2010, BG Group announced it had reached an agreement to sell its 50% interest in Seabank Power Limited, which operates the 1,140MW CCGT near Bristol in which SSE has the other 50% interest. SSE has pre-emption rights in respect of BG Group's interest in Seabank Power Limited, which it does not expect to exercise.

Coal and Biomass Generation – Operations

During 2009/10, SSE generated 11.5TWh of electricity at its coal-fired power stations at Fiddler's Ferry and Ferrybridge, compared with 7.8TWh in the previous year. The stations achieved 92% of their maximum availability to generate electricity, excluding planned outages, compared with 89% in the previous year.

The increase in output reflects the removal, in the early part of 2009, of the constraints on running hours at the stations imposed by Article 5(1) of the Large Combustion Plant Directive (LCPD), following hot commissioning of flue gas desulphurisation (FGD) equipment. The equipment has been installed to cover all of the capacity at Fiddler's Ferry and half of the capacity at Ferrybridge (3,000MW in total), making it possible for it to remain operational beyond 2015 (subject to emerging policy under the proposed Industrial Emissions Directive). The other 1,000MW of capacity at Ferrybridge was opted out of the LCPD and so operates under restrictions on its ability to generate electricity and must close in 2015.

The installation of FGD equipment means that the power stations are able to use higher-sulphur coal mined in the UK. As a result, in April 2009, SSE entered into an agreement with UK Coal under which it will obtain 3.5 million tonnes of deep- and surface-mined coal from Great Britain, including Kellingley Colliery in West Yorkshire, to provide fuel for Ferrybridge power station up to 2015. This should be enough to meet around 15% of the station's requirements during that period. In addition, SSE has advanced a secured loan to UK Coal, on which interest is payable, to be repaid by 2014.

The stations co-fire fuels from renewable sources (biomass) in order to displace fossil fuels. During the year, their output qualifying for ROCs (Renewable Obligation Certificates – see below) was 218GWh, compared with 267GWh in the previous year (included within the above total for the stations as a whole). This follows the change on 1 April 2009, since when electricity output resulting from co-firing has received 0.5 ROCs per MWh, compared with 1.0 ROC per MWh previously. Electricity suppliers can now meet up to 12.5% of their Renewables Obligation from this technology.

Coal and Biomass Generation - Investment

In August 2009, SSE acquired Uskmouth Power Company Limited, the owner and operator of the 363MW Uskmouth coal-fired power station near Newport, South Wales for a total cash consideration of £27m (including £10m of cash and working capital balances). Uskmouth comprises three independent power generating units, each with 121MW of capacity. The power station dates from the 1960s and was substantially refurbished in 2000, including having FGD equipment fitted. It routinely operates on a two-shift basis to help meet shorter-term power requirements. Following the acquisition, around 100 people employed at the station joined SSE. The integration of Uskmouth into SSE's portfolio of power generating assets went well. Its availability was 96%, following completion of an outage that was extended because of the need to secure spare parts.

The LCPD also requires reduced emissions of nitrogen oxides. SSE has already invested £31m to install SOFA (Separated Overfire Air) and BOFA (Boosted Overfire Air) equipment at the stations to reduce such emissions. From 2016 limits on emissions of nitrogen oxides from power stations will be tightened significantly. As a result, SSE is undertaking a front-end engineering design (FEED) study, which it expects to complete next year, into options for installing Selective Catalytic Reduction (SCR) technology at Fiddler's Ferry. The alternative to fitting SCR is to operate the station within limits required under a derogation from the LCPD's requirements.

SSE has applied for consent to install the SCR technology at Fiddler's Ferry under Section 36 of the Electricity Act 1989. Its analysis of the issues around installing SCR will also take into consideration the progress of the draft EU Industrial Emissions Directive, which the European Commission has proposed in order to overhaul seven existing pieces of legislation on industrial emissions, including the LCPD, into a single directive. As a result, it does not expect to take a decision on installing SCR until 2011.

Coal and Biomass Generation – Decarbonisation

Coal is a critically important fuel for the UK, because of its flexibility, its availability and because it reduces reliance on imported gas. Existing coal-fired power stations still have a crucial role to play in maintaining secure supplies of electricity, but it is clear that that role will have to change if legally-binding carbon dioxide emissions targets are to be met. In October 2009, the UK's Committee on Climate Change re-stated its previous recommendation that 'there can be no role for conventional coal generation in the UK beyond the early 2020s'. SSE certainly believes that no new coal-fired power stations should be built without full carbon dioxide abatement and that no coal-fired power stations without such abatement should be allowed to operate beyond 2030.

In April 2010 it secured consent from Wakefield District Council to develop at Ferrybridge the UK's biggest carbon dioxide capture trial facility. The £21m trial will be carried out in collaboration with Doosan Babcock and Vattenfall and will demonstrate the carbon dioxide capture element of carbon capture and storage (CCS) technology. In March 2009, it secured £6.3m of funding from the UK Department of Energy and Climate Change, the Technology Strategy Board and Northern Way. Construction work is expected to start later this year, with the trial itself commencing in 2011 and running through to the end of 2012.

The scale of the project, equivalent to 5MW of coal-fired power generating capacity producing 100 tonnes of carbon dioxide per day, bridges the gap between the various laboratory-scale trials that are under way and the larger-scale projects envisaged by the UK government. The significance of the project therefore lies in its scale and its ability to demonstrate: the operational characteristics of capture plant on an actual power station; and the performance of the amine solvent on real flue gas.

Coal and Biomass Generation – Recycling

The development by Lafarge Plasterboard Ltd of a plasterboard factory at Ferrybridge has been completed. The plant is operational and using the gypsum produced on site as a result of FGD as its main raw material in the production of plasterboard.

The ash separation plant developed at Fiddler's Ferry by RockTron (Widnes) Ltd is now operational. It removes and processes all fresh ash produced by the power station, and much of that currently stored in lagoons at the site, turning it into constituent parts which become marketable mineral products, with the largest volume being initially used as cement substitutes.

SSE now has 49.9% of the equity in RockTron (Widnes) Ltd, a subsidiary of RockTron Ltd, enabling it to secure a share of the income from the ash separation plant, in addition to the benefits which result from avoiding the environmental liabilities associated with ash production and storage.

EU Emissions Trading Scheme

Phase II of the EU Emissions Trading Scheme (EU ETS) began on 1 January 2008. Across its electricity generation portfolio (taking account of contractual shares), SSE now has an allocation of 18.9 million tonnes of carbon dioxide emissions allowances per calendar year, including the allowances for Marchwood and Uskmouth. Its emissions allowances requirement for 2009/10, beyond those allocated under EU ETS, was 4.9 million tonnes. This compares with 2.5 million tonnes in the previous year. During 2009/10, the price of allowances ranged from around €11.50 to around €15.50 per tonne. From 2013, all of the carbon dioxide emissions allowances for electricity producers will be auctioned.

Emissions of Carbon Dioxide

In 2009/10, emissions of carbon dioxide from power stations in which SSE has an ownership or contractual interest totalled 23.1 million tonnes, compared with 19.3 million tonnes in the previous year, reflecting the increase in the amount of electricity generated from thermal power stations

following the unusually low level in the previous year. Assuming it displaced electricity produced from coal-fired power stations, the output of SSE's wind farms and conventional hydro electric schemes (see below) saved around 4.5 million tonnes of carbon dioxide in 2009/10. SSE's carbon emissions data is externally verified by a UK Accreditation Service (UKAS)-accredited organisation.

SSE's target is to reduce the amount of carbon dioxide per kilowatt-hour of electricity generated at plant in which it has an ownership or contractual interest by 50%, between 2006, the first full year after it acquired coal-fired power stations, when it was around 600g/kWh, and 2020. On this basis, its carbon intensity in 2009/10 was 494g/kWh, compared with 491g/kWh in the previous year, reflecting the greater thermal content of SSE's electricity fuel mix.

The decisions SSE takes and the investments it makes are influenced by this target. For example, since 2005/06, it has invested over £65m in carbon dioxide efficiency improvements, or to facilitate the burning of carbon neutral fuels such as biomass, at its coal-fired power stations. More fundamentally, SSE's extensive programme of investment in energy from renewable sources, including the acquisition in December 2009 of a 25.1% stake in the Walney offshore wind farm development, demonstrates its financial commitment to a lower-carbon future.

Since 2000, the Carbon Disclosure Project (CDP) has, on behalf of institutional investors, 'challenged the world's largest companies to measure and report their carbon emissions; integrating the long-term value and cost of climate change into their assessment of the financial health and future prospects of their business'. In 2009, CDP received the highest response rate to date. SSE secured a score of 78%, the same as in 2008, missing the Carbon Disclosure Leadership Index by just 1%.

Renewable Energy – Overview

Tackling climate change and securing future supplies remain the two main goals of energy policy in the UK, Ireland and the EU. Against this background, the EU Renewable Energy Directive imposes legally-binding targets on Member States, specifying the proportion of all energy consumption that must be met by renewable energy sources by 2020. The national target for the UK is 15% (compared with 2.25% achieved in 2008) and for the Republic of Ireland it is 16%. In practice, this is likely to mean that around one third of the countries' electricity requirements will have to be met from renewable sources. Amongst other things, decarbonising the production of electricity through investment in renewable sources of energy will help to reduce dependence on imported gas.

The Renewables Obligation (RO) has been the UK's main support scheme for electricity generated from renewable sources since 2002. Under the RO, generators receive Renewable Obligation Certificates (ROCs) for electricity generated from eligible renewable sources and electricity suppliers are required to source an increasing proportion of their electricity from eligible renewable sources; in 2009/10, the proportion was:

- 0.097 ROCs per MWh (or 9.7%) of electricity supplied in England, Wales and Scotland; and
- 0.035 ROCs per MWh (or 3.5%) of electricity supplied in Northern Ireland.

In 2010/11 it is 0.111 ROCs per MWh of electricity supplied in England, Wales and Scotland and 0.0427 ROCs in Northern Ireland. The effect of this is to encourage the necessary investment in electricity generation from renewable sources by enhancing the value of the output.

A number of changes to the RO were introduced on 1 April 2010. Key changes were:

- an extension of the life of the RO to at least 2037;
- an increase in the level of 'headroom' between the proportion of renewable electricity required by the RO and the expected level of output; and
- an increase in the ROCs earned on output from all offshore wind farm projects accredited between April 2010 and March 2014, from 1.5 to 2.0. (The Walney and Greater Gabbard offshore wind farms are expected to be fully accredited in 2011 and 2012 respectively.)

The effect of these changes is to provide developers and investors with greater long-term certainty about, and confidence in, the financial support for electricity generated from renewable sources.

In the Republic of Ireland, the Renewable Energy Feed In Tariff (REFIT) scheme is used to support renewable energy by providing a guaranteed price for output and a 15% rebate (subject to a cap) on suppliers' purchase of REFIT energy.

SSE has 2,370MW of commissioned renewable energy capacity in the UK and Ireland, comprising hydro electric schemes (including pumped storage), wind farms and a dedicated biomass facility at Slough, an increase of 150MW during the year. Of this, 1,050MW qualifies for ROCs (including dedicated biomass).

Total output from all of SSE's conventional hydro electric schemes, wind farms and its dedicated biomass plant was 5,013GWh during 2009/10, compared with 5,182GWh in 2008/09. This was over 10% lower than expected because of the unusually dry and still weather conditions experienced in the winter of 2009/10.

Looking ahead, SSE has set itself the target of owning 4,000MW of renewable energy capacity in the UK and Ireland that is either commissioned or under construction by the end of 2013. The achievement of this milestone will mean SSE is making a significant contribution to the achievement of the 2020 targets for renewable energy and carbon dioxide emissions in the UK and Ireland. It is also making comprehensive plans to build on its 2008-13 programme of investment in renewable energy in the subsequent years.

Moreover, in addition to the clear environmental benefits associated with harnessing their power, water and wind are key sources of free and indigenous primary energy which reduce SSE's exposure to volatile prices for fossil fuels, especially gas, sources of which are in decline but which will be in huge demand from growing, populous economies across the world.

Hydro Generation – Operations

SSE owns and operates just over 1,450MW of capacity in hydro electric schemes, including the 300MW pumped storage facility at Foyers, on Loch Ness.

Total output from the conventional hydro electric schemes was 3,016GWh during 2009/10, compared with 3,316GWh during the previous year. As at 31 March 2010, the amount of water held in SSE's reservoirs which could be used to generate electricity was 52% of the maximum, compared with 73% in the previous year. The unusually cold weather experienced from December to March, with prolonged spells of sub-zero temperatures, resulted in the amount of water running off into reservoirs being much less than normal.

In order to encourage long-term investment to maintain smaller schemes, the output of refurbished hydro electric stations with capacity of up to 20MW qualifies for ROCs, as does the output from all stations commissioned after 2002. SSE has just over 500MW of capacity in this category. Of the total hydro output in 2009/10, 1,456GWh qualified for ROCs, compared with 1,656GWh in the previous year. Assuming average run off of water into SSE's reservoirs during the year, the ROC-qualifying output from hydro generation is expected to be almost 1,500GWh in 2010/11.

In August 2009, SSE identified a blockage caused by a fall of rock near the top of the tunnel carrying water from the reservoir to the power station at the 100MW Glendoe hydro electric scheme, thus stopping operations at the station. The repair will require the construction of two new tunnels: one around 900 metres, to divert water around the blockage; and a second, shorter, access tunnel. The tunnelling work will be carried out using the drill and blast method. BAM Nuttall has been retained as the contractor for this work, which is under way. Nevertheless, the extent of the repair work is such that electricity generation is unlikely to resume before the summer of 2011.

Hydro Generation – Investment

The vast majority of SSE's hydro electric stations were built in the 1950s and early 1960s and are the subject of a rolling programme of investment to prolong their working life and improve their operational efficiency. Since the Renewables Obligation was introduced in April 2002, SSE has invested around £450m in refurbishing and developing hydro electric schemes in Scotland. Investment in this area totalled £4.6m during 2009/10.

Hydro electric schemes which use impounded water to generate electricity have an important part to play in meeting peak demand and also complement the growing, but variable, amount of output from wind farms. Against this background, SSE has submitted to Scottish Ministers an application for consent to develop a 60MW pumped storage scheme as part of its 152MW Sloy power station, near Loch Lomond. This means that, in addition to electricity produced from water collected and held in the Loch Sloy reservoir, Sloy would generate electricity using water pumped from Loch Lomond to the reservoir.

In an average year, Sloy produces around 120GWh of electricity and adding to it a pumped storage facility would allow it to store an additional 100GWh of electricity in a typical year to help meet peak demand. SSE currently expects that developing a pumped storage facility at Sloy will require investment of over £30m.

In addition, SSE is proposing to develop two new large-scale pumped storage hydro electric schemes at Coire Glas at Loch Lochy and Balmacaan at Loch Ness. In October 2009, it asked the Scottish Government for its formal opinion on the scope of the environmental impact statement that would accompany planning applications for the schemes, currently planned to be submitted during 2012. Construction is unlikely to start before 2014 at the earliest, and progress of the schemes (and other such developments) will be dependent upon a satisfactory public policy and regulatory framework, including TNUoS charges.

They would be the first brand new pumped storage schemes to be developed in Great Britain since work began on the Dinorwig scheme in Wales in 1974. Subject to final agreements and design, it is envisaged that the proposed schemes would each have an installed capacity of between 300MW and 600MW; and each would be able to produce in excess of 1,000GWh of electricity in a typical year to help meet peak demand.

In both cases, the upper reservoirs would be large, enabling electricity generation to continue for longer periods, without the need to pump water from the loch below, than is the case for other pumped storage schemes in Great Britain. Both schemes would require the construction of a dam to impound water and create the upper reservoirs, but it is currently envisaged that water pumping and electricity generation at both developments will be carried out under ground, thereby avoiding any visual impact in the Great Glen itself.

Wind Generation – Operations

As at 31 March 2010, SSE owns and operates 840MW of onshore wind farm capacity in the UK and Ireland, compared with 690MW at 31 March 2009. Of the 2010 total, 370MW is in the Republic of Ireland. SSE also has 2MW of onshore wind farm capacity in Portugal.

Output from SSE's portfolio of wind farms in 2009/10 was (comparison with previous year in brackets):

- 1,007GWh in the UK, (953GWh); and
- 854GWh in the Republic of Ireland, (765GWh).

On average, the turbines at SSE's wind farms in the UK and Ireland achieved 97% of their maximum availability to generate electricity, compared with 96% in the previous year. Their average load factor was lower than expected, at just over 26%, compared with 29% in the previous year, due to the unusually still weather conditions experienced in the winter of 2009/10.

Wind Generation – Investment Overview

When SSE entered into the agreement to acquire Airtricity (which has since been re-named SSE Renewables for renewable energy development) in January 2008, the combined business had just over 870MW of onshore wind farm capacity in operation, in construction or with consent for development in the UK and Ireland. This capacity now totals 1,780MW, comprising:

- 840MW in operation;
- 790MW in construction or pre-construction; and
- 150MW with consent for development.

SSE has also submitted for approval by the relevant planning authorities in the UK and Ireland proposals for onshore wind farms with a total capacity of 1,400MW. Beyond this, SSE has around 2GW of onshore wind farm capacity development opportunities in the pre-planning phase in the UK and Ireland and over 3GW under development in mainland Europe.

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

- a 50% stake in the 10MW Beatrice offshore wind farm in the Moray Firth;
- a 50% share of the 500MW Greater Gabbard development now under construction in the outer Thames Estuary; and
- a 25.1% share of the 367MW Walney offshore wind farm now under construction in the Irish Sea.

All of this means that SSE now has 3,660MW of renewable energy capacity (onshore wind, offshore wind, hydro and dedicated biomass) in operation, under construction or with consent for development in the UK and the Republic of Ireland.

Not included within this total is the foreshore lease that SSE holds to develop in excess of 500MW at the fully-consented Arklow Bank site in the Irish Sea. The timing of future developments at Arklow Bank will be dependent upon, amongst other things, the extent of financial support for offshore wind farms available from the Irish government.

In December 2009, SSE and DONG Energy announced an agreement to form a 50:50 joint venture to develop three offshore wind farms in the Dutch sector of the North Sea with a total capacity of just over 1,000MW, which SSE previously had the entire right to develop. As a result, SSE also now has around 800MW of offshore wind farm capacity with consent for development in northern Europe, including the Dutch sector of the North Sea. This agreement, and that to acquire Walney, demonstrated SSE's flexible approach to the development of its wind energy capacity, with acquisitions and disposals both being considered to optimise the overall portfolio.

Wind Generation – Investment Approach

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

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

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

Onshore Wind Investment Projects

The principal projects within SSE's onshore wind farm construction portfolio are Clyde (350MW), in South Lanarkshire, and Griffin (156MW), in Perthshire:

- **Clyde:** Work at the site is continuing, following the resolution of the secondary, and some of the primary, radar-related issues associated with the consent granted for the development. The wind farm is being developed in three sections, with the appointments of the remaining lead contractors for each of the three sections expected to be finalised this year. Clyde is expected to have a load factor of around 35% and produce over 1,000GWh of electricity in a typical year. The first section of the development should be completed by the end of 2011 and the development as a whole in 2012. Its total construction cost is expected to be around £500m.

- **Griffin:** Pre-construction work is well under way at the site, in which SSE now has a 100% stake. The annual output is expected to be around 400GWh. Its construction cost is expected to be around £200m and it should be completed in 2012.

SSE has a total of 14 wind farm projects currently under construction and expects a total of over 100MW of onshore wind farm capacity currently under construction to be commissioned during 2010/11. In addition to the timely completion of construction work, the commissioning of wind farm developments is dependent on their ability to connect to the electricity network. This has been identified as one of the key barriers to new renewable energy across the UK and Ireland.

SSE is pursuing other options for the development of its onshore wind farm portfolio and will shortly ask the Scottish Government for its formal opinion on the scope of the environmental statement that would accompany the planning application for a 67 turbine extension to the Clyde wind farm.

Offshore Wind Investment Projects

SSE has a stake in two major wind farms under construction off the coast of the UK: Greater Gabbard (500MW; 50%; in partnership with RWE npower renewables through Greater Gabbard Offshore Winds Limited); and Walney (367MW; 25.1%; in partnership with DONG Energy):

- **Greater Gabbard:** Following the initial delay in commencing foundation installation, good progress has been made and half of the 140 turbine foundation monopiles and almost one third of the transition pieces have now been installed, as has the first of two transformer platforms. Greater Gabbard Offshore Winds Limited expects to resolve satisfactorily, as part of the normal contractual process, the claim it has received for additional costs relating to foundation monopiles. Commissioning of the onshore sub-station is well-advanced and installation of the first export cable, inter-array cables and turbines is under way. Greater Gabbard is expected to have a load factor of over 40% and produce around 1,900GWh of electricity in a typical year, of which SSE will take 50%. The wind farm is expected to require a total investment by SSE of around £650m, excluding connection to the electricity grid. The development remains on course to be completed in 2012.
- **Walney:** SSE acquired its 25.1% stake in Walney from DONG Energy, which retains a 74.9% stake, for a total consideration of up to around £39m, of which around £17m is subject to the operational performance of the wind farm. As a shareholder in the project, SSE will pay its pro rata share of the construction costs (just under £250m) with payments being made when each phase of the wind farm is commissioned. Walney will be constructed in two phases, each totalling 183.6MW. Construction of the first phase is now under way, with the first monopiles installed, and construction of the second phase is scheduled to start in the spring of 2011. The wind farm is therefore expected to enter commercial operation in two phases: during the first half of 2011 and towards the end of 2011. DONG Energy is leading the construction and operation of the wind farm. The wind farm is expected to have an average load factor of around 43% and produce around 1,300 GWh of electricity in a typical year. SSE and DONG Energy will market the output of the wind farm in proportion to their equity stakes. Excluding the connection to the Great Britain electricity network, the cost of constructing Walney is expected to total just under £1bn. DONG Energy has provided SSE with financial guarantees relating to the final capital cost of the project and its timely completion.

In December 2009, the UK government announced that 2.0 ROCs will be earned by the output of all offshore wind projects accredited between April 2010 and March 2014, an increase from 1.5 ROCs, and this was confirmed by Parliamentary Order in April 2010.

Offshore Wind Future Opportunities

SSE believes that the Greater Gabbard and Walney projects give it a strong offshore wind construction portfolio for the next few years. Beyond that, other options are being developed. In May 2010, SSE and RWE npower renewables secured rights from The Crown Estate to develop a 500MW wind farm close to the existing Greater Gabbard development. A planning application is expected to be submitted to the Infrastructure Planning Commission by 2011, with a decision expected in 2012. A grid connection for the project was secured with National Grid in 2009, to be potentially available from October 2015.

In addition, SSE is a member of two consortia which have secured development partner status from The Crown Estate in Round 3 of its UK offshore wind farm development programme:

- Forewind, formed by SSE, RWE npower renewables, Statoil and Statkraft, has been awarded development partner status for the 9GW offshore wind farm proposed for Dogger Bank, 125km from the coast of Yorkshire: and
- Seagreen, formed by SSE and Fluor Corporation, has been awarded development partner status for the proposed 3.4GW offshore wind farm proposed for the Firth of Forth, 25km from the coast of Fife.

SSE's capacity share of the two proposed wind farm developments totals around 4GW. Over the next few years, both consortia will be working closely with The Crown Estate to undertake site-specific surveys, secure grid connections and work with stakeholders before bringing forward applications to build the wind farms. As a result, construction work would not begin until 2015 at the earliest.

SSE has also been awarded exclusive rights from The Crown Estate to develop offshore wind farms at locations in Scottish territorial waters (including two where it is in partnership with other specialist developers) with a total capacity of over 2GW, of which its share is 1.7GW. Their development is subject to site-specific consultations and environmental impact assessments, statutory consents and satisfactory completion of the Strategic Environmental Assessment for offshore wind announced by the Scottish government in October 2008. Fluor Limited and SSE have decided against taking the proposed Bell Rock development any further. This is a result of existing and ongoing radar activity in the area for which mitigation has been examined and no solution found.

SSE believes that harnessing the power of offshore wind will enable the UK to generate significant amounts of low-carbon energy from a totally renewable source and therefore meet the country's energy security and climate change objectives. Its success in the Round 3 and Scottish territorial waters processes adds to its options for developing its generation portfolio in the longer term. The strength of those options in offshore wind is reinforced by its:

- partnerships with other developers, in line with its drive to minimise the inevitable risks involved in projects of this kind and to maximise the development potential of the sites; and
- focus on establishing a strong supply chain for offshore wind developments through, for example, participation in the Carbon Trust's Offshore Wind Accelerator, a research and development initiative to reduce costs, and investment in Burntisland Fabrication Ltd (BiFab) (see 'Emerging Technologies' below).

SSE's priority in offshore wind for the next three years is the successful completion and commissioning of Greater Gabbard and Walney. The opportunities secured through the Round 3 and Scottish territorial waters processes are for development in the second half of this decade.

Wind Generation – Businesses and Communities

Energy price certainty and environmental targets continue to drive businesses' demand for wind turbines sited on their premises and there is significant community interest in the potential for wind energy to help meet sustainable energy needs and bring local benefits. SSE's first consented community wind turbine will be erected later this year for the Sanday Development Trust on the Orkney island of Sanday. A further 50MW of projects are nearing readiness for submission to the relevant planning authorities and 450MW of projects are currently in development.

Wind Generation Investment – Continental Europe

In addition to its wind and hydro investments in the UK and Ireland, SSE has options to invest in renewable energy in Europe, principally Portugal, Scandinavia, Italy, Germany and the Netherlands where there are particular opportunities for growth in renewables. Any investment will involve working with partners and will largely be on an equity basis, with non-recourse or project-specific debt typically expected to account for around 75% of the total cost of the investment. At the same time, SSE continues to believe that the scope for the development of its existing businesses in the UK and Ireland is very substantial, and investments there will continue to be prioritised.

Marine Energy

SSE has a 47.8% stake in Aquamarine Power, which in September 2009 successfully completed the first round of its fundraising to raise £10m from investors in the UK and Ireland. This followed the successful deployment of a full scale demonstrator of Aquamarine's 300kW Oyster wave energy converter at its testing berth at the European Marine Energy Centre (EMEC) in Orkney. Testing is expected to take up to two years. Aquamarine expects to have a fully commissioned, commercially available wave farm in place by 2014.

In March 2010, SSE was awarded exclusive rights to develop 400MW of wave and tidal energy at four sites in the Pentland Firth and Orkney Waters and a further 400MW with its partners, Aquamarine Power and OpenHydro. The award was part of the world's first commercial leasing programme for wave and tidal energy generation projects, undertaken by The Crown Estate. Over the next few years, SSE and its partners will be working closely with The Crown Estate and other stakeholders before bringing forward applications to construct the wave and tidal energy developments. The vast majority of construction work is not expected to begin until after 2015.

As the leading generator of renewable energy in the UK, SSE is committed to building on its existing renewable portfolio by developing viable wave and tidal sites using industry-leading marine technologies. It will now work closely with statutory bodies, local communities and The Crown Estate to take forward this significant opportunity.

Alternative Energy - Operations

SSE's plant at Slough has a current generating capacity of 80MW and remains the UK's largest dedicated biomass energy facility. During 2009/10, it produced 136GWh of electricity qualifying for ROCs, compared with 148GWh during the previous year. The output from dedicated regular biomass plants attracts 1.5 ROCs per MWh.

Alternative Energy - Investment

Experience of managing the plant at Slough has given SSE a platform from which to invest in biomass and other alternative fuels such as those derived from waste. In line with its approach of developing a number of options for the site, SSE has submitted an application for consent to develop a multi-fuel combined heat and power (CHP) facility at Ferrybridge.

The reliability of fuel sources is a key issue in alternative energy. The proposed multi-fuel CHP facility would use a range of fuel sources, which could include biomass, waste-derived fuels and wood products, to generate 108MW of electricity and to provide heat to the Ferrybridge site. It would be compliant with the Waste Incineration Directive. The development is currently estimated to require investment of around £350m and SSE expects to take a decision on whether to proceed with it in the course of the next year.

In addition, the acquisition of the three-unit power station at Uskmouth gives SSE further options for the development of new lower-carbon generation assets alongside the existing generation assets.

Alternative Energy – Biogas

In May 2010, SSE agreed to invest a net £11.3m to allow the construction of Scotland's largest biogas plant at the former landfill site at Barkip in North Ayrshire. The deal made SSE the first energy company in the UK to commit to the construction and operation of an anaerobic digestion biogas plant of this type. The Barkip site will be capable of processing around 80,000 tonnes of waste annually, producing enough gas to generate up to 2MW of electricity. The new project will enable SSE to gain experience in owning and operating this technology, which it believes could offer opportunities beyond on-site electricity generation, including connection to the gas distribution network in the future.

Alternative Energy – Forth Energy

Forth Energy, the joint venture between SSE and Forth Ports PLC created in 2008, has prepared proposals for the development of dedicated biomass power stations at four of Forth Ports' sites in Scotland. It is undertaking consultations on the proposals and intends to seek consent during the course of this year to build the plants. The plants are proposed for Dundee, Leith, Rosyth and Grangemouth. Their total installed capacity would be around 400MW and they could also produce heat to be used at other facilities at the Forth Ports' sites and, potentially, other neighbouring sites.

Emerging Technologies – SSE Ventures

In 2007, SSE set up SSE Ventures (SSEV) to develop and grow its portfolio of investments in small and medium-sized businesses offering renewable, sustainable and energy efficiency-enhancing products and services. These include Aquamarine Power and RockTron (Widnes) Ltd (see above) and Smarter Grid Solutions Ltd (see below).

In addition to the financial support offered, SSEV works in close partnership with investee companies to help their products or services make progress towards full commercial viability. Participation in emerging technology developments helps SSE to anticipate, be at the forefront of, and adapt to, the changes in energy production and consumption that are likely to occur over the next decade.

For example, in April 2010, SSE purchased a 15% stake in Burntisland Fabrications Ltd for a total consideration of £11m. In addition to the equity stake, SSE has secured an agreement with BiFab for the supply of at least 50 jacket substructures annually to support SSE's offshore wind developments.

BiFab is an established fabricator of structures and equipment for the oil and gas industry which has recently extended its expertise into the fabrication of jacket substructures suitable for offshore wind developments. BiFab has already attracted government support to develop a new manufacturing facility for offshore wind jacket substructures. SSE's investment will be used to further develop this facility and this is expected to expand BiFab's capabilities to a total annual capacity of up to 130 units. The investment follows BiFab's successful delivery of jackets for the Greater Gabbard offshore wind project.

Through equity and loans, and including the BiFab investment, SSEV has invested or committed to invest a total of £120m in a variety of emerging technologies since it was formed and now holds direct or indirect stakes in a total of 36 companies. In total, these companies employ over 1,000 people.

Nuclear Power

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

These question marks do not apply to modern nuclear power stations, which Malcolm Wicks MP said in his August 2009 review of energy security, represent a proven, low-carbon generation technology which could benefit security of energy supply by increasing the diversity of the fuel mix and reducing reliance on gas imports. He suggested that nuclear power should provide some 35%-40% of the country's electricity after 2030.

SSE believes that some participation in new nuclear power stations may make sense in view of its commitment to a diverse generation portfolio and complements its core investment in renewable sources of energy.

During 2009, a consortium of GDF Suez SA, Iberdrola SA and SSE, in which SSE has a 25% stake, secured an option to purchase from the Nuclear Decommissioning Authority land for the development of new nuclear power generating plant adjacent to Sellafield in Cumbria, for a total cash consideration that could reach £70m.

The consortium now intends to prepare detailed plans for developing new nuclear power plant at the site with a total capacity of up to 3.6GW. These plans will be prepared in consultation with the safety authorities and local stakeholders and will be submitted for consideration by the relevant planning authorities, with the aim of being able to begin construction of the first new reactor around 2014. On this basis, the new power station would not be commissioned before 2020.

Generation Priorities for 2010/11 and beyond

SSE's key operational objectives in Generation during 2010/11 are the same as in any given year:

- comply fully with all safety standards and environmental requirements;
- ensure those power stations are available to generate electricity as and when required in response to customer demand and market conditions; and

- operate power stations efficiently to achieve the optimum conversion of primary fuel into electricity.

During 2010/11, SSE expects to invest over £1bn in maintaining and upgrading existing generation assets and in developing new assets. Its investment priorities in 2010/11 are to:

- complete asset maintenance and refurbishment programmes on time and on budget;
- meet key milestones in new asset development, including completion of another 100MW of onshore wind farm capacity and first electricity generation at Greater Gabbard; and
- make progress in developing the diverse range of investment options it has created for the second half of this decade

In the five years between 2008 and 2013, SSE currently expects that its investment across its entire generation portfolio will be over £4bn, including investment in existing assets. This investment programme is designed to abate the environmental impact of existing assets and extend their working lives and to deliver new assets, principally in renewable energy but also thermal generation. All of this will support security of energy supply.

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

SSE will also actively seek to maintain optionality and diversity in the future development of its generation portfolio so that it remains on course to reduce by 50% the carbon dioxide intensity of electricity produced at power stations in which it has an ownership or contractual interest, over the period from 2006 to 2020.

ENERGY SUPPLY

Energy Supply Key Performance Indicators	Mar 10	Mar 09
Electricity customer accounts (GB domestic) - m	5.17	5.10
Gas customer accounts (GB domestic) - m	3.54	3.50
Energy customers (GB business sites) - m	0.45	0.45
Total GB energy customer accounts - m	9.16	9.05
All-Island Energy Market customers (Ire) -m	0.19	0.05
Total energy customer accounts (GB and Ire) - m	9.35	9.10
Home services customer accounts (GB)	0.41	0.33
Total customer accounts (GB and Ire) – m	9.76	9.43
Electricity supplied household average - kWh (GB)	4,540	4,748
Gas supplied household average – therms (GB)	558	598
Complaints to Energy Supply Ombudsman (GB)	374	183*

* Six months only

Context

The Great Britain energy regulator, Ofgem, states on its website that: 'Competition in the retail energy markets has brought considerable benefits to industrial, commercial and domestic customers since it was introduced. Allowing customers to choose the supplier of their choice keeps the pressure on costs and promotes greater choice of tariffs and services for customers.'

This was endorsed by the UK Treasury and the UK Department of Energy and Climate Change, who stated in March 2010 that: 'In principle, competitive markets should provide the best outcome for consumers. The liberalisation of Great Britain's market has delivered increased choice in tariffs and services and the ability to switch supplier.' It added that the UK's electricity switching rate per annum is the highest in Europe and the highest of any sizeable competitive energy market in the world. Over the last five years, more energy and gas customers switched supplier than in any other UK consumer services sector of a comparable size, apart from car insurance.

As part of its market monitoring role, Ofgem publishes periodic reports on developments in the domestic retail market and conducts investigations and consultations into the performance of the domestic and the non-domestic markets. As retail competition develops the regulatory framework is kept under review.

Ofgem published its most recent *Electricity and Gas Supply Market Report* in February 2010, which reiterated a key point from its Energy Supply Probe in 2008: 'The Probe highlighted that the energy supply businesses of the Big 6 act as a hedge for the electricity generation businesses.....Generally we found that the top priority of the vertically integrated energy businesses was to deliver profits from the business as a whole and that, as part of this, suppliers accepted that changing wholesale prices may lead to profit shifting from upstream to downstream and vice versa.'

Ofgem's February 2010 Report also noted 'the declining trend in domestic average gas consumption since 2005'. This reflects the fact that obligations on energy suppliers to help customers make energy savings have been in place since 1994. In July 2009, it was announced that the current energy efficiency scheme, the Carbon Emissions Reduction Target (CERT), would be extended to 2012 and that smart meters should be installed in every home by 2020. In addition, the Community Energy Saving Programme (CESP) came into effect on 1 September 2009. It requires gas and electricity suppliers and electricity generators to deliver energy-saving measures to domestic customers in specific low income areas of Great Britain.

Energy Supply Objectives

All of this demonstrates that the key issues in energy supply are prices, products, customer service and energy efficiency. Against this background, SSE's objective is to retain and gain energy supply customers by:

- offering consistently competitive prices over the medium term;
- providing market-leading products and services to help transform energy consumption;
- delivering a quality of service that goes beyond best-in-sector; and
- successfully delivering energy efficiency schemes.

As consumption of energy changes, SSE believes that a sustainable supply business is one which provides the energy and the related products and services that people actually need in the higher-unit price, lower-carbon environment expected in the future. This is central to retaining and gaining customers.

Energy Supply Operations - Customer Numbers

SSE supplies electricity and gas in Great Britain as Southern Electric and SSE (England), Swalec (Wales), Scottish Hydro (Scotland) and Atlantic. During 2009/10, it achieved a net gain of 100,000 energy supply customer accounts in Great Britain, taking the total to 9.16 million. This was the eighth successive year in which SSE achieved a net gain in energy supply customer numbers and means it has more than doubled its total number in that period. The total comprises:

- 5.17 million domestic electricity customer accounts;
- 3.54 million domestic gas customer accounts; and
- 0.45 million business electricity and gas sites.

Within the total, 3.16 million customer accounts are for loyalty products such as energyplus Argos, which rewards customers with money-off discount vouchers, and energyplus Pulse, under which customers are able to support the British Heart Foundation (which received £205,000 from SSE in respect of energyplus Pulse customers during 2009/10, taking the total since the product was launched to over £1.1m).

The total also includes M&S Energy, a dual fuel product launched in October 2008 by SSE and Marks & Spencer (M&S). The product is available to M&S customers exclusively through M&S' stores and website, and by 31 March 2010 had attracted 175,000 customer accounts.

During 2009/10, SSE, supplying energy as Airtricity, increased its customer base in the all-island electricity market in Ireland from 50,000 accounts to 190,000. Of these accounts, 75% are household and 25% are industrial and commercial.

Energy Supply Operations – Prices in Great Britain

Over the past few years, SSE has maintained a responsible pricing policy, with the objectives of providing consistently competitive prices over the medium term and protecting customers from the full impact of volatile wholesale prices. The application of this policy means SSE was the cheapest energy supplier on average over the five years to 31 March 2010, compared to all other major suppliers in the GB market (based on a standard quarterly or monthly direct debit dual fuel annualised bill calculated at the end of every month averaged across all regions and based on industry standard electricity consumption of 3,300kWh per annum and gas consumption of 20,500kWh per annum).

SSE introduced a package of changes in prices for household gas supply from 29 March 2010 under which it cut unit prices, adjusted the fixed charge element in bills and removed the extra charges levied on its single fuel and pre-payment tariffs compared with standard credit tariffs. The effect of these changes on a typical customer using the industry standard amount of gas was to reduce SSE's gas bills by: 4% or £30 (standard credit/direct debit); 7% or £56 (single fuel); and 9% or £70 (pre-payment). The removal of the extra charges levied on SSE's gas pre-payment tariff followed the earlier removal of the extra charges levied on its electricity pre-payment tariff.

Future trends in energy prices for domestic customers will depend on what happens in wholesale electricity and gas markets, with public policy and regulatory decisions on energy production, distribution and consumption also having a significant impact. For example, the costs associated with the EU ETS, RO and CERT are all on an increasing trend, as are the costs of distributing energy. The UK Energy Act 2010 contains measures, such as a financial support mechanism for carbon capture and storage (CCS) and mandatory social price support, which will maintain upward pressure on retail energy prices.

In practice, the competitive supply market and the exhaustive scrutiny to which energy suppliers are subject represent the best means of ensuring that prices under any scenario are as low as possible.

Energy Supply Operations – Bills in Great Britain

There is a clear distinction between the price of a unit of energy and the amount that customers pay for heating and powering their homes. The sustained investment in energy efficiency programmes undertaken in recent years is delivering a sustained reduction in the amount of gas being consumed in Britain's homes. In *Energy Trends* in March 2010, the UK Department of Energy and Climate Change reported that the UK was one of just seven of the EU-27 countries to increase progress on energy efficiency between 2000 and 2007 compared with 1996-2000. It also showed that in the UK in 2009, compared with 2008:

- final consumption of electricity fell by 6.8%, with domestic use down by 3.2%; and
- demand for gas was 7.7% lower, with consumption in the domestic sector down by 5.4% (provisional estimate).

In spite of progressively colder winters over the last three years, SSE household customers reduced their average usage to:

- 558 therms of gas, compared with 598 therms in the previous year, and 597 therms in 2007/08; and
- 4,540kWh of electricity, compared with 4,748kWh in the previous year, and 4,834kWh in 2007/08.

On a weather-corrected basis, average household usage of both gas and electricity reduced in all three years. As a result of these trends, households are less exposed to the impact of high prices than they otherwise would be. In 2009/10, the reduction in energy consumption meant household bills were around 5.5% lower than they would have been had consumption levels in 2007/08 been maintained, reducing the average bill by around £70 per annum.

Much more progress is possible. The UK Committee on Climate Change stated in October 2009 that 'energy efficiency in homes could be improved by 35% by 2020' with an ambitious programme of improved insulation, the installation of energy efficient condensing boilers and major improvements in

electrical appliance efficiency. SSE believes that achieving this step change in energy efficiency must be a key priority over the next decade.

Energy Supply Operations - Payment Profiles

A total of 58% of SSE's domestic electricity and gas accounts are paid by direct debit or standing order. A further 11% are paid through pay-as-you-go (or pre-payment) meters and the balance are on credit terms and settled by cheque or other such payment methods. In September 2009, Ofgem published data on payment methods which showed that 50% of all electricity customers in Great Britain and 53% of all gas customers pay by direct debit.

As at 31 March 2010, the total aged debt (ie debt that is overdue by more than six months) of SSE's domestic and small business electricity and gas customers was £90m, compared with £72m in March 2009, an increase of 25%. A bad debt-related charge to profits of £73m has been made. This comprises a £20m increase in the energy supply bad debt provision and £53m of debt write-off and compares with a charge of £35m in the previous year.

As expected, given the general economic climate, 2009/10 posed significant debt management challenges, with the volume of work in this area for SSE's Customer Service division increasing. SSE has sought to manage this situation by taking a number of steps, including rigorous assessment of the credit-worthiness of potential business customers, and making earlier contact with the customer (business or household) when it becomes apparent that payments are in arrears, so that the issues are more manageable from everyone's point of view. The work of office-based credit agents is supplemented by the work of field-based teams (the number and geographic coverage of which has been increased) who work with customers to resolve debt.

As a result, aged debt among business customers has been reduced from £15m to £12m and aged debt levels overall were on a reducing trend towards the end of the financial year. Nevertheless, with the economic outlook remaining uncertain, there is a significant risk that aged debt will remain at a high level in 2010/11.

Energy Supply Operations - Customer Service

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

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

- the Customer Satisfaction Report from uSwitch.com, published in September 2009, in which SSE was ranked the best energy supplier for the sixth successive time. uSwitch.com stated: 'SSE remains the customer service benchmark for the rest of the industry.';
- the JD Power and Associates 2009 UK Electricity and Gas Supplier Customer Satisfaction Study, in which SSE's four supply brands took four of the top five places in electricity supply and gas supply, with its Atlantic brand ranked first in electricity; and
- the UK Customer Satisfaction Index, published by the Institute of Customer Service in January 2010, in which SSE was the top performer in the Utilities sector.

Under the Consumer, Estate Agents and Redress (CEAR) Act 2007, customers who are unable to resolve issues with their energy supplier can take them up with Consumer Direct. Complaints which are not resolved within eight weeks, or which become 'deadlocked' may be taken to the new Energy Supply Ombudsman. During 2009/10, there were 374 SSE-related complaints to the Ombudsman, compared with 183 in the six months following the launch of the new arrangements in October 2008.

Although SSE maintained its best-in-sector position in customer service during 2009/10, it was a year in which the profile of the energy supply sector remained very high. In total, SSE's energy supply customers in Great Britain made 21 million calls to the Company's teams in Basingstoke, Cardiff, Cumbernauld, Havant and Perth during 2009/10. These conversations allow SSE to assess, consider and respond to customers' concerns and, over time, adapt the services and products it provides accordingly.

SSE measures the performance of key customer service functions such as General Enquiries and Housemoves through a Net Promoter Score (NPS). The most recent results suggest the NPS ranges from +38% to +54%.

More broadly, SSE recognises that energy supply in Great Britain is not well-regarded among customers for its transparency. In response to this issue, the UK government undertook to require energy suppliers to publish information about available tariffs in annual statements. In keeping with its commitment to further improvements in customer service, and maintaining its sector-leading position, SSE has committed to going above this requirement and publishing information on all bills. This was welcomed by MPs from all parties in an Early Day Motion in the House of Commons in March 2010.

Web and email are now firmly established as the second most common means of communication with the Company used by SSE's customers. Around 18% of SSE's transactions with customers now take place online and its customers now have 490,000 paperless billing accounts, up from 287,000 a year before. This, in turn, indicates that the popularity of e-services such as paperless billing is likely to continue to increase rapidly over the next few years. Enabling customers to carry out more transactions online if they choose is now one of SSE's top customer service priorities. In line with that, the capability of its websites were upgraded during 2009/10 to create a technical platform to allow the deployment of enhanced functionality in the future.

Energy Supply Operations – Energy Efficiency

Using energy more efficiently is the fastest and most cost-effective way of reducing customers' energy costs, sustaining supplies for the long term and reducing emissions of carbon dioxide. As an energy supplier, SSE has obligations under the CERT scheme to deliver energy efficiency measures to households throughout Great Britain and in 2009/10 funded the installation of cavity wall insulation in 146,000 homes and loft insulation in 128,000 homes (excluding DIY insulation). This is up from 87,000 homes and 104,000 homes respectively.

In its CERT Annual Report, a review of CERT in 2008/09, published in August 2009, Ofgem stated that SSE had met half of its overall carbon emissions reduction obligation for the three years to 2011. SSE also achieved the highest level of solid wall insulation for hard-to-treat properties among all the obligated energy suppliers.

Complementing CERT, the CESP aims to deliver energy efficiency measures on a community basis. The CESP will promote a 'whole house' approach, to be delivered through the development of community-based partnerships involving local authorities and energy suppliers via a house-by-house, street-by-street approach. SSE's first CESP programmes will begin during 2010/11 at locations in throughout England, Scotland and Wales.

CESP and CERT will require the commitment of significant resources by energy suppliers, including SSE, in the coming years. Nevertheless, SSE supports the goal of securing substantial savings in energy bills and reductions in emissions of carbon dioxide, and achieving greater energy efficiency continues to be the most sustainable way of achieving this.

Energy Supply Operations - Vulnerable Customers

While any type of poverty, including fuel poverty, fundamentally results from an individual or household having insufficient income, SSE recognises that it has a significant role to play in reducing its customers' energy consumption (and thus the associated costs) and a role also in helping those of its customers who struggle to pay for their basic energy needs.

SSE's social tariff, energyplus care, gives eligible dual fuel customers a discount compared with its standard tariff, as well as other help including benefit entitlement checks and free energy efficient appliances and home insulation. During 2009/10, SSE implemented a two-tier level of assistance for fuel-poor customers, featuring a rebate as well as energyplus care, and thus has been able to assist a larger number of customers than would be the case if the flat rate was maintained. The number of customer accounts benefiting from these measures at 31 March 2010 was 155,000, compared with 103,000 the previous year.

This fulfilled SSE's voluntary agreement with the UK government to operate schemes with a total value of £22m to help vulnerable customers in 2009/10. Under this agreement, SSE's contribution will increase to around £27m in 2010/11. In addition to this, SSE issued credits worth a total of almost £3.5m in January 2010 to its 280,000 customers using gas pre-payment meters to assist them during the coldest part of the year.

The Energy Act 2010 created a statutory framework for schemes which allow the Secretary of State for Energy and Climate Change to require energy suppliers to support vulnerable customers under the existing voluntary agreement (see above). It also set a framework requiring energy suppliers to provide a specified level of social price support (direct assistance with energy bills) to more of the most vulnerable customers. Further details, including the nature of the benefit and the eligibility criteria, will be set out in secondary legislation after a consultation later this year.

It is SSE's policy to do all it can to help customers who may be having difficulties in paying for the electricity and gas they use by offering tailor-made payment arrangements that suit their needs and their circumstances. In March 2010, customers with 233,000 electricity and gas accounts were taking advantage of these arrangements.

Energy Supply Operations – Energy Products

Energy supply remains intensely competitive and gaining and retaining customers' loyalty is key to long-term success. At a time of higher energy prices, 'better plan' is at the centre of the portfolio of products and services which SSE currently markets. It offers a variety of incentives to help customers use less energy and earn credits as a result. The credits are then applied as a reduction to customers' energy bills.

SSE launched 'better plan' towards the end of 2007 as part of its commitment to work in partnership with its customers to help them reduce their energy use and to create a more sustainable level of energy consumption. During 2009/10, customers with an additional 50,000 energy accounts joined 'better plan', taking the total to 215,000.

Increasingly, 'smart' technologies will feature in SSE's products and it is working on a number of options for using new technology to provide customers with greater control over their energy consumption and, therefore, its cost.

Energy Supply Operations – Other Products

'Home services' is a frequently used term, which has different meanings within different organisations. For SSE it means products and services which complement the supply of electricity and gas. SSE offers a range of gas boiler, central heating and wiring maintenance and installation products and services for household customers across 43 postcode areas covering around two thirds of its energy supply customer base. During 2009/10, it increased its maintenance customer numbers by 37%, to 158,000, and performed gas and electric installation and re-wiring work in 7,000 properties, an increase of 13%.

During 2010/11, SSE will aim to increase further the number of customers with energy-related products by expanding its product and service range, improving operational productivity and efficiency and enhancing customer service levels. The expansion of its home services activities in this way, with the supporting infrastructure, systems and processes that are being developed, will allow SSE to deploy a comprehensive 'whole house' approach to home energy services.

The 'talk' telecoms package, under which telephone line rental, calls and broadband services are supplied, now has 252,000 customers, an increase of 32,000 on the previous year. The 'talk' package has benefited from being aligned to, and integrated with, SSE's main energy customer systems and processes and this has allowed it to grow customer numbers organically since it was launched in 2003.

In response to the evolving telecommunications market, SSE continually reviews the structure of its telephony products and tariffs and expects to introduce minimum terms contracts during 2010/11 to retain and attract additional customers.

Sales of electrical and gas appliances have continued to struggle in the light of the recession and in line with the downturn in sales experienced across the retail sector, and this prompted a continuing reorganisation of SSE's activities in this area.

Energy Supply Operations - Ireland

During 2007, SSE identified Ireland as a market where the skills used in Great Britain could be successfully deployed, giving it additional room for expansion. In 2009/10, through Airtricity, it increased its customer base in the all-island electricity market in Ireland from 50,000 accounts to 190,000, including 10,000 customers in Northern Ireland. Almost all of these accounts are paid by direct debit and almost half of them are online accounts. SSE is now the third largest energy supplier in the Republic of Ireland and the fourth largest in the all-island market.

The profile of Airtricity as a supplier of energy has been significantly enhanced by SSE's acquisition of the assets of ESB Contracts, the street-lighting business of ESB (see 'Street Lighting' below). It currently maintains around 300,000 street lights in the Republic of Ireland.

Energy Supply Priorities in 2010/11

During 2010/11, and beyond, SSE will seek to:

- provide consistently competitive prices;
- increase the number of customer accounts across the Great Britain and Irish all-island markets;
- secure further efficiencies in day-to-day operations, including the ways in which customers are retained and gained and the ways in which they are given the services they need;
- maintain best-in-sector service, including improvements in billing, call handling times and enhancements to online and smart services;
- increase further the number of customers on 'better plan' and other loyalty programmes;
- deliver energy efficiency improvements, principally through the CERT and CESP programmes; and
- continue to ensure customers' energy accounts are well-managed.

In summary, SSE aims to build on its position as the energy supplier with the strong regional brands, best-in-sector service, consistently-competitive pricing policy and range of value-adding offers to secure another year of customer growth.

FUEL STORAGE AND PRODUCTION

Fuel Storage and Production Key Performance Indicators	Mar 10	Mar 09
Gas storage net capacity in operation (mcm)	400	325
Gas storage customer nominations met - %	100	100

Fuel Storage and Production Overview

It is generally recognised that the UK now has insufficient gas storage. This under-capacity reflects the reliance it was able to place in past years on gas production from the North Sea. As North Sea gas declines, UK imports will continue to increase to meet demand from domestic customers, the increasing number of gas-fired power stations and other industrial and commercial users. Imports could be put at risk by periods of unusually low temperatures, operational failures in pipelines delivering gas to the UK, political disputes in gas-producing regions or high demand in other parts of the world.

SSE owns and operates the UK's largest onshore gas storage facility near Hornsea in East Yorkshire, in which around 325 million cubic metres (mcm) of gas can be stored in a total of nine caverns. Hornsea accounts for around 7% of the total gas storage capacity in the UK and 15% of deliverability. With Statoil (UK) Ltd, SSE is developing another gas storage facility at nearby Aldbrough, where an initial 115mcm of capacity in four caverns is already available for commercial operation. To form such

caverns, salt deposits around 2km under ground are leached out by seawater which, in turn, is replaced (dewatered) by gas under pressure.

On 31 March 2010, SSE entered into an agreement with Hess Corporation (UK) to acquire its natural gas producing assets in three regions of the North Sea (Everest/Lomond; Easington Catchment; and Bacton) for a total cash consideration of US\$423m. The transaction is subject to the receipt of all necessary partner and regulatory approvals.

Gas Storage – Operations

Gas Storage delivered an operating profit* of £41.8m, during 2009/10, compared with £42.7m in the previous year, due to lower differentials between summer and winter gas prices.

At Hornsea, gas can be injected at a rate of 2mcm per day and delivered to the National Transmission System at a rate of 18mcm per day, which is equivalent to the requirements of around four million homes. The services offered at Hornsea provide customers with a reliable source of flexibility with which to manage their gas supply/demand and respond to market opportunities. During 2009/10, including the critical period of the UK's unusually cold winter, Hornsea maintained its excellent record of dependability and was 100% available to customers, except in instances of planned maintenance. This enabled storage customers to manage their gas market risks and respond to gas trading opportunities.

The new capacity which became available at Aldbrough during 2009/10 (115mcm in total – see below) also performed well during 2009/10, with multiple cycles of the capacity and significant delivery on to the National Transmission System during the cold period early in 2010. Following the start of commercial operations in July 2009, 387mcm of gas were injected in to the new capacity and 401mcm were withdrawn. Aldbrough added £2m to operating profit in Gas Storage.

Gas Storage - Investment

The growing demand in the UK for more gas storage facilities to help provide security of supply of gas means such facilities have a long-term value, especially if their cycle rate (the speed at which gas can be withdrawn from storage and then replaced) is fast enough.

SSE's joint venture with Statoil (UK) Ltd to develop at Aldbrough what will become the UK's largest onshore gas storage facility made further important progress during 2009/10, with the first commercial operations getting under way. Aldbrough now provides a total of 115mcm of capacity in four caverns – the first new gas storage capacity to become available in the UK for four years. A further 85mcm of capacity are expected to become available in the course of 2010/11.

When fully commissioned, currently expected to be in 2012, it will have the capacity to inject gas and store up to 370mcm in nine underground caverns (of which SSE will own two thirds). Aldbrough will be the largest onshore gas storage facility in the UK and have the capacity to deliver gas to the National Transmission System at a rate of 40mcm per day, equivalent to the average daily consumption of eight million homes, and the ability to have up to 30mcm of gas per day injected.

SSE still expects its total investment on the development at Aldbrough to be around £290m. With its ability to inject and deliver gas rapidly to meet fluctuations in demand and supply, Aldbrough will provide a valuable source of flexibility to the UK gas market as it becomes increasingly dependent on imported gas to meet its energy needs.

SSE and Statoil (UK) Ltd have consent to increase the storage capacity at the Aldbrough site beyond that currently under development. If developed in full, this would approximately double the amount of gas that can be stored, to around 700mcm. SSE expects to take a final decision on whether and how to invest in a second phase of development at Aldbrough by early 2011.

Gas Production

In March 2010, SSE entered into an agreement with Hess Limited to acquire its natural gas assets and infrastructure in three regions of the North Sea (Everest/Lomond; Easington Catchment; and Bacton).

SSE has agreed to pay a total cash consideration of US\$423m for Hess' assets, maintaining its commitment to its financial principle of a disciplined approach to acquisitions. The transaction is subject to the receipt of all necessary partner and regulatory approvals.

The gas resources which SSE is acquiring total around 3,965 million therms (mth). The headline transaction price for these resources is \$6.6/barrels of oil equivalent. Additional, less certain resources of gas may also be identified through further exploration. The main production asset operators are BG Group, BP and Perenco.

SSE currently needs on average around 13.5mth of gas per day to supply its customers and to fuel its power stations, and gas from the acquired assets will provide around 8% of that initially, declining over the next 10 years.

While the upstream gas assets represent the large majority of the transaction, SSE will also acquire a number of other assets from Hess, including its 17.7% equity interest in the Central Area Transmission System (CATS) pipeline, which delivers over 10% of the UK's total gas demand through a 400km pipeline from the central North Sea to a processing terminal in Teesside. The CATS pipeline is operated by BP.

This timely acquisition will enable SSE to enter the upstream gas sector in a measured way by buying proven and geographically diverse production assets. These assets will provide a new source of primary fuel and a hedge for SSE's gas generation and supply activities. The acquisition will also give SSE involvement throughout the gas chain – production, transmission, storage, distribution and supply.

Fuel Storage and Production Priorities in 2010/11 and Beyond

SSE's operational and investment priorities in Gas Storage and Production during 2010/11 are to:

- maintain its excellent record of safety and reliability at Hornsea;
- ensure safe and effective operation of capacity at Aldbrough;
- maximise the amount of capacity at Aldbrough that is available for commercial storage;
- make a decision on whether to proceed with the Aldbrough extension; and
- complete the acquisition of gas production assets, in keeping with its financial principles.

NETWORKS

Networks Overview

SSE owns three electricity network companies:

- Scottish Hydro Electric Transmission;
- Scottish Hydro Electric Power Distribution; and
- Southern Electric Power Distribution

These networks transmit and distribute electricity to 3.5 million businesses, offices and homes via 128,000km of overhead lines and underground cables.

SSE also has an equity interest of 50% in, and provides corporate and management services to, Scotia Gas Networks (SGN) which, through Southern Gas Networks and Scotland Gas Networks, owns and operates the medium and low pressure networks which deliver gas to 5.7 million properties in their areas of the UK.

All of these companies are the subject of economic regulation through a Price Control set by Ofgem which sets for periods of five years the index-linked revenue they can earn, through charges levied on network users, to cover their costs and earn a return on their regulated assets. Ofgem also places incentives on companies to be more efficient and innovative and to deliver an enhanced quality of service.

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

Overall, Ofgem seeks to strike the right balance between attracting investment in electricity and gas networks, encouraging companies to operate them as efficiently as possible and ensuring that prices ultimately borne by customers are no higher than they need to be. In electricity, a new Distribution Price Control started on 1 April 2010 and will run until 31 March 2015 and the current Transmission Price Control is now expected to run until 31 March 2013. 2009/10 was the second year of the gas Distribution Price Control for the five years to 31 March 2013.

As at 31 March 2010, SSE's estimate of Ofgem's valuation of the assets of its electricity distribution and transmission businesses (the Regulated Asset Value, or RAV) was £2.97bn, based on Ofgem's methodology, including £405m for transmission. This gives it around 12% of the total Great Britain electricity transmission and distribution RAV.

SGN estimates that the RAV of the networks it owns was around £3.94bn, based on Ofgem's methodology, as at 31 March 2010. This makes it the UK's second largest gas distribution company, with around one quarter of the total Great Britain gas distribution RAV. SSE's share of this RAV is £1.97bn which, when added to its electricity networks businesses, gives it a total RAV of £4.94bn, making it the second largest distributor of energy in Great Britain.

SSE is the only energy company in the UK to be involved in electricity distribution, gas distribution and electricity transmission. It therefore participates in three price control reviews in every five years, which gives it ongoing involvement in, and extensive experience of, price control issues in the UK. Together, these lower-risk economically-regulated natural monopoly businesses provide a financial backbone and operational focus for SSE and balance its activities in the competitive Generation and Supply markets.

Moreover, in addition to being relatively low risk in themselves, the absolute level of risk in these businesses has been progressively reduced through the regulatory process with, for example, companies' income no longer being dependent on the volume of energy distributed through their networks.

In March 2009, the Presidency of the EU and Members of the European Parliament agreed on new rules to increase competition in the EU's energy market by separating the management of electricity generation companies from that of transmission operators. An Independent System Operator (ISO) - where companies retain ownership of their transmission networks although their operation is managed by a separate, independent body (the ISO) - already operates in Scotland, where SSE's transmission network is located.

After electricity and gas, telecoms is SSE's third networks business. Unlike the other two, it is not the subject of economic regulation. It operates a national telecoms network and provides capacity and bandwidth services for commercial and public sector organisations and other communications providers. Its network now extends to around 11,200km throughout Great Britain.

Energy Networks Performance Overview

Operating profit* in Energy Networks increased by 2.6%, from £584.2m to £599.5m, contributing 36.9% of SSE's total operating profit*. This comprised:

- £415.8m in electricity networks, compared with £403.7m in the previous year; and
- £183.7m representing SSE's share of the operating profit* for SGN, compared with £180.5m in the previous year.

Energy Networks Key Performance Indicators	Mar 10	Mar 09
ASSETS		
Electricity network Regulated Asset Value (RAV) - £bn	2.97	2.89
Gas network RAV (share) - £bn	1.97	1.82

Total RAV of energy network assets £- bn	4.94	4.71
Electricity network capital expenditure - £m	334.5	314.6
Gas network capital/replacement spend (share) - £m	206.4	191.4

OPERATIONS

SEPD customer minutes lost	65	66
SEPD customer interruptions	61	64
SHEPD customer minutes lost	74	75
SHEPD customer interruptions	76	76
SEPD/SHEPD Performance-based revenue - £m	24.0	18.0
SGN uncontrolled gas escapes attended within one hour	97.9	98.6
SGN gas mains replaced (km)	1,062	951

VOLUME (TERA WATT HOURS – TWh)

SEPD electricity units distributed	33.7	34.4
SHEPD electricity units distributed	8.4	8.5
SGN gas volume distributed (Scotland)	55.2	58.6
SGN gas volume distributed (Southern)	107.8	114.9

ELECTRICITY NETWORKS

Objectives

SSE's objectives in electricity networks are to:

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

Southern Electric Power Distribution Operations

In Southern Electric Power Distribution (SEPD) in 2009/10:

- operating profit* increased by 5.6% to £256.9m;
- electricity distributed fell by 0.7TWh to 33.7TWh;
- the average number of minutes of lost supply per customer was 65, down from 66;
- the number of supply interruptions per 100 customers was 61, down from 64; and
- performance-based additional income of £15.8m is expected to be earned, compared with the final out-turn of £12.0m in the previous year.

The increase in operating profit reflects changes in the price of units distributed, which have mitigated the reduction in volume. Performance in respect of both minutes lost and interruptions was ahead of the targets set by Ofgem under its Quality of Service Incentive Scheme (QSI), which gives financial benefits to distribution network operators that deliver good performance for customers. Performance-based income covers a number of issues, including the quality of service provided to customers and innovation.

Scottish Hydro Electric Power Distribution and Scottish Hydro Electric Transmission Operations

In Scottish Hydro Electric Power Distribution (SHEPD) and Scottish Hydro Electric Transmission (SHETL) in 2009/10:

- operating profit* fell from £160.4m to £158.9m;

- electricity distributed fell by 0.1TWh to 8.4TWh;
- the average number of minutes of lost supply per customer was 74, down from 75;
- the number of supply interruptions per 100 customers was 76, the same as in the previous year; and
- performance-based additional income of £8.2m is expected to be earned, compared with the final out-turn of £6.0m in the previous year.

The fall in operating profit follows the fact that the number of units of electricity distributed was down compared with the previous year. In addition, the recovery of transmission upgrade-related costs has been delayed to 2010/11. Performance in respect of both minutes lost and interruptions was, however, ahead of Ofgem's QSI targets.

Energy Volumes

The volume of electricity distributed by SSE during 2009/10 was 42.1TWh, down from 42.9TWh in the previous year and the volume of gas transported by SGN during the year also fell, by 10.5TWh to 163TWh. Under the electricity Distribution Price Control for 2010-15, the volume of electricity distributed will no longer affect companies' income. Only 3.5% of SGN's income is volume-related. This further reduces the level of risk associated with energy networks businesses.

Operations - Power Distribution Quality of Service

According to Ofgem's Distribution Quality of Service Report, published in December 2009, covering performance in respect of Customer Interruptions and Customer Minutes Lost, SSE's two networks earned additional revenue of £46m in nominal prices in the four years to March 2009 (the most recent period for which comparative data is available), making them the two most successful electricity distribution companies in Great Britain. This reflects effective investment in the automation of the networks and effective operational responses to electricity supply interruptions.

Operations - Cost Efficiency

Efficiency is one of SSE's core values and amongst Ofgem's explicit purposes in setting Price Controls is to keep the costs of providing secure and reliable networks as low as possible. As part of the most recent Price Control review, in December 2009, Ofgem published analysis which showed SSE continues to be at the forefront of efficiency for overall operating costs.

This is based on SSE's straightforward operating model, under which the vast majority of activities are in-house. Under this model:

- customer-facing activities such as, restoring power supplies or providing new connections, are managed from a network of 14 depots in communities throughout central, southern England and the north of Scotland;
- network management activities such as, inspections, maintenance and investment, are carried out in Operational Production Groups; and
- there is a strong emphasis on work being in-sourced and carried out by directly-employed people.

Operations – Customer Service Reward Scheme

In August 2009, SSE received an award of £200,000 under Ofgem's Customer Service Reward Scheme 2008/09 'in recognition of the breadth of its corporate responsibility programme which was seen to go beyond core business drivers'.

Electricity Network Investment and RAV Growth

The key responsibility of SSE's electricity networks businesses is to maintain safe and reliable supplies of electricity and to restore supplies as quickly as possible in the event of interruptions. The Distribution Price Control Review for 2005-10 resulted in substantially increased allowances for capital expenditure to maintain and improve the networks' performance. By earning a return from this investment, SSE is able to increase its revenue from the networks and the efficient delivery of this enhanced investment programme was one of its priorities for 2009/10.

Investment is focused on renewing SSE's networks, which were largely built in the 1950s and 1960s, and thereby reducing the number and duration of power supply interruptions. It is also geared to

providing the infrastructure to accommodate customers' demand for power. Capital expenditure in the electricity networks during 2009/10 was £334.5m (comprising £274.8m in distribution and £59.7m in transmission). In the 2005-10 electricity Distribution Price Control period, SSE invested £1,084.8m in its distribution networks (which excludes metering) and a further £208.1m in its transmission network. This represents an 88% increase compared with the previous Price Control, 2000-2005.

One feature of the 2005-10 Price Control that was widely welcomed was the ability to place underground electricity lines which were previously overhead, to help restore views in national parks and areas of outstanding natural beauty. For example:

- in early 2010, SSE engineers removed a 30 metre electricity pylon in Langstone Harbour as part of a £1.6m project to remove 700 metres of overhead line from the harbour and from the road linking Langstone with Hayling Island and replacing it with underground cabling - the area is a Site of Special Scientific Interest; and
- in the autumn of 2009, SSE placed underground 500m of cable to replace an overhead line at Sligachan on Skye, thus enhancing the classic view from Sligachan Bridge towards the Cuillins.

The need for further significant investment in Great Britain's electricity distribution networks, to maintain and/or replace ageing assets or to provide additional capacity, was a key feature of the electricity Distribution Price Control for 2010-15 and it allows for total investment of £14bn in the networks over the next five years. For SSE, this is likely to mean investment of around £210m in its distribution networks in 2010/11.

Distribution Price Control Review 2010-15

In December 2009, SSE decided, on balance, to accept Ofgem's final proposals for the electricity Distribution Price Control for the five years from 1 April 2010 in respect of Scottish Hydro Electric Power Distribution and Southern Electric Power Distribution.

SSE assessed Ofgem's final proposals against the combined impact of three key criteria:

- the scope to earn additional revenue through operational efficiency and excellence;
- the treatment of ongoing pension costs; and
- the allowed return for shareholders as measured by the weighted average cost of capital.

On its own, the headline allowed weighted average cost of capital contained within the proposals (4.0%, on a post-tax, real return on capital basis) would not be enough to provide an adequate return on investment in electricity distribution or transmission. In addition to the cost of capital, however, Ofgem's proposals contained enhanced incentive mechanisms in areas such as customer service. They also reduced further the level of risk associated with energy network businesses by ensuring that the volume of electricity distributed will no longer affect companies' income.

The overall package should, therefore, allow SSE, the most efficient operator in Great Britain, to add to the return it earns from its electricity distribution assets by delivering good operational performance and innovations in network management.

Examples of SSE's activities which should support the achievement of a sufficient return include:

- dynamic line rating that allows the overhead line network to be operated to its maximum capacity rather than to constraints based on design assumptions;
- protective coatings and enhanced condition assessments that allow the life of assets to be extended without risking performance degeneration; and
- trench-less cable-laying technology, which reduces the public disruption and costs associated with cable-laying.

In addition, SSE will seek to secure a significant proportion of the new £500m Low Carbon Network Fund, designed by Ofgem to support larger-scale trials of advanced technology, including smart grids. It will also seek to manage effectively the new arrangement under which 100% of support costs are deemed to be expenses and 85% of network costs are deemed to be capital, with associated output measures in place.

Smart Grids

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

Smart grid technology has the potential to improve significantly the efficiency of the electricity distribution and transmission networks in the UK and this deployment provides a blueprint for how smart grids can be used to connect high penetrations of renewable generation in a cost effective way and resolve grid congestion as a result. The connection of similar levels of renewable generation on Orkney by the conventional means of network reinforcement would have cost around £30m, compared with smart-related costs of less than £1m. In other words, the total cost of developing and delivering this innovative solution has been substantially cheaper and much faster than the alternatives.

Energy Network Regulation – Future Developments

In January 2010, Ofgem published its *Emerging Thinking* document on the future of electricity and gas network regulation. It suggests that the RPI-X price control mechanism needs to be changed as it will not be able to cope with the pace, uncertainty and scale of change needed to deliver sustainable energy supplies for customers. The document's proposals are designed to change the focus of regulation from companies' costs to looking more at what companies can deliver in terms of reliable networks, safety and investment to support low-carbon generation and meet the needs of customers.

This approach builds on the electricity Distribution Price Control 2010-15, and could amount to a form of contract between Ofgem and the regulated network company, with the emphasis on delivery of certain key outputs. Ofgem is consulting on its 'emerging thinking' before more 'concrete and detailed' proposals are published in the summer of 2010.

Electric Vehicles

Electric vehicles will be an essential part of the move towards a low-carbon transport infrastructure. The next decade is likely to see a significant uptake of such vehicles, which some reports have suggested could reach around 1.5 million in the UK as early as 2020. They also have the potential to influence dramatically the demand profile and quantity of electricity required by customers, and will impact on all aspects of SSE's business, including electricity distribution.

For this reason, SSE is taking part in the Technology Strategy Board's Ultra Low Carbon Vehicle Demonstration (ULCVD) project, which consists of eight consortia bringing over 300 vehicles to trial. The two consortia in which SSE is involved are with:

- BMW UK Ltd, Oxford Brookes University and the South East England Development Agency: 40 MINI E vehicles are being trialled by members of the public, SSE employees and fleet users in southern England. SSE has installed 32 Amp domestic charging facilities at the homes of the drivers, together with the smart metering to gather usage data. SSE is also installing public charging posts at selected locations; and
- Ford, Strathclyde University and the London Borough of Hillingdon: 20 prototype electric vehicles are being introduced and SSE will be providing the private and public charging infrastructure.

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

Future Transmission Developments

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

Four major developments currently under way have the potential to transform the scale and scope of SSE's electricity transmission business:

- **Knocknagael, Beaully-Blackhillock-Kintore and Beaully-Dounreay:** In January 2010, Ofgem announced authorisation of pre-construction and construction funding for these three upgrades in the SHETL area, which form part of the first tranche of transmission projects to help connect renewable energy to the electricity network. These projects have a total value of almost £200m and should all be completed by 2014.
- **Beaully-Denny:** Scottish Ministers announced in January 2010 that they have granted consents, with associated conditions, to install a 400,000 volt overhead electricity transmission line to replace the existing 132,000 volt overhead transmission line between Beaully and Denny. The existing line will be dismantled. The final cost of replacing the Beaully-Denny line can only be established once analysis of all of the conditions associated with the consent has been completed; and full construction work can only begin once it is clear that all of the conditions can be satisfied and Ofgem is able to confirm the investment is necessary, efficient and economical. SSE has concluded it should be able to undertake preliminary construction works this year, with a value of around £50m, with a further four summers of construction work required to complete the new line.
- **Western Isles:** SSE's proposal for an electricity transmission connection between the Western Isles and the north west of Scotland features, for the 77km mainland section, an underground cable between the west coast of Sutherland and the Beaully substation. SHETL submitted to Scottish Ministers an application for consent to construct the connection in October 2008. The connection will be required to transmit renewable energy from the Western Isles, and a significant milestone was reached in January 2010 when a developer received approval for a 118MW wind farm at Eishken.
- **Shetland:** In July 2009, SHETL submitted planning applications for converter stations associated with the proposed 320km subsea high voltage direct current (HVDC) transmission link between the Shetland Islands and Moray on the Scottish mainland to accommodate renewable energy developments in Shetland. It would also connect properties in Shetland to the mainland electricity network for the first time. Related to this, in December 2009, the European Commission announced that SSE had been successful in securing a capital grant of €74m under the European Energy Programme for Recovery. The grant is towards the incremental cost of including an intermediate offshore HVDC hub off Caithness on the route of the proposed Shetland link and increasing the capacity of the southern section to Moray. The hub is at the centre of a potential, innovative three-ended 'Y' configuration, with legs from Caithness and Shetland to accommodate substantial planned renewable energy developments in the far north east of Scotland and the Northern Isles.

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

Electricity Distribution and Transmission Priorities in 2010/11 and Beyond

During 2010/11 SSE's priorities in electricity networks are to:

- maintain safe and reliable supplies of power and to restore supplies as quickly as possible in the event of interruptions;
- respond effectively to the new arrangements in electricity distribution for allocating costs between support activities (expenses) and networks (capital);
- deliver successfully its investment plans in its electricity distribution networks;
- deploy innovative techniques to maximise the returns from good performance in electricity networks; and

- make further progress in upgrading the transmission network in the north of Scotland.

With such significant investment requirements over the next few years, not least in providing the infrastructure to accommodate electricity produced from renewable sources, the scope for additional incremental growth in electricity networks is clear. When opportunities arise to supplement that growth through the acquisition of additional networks, SSE considers them carefully. It will not, however, depart from its long-stated financial principle of deploying a selective and disciplined approach to acquisitions.

GAS NETWORKS

Scotia Gas Networks (SGN) – Financial

SGN, in which SSE holds 50% of the equity, owns and operates the Scotland and the Southern gas distribution networks. The networks comprise around 75,000km of gas mains, delivering gas to around 5.7 million industrial, commercial and domestic customers. SSE receives 50% of the distributable earnings from SGN, in line with its equity holding, and also provides it with corporate and management services.

SSE's share of the adjusted operating profit* of SGN was £183.7m in 2009/10, compared with £180.5m in the previous year. This is primarily due to two things:

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

A small part of SGN's operating profit is derived from the non-regulated activities of its contracting, connections and commercial services operations.

In October 2009, SGN successfully issued two new Sterling bonds: a 30-year, £125m index-linked bond; and a nine-year, £300m fixed-rate bond.

Scotia Gas Networks - Operational

In March 2009, Ofgem published its *Gas Distribution Annual Report for 2007/08*. It included a top-down regression analysis of controllable operating costs which showed that SGN's two networks are first and third out of the eight networks in Great Britain for operating cost efficiency, compared with seventh and sixth when they were acquired by SGN in 2005.

One of the conditions in SGN's license to operate is that it should attend at least 97% of uncontrolled gas escapes within one hour of notification; in 2009/10, 97.9% were attended within one hour.

During 2009/10, SGN's gas transportation volumes were:

- 55.2TWh in Scotland, compared with 58.6TWh in the previous year; and
- 107.8TWh in Southern, compared with 114.9TWh in the previous year.

Only 3.5% of SGN's transportation income is volume-related; the remaining 96.5% is related to the maximum capacity requirements of its customers.

When SGN acquired its networks in June 2005, National Grid was contracted to provide it with services with a total value of £30m per annum. In the five years since, services have been brought within SGN, and by the end of 2010/11 it is expected that SGN's remaining service contracts with National Grid will total £7m per annum. These contracts cover transmission services, control and IT services and emergency call handling.

Scotia Gas Networks – Investment

The five-year gas Distribution Price Control, which began in April 2008, provides the opportunity for SGN to increase significantly investment in its gas distribution networks, thereby reinforcing their

safety and reliability and securing another significant increase in their RAV. By 2013, SGN estimates that its total RAV will be around £4.6bn.

During 2009/10, SGN invested £412.8m in capital expenditure and mains and services replacement projects, compared with £382.8m in the previous year. The majority of the mains replacement expenditure was incurred under the 30:30 mains replacement programme which was started in 2002. This requires that all iron gas mains within 30 metres of homes and premises must be replaced over a 30-year period, and in 2009/10 SGN replaced over 1,050km of its metallic gas mains with modern polyethylene pipes.

SGN has commenced work on a £21m project to replace the under-sea gas main between the south coast mainland and the Isle of Wight. The project involves the longest directional drill ever undertaken (3.9km), going across the Solent between Lepe and Gurnard. Two tunnels will be bored to take two 30cm diameter gas pipes, which will be installed some 30m to 50m below the seabed.

SGN is committed to making new gas connections to existing homes that are not on mains gas as affordable as possible and is running a new scheme to help fuel-poor customers. Already, over 4,000 acceptances have been received to provide a mains gas connection to homes under the new Ofgem-approved scheme. One of the first communities to benefit was Rattray in Perthshire where, thanks to an extension to the gas network, some 300 homes will now have access to mains gas, giving residents the choice of gas-fired heating for the first time.

This scheme, along with other initiatives on carbon monoxide safety and reducing environmental impacts, helped SGN secure a £550,000 award from Ofgem under its first ever discretionary rewards scheme for the UK's gas distribution networks. The scheme, which is judged by a panel of industry experts, was established as part of Ofgem's gas Distribution Price Control 2008-13.

Investment will continue to be a top priority and, in line with that, SGN expects to invest around £400m in capital expenditure and mains and services replacement projects during 2010/11.

Scotia Gas Networks Priorities in 2010/11 and Beyond

During 2010/11, SGN's priorities are to:

- deliver a safe and secure gas supply to customers;
- deliver to time and budget the 2010/11 mains replacement and capital works programmes; and
- provide sector-leading customer service and exceed the standards of response levels set by Ofgem.

TELECOMS NETWORKS

Introduction to Telecoms

After electricity and gas, Telecoms is SSE's third networks business. Its origins lie in the installation, a decade ago, of fibre optic cable on SSE's electricity network. The business combines SSE Telecoms and Neos Networks and, following several acquisitions in recent years, including the ATLAS Connect fibre network from Scottish Enterprise in March 2010, it now operates a 11,200km UK-wide telecoms network.

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

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

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

To complement its core telecoms network business, SSE completed the acquisition of a Fareham-based data centre business in June 2009.

Telecoms Operations

SSE's combined Telecoms business achieved an operating profit* of £16.4m during 2009/10, compared with £15.5m in the previous year. This reflected principally increased sales and ongoing cost controls.

Telecoms Investment

In 2009/10, SSE undertook capital expenditure of £25.9m in respect of its telecoms network, principally focused on improving network reliability and reach.

The data centre at Fareham was acquired for £4.85m. It provides capacity for more than 2,000 racks for the co-location of IT services within the 80,000 square feet secure site and 15MW of power in a resilient and energy efficient environment, which will include one of the UK's largest rooftop solar photovoltaic installations. The data centre uses a modular design which allows customers to select the level of service that they require.

Following the acquisition, a trading division, SSE Data Centres, was created, and in October 2009 it was awarded a new long-term contract to provide Kingfisher plc with its own dedicated data centre pod to support IT infrastructure to be migrated from a number of existing data centres. The connection between telecoms networks and data storage is illustrated by the fact that SSE secured two orders for bandwidth capacity from Kingfisher following this agreement. In addition, in April 2010, a 10-year data storage contract was signed with Thompson Reuters.

Telecoms Priorities in 2010/11 and Beyond

SSE's priorities in Telecoms in 2010/11 are to:

- complete the integration of recently acquired network assets;
- retain and gain customers for key services such as capacity and bandwidth; and
- add to the number of customers for its data centre business.

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

ENERGY SERVICES

Energy-Related Services Overview

As well as being involved in Generation and Supply, Fuel Production and Storage and Networks, SSE also provides an additional range of energy services which complement its other businesses: Contracting and Connections (including Utility Solutions) and Metering. These are important services, on which customers depend, so that their increasingly complex energy requirements can be met.

Key Performance Indicators	Mar 10	Mar 09
SSE Contracting order book (£m)	115	101
New electrical connections	24,300	36,000
New gas connections	6,700	7,300
Out-of-area networks in operation	53	47
Meters read - m	10.7	9.0

CONTRACTING, CONNECTIONS AND METERING

Operating profit* in Contracting, Connections and Metering was £80.2m during 2009/10, compared with £74.8m in the previous year.

Introduction to Contracting

SSE Contracting trades principally as Southern Electric Contracting (SEC) and has three main areas of activity:

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

It is one of the largest mechanical and electrical contracting businesses in the UK. It operates from over 60 regional offices throughout Great Britain and also trades as Swalec Contracting in Wales and Scottish Hydro Contracting in Scotland.

Contracting Performance During 2009/10

SSE Contracting continued to make solid progress during 2009/10, with its order book ending the year at £115m, despite the UK's economic difficulties. The order book was supported by significant new contract wins with a number of major organisations in recent months, including Southend University Hospital, Murco Petroleum, British Telecom, Network Rail and Glasgow Housing Association.

A major proportion of SSE Contracting's business is from public sector bodies and end-user client organisations with a high degree of repeat business or long-term contracts. This has put it in a relatively good position to withstand the initial effects of the economic downturn. Given the downturn, during the year, it focused on:

- pre-sales activity, with careful analysis of the markets and areas of work it should prioritise; and
- post-sales control, with a strong emphasis on controlling costs while meeting customers' requirements.

There is clearly a risk that the business' order book and profitability will be affected as a result of the cumulative impact of the continuing economic uncertainty and the expected constraints on public expenditure. As a result, cost control and customer relationships will remain particularly high priorities for SSE Contracting during 2010/11.

Contracting – Street Lighting

SSE Contracting remains the UK's leading street-lighting contractor, and in 2009/10 retained contracts with 26 authorities to maintain over 1.1 million lighting columns.

In August 2009, SSE was awarded the £225m, 25-year South Coast Streetlighting PFI (Private Finance Initiative) contract, through its PFI street-lighting entity Tay Valley Lighting. Under the contract, SSE Contracting will replace and maintain 250,000 street lights, illuminated signs and bollards on behalf of Hampshire and West Sussex County Councils and Southampton City Council. It took the number of local authorities with which SSE has long-term street-lighting replacement and maintenance PFI contracts to 10 and the number of lighting units covered by such contracts to over 530,000.

Again through Tay Valley Lighting, SSE has been appointed preferred bidder on the Nottingham City Council street lighting PFI project. The 25-year contract involves the replacement and maintenance of around 40,000 columns, and illuminated signs. Tay Valley Lighting is actively bidding for a number of other PFI projects.

In November 2009, SSE acquired the assets of ESB Contracts Ltd (ESBC), the street-lighting business of ESB, for a total cash consideration of €6.4m, making it Ireland's leading street-lighting contractor. ESBC maintained around 300,000 street lights in the Republic of Ireland. Street-lighting will in due course become the subject of competitive tendering by local authorities. Under SSE's ownership, the business is known as Airtricity Utility Solutions and employs over 100 people, including people who previously worked with ESBC. Including Ireland, SSE now maintains around 1.4 million street lights.

Over the last 12 months SSE also acquired the rights to 'Mayflower', an intelligent management system for controlling street-lighting from a central location. The functionality of the system will allow

local authorities to switch lights on and off and to dim them when there is less requirement for high lighting levels. Mayflower already has orders for over 300,000 units.

Contracting - Microgeneration

SSE Contracting is also spearheading SSE's response to the introduction on 1 April 2010 of Feed-in Tariffs (FiTs) to encourage householders, communities and other groups to generate their own electricity from low-carbon technologies such as solar PV. The capacity of installations can be up to 5MW. FiTs will be followed by the Renewable Heat Incentive in April 2011.

Microgeneration is a very small market at the moment, but it is growing fast and FiTs will provide additional impetus to this growth. With its technical, contract management and project management skills, SSE Contracting is ideally-placed to provide customers with the services they need in all aspects of microgeneration and developing the full array of necessary services is now under way.

SSE is to become the first utility in the UK to build and monitor its own development of zero-carbon homes. The 10-home development, under construction near Slough, is being built on land previously occupied by an SSE office building. The properties have been designed to achieve the highest specification for sustainable building, Code Level 6 in the Code for Sustainable Homes. The installation of renewable energy features will be carried out by SSE Contracting and SSE Utility Solutions. All new homes built in England from 2016 onwards must be zero carbon.

In one of the first ever live demonstrations of what will be needed to achieve highly energy efficient living, SSE will test the every-day performance of the technology installed in the homes, such as a photovoltaic (solar) roof and a renewable district heating system. The development will feature a renewable energy heat hub, housing five different types of micro-generation including air and ground source heat pumps, a biomass boiler and solar thermal panels. The homes will be fitted with the latest energy efficient appliances and SSE will use smart meters to monitor the energy and water usage of the homes for 24 months.

The information gleaned will help SSE understand how householders respond and adapt to zero-carbon living. It will also provide SSE and its related companies, such as those linked with SSE Ventures, with valuable information to share with stakeholders such as construction partners, technology manufacturers and industry bodies.

Contracting Priorities in 2010/11 and Beyond

The key priority for SSE Contracting during 2010/11 is to position itself for the long term by:

- working safely;
- delivering a high standard of service to all customers;
- maintaining a strong order book;
- maximising business opportunities with existing customers,
- adding to its list of street-lighting contracts; and
- building up opportunities in microgeneration, including the zero-carbon homes project.

This, in turn, should enable SSE Contracting to consolidate its position among the leading GB-wide electrical and mechanical contractors and prepare for the rapid move to lower carbon technologies that will take place over the next decade.

Introduction to Connections, including Utility Solutions

As its name implies SSE's Connections business provides electricity connections for homes, offices and businesses.

Separately, during 2008/09, SSE combined the following activities to form SSE Utility Solutions:

- out-of-area embedded electricity networks (previously known as 'National Networks');
- licensed gas transportation (SSE Pipelines);
- water and sewerage services (SSE Water); and
- low-carbon local energy (energy services or 'ESCo').

SSE Utility Solutions is, therefore, able to provide a one-stop solution for multi-utility infrastructure requirements to customers in the property development and house-building sectors. It can design, construct, own and operate this range of closely-related services.

Electricity Connections

During 2009/10, SSE completed 24,300 electrical connections, compared with 36,000 in the previous year. This was the third successive year in which the number of connections completed fell, and the weakness of the economy means SSE expects a further decline in 2010/11 – although the financial impact of any decline should be partly offset by connection work relating to wind farms.

Utility Solutions - Electricity Networks

SSE has continued to develop its portfolio of electricity networks outside the Southern Electric and Scottish Hydro Electric Power Distribution areas. It now owns and manages 53 energised electricity networks outside these two areas, with development work ongoing at a number of these, and a further 25 are under construction, including residential and commercial developments across England, Scotland and Wales. In total, SSE has 436MW of networks capacity, including 157MW currently under construction. Nevertheless, a reduction in new development activity in the UK economy has been clearly evident and this will have an impact on SSE's shorter-term growth ambitions in this area, although its market share has been increasing and it expects this to continue.

Utility Solutions - Gas Pipelines

SSE is also a licensed gas transporter. This business installs, owns and operates gas mains and services on new housing and commercial developments throughout the UK. Although at a slower rate than in previous years, the total number of new premises connected to its gas networks has continued to grow, and during 2009/10 it connected a further 6,700 premises, taking the total number of connections to more than 66,000. This is despite a significant number of building sites being mothballed, and building projects being deferred, which means the number of gas connections completed in 2010/11 is likely to be lower than in the previous year.

Utility Solutions - Water

SSE Water (SSEW) is the first new company to offer both water and sewerage services since privatisation in England and Wales in 1989. An 'inset' appointment is the route by which one company replaces another as the appointed water and/or sewerage company for a specified area. SSE Water was granted its first inset appointment in October 2007, had five as at March 2010 and has since been awarded a sixth. Under these appointments, SSE will provide water and sewerage services to over 5,000 properties.

Utility Solutions - Energy Services

SSE Energy Services provides low-carbon local energy services, such as the commercial and domestic heating system and 4.5MW Combined Heat and Power (CHP) facility at Woolwich. During 2009/10, it secured energy services agreements for local energy infrastructure for a further two heat networks. It is developing biomass, heat pump and wind energy solutions for communities and commercial enterprises. The impact of the economic slowdown on the UK's construction sector means that projects to develop new residential CHP schemes are fewer than was the case two years ago and SSE is now seeking to participate in other markets such as health, education and defence.

Utility Solutions Priorities for 2010/11 and Beyond

SSE Utility Solutions increased its market share during 2009/10 by focusing on providing good customer service and because a number of its competitors operated under significant financial constraints as a result of the economic downturn. During 2010/11 its priority is to build on this increase and further increase its number of electricity networks, gas connections, water and sewerage inset appointments and energy services agreements.

Introduction to Metering

SSE's Metering business provides services to most electricity suppliers with customers in central southern England and the north of Scotland and has undertaken a programme of in-sourcing of meter reading operations and meter operator work in other parts of Great Britain to establish a national metering business. It supplies, installs and maintains domestic meters and carries out metering work in the commercial, industrial and generation sectors. It also offers data collection services to the domestic and SME sectors.

Metering Performance During 2009/10

In total, SSE owns 3.8 million meters. During 2009/10, it collected:

- 6.8 million electricity readings, up from 6.4 million in the previous year; and
- 3.9 million gas readings, up from 2.6 million.

This increase reflects the fact that SSE has completed the in-sourcing of its meter reading and electricity meter operation services throughout Great Britain, a year ahead of schedule.

Before the in-sourcing was completed, SSE relied on a combination its own employees in central southern England and the north of Scotland and up to nine external agencies elsewhere in the country to read electricity and gas meters and install and repair electricity meters.

In line with its general preference for services and operations to be carried out in-house, SSE decided to in-source metering services in a programme which started in 2007. This programme has now been completed and, as a result, SSE's metering team now comprises 1,500 directly-employed people working in all parts of Great Britain. In addition to securing annual cost savings of at least £5m, the in-house metering team delivers more reliable metering services, allows more effective management of customer data and creates face-to-face contact between SSE and its customers. It thus helps in the retention of customers.

Longer-term, SSE's Great Britain-wide metering team will be able to support the transition to smart meters which will take place over the next 10 years and will help SSE deploy other energy-related services and products during that time.

Smart Metering

Smart metering is an emerging system that enables the quantity and value of electricity and gas used by the customer to be continuously monitored and allows information about its use and cost to be available to the customer and exchanged with the supplier, through two-way electronic communications. All homes in Great Britain are expected to have smart meters by 2020.

In early 2010, SSE successfully completed the first community-wide energy reduction trials in the UK, helping two communities achieve a 10% reduction in their electricity consumption. The trials, part of the Energy Research Demand Project (EDRP), involved working with communities to help them achieve the reduction over a two-and-a-half-year period.

The EDRP trials are managed by Ofgem, on behalf of the UK Department of Energy and Climate Change, and aim to gain an understanding of how consumers react to improved information about their energy consumption. The trials consist of different elements using different methods to provide feedback on energy consumption.

SSE was the only energy supplier in the EDRP to hold trials involving engagement with entire communities. The trials were held in North Leigh in Oxfordshire, Alyth in Perthshire and St Athan in South Wales. The communities of North Leigh and Alyth achieved their community-wide 10% energy reduction and received an award of £20,000 each from SSE. The trial in St Athan started later, and is therefore not due to be completed until later this year, but good progress is being made.

A variety of measures was available to each community including smart meters, real-time display devices (which show energy use in monetary value), energy efficiency advice and insulation offers. As well as the support provided by SSE, the communities arranged various events locally, designed to involve the whole community.

The information that has been obtained during the trials has been and will be extremely useful and it will be used to help shape the future of the energy industry. The primary purpose of the trials was to understand how people use energy and how savings can be made when more control is given to individuals and communities.

Metering Priorities in 2010/11 and Beyond

For Metering, the key priorities are:

- maximising the number of bills issued to customers on the basis of an actual – as opposed to estimated – meter reading;
- applying the lessons learned from the EDRP to inform a full roll-out of smart meters throughout the country.

SSE believes that there must be radical changes in the way that energy is produced and consumed and these energy reduction trials, which have used a number of innovative technologies, will assist customers in reducing their energy consumption. It strongly supports smart meters, and the opportunity they provide to help customers cut their energy consumption, while reducing the number of service-based tasks which are largely administrative and reactive in nature, and replacing them with more substantive energy advice, products and services. They have the potential to help transform the relationship between customers and their energy supplier.

Disclaimer

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

Consolidated Income Statement
for the year ended 31 March 2010

		2010			2009		
	Note	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 5) £m	Total £m	Before exceptional items and certain re-measure- ments £m	Exceptional items and certain re-measure- ments (note 5) £m	Total £m
Revenue	4	21,550.4	-	21,550.4	25,424.2	-	25,424.2
Cost of sales		(19,504.8)	432.2	(19,072.6)	(23,552.7)	(1,291.7)	(24,844.4)
Gross profit		2,045.6	432.2	2,477.8	1,871.5	(1,291.7)	579.8
Operating costs		(683.7)	-	(683.7)	(576.5)	-	(576.5)
Other operating income		-	-	-	-	102.7	102.7
Operating profit before jointly controlled entities and associates		1,361.9	432.2	1,794.1	1,295.0	(1,189.0)	106.0
Jointly controlled entities and associates:							
Share of operating profit		264.1	-	264.1	246.4	-	246.4
Share of interest		(107.1)	-	(107.1)	(128.2)	-	(128.2)
Share of movement on derivatives		-	4.1	4.1	-	3.8	3.8
Share of tax		(50.1)	(1.2)	(51.3)	(39.3)	(1.1)	(40.4)
Share of profit on jointly controlled entities and associates		106.9	2.9	109.8	78.9	2.7	81.6
Operating profit	4	1,468.8	435.1	1,903.9	1,373.9	(1,186.3)	187.6
Finance income	6	203.2	-	203.2	209.7	-	209.7
Finance costs	6	(432.0)	(36.5)	(468.5)	(369.8)	25.8	(344.0)
Profit before taxation		1,240.0	398.6	1,638.6	1,213.8	(1,160.5)	53.3
Taxation	7	(292.2)	(110.9)	(403.1)	(300.6)	359.6	59.0
Profit for the year		947.8	287.7	1,235.5	913.2	(800.9)	112.3
Attributable to:							
Equity holders of the parent		947.6	287.7	1,235.3	913.2	(800.9)	112.3
Minority interest		0.2	-	0.2	-	-	-
Basic earnings per share	9			134.0p			12.7p
Diluted earnings per share	9			133.9p			12.8p
Adjusted earnings per share	9			110.2p			108.0p
Dividends paid in the year	8			£618.5m			£551.9m

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

Consolidated Statement of Comprehensive Income
For the year ended 31 March 2010

	2010	2009
	£m	£m
Profit for the year	1,235.5	112.3
(Loss)/gain on effective portion of cash flow hedges	(26.6)	22.9
Taxation on cashflow hedges	2.1	(6.4)
	(24.5)	16.5
Effective net investment hedge	(47.2)	(142.9)
Taxation on net investment hedge	13.2	40.0
	(34.0)	(102.9)
Actuarial losses and other equity movements on retirement benefit schemes	(508.8)	(278.9)
Taxation on actuarial losses and other equity movements on defined benefit pension schemes	142.5	78.1
	(366.3)	(200.8)
Exchange difference on translation of foreign operations	0.4	221.7
Jointly controlled entities and associates:		
Share of (loss) / gain on effective portion of cash flow hedges	(30.0)	4.4
Share of taxation on cashflow hedges	19.1	(1.2)
	(10.9)	3.2
Share of actuarial losses on retirement benefit schemes	(82.1)	(53.2)
Share of taxation of actuarial losses on retirement benefit schemes	23.0	14.9
	(59.1)	(38.3)
Net share from jointly controlled entities and associates	(70.0)	(35.1)
Other comprehensive income	(494.4)	(100.6)
Total comprehensive income for the period	741.1	11.7
Attributable to:		
Equity holders of the parent	740.9	11.7
Minority Interest	0.2	-
	741.1	11.7

Consolidated Balance Sheet
as at 31 March 2010

	2010	2009
Note	£m	£m
Assets		
Property, plant and equipment	8,204.2	7,232.2
Biological assets	4.4	-
Intangible assets:		
Goodwill	726.3	724.0
Other intangible assets	288.2	253.0
Investments in associates and jointly controlled entities	1,037.3	918.7
Other investments	9.2	18.3
Deferred tax assets	157.1	100.1
Derivative financial assets	466.3	449.2
Non-current assets	10,893.0	9,695.5
Intangible assets	213.3	213.9
Inventories	272.5	366.7
Trade and other receivables	5,018.8	5,659.6
Cash and cash equivalents	261.7	295.9
Derivative financial assets	1,468.3	1,537.7
Current assets	7,234.6	8,073.8
Total assets	18,127.6	17,769.3
Liabilities		
Loans and other borrowings	903.7	1,060.1
Trade and other payables	4,064.5	4,364.9
Current tax liabilities	216.9	254.6
Provisions	6.5	13.8
Derivative financial liabilities	2,020.7	2,451.0
Current liabilities	7,212.3	8,144.4
Loans and other borrowings	5,143.3	4,336.1
Deferred tax liabilities	624.0	594.7
Provisions	324.5	60.2
Trade and other payables	83.2	426.0
Retirement benefit obligations	720.3	273.5
Derivative financial liabilities	899.0	959.5
Non-current liabilities	7,794.3	6,650.0
Total liabilities	15,006.6	14,794.4
Net assets	3,121.0	2,974.9
Equity:		
Share capital	461.5	460.2
Share premium	857.5	835.3
Capital redemption reserve	22.0	22.0
Equity reserve	-	0.8
Hedge reserve	(16.2)	19.6
Translation reserve	113.4	146.6
Retained earnings	1,686.6	1,492.7
Total equity attributable to equity holders of the parent	3,124.8	2,977.2
Minority Interest	(3.8)	(2.3)
Total Equity	3,121.0	2,974.9

Statement of Changes in Equity
as at 31 March 2010

Consolidated

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

Consolidated

Reconciliation of movement in reserves	Share capital £m	Share premium account £m	Capital redemption reserve £m	Equity reserve £m	Hedge reserve £m	Translation reserve £m	Retained earnings £m	Minority Interest £m	Total £m
At 1 April 2008	435.1	315.7	22.0	3.9	2.3	25.4	2,175.6	0.3	2,980.3
Profit for the year	-	-	-	-	-	-	112.3	-	112.3
Effective portion of changes in fair value of cash flow hedges (net of tax)	-	-	-	-	16.5	-	-	-	16.5
Effective net investment hedge (net of tax)	-	-	-	-	-	(102.9)	-	-	(102.9)
Exchange differences on translation of foreign operation	-	-	-	-	(2.4)	224.1	-	-	221.7
Actuarial gains on retirement benefit schemes (net of tax)	-	-	-	-	-	-	(200.8)	-	(200.8)
Jointly controlled entities and associates:									
Share of change in fair value of effective cash flow hedges	-	-	-	-	3.2	-	-	-	3.2
Share of actuarial losses on retirement benefit schemes (net of tax)	-	-	-	-	-	-	(38.3)	-	(38.3)
Total comprehensive income for the period	-	-	-	-	17.3	121.2	(126.8)	-	11.7
Dividends to shareholders	-	-	-	-	-	-	(551.9)	(2.6)	(554.5)
Convertible bond converted to equity	3.5	61.6	-	(3.1)	-	-	-	-	62.0
Issue of shares	21.6	458.0	-	-	-	-	-	-	479.6
Credit in respect of employee share awards	-	-	-	-	-	-	14.3	-	14.3
Investment in own shares	-	-	-	-	-	-	(15.8)	-	(15.8)
Current and deferred tax recognised in equity in respect of employee share awards	-	-	-	-	-	-	(2.7)	-	(2.7)
At 31 March 2009	460.2	835.3	22.0	0.8	19.6	146.6	1,492.7	(2.3)	2,974.9

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

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

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

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

Consolidated Cash Flow Statement
for the year ended 31 March 2010

	2010	2009
	£m	£m
Cash flows from operating activities		
Profit for the year after tax	1,235.5	112.3
Taxation	403.1	(59.0)
Movement on financing and operating derivatives	(395.7)	1,265.9
Finance costs	432.0	369.8
Finance income	(203.2)	(209.7)
Share of jointly controlled entities and associates	(109.8)	(81.6)
Pension service charges less contributions paid	(88.8)	(49.3)
Depreciation and impairment of assets	356.4	315.9
Amortisation and impairment of intangible assets	22.2	14.4
Impairment of inventories	3.0	8.2
Release of provisions	(7.1)	(47.5)
Deferred income released	(15.2)	(16.7)
Decrease/(Increase) in inventories	97.2	(127.7)
Decrease/(Increase) in receivables	914.3	(2,048.3)
(Decrease)/Increase in payables	(486.8)	958.0
Increase in provisions	5.9	4.7
Charge in respect of employee share awards (before tax)	17.9	14.3
Profit on disposal of property, plant and equipment	(5.7)	(1.7)
Profit on disposal of 50% of Greater Gabbard Offshore Winds	-	(102.7)
Loss/(profit) on disposal of fixed asset investment	0.1	(2.2)
Cash generated from operations	2,175.3	317.1
Dividends received from jointly controlled entities	23.7	39.8
Dividends paid to minority investment holders	(1.7)	(2.6)
Interest income	102.5	74.4
Interest costs	(341.4)	(219.2)
Income taxes paid	(307.7)	(255.5)
Payment for consortium relief	-	(0.4)
Net cash from operating activities	1,650.7	(46.4)
Cash flows from investing activities		
Purchase of property, plant and equipment	(995.0)	(1,172.2)
Purchase of other intangible assets	(4.2)	(37.5)
Deferred income received	18.7	24.8
Proceeds from sale of property, plant and equipment	40.2	3.8
Proceeds from disposal of 50% of Greater Gabbard Offshore Winds	-	308.5
Purchase of 50% of Greater Gabbard Offshore Winds	-	(40.0)
Proceeds from sale of fixed asset investment	0.9	2.4
Loans to jointly controlled entities	(336.4)	(262.0)
Purchase of businesses and subsidiaries	(67.8)	(28.4)
Cash acquired in purchases	9.7	0.1
Investment in jointly controlled entities and associates	(61.8)	(64.4)
Loans and equity repaid by jointly controlled entities	34.5	79.7
Increase in other investments	(1.1)	(12.5)
Net cash from investing activities	(1,362.3)	(1,197.7)
Cash flows from financing activities		
Proceeds from issue of share capital	6.8	479.6
Dividends paid to company's equity holders	(618.5)	(551.9)
Employee share awards share purchase	(15.8)	(15.8)
New borrowings	1,338.3	3,203.1
Repayment of borrowings	(1,035.3)	(1,835.3)
Net cash from financing activities	(324.5)	1,279.7
Net (decrease) / increase in cash and cash equivalents	(36.1)	35.6
Cash and cash equivalents at the start of year	293.6	243.1
Net (decrease) / increase in cash and cash equivalents	(36.1)	35.6
Effect of foreign exchange rate changes	(5.0)	14.9
Cash and cash equivalents at the end of year	252.5	293.6
Cash and cash equivalents as above	252.5	293.6
Bank overdraft (i)	9.2	2.3
Cash and cash equivalents per balance sheet	261.7	295.9

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

Notes to the Preliminary Statement

For the year ended 31 March 2010

1. Financial Information

The financial information set out in this announcement does not constitute the Group's statutory accounts for the years ended 31 March 2010 or 2009 but is derived from those accounts. Statutory accounts for 2009 have been delivered to the Registrar of Companies, and those for 2010 will be delivered in due course. The auditors have reported on those accounts; their reports were (i) unqualified, (ii) did not include a reference to any matters to which the auditors drew attention by way of emphasis without qualifying their report and (iii) did not contain a statement under section 237 (2) or (3) of the Companies Act 1985 in respect of the accounts for 2009 nor a statement under section 498 (2) or (3) of the Companies Act 2006 in respect of the accounts for 2010. This preliminary announcement was authorised by the Board on 18 May 2010.

2. Basis of preparation

The financial information set out in this announcement has been prepared under the historical cost convention excepting certain assets and liabilities stated at fair value and in accordance with International Financial Reporting Standards and their interpretations as adopted by the European Union (adopted IFRS). The accounting policies adopted by the Group in this financial information are consistent with those used in the financial statements for the year ended 31 March 2010. The Directors consider that the Group has adequate resources to continue in operational existence for the foreseeable future and expects to issue further debt in the capital markets during 2010/11 to meet its funding requirements if necessary. The financial information has therefore been prepared on a going concern basis. Certain items have been reclassified to enhance understanding of the prior year results and to aid comparability with the current year presentation. The financial statements are presented in pounds sterling.

3. Basis of consolidation of the Group

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

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

The Group's share of the total recognised gains and losses of associates are included on an equity accounted basis from the date that significant influence commences until the date significant influence ceases. Investments in jointly controlled entities are accounted for under the equity method of accounting from the date that joint control commences until the date joint control ceases. Jointly controlled operations are businesses which use assets and liabilities that are separable from the rest of the Group. In these arrangements, the Group accounts for its own share of property, plant and equipment, carries its own inventories, incurs its own expenses and liabilities and raises its own finance.

4. Segmental information

The Group has adopted IFRS 8 Operating Segments in the financial statements. IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the chief operating decision maker in order to allocate resources to the segment and to assess its performance. In the Group's case the chief operating decision maker has been identified as the Board. In contrast, the predecessor Standard (IAS 14 'Segment Reporting') required an entity to identify two sets of segments (business and geographical), using a risks and rewards approach. Following the adoption of IFRS 8 the Group's reportable segments have not changed.

The Group's operating segments are therefore those used internally by the Board to run the business and make strategic decisions. The operating segments are also the Group's reportable segments.

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

Segment	Geographical location	Description
Power Systems	UK	Transmits and distributes electricity to over 3 million businesses, offices and homes.
Generation and supply	Great Britain, Ireland and Europe	The Group views this as a single value chain within a vertically-integrates business. It generates and supplies electricity to domestic, commercial and industrial customers in Great Britain and Ireland. In addition, it also supplies gas to customers in the same locations. Generation is provided by a portfolio of thermal power stations and from renewable sources of energy.
Other businesses:		
Contracting	UK and Ireland	Mechanical and electrical contracting services, public and highway lighting and electrical and instrumentation engineering
Connections	UK	Out-of-area electricity networks, licensed gas transportation and water and sewerage services
Metering	UK	Supplies, installs and maintains electricity meters and provides data collection services
Gas Storage	UK	Develops, owns and operates underground onshore gas storage facilities
Telecoms	UK	Provides network capacity, data centre and bandwidth services to customers

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

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for the year ended 31 March 2010

4. Segmental information (continued)

a) Revenue by segment

	Total revenue		Intra-segment revenue		External revenue	
	2010	2009	2010	2009	2010	2009
	£m	£m	£m	£m	£m	£m
Power Systems						
Scotland	309.1	292.1	105.5	104.1	203.6	188.0
England	473.5	450.9	212.2	204.1	261.3	246.8
	782.6	743.0	317.7	308.2	464.9	434.8
Generation and Supply						
Retail	8,234.4	8,516.5	-	8.2	8,234.4	8,508.3
Wholesale and Trading	12,000.3	15,409.4	12.0	-	11,988.3	15,409.4
Other businesses	216.4	440.7	7.8	20.7	208.6	420.0
	20,451.1	24,366.6	19.8	28.9	20,431.3	24,337.7
Other businesses	1,173.9	1,077.2	519.7	425.5	654.2	651.7
	22,407.6	26,186.8	857.2	762.6	21,550.4	25,424.2

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

Revenue from the Group's investment in Scotia Gas Networks (SSE share being 2010 – £373.5m; 2009 – £365.7m) is not recorded in the revenue line in the income statement.

b) Operating profit by segment

	2010				
	Adjusted	JCE / Associate share of interest and tax (i)	Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements	Total
	£m	£m	£m	£m	£m
Power Systems					
Scotland	158.9	-	158.9	-	158.9
England	256.9	-	256.9	-	256.9
	415.8	-	415.8	-	415.8
Scotia Gas Networks plc	183.7	(130.5)	53.2	2.4	55.6
Energy Systems	599.5	(130.5)	469.0	2.4	471.4
Generation and Supply	896.0	(26.5)	869.5	432.7	1,302.2
Other businesses	140.3	(0.2)	140.1	-	140.1
	1,635.8	(157.2)	1,478.6	435.1	1,913.7
Unallocated expenses (ii)	(9.8)	-	(9.8)	-	(9.8)
	1,626.0	(157.2)	1,468.8	435.1	1,903.9
	2009				
	Adjusted	JCE / Associate share of interest and tax (i)	Before exceptional items and certain re-measurements	Exceptional items and certain re-measurements	Total
	£m	£m	£m	£m	£m
Power Systems					
Scotland	160.4	-	160.4	-	160.4
England	243.3	-	243.3	-	243.3
	403.7	-	403.7	-	403.7
Scotia Gas Networks plc	180.5	(146.3)	34.2	3.9	38.1
Energy Systems	584.2	(146.3)	437.9	3.9	441.8
Generation and Supply	832.0	(20.9)	811.1	(1,190.2)	(379.1)
Other businesses	134.1	(0.3)	133.8	-	133.8
	1,550.3	(167.5)	1,382.8	(1,186.3)	196.5
Unallocated expenses (ii)	(8.9)	-	(8.9)	-	(8.9)
	1,541.4	(167.5)	1,373.9	(1,186.3)	187.6

(i) The adjusted operating profit of the Group is reported after removal of the Group's share of interest, fair value movements on financing derivatives and tax from jointly controlled entities and associates. The share of Scotia Gas Networks plc interest includes loan stock interest payable to the consortium shareholders, £33.8m (2009 - £33.6 m). The Group has accounted for its 50% share of this as finance income (note 6).

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

Notes to the Preliminary Statement
for the year ended 31 March 2010

5. Exceptional items and certain re-measurements

i) Exceptional items

In the previous financial year, the Group disposed of 50% of its equity shareholding in Greater Gabbard Offshore Wind Limited (GGOWL) to npower renewables Limited, the UK fully owned subsidiary of RWE Innogy GmbH, for a total cash consideration of £308.5m.

GGOWL was originally a jointly controlled entity between Airtricity, acquired by SSE in February 2008, and Fluor International Limited. In May 2008, SSE acquired Fluor's 50% stake for a cash consideration of £40.0m, while stating its intention to dispose of it later in the year.

The total proceeds on disposal was £308.5m, which comprised £165.6m reimbursement of 50% of the capital costs already incurred in developing the project and £142.9m in relation to the 50% of the equity. The gain on sale recognised was £102.7m, which has been disclosed separately in the income statement as an exceptional item. While no tax charge was recognised in relation to the gain on disposal, a tax credit was recognised on the reversal of deferred tax related to the derecognition of fair value items deemed to have been part of the costs of disposal (£5.7m).

ii) Certain re-measurements

Certain re-measurements arising from the adoption of IAS 39 are disclosed separately to aid understanding of the underlying performance of the Group. This category includes the movement on derivatives as described in note 11.

iii) Taxation

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

These transactions can be summarised thus:

	2010	2009
	£m	£m
Exceptional items		
Gain on disposal of share in Greater Gabbard Offshore Winds	-	102.7
	-	102.7
Certain re-measurements		
Movement on operating derivatives (note 11)	432.2	(1,291.7)
Movement on financing derivatives (note 11)	(36.5)	25.8
Share of movements on derivatives in jointly controlled entities (net of tax)	2.9	2.7
	398.6	(1,263.2)
Profit/(loss) before taxation	398.6	(1,160.5)
Exceptional items		
Taxation on other exceptional items	-	5.7
	-	5.7
Taxation on certain re-measurements	(110.9)	353.9
Taxation	(110.9)	359.6
Impact on profit for the year	287.7	(800.9)

Notes to the Preliminary Statement
for the year ended 31 March 2010

6. Net finance costs

Recognised in income statement

	Before Exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments £m	2010 £m	Before Exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments £m	2009 £m
Finance income:						
Return on pension scheme assets	100.7	-	100.7	135.3	-	135.3
Interest income from short term deposits	3.5	-	3.5	9.4	-	9.4
Other interest receivable:						
Scotia Gas Networks loan stock	33.8	-	33.8	33.6	-	33.6
Other jointly controlled entities and associates	20.1	-	20.1	14.6	-	14.6
Other receivable	35.1	-	35.1	16.8	-	16.8
Foreign exchange translation of monetary assets and liabilities	10.0	-	10.0	-	-	-
Total finance income	203.2	-	203.2	209.7	-	209.7
Finance costs:						
Bank loans and overdrafts	(49.9)	-	(49.9)	(149.9)	-	(149.9)
Other loans and charges	(284.1)	-	(284.1)	(132.9)	-	(132.9)
Interest on pension scheme liabilities	(127.5)	-	(127.5)	(130.1)	-	(130.1)
Accretion of convertible debt component	-	-	-	(0.6)	-	(0.6)
Notional interest arising on discounted provisions	(3.5)	-	(3.5)	(5.1)	-	(5.1)
Foreign exchange translation of monetary assets and liabilities	-	-	-	(2.4)	-	(2.4)
Finance lease charges	(13.2)	-	(13.2)	-	-	-
Less: interest capitalised	46.2	-	46.2	51.2	-	51.2
Total finance costs	(432.0)	-	(432.0)	(369.8)	-	(369.8)
Changes in fair value of financing derivative assets or liabilities designated at fair value through profit or loss	-	(36.5)	(36.5)	-	25.8	25.8
Net finance costs	(228.8)	(36.5)	(265.3)	(160.1)	25.8	(134.3)
Finance income	203.2	-	203.2	209.7	-	209.7
Finance costs	(432.0)	(36.5)	(468.5)	(369.8)	25.8	(344.0)
Net finance costs	(228.8)	(36.5)	(265.3)	(160.1)	25.8	(134.3)

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

	2010 £m	2009 £m
Net finance costs	(265.3)	(134.3)
(add)/less:		
Share of interest from jointly controlled entities and associates		
Scotia Gas Networks loan stock	(33.8)	(33.6)
Other jointly controlled entities and associates	(73.3)	(94.6)
	(107.1)	(128.2)
Accretion of convertible debt component	-	0.6
Movement on financing derivatives (note 11)	36.5	(25.8)
Adjusted finance income and costs	(335.9)	(287.7)
(add)/less:		
Return on pension scheme assets	(100.7)	(135.3)
Interest on pension scheme liabilities	127.5	130.1
Notional interest arising on discounted provisions	3.5	5.1
Finance lease charges	13.2	-
Adjusted finance income and costs for interest cover calculation	(292.4)	(287.8)

Notes to the Preliminary Statement
for the year ended 31 March 2010

7. Taxation

Analysis of charge recognised in the income statement:

	2010			2009		
	Before Exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments £m	Total £m	Before Exceptional items and certain re- measure- ments £m	Exceptional items and certain re- measure- ments £m	Total £m
Current tax						
UK corporation tax	277.4	-	277.4	298.6	-	298.6
Adjustments in respect of previous years	(19.1)	-	(19.1)	(10.1)	-	(10.1)
Total current tax	<u>258.3</u>	<u>-</u>	<u>258.3</u>	<u>288.5</u>	<u>-</u>	<u>288.5</u>
Deferred tax						
Current year	32.2	110.9	143.1	13.8	(359.6)	(345.8)
Adjustments in respect of previous years	1.7	-	1.7	(1.7)	-	(1.7)
Total deferred tax	<u>33.9</u>	<u>110.9</u>	<u>144.8</u>	<u>12.1</u>	<u>(359.6)</u>	<u>(347.5)</u>
Total taxation charge/(credit)	<u>292.2</u>	<u>110.9</u>	<u>403.1</u>	<u>300.6</u>	<u>(359.6)</u>	<u>(59.0)</u>

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

	2010		2009	
	£m	%	£m	%
Group profit before tax	1,638.6		53.3	
Less: share of results of associates and jointly controlled entities	(109.8)		(81.6)	
Profit/(loss) before tax	<u>1,528.8</u>		<u>(28.3)</u>	
Tax on profit/(loss) on ordinary activities at standard UK corporation tax rate of 28% (2009 – 28%)	428.1	28.0	(7.9)	28.0
Tax effect of:				
Expenses not deductible for tax purposes	7.6	0.5	3.7	(13.1)
Non taxable income	(2.3)	(0.2)	(34.4)	121.5
Impact of foreign tax rates and foreign dividends	(0.2)	-	0.3	(1.1)
Adjustments to tax charge in respect of previous years	(17.4)	(1.1)	(11.8)	41.7
Consortium relief not paid for	(9.8)	(0.6)	(9.1)	32.2
Utilisation of tax losses	-	-	(1.5)	5.3
Effect of enhanced reliefs and incentives	(2.4)	(0.2)	-	-
Other items	(0.5)	-	1.7	(6.0)
Group tax charge/(credit) and effective rate	<u>403.1</u>	<u>26.4</u>	<u>(59.0)</u>	<u>208.5</u>

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

	2010		2009	
	£m	%	£m	%
Total taxation charge/(credit)	403.1	26.4	(59.0)	208.5
Effect of adjusting items (see below)	-	4.8	-	(213.2)
Total taxation charge/(credit) on adjusted basis	<u>403.1</u>	<u>31.2</u>	<u>(59.0)</u>	<u>(4.7)</u>
(add)/less:				
Share of current tax from jointly controlled entities and associates	15.8	1.2	11.9	1.0
Exceptional items	-	-	5.7	0.5
Tax on movement on derivatives	(110.9)	(8.6)	353.9	28.2
Deferred tax (excluding share of jointly controlled entities)	(33.9)	(2.6)	(12.1)	(1.0)
Adjusted current tax charge and effective rate	<u>274.1</u>	<u>21.2</u>	<u>300.4</u>	<u>24.0</u>

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

	2010	2009
	£m	£m
Profit before tax	1,638.6	53.3
(add)/less:		
Exceptional items and certain re-measurements	(398.6)	1,160.5
Share of tax from jointly controlled entities and associates	50.1	39.3
Accretion of convertible debt component	-	0.6
Adjusted profit before tax	<u>1,290.1</u>	<u>1,253.7</u>

Notes to the Preliminary Statement
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8. Dividends

	2010	2009
	£m	£m
Amounts recognised as distributions from equity		
Final dividend for the previous year of 46.2p (2009 – 42.4p) per share	425.1	370.0
Interim dividend for the current year of 21.0p (2009 – 19.8p) per share	193.4	181.9
	618.5	551.9
Proposed final dividend for the current year of 49.0p (2009 – 46.2p) per share	452.3	425.2

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements. The final dividend paid for the previous year, £425.1m (46.2p, 2009 – 42.4p), was declared on 21 May 2009, approved at the Annual General Meeting on 23 July 2009 and was paid to shareholders on 25 September 2009. An interim dividend for the current year, £193.4m (21.0p, 2009 – 19.8p), was paid on 26 March 2010.

9. Earnings per share

Basic earnings per share

The calculation of basic earnings per share at 31 March 2010 is based on the net profit attributable to ordinary shareholders and a weighted average number of ordinary shares outstanding during the year ended 31 March 2010. All earnings are from continuing operations.

Adjusted earnings per share

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

	2010		2009	
	Earnings (i)	Earnings	Earnings (i)	Earnings
	£m	per share	£m	per share
		pence		pence
Basic	1,235.3	134.0	112.3	12.7
Exceptional items and certain re-measurements (note 5)	(287.7)	(31.2)	800.9	90.7
Basic excluding exceptional items and certain re-measurements	947.6	102.8	913.2	103.4
Adjusted for:				
Deferred tax (note 7)	33.9	3.7	12.1	1.4
Deferred tax from share of jointly controlled entities and associates results	34.3	3.7	27.4	3.1
Accretion of convertible debt component	-	-	0.6	0.1
Adjusted	1,015.8	110.2	953.3	108.0
Basic	1,235.3	134.0	112.3	12.7
Convertible debt interest (net of tax)	-	-	1.2	0.1
Dilutive effect of convertible debt	-	(0.1)	-	-
Diluted	1,235.3	133.9	113.5	12.8
Exceptional items and certain re-measurements (note 5)	(287.7)	(31.2)	800.9	90.5
Diluted excluding exceptional items and certain re-measurements	947.6	102.7	914.4	103.3

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

	2010	2009
	Number of	Number of
	shares	shares
	(millions)	(millions)
For basic and adjusted earnings per share	921.9	883.0
Effect of exercise of share options	0.4	0.8
	922.3	883.8
Effect of dilutive convertible debt	0.7	1.7
For diluted earnings per share	923.0	885.5

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

Notes to the Preliminary Statement
for the year ended 31 March 2010

10. Pensions

Valuation of combined Pension Schemes

	Long- term rate of return expected at 31 March 2010 %	Value at 31 March 2010 £m	Long- term rate of return expected at 31 March 2009 %	Value at 31 March 2009 £m
Equities	8.0	1,063.4	7.7	665.8
Government bonds	4.5	563.4	4.2	576.7
Corporate bonds	5.5	449.0	6.7	244.3
Other investments	4.1	222.5	3.4	300.0
Total fair value of plan assets		<u>2,298.3</u>		1,786.8
IFRIC 14 liability		(256.3)		(130.5)
Present value of defined benefit obligations		<u>(2,762.3)</u>		<u>(1,929.8)</u>
Deficit in the schemes		<u>(720.3)</u>		<u>(273.5)</u>

Movements in the defined benefit obligation are as follows:

	2010 £m	2009 £m
At 1 April	(1,929.8)	(1,919.5)
Movements in the year:		
Service costs	(21.4)	(21.8)
Member contributions	(8.1)	(8.1)
Benefits paid	101.6	96.5
Interest on pension scheme liabilities	(127.5)	(130.1)
Actuarial (losses) / gains	(777.1)	53.2
At 31 March	<u>(2,762.3)</u>	<u>(1,929.8)</u>

Movements in scheme assets during the year:

	2010 £m	2009 £m
At 1 April	1,656.3	1,870.4
Movements in the year:		
Expected return on pension scheme assets	100.7	135.3
Assets distributed on settlement	(101.6)	(96.5)
Employer contributions	110.2	71.1
Member contributions	8.1	8.1
Actuarial gains / (losses)	394.1	(412.2)
IFRIC 14 liability	(125.8)	80.1
At 31 March	<u>2,042.0</u>	<u>1,656.3</u>

The Scottish Hydro Electric Pension Scheme net liability of £251.1 (2009 - £nil) is presented after an IFRIC 14 minimum funding requirement restriction of £256.3m (2009 - £130.5m IFRIC 14 liability).

Notes to the Preliminary Statement
for the year ended 31 March 2010

11. Derivative financial assets and liabilities

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

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

	2010 £m	2009 £m
Operating derivatives		
Total result on operating derivatives (i)	(3,449.6)	(3,964.8)
Less: amounts settled in the year (ii)	3,881.8	2,673.1
Movement in unrealised derivatives	<u>432.2</u>	<u>(1,291.7)</u>
Financing derivatives (and hedged items)		
Total result on financing derivatives (i)	456.8	70.5
Less: amounts settled in the year (ii)	(493.3)	(44.7)
Movement in unrealised derivatives	<u>(36.5)</u>	<u>25.8</u>
Net income statement impact	<u>395.7</u>	<u>(1,265.9)</u>

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

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

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

	2010 £m	2009 £m
Derivative financial assets		
Non-current	466.3	449.2
Current	1,468.3	1,537.7
	<u>1,934.6</u>	<u>1,986.9</u>
Derivative financial liabilities		
Non-current	(899.0)	(959.5)
Current	(2,020.7)	(2,451.0)
Total derivative liabilities	<u>(2,919.7)</u>	<u>(3,410.5)</u>
	<u>(985.1)</u>	<u>(1,423.6)</u>