

MIDLANDS ELECTRICITY Plc

COMPANY ANNUAL REPORT & ACCOUNTS

FOR THE YEAR ENDED
31 DECEMBER 2002



Midlands Electricity Plc

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Midlands Electricity Plc

DIRECTORS' REPORT

The Directors submit their report and the audited accounts for Midlands Electricity Plc for the year to 31 December 2002.

Principal activity

The principal activities of the Company during the year were metering services, support services and electrical contracting.

Financial results and review of the business

The Company's profit before tax for the year ended 31 December 2002 was £29.9m (period ended 31 December 2001: £67.2m).

Dividends

Interim dividends of £48.0m were paid during the year (period ended 31 December 2001: £6.2m). No final dividend has been proposed (31 December 2001: £8.5m).

Research and development

The Company subcontracts its research and development activity to a number of third party organisations.

Share capital

The authorised share capital of the Company, is shown in Note 21 to the accounts on page 29.

Donations

During the year to 31 December 2002 the Group made donations of £33,157 (nine months ended 31 December 2001: £58,719) to a wide range of charitable organisations. This included donations totalling £18,126 (nine months ended 31 December 2001: £23,671) made through its Staff Community Links Awards Scheme to charitable organisations which its employees are involved with in their local communities. The Group has made no political donations (nine months ended 31 December 2001: £nil).

Midlands Electricity Plc

DIRECTORS' REPORT (continued)

Directors

The following served as Directors:

Mr D G Bacon	(appointed 8 May 2002)	Executive
Mr M T Clark	(appointed 8 May 2002)	Non Executive
Mr R K Green	(alternate to Mr D G Bacon and Mr K G Stamm, appointed 8 May 2002)	Non Executive
Mr F D Hafer	(resigned 8 May 2002)	Non Executive
Mr M A Hughes	(resigned 8 May 2002)	Executive
Mr K J Keough	(appointed 8 May 2002, resigned 31 January 2003)	Non Executive
Mr S A King	(resigned 31 January 2003)	Executive
Mr R H Marsh	(appointed 23 July 2002)	Non Executive
Mr R D Murray	(resigned 8 May 2002)	Executive
Ms C B Snyder	(resigned 8 May 2002)	Non Executive
Mr K G Stamm	(appointed 8 May 2002)	Non Executive

No Director held an interest in the shares of the Company or any other UK Group company, at either period end, other than as a non-beneficial nominee.

Employees

During the year the Group invested £1.9m (nine months ended 31 December 2001: £2.2m) in training to develop the talents and skills of employees. Employees are consulted regularly on a wide range of matters affecting their current and future interests and those of the Group. The communication methods used include a quarterly newspaper, team briefing and video programmes. The Company is committed to equal opportunities in employment and aims to select people based on ability and aptitude in relation to the jobs for which they apply. As part of the Group's equal opportunities policy, full consideration is given to disabled people in employment, career development, training and promotion as well as making every effort to retain people who become disabled.

Health and safety

The health and safety of employees, contractors' employees and other parties affected by the Company's activities, continues to be a priority throughout the organisation. The Group Health and Safety Policy Statement entitled 'Working Together for Health and Safety' has recently been reviewed and revised to confirm this commitment. The policy is signed by the Chief Executive Officer and its implementation is overseen by the Corporate Safety Steering Group which consists of the Executive Directors and the Heads of Each Business Unit.

The policy clearly sets out the commitment of the board to meet the statutory requirements placed upon it. It also explains how health and safety is managed both at Group and Business Unit level in accordance with guidance provided by the Health and Safety Executive in their publication 'Successful Health and Safety Management', more commonly known as HSG65. This approach ensures that: -

- the Company adopts effective health and safety policies that contribute to all aspects of business performance and demonstrate a commitment to continuous improvement
- the Company organises effective management structures and arrangements, including involvement and participation of staff at all levels. Partnership, co-operation, communication and consultation are a fundamental part of this approach. There are joint employee and management Health and Safety Committees and also Safety Circles and Cells are operated. Training needs analysis to ensure competent employees are used
- the Company systematically plans how the policy will be implemented. A risk-based approach is used to determine priorities. Group procedures are being developed that contain standards used for measuring performance. In addition to personal health and safety action plans, objectives are set at Group and Business Unit level. This process is overseen by the Group Safety, Health and Environment Manager

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DIRECTORS' REPORT (continued)

Health and safety (continued)

- proactive and reactive key performance indicators are identified that enable managers to determine how effectively the management system is operating. Proactive indicators include the number and quality of inspections and monitoring. Reactive indicators include the numbers and types of accidents and cases of occupational ill health
- the Company reviews the results of audits and monitoring to ensure that continuous improvement is sustained. Data is reviewed by the Corporate Safety Steering Group, by business specific steering groups and by the Health and Safety Committees.

Occupational Health is an integral element of the Company's health and safety management system. The Occupational Health section works in conjunction with the Human Resources section and line managers, to implement structured returns to work and rehabilitation programmes, to ensure that employees are able to make an early but sustained return to work following sickness or injury. Good health and general well-being is promoted at roadshows held at locations throughout the Group.

The number of over three-day lost time accidents that occurred in 2002 reduced by over 20%, compared - with 2001. Significant improvements were achieved in both Engineering Services and Metering Services Ltd.

More than 30 audits were completed covering general and electrical safety activities, the majority having satisfactory outcomes. A small number of significant areas of non compliance were identified in some Business Units relating to 'Management of Contractors', 'Serious Incident Management' and 'Compliance with Operational Safety Procedures'. Action plans have been developed and are being implemented to ensure that appropriate remedial actions are undertaken.

Caring for the environment

The duty of environmental care is an underlying principle covering all of the Group's operations and programmes and is applied responsibly through practical policies. The policy statement is available free from any of the Group's offices.

Energy efficiency

At 31 December 2002, the Group's annual energy usage was on target. Energy consumption saw a reduction of 2% over the previous period, whilst water consumption fell by 14%. This represents overall savings to the Group of £12,700, as well as the associated environmental benefits.

Regulatory Accounts

Additional accounts are prepared by Aquila Networks Plc for the Chairman of the Gas and Electricity Markets Authority in respect of the fiscal year ending 31 March as required by our Electricity Distribution Licence. Extracts from these regulatory accounts are available free from the Regulation Manager, Aquila Networks Plc, Toll End Road, Tipton, West Midlands, DY4 0HH.

Creditor payment policy

The Company's policy concerning the payment of the majority of its trade creditors is to follow the CBI's Prompt Payers Code (copies available from the CBI, Centre Point, 103 New Oxford Street, London, WC1A 1DU). For other suppliers the Company's policy is to:

- settle the terms of payment with those suppliers when agreeing the terms of each transaction;
- ensure that those suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts; and
- pay in accordance with its contractual and other legal obligations.

The payment policy applies to all payments to creditors for revenue and capital supplies of goods and services. Wherever possible all UK subsidiaries follow the same policy. The average trade creditor payment period for the Company was 34 days (nine months ended 31 December 2001: 40 days).

Future developments

The Company will continue to develop its business in the energy sector taking advantage of appropriate profitable opportunities while concentrating on the sound management of its core operations.

Midlands Electricity Plc

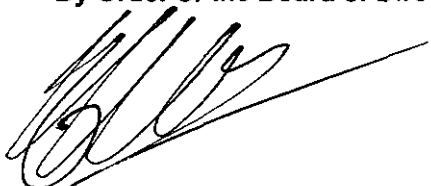
DIRECTORS' REPORT (continued)

Auditors

On 31 July 2002, following the acquisition of a 79.9% economic interest in Avon Energy Partners Holdings by Aquila, Inc., Arthur Andersen resigned as auditors. On the same day KPMG Audit Plc were appointed auditors.

KPMG Audit Plc have expressed their willingness to continue in office as auditors and a resolution to reappoint them will be proposed at the forthcoming Annual General Meeting.

By Order of the Board of Directors



Ian Elcock
Company Secretary
21 May 2003

Secretary and Registered Office
Ian Elcock, Company Secretary, Midlands Electricity Plc
Whittington Hall, Whittington, Worcester, WR5 2RB
Telephone 08457 353637

Registered in England and Wales No. 2366928

Midlands Electricity Plc

REPORT ON DIRECTORS' REMUNERATION

None of the Directors received any remuneration in respect of their services to Avon Energy Partners Holdings. Mr S A King received remuneration in respect of his services as Executive Director of Midlands Electricity Plc ("the Company"), as did Mr M A Hughes and Mr R D Murray until the termination of their employment on 8 May 2002. The Chief Executive Officer Mr D G Bacon, who replaced Mr M A Hughes and Mr R D Murray, was appointed directly by Aquila, Inc., who manage his remuneration from Canada. Mr S A King has resigned his post and left the Company on 31 January 2003.

For the purposes of this report 'Executive Directors' means Directors involved in the day to day management of Midlands Electricity Plc, and 'Non-Executive Directors' means Directors appointed by First EnergyCorp. or Aquila, Inc.

Until 8 May 2002 the remuneration of the Executive Directors was set by the Remuneration Committee of the Board which consisted solely of Non-Executive Directors of the Company. The Committee determined the detailed terms of service of the Executive Directors including basic salary, incentive schemes, other benefits and the terms upon which their service may be terminated. It received advice and information from leading independent firms of compensation and benefit consultants. A Remuneration Committee consisting of the Chief Executive Officer and the Group Human Resources Director has set Mr S A King's remuneration since 8 May 2002, reporting the detail to the Board.

Both Remuneration Committees supported and adhered to the principles set out in the Combined Code of the Committee on Corporate Governance in June 1998. In addition proper consideration continued to be given to a letter received in May 1999 from the Director General of Ofgem on the importance of the link between pay and standards of performance.

General policy

The remuneration policy for Executive Directors is designed to attract, retain and motivate executives of the high calibre required to ensure that the Company is managed successfully for the benefit of all its stakeholders. In order to achieve this, a competitive package of rewards and incentives is provided which is linked to performance. The Committee therefore takes into account information provided in respect of other companies of similar type, size and complexity.

Service contracts

Mr S A King, had a one year rolling contract.

Basic salary

The salary of Executive Directors is based on a number of factors including market rates together with the individual Director's experience, responsibilities and performance. Individual salaries are reviewed annually by the Committee, taking account of these various factors.

Annual performance related bonus

The Committee believes there should be an annual bonus scheme, which focuses the Executives' attention on a balanced combination of profitability, cashflow, various customer service issues and certain business improvement initiatives.

The Scheme's performance levels were graduated between Level 1 and Level 3 and a level of 2.7 was achieved for the twelve months ended 31 December 2002. This in turn produced a bonus payment for Mr S A King of £63,000 (32% of salary). On leaving Mr M A Hughes received a final bonus of £41,000 and Mr R D Murray received a final bonus payment of £20,000 in respect of 2002.

Long term incentive schemes

The Greenbury Report of 1995 on best practice expressed the view that Directors should have a bonus scheme related to the longer term and which is effective in linking the interests of Directors to those of shareholders. The Remuneration Committee strongly support this view and a scheme linked to performance criteria over a three year period between 1 April 1999 and 31 March 2002 was implemented. Measures related to profit, cost reduction and various elements of customer service.

Midlands Electricity Plc

REPORT ON DIRECTORS' REMUNERATION (continued)

Long term incentive schemes (continued)

The total payments of the scheme over the three year period were calculated as a percentage of individual Director's average annual salary over the three year period. The percentages used in calculations for individual Directors were as follows:

	<u>Performance Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Mr M A Hughes	45%	90%	150%
Mr R D Murray and Mr S A King	45%	75%	120%

Level 2.8 was achieved in respect of the 1999-2002 Plan and Mr S A King received a first instalment of £99,898 in July 2002. Following his resignation Mr S A King will not receive any further payments in respect of this Plan. In redundancy situations the Plan rules provide for Directors to receive payments calculated up to the termination date; therefore Mr M A Hughes received £427,435 (138% of average salary) and Mr R D Murray received £205,014 (111% of average salary). These payments were made in July 2002 as the final calculation was not available at their time of leaving.

Although no Directors remain in service, the Company's agreed policy on long term incentive schemes includes a further scheme, which accords with the combined code, covering the period from 1 January 2002 to 31 December 2004. Opportunity levels and payments remain the same as the 1999/2002 plan.

Benefits in kind

These comprise principally of car benefits and membership of the Group's healthcare insurance scheme. The level of benefits provided to Executive Directors is consistent with that provided by other major companies. These benefits do not form part of pensionable earnings.

Pensions

The pensions of Executive Directors are based on final pensionable salary, which excludes bonus payments. In the case of funded approved benefits, the employer pays contributions to formally constituted pension schemes independent of the Group. In the case of unfunded unapproved benefits, the employer makes provision within its own accounts. The contributions to funded schemes and the provisions made in respect of unfunded benefits are based on external actuarial advice.

Mr M A Hughes and Mr S A King joined the company after 1 June 1989 and are subject to the salary cap on pension benefits introduced by the 1989 Finance Act. Benefits in respect of salary, in excess of the cap, are provided by unapproved unfunded arrangements.

During the year, Mr M A Hughes and Mr R D Murray retired and their benefits became established and, in respect of Mr S A King, the Company established a Funded Unapproved Retirement Benefits Scheme (FURBS) to replace the unfunded unapproved arrangement. This had the effect of transferring the provision in the employer's account to a formally constituted scheme independent of the Group.

Termination Compensation

When Aquila, Inc. acquired the Company they immediately dispensed with the services of Mr M A Hughes and Mr R D Murray. The terminations were effective from the date the purchase was concluded (8 May 2002). As both Directors had two year rolling contracts, it was necessary to compensate each director in accordance with the terms of their employment contract being breached. The compensation payments were calculated to incorporate contractual entitlement to remuneration, incentives and benefits including pension, in accordance with legal advice provided by Clifford Chance. Mr M A Hughes received £1.2million and Mr R D Murray received £700,000.

Directors' emoluments

Full details of Directors' emoluments as required by the Combined Code are set out in note 7 on pages 18 to 20.

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CORPORATE GOVERNANCE

The Board supports the highest standards of corporate governance, and whilst there is no statutory requirement for Midlands Electricity Plc to comply with the Combined Code, the Board is pleased to confirm that the Company has, wherever practical, followed the spirit of the Code throughout the year to 31 December 2002.

Board composition

During the period to 8 May 2002 the Board of Midlands Electricity Plc comprised the Chairman, three Executive Directors and three Non-Executive Directors. Following the acquisition by Aquila Inc of a 50% voting interest in the Company's immediate parent undertaking, Avon Energy Partners Holdings (Avon), the composition of the Board of Directors changed. With effect from 8 May 2002, the Board comprised the Chairman, two Executive Directors and three Non-Executive Directors. At 31 December 2002, the Chairman was Mr K G Stamm. The Board, collectively, is responsible for Company policy and strategic matters and for securing the optimum performance from its assets. The Board meets every quarter.

The Executive Directors meet as necessary to discuss in detail matters arising from the day to day operations of the Company.

The Non-Executive Directors draw upon their different backgrounds and wide-ranging commercial and professional expertise to maintain a balance between the interests of the Company's customers, employees and the community at large. None of the Non-Executive Directors have any responsibility for the day to day management of the Company's business.

Going concern

After making appropriate enquires the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason they continue to adopt the 'going concern' basis in preparing the Company's financial statements.

Internal control

The Midlands Electricity Plc Board of Directors is ultimately responsible for the Company's system of internal control and for reviewing its effectiveness. This system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. It complies with 'Internal Control: Guidance for Directors on the Combined Code' (the Turnbull guidance) published in September 1999. The key elements of the Company's system of internal control are set out in the paragraphs below.

Control environment

The Company's control environment is ultimately the responsibility of the Company's Directors and managers at all levels. The Company's organisational structure includes clear lines of responsibility. Operating and financial responsibility for subsidiary companies is delegated to local boards although, in the majority of cases, main Board Directors sit on subsidiary boards. Commercial, accounting and ethical procedures are communicated to employees in each subsidiary.

Identification of business risks

The Company's management has a clear responsibility for identifying the risks facing each of the Company's businesses and for developing systems and procedures to mitigate and monitor such risks. Standard risk management techniques have been embedded in the Company's businesses. Each business reports on its key risks, the embedded controls to mitigate those risks and the resultant residual risk. These risks are monitored on a day to day basis by members of the senior management team. This enables significant concerns to be discussed with the Non-Executive Directors at Board meetings.

Main corporate information systems

The Company's accounting procedures are set out in various policy and procedural documents. The Company operates a comprehensive budgeting and financial reporting system, which as a matter of routine, compares actual out-turn to budget. Management accounts are compiled on a monthly basis. Variances from plan are investigated and updated forecasts are prepared as necessary. Cash flow forecasts are prepared on a regular basis to ensure that the Company has adequate funds and resources for the foreseeable future.

Midlands Electricity Plc

CORPORATE GOVERNANCE (continued)

Main control procedures

Management has established control procedures in response to the key risks identified. Standard financial control procedures operate throughout the Company to ensure the integrity of the Company's financial statements. The Board has established procedures for the authorisation of expenditure.

Monitoring system used by the Board

The Board reviews and approves budgets and monitors the Company's performance against these budgets on a monthly basis. Variances from the expected out-turn are investigated fully and should lapses in internal control be detected, these are rectified. The Company's cash flow is also monitored by the Board.

The Company has an internal audit function which, throughout the period, reported to the Group Finance Director. The internal audit plan of work is determined following an evaluation of key commercial and financial risks. Internal audit issues are reported as an agenda item for consideration by the Board. Under that item the Board considers: the key accounting policies, practices and financial accounts, giving particular attention to the need for these to comply with statutory and regulatory requirements and best practice; the suitability and effectiveness of the Group's internal controls; the reliability of internal financial information available for decision making; and the work programme and findings of Internal Audit. The Group Audit Manager is invited to attend Board Meetings for that agenda item when the yearly plan of work is approved and findings are reported. Control issues raised during the period have been monitored to ensure that they have been resolved or are being addressed. The Board also considers the findings of the external Auditors and takes appropriate action. The Board has agreed Terms of Reference for an Audit Committee.

Compliance with regulatory matters

The Company has a department dedicated to ensuring compliance with the terms of its Distribution Licence, that all regulatory returns are made, and that these accurately reflect relevant information. Where returns to the Office of Gas and Electricity Markets (Ofgem) require significant judgement or are sensitive because of the values or nature of the information disclosed, approval is sought from the Board.

Statement of compliance

The Board considers that compliance with the Turnbull guidance has been achieved during the period and that it has complied with other provisions set out in the Combined Code, throughout the period to 31 December 2002, except in the instances detailed below, (the references in parentheses are to the specific provisions of the Combined Code). The non-compliance in the first three of these areas arises because of the nature of Midlands Electricity Plc's ownership whereby the shareholders appoint Non-Executive Directors.

- There is no senior independent director, other than the Chairman identified in the annual report (A.2.1);
- Non-executive Directors are not appointed for specified terms subject to re-election (A.6.1);
- No Nomination Committee exists (A.5.1)
- Terms of Reference to formally establish an Audit Committee were approved by the Board in November 2002 (D.3.1 and D.3.2); and
- The Remuneration Committee does not consist solely of non-executive Directors as explained in the Report on Directors' Remuneration (B.2.2).

On behalf of the Board of Directors



D G Bacon
Director
21 May 2003

Midlands Electricity Plc

RESPONSIBILITIES OF THE DIRECTORS

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and of the profit or loss for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Company and to prevent and detect fraud and other irregularities.

Midlands Electricity Plc

INDEPENDENT AUDITORS' REPORT

to the members of Midlands Electricity Plc

We have audited the financial statements on pages 12 to 31.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and Auditors

The Directors are responsible for preparing the Annual Report. As described on page 10, this includes responsibility for preparing the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Group is not disclosed.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises only the Directors' report, Corporate governance statements, Remuneration report and Statement of Directors' responsibilities. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion: the financial statements give a true and fair view of the state of affairs of the Company as at 31 December 2002 and of the profit of the Company for the year then ended; and the financial statements have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc

KPMG Audit Plc
Chartered Accountants
Registered Auditor
London
21 May 2003

Midlands Electricity Plc

PROFIT AND LOSS ACCOUNT

for the year ended 31 December 2002

	<u>Note</u>	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Turnover			
Continuing operations	2	73.6	193.5
Cost of sales		(39.8)	(38.2)
Gross profit		33.8	155.3
Net operating expenses	3	(28.7)	(84.3)
Exceptional items		(18.6)	-
Operating (loss)/profit		(13.5)	71.0
Income from fixed asset investments	4	33.5	4.0
Profit on ordinary activities before interest		20.0	75.0
Net interest receivable/(payable)	5	9.9	(7.8)
Profit on ordinary activities before taxation	6	29.9	67.2
Taxation	8	36.9	(17.9)
Profit for the financial period		66.8	49.3
Dividends	9	(48.0)	(14.7)
Profit retained	23	18.8	34.6

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

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES

for the year ended 31 December 2002

	<u>Year ended 31</u> <u>December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Profit for the financial period	66.8	49.3
Total recognised gains and losses	66.8	49.3

Midlands Electricity Plc

BALANCE SHEET

at 31 December 2002

	<u>Notes</u>	<u>2002</u> £m	<u>2001</u> £m
Fixed assets			
Intangible assets	11	0.8	-
Tangible assets	12	35.6	36.8
Investments	13		
- shares in group undertakings		182.1	186.4
		<u>218.5</u>	<u>223.2</u>
Current assets			
Stocks	14	2.6	2.2
Debtors (amounts falling due after more than one year)	15	149.6	132.8
Debtors (amounts falling due within one year)	15	459.5	891.2
Short term deposits	16	-	10.8
Cash at bank and in hand		5.4	28.5
		<u>617.1</u>	<u>1,065.5</u>
Creditors (amounts falling due within one year)	17	(218.4)	(655.0)
		<u>398.7</u>	<u>410.5</u>
Net current assets			
Total assets less current liabilities		<u>617.2</u>	<u>633.7</u>
Creditors (amounts falling due after more than one year)	17	(150.7)	(182.7)
Provisions for liabilities and charges	18	(1.7)	(0.1)
Deferred taxation	18	(48.5)	(53.4)
		<u>416.3</u>	<u>397.5</u>
Net assets			
Capital and reserves			
Called up share capital	21, 22	124.2	124.2
Share premium account	22	11.7	11.7
Capital redemption reserve	22	10.6	10.6
Profit and loss account	22	269.8	251.0
		<u>416.3</u>	<u>397.5</u>
Equity shareholders' funds	23	<u>416.3</u>	<u>397.5</u>

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

The accounts on pages 12 to 31 were approved by the Board of Directors on 21 May 2003 and were signed on its behalf by:



D G Bacon
Director

Midlands Electricity Plc

NOTES TO THE ACCOUNTS

1 Accounting policies

Basis of preparation.

The financial statements have been prepared using historical cost accounting principles and in accordance with applicable Accounting Standards in the United Kingdom. A summary of the principal accounting policies, which have been applied consistently during the year and prior period, are set out below.

Related party transactions

As permitted by paragraph 3(c) of Financial Reporting Standard No. 8, Related Party Disclosures, the Company has taken advantage of the exemption for 90% subsidiaries not to disclose related party transactions with other group entities.

Turnover

Turnover represents the invoiced value of goods and services provided; exclusive of value added tax.

Computer software costs

Costs incurred on major computer software developments are charged to capital in the period in which they are incurred. Other computer software costs are written off to the profit and loss account in the period in which they are incurred.

Research and Development

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

Investment income

Investment income is included in the accounts in the period in which it is receivable.

Tangible assets

Tangible fixed assets are stated at cost less depreciation which is calculated to write off assets over their useful economic lives. The cost of fixed assets is their purchase cost and any costs directly attributable to bringing them into working condition for their intended use. Where appropriate, cost includes own labour and associated overheads.

Depreciation

The charge for depreciation is based on the estimated useful lives of each major class of depreciable asset as follows:

	Years
Buildings – freehold	Up to 60
– leasehold	Lower of lease period or 60 years
Fixtures and equipment	Up to 10
Vehicles and mobile plant	Up to 10
Major computer software developments	Up to 15

Freehold land is not depreciated. No allowance is made for residual values.

Disposals

The profit or loss on disposal of tangible fixed assets is taken to the profit and loss account as part of the depreciation charge.

Fixed asset investments

Investments are carried at cost less any provision for impairment.

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NOTES TO THE ACCOUNTS (continued)

1 Accounting policies (continued)

Stocks

Stocks are valued at the lower of cost and net realisable value. The valuation of work in progress is based on the cost of labour plus appropriate overheads and the cost of materials. Progress invoices are deducted in arriving at the amounts stated.

Borrowings

All borrowings are initially stated at the fair value of the consideration received after the deduction of issue costs. Issue costs together with deferred finance costs are charged to the profit and loss account over the term of the borrowings pro rata to the balance of capital outstanding.

Deferred taxation

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

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

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in future has been entered into by the subsidiary or associate.

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

Pension costs

Contributions to pension schemes are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives within the Company. The capital cost of ex gratia and supplementary pensions is charged to the profit and loss account in the accounting period in which they are granted.

Differences between the amounts charged in the profit and loss account and payments made to the schemes are treated as assets or liabilities in the balance sheet.

The pension cost is assessed in accordance with the advice of qualified actuaries.

Financing costs in relation to unfunded pension obligations are charged to net interest payable.

Leases

Rental costs under operating leases are charged to the profit and loss account in equal annual amounts over the period of the lease. Amounts receivable under finance leases are recorded in the balance sheet within debtors and rental income is apportioned between the reduction of this debtor and interest recoverable to give a constant periodic rate of return.

Financial instruments

The financial instruments held by the Company are primarily used to manage exposure to interest rate fluctuations. Interest rate swaps, forward rate agreements and options are used to manage interest rate exposures. Amounts payable or receivable are recognised as adjustments to interest expense over the length of the swap agreement or when they are settled.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

2 Segmental analysis

Geographical analysis

Turnover is derived from operations within the UK.

By class of business

	<u>Year ended</u> <u>31 December 2002</u>			<u>Nine months ended</u> <u>31 December 2001</u> <u>Restated</u>		
	Total Sales £m	Inter- segment Sales £m	External Sales £m	Total Sales £m	Inter- segment Sales £m	External Sales £m
Turnover						
Distribution	-	-	-	143.4	-	143.4
Trading and other	73.6	-	73.6	57.1	(7.0)	50.1
	<u>73.6</u>	<u>-</u>	<u>73.6</u>	<u>200.5</u>	<u>(7.0)</u>	<u>193.5</u>

	<u>Year ended</u> <u>31 December 2002</u>	<u>Nine months ended</u> <u>31 December 2001</u> <u>Restated</u>
Profit on ordinary activities before taxation	£m	£m
Distribution	-	47.4
Trading and other	5.1	23.6
Dividends receivable	33.5	4.0
Net interest receivable/(payable)	9.9	(7.8)
Exceptional item – severance costs	(18.6)	-
Profit on ordinary activities before taxation	<u>29.9</u>	<u>67.2</u>

For the 2001 comparatives, the Metering turnover and profit before tax has been reclassified as trading and other.

	<u>2002</u>	<u>2001</u> <u>Restated</u>
Net assets	£m	£m
Trading and other	<u>416.3</u>	<u>397.5</u>

The 2001 net assets have been restated to include the previous unallocated figures within the segment trading and other.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

3 Net operating expenses

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine Months ended</u> <u>31 December 2001</u> £m
Distribution costs	3.9	43.2
Administrative expenses	24.8	41.1
Net operating expenses – continuing activities	<u>28.7</u>	<u>84.3</u>

4 Income from fixed asset investments

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Dividends receivable	<u>33.5</u>	<u>4.0</u>

5 Net interest receivable/(payable)

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Interest payable on:		
bank loans and overdrafts	(12.6)	(5.7)
other loans	(0.5)	(8.2)
loans from group undertakings	(2.8)	(0.2)
	<u>(15.9)</u>	<u>(14.1)</u>
Interest receivable from:		
external	0.1	0.3
group undertakings	25.7	6.0
	<u>25.8</u>	<u>6.3</u>
	<u>9.9</u>	<u>(7.8)</u>

6 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging:

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Depreciation and profit or loss on disposal of fixed assets	4.4	25.4
Auditors' remuneration:		
- audit fees	0.2	0.1
Operating lease rentals - land and buildings	0.9	0.5

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

7 Directors and employees

Employment costs

The aggregate remuneration of all employees, including Directors, comprised:

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Wages and salaries	34.0	50.9
Social security costs	3.1	4.0
Other pension costs (note 23)	1.7	1.0
	38.8	55.9
Less: charged as capital expenditure	(0.7)	(13.9)
	<u>38.1</u>	<u>42.0</u>

Average number of employees

The average monthly number of employees, including Directors, during the period was:

	<u>Year ended</u> <u>31 December 2002</u> Number	<u>Nine months ended</u> <u>31 December 2001</u> Number
Managerial	14	25
Non-industrial	1,420	1,853
Industrial	449	1,162
Trainees	47	62
	<u>1,930</u>	<u>3,102</u>

The aggregate number of employees at 31 December 2002 was 1,904 (31 December 2001: 1,912).

Directors' emoluments

The remuneration of the Executive Directors is determined by a Remuneration Committee. A full Remuneration Report is set out on pages 6 and 7. None of the Directors receive any remuneration in respect of their services to Avon Energy Partners Holdings. Mr D G Bacon and Mr S A King receive and Mr M A Hughes and Mr R D Murray received remuneration in respect of their services as Executive Directors of Midlands Electricity Plc ("the Company").

Mr M A Hughes and Mr R D Murray retired on 8 May 2002. Prior to their retirement they had service contracts with the Company for a rolling two year period. Mr S A King had a one year rolling service contract with the Company. Mr S A King has resigned his post and left the Company on 31 January 2003.

Midlands Electricity Plc

NOTES TO THE ACCOUNTS (continued)

7 Directors and employees (continued)

The Directors' emoluments were:

	Mr M A Hughes	Mr R D Murray	Mr S A King	Mr D G Bacon	Year ended 31 December 2002 Total £000	Nine months ended 31 December 2001 Total £000
	£000	£000	£000	£000		
Remuneration	112	69	195	158	534	520
Benefits in kind	7	6	17	29	59	38
Performance related bonus	41	20	63	-	124	234
Long term incentive plan (LTIP)	-	-	100	-	100	143
Contractual compensation	1,200	699	-	-	1,899	-
Frozen holiday pay	-	15	-	-	15	-
Compensation for tax liability on FURBS	-	-	194	-	194	-
Year ended 31 December 2002	<u>1,360</u>	<u>809</u>	<u>569</u>	<u>187</u>	<u>2,925</u>	<u>935</u>
Nine months ended 31 December 2001	<u>445</u>	<u>250</u>	<u>240</u>	<u>-</u>		

On their retirement on 8 May 2002, accelerated LTIP payments due to termination were paid. Mr M A Hughes received £427,435 and Mr R D Murray received £205,014. Included within the contractual compensation payments for Mr R D Murray was £285,945 used to augment pension arrangements.

Mr M A Hughes was the highest paid Director. He was the Chief Executive until his retirement on 8 May 2002. For the nine months ended 31 December 2001, the Chief Executive was the highest paid director.

Up to the 31 August 2002, Mr S A King was accruing retirement benefits under an approved defined benefit scheme and an unfunded unapproved retirement benefit scheme ("UURBS"). From 1 September 2002, the unfunded unapproved arrangement was converted to a funded unapproved retirement benefits scheme ("FURBS").

The following table gives details in respect of the approved defined benefit scheme:

	Accrued pension entitlement including inflation		Increase in accrued pension in the period excluding inflation		Transfer value of increase in accrued benefits	
Mr S A King	Dec 2002	Dec 2001	Dec 2002	Dec 2001	Dec 2002	Dec 2001
	£	£	£	£	£	£
approved defined benefit scheme	13,042	28,750	2,211	5,429	5,199	29,962
	<u>13,042</u>	<u>28,750</u>	<u>2,211</u>	<u>5,429</u>	<u>5,199</u>	<u>29,962</u>

Note: the figures for 2001 relate to both funded approved and unfunded unapproved benefits.

The accrued pension entitlement shown is the amount that would be paid each year on retirement, based on service to the end of the year.

During the year £299,865 was transferred from the UURBS to the FURBS. This is the current value in the scheme which will be used to buy a pension on retirement, the value of which cannot be determined at 31 December 2002.

The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11, less directors' contributions. Members of the approved scheme have the option of paying Additional Voluntary Contributions. Neither the contributions, nor the resulting benefits are included in the above table. The transfer values disclosed above do not represent a sum paid or payable to the individual Director. Instead they represent a potential liability of the pension scheme.

Midlands Electricity Plc

NOTES TO THE ACCOUNTS (continued)

7 Directors and employees (continued)

Directors' interests

No Director had any interest in the shares of Midlands Electricity Plc or any other UK Group Company at 31 December 2002 or at 31 December 2001 other than as a non-beneficial nominee.

8 Taxation

Taxation credit/(charge) on profit for the period comprised:

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Current UK Corporation tax	(2.2)	(16.5)
Prior year UK Corporation tax	3.5	4.4
Total current tax charge/(credit)	1.3	(12.1)
Deferred taxation:		
Current year:		
Accelerated capital allowances	1.6	(2.8)
Short term timing differences	(0.1)	(0.5)
Amounts in respect of prior years	3.5	-
Decrease in discount	(0.1)	(2.5)
Total deferred tax	4.9	(5.8)
Exceptional tax – release of consortium relief creditor	30.7	-
Total tax charge/(credit) for the year	<u>36.9</u>	<u>(17.9)</u>

Following negotiations with lenders to the Teesside Project, an agreement was finalised in May 2002 under which £30.7m due to Teesside Power Ltd for consortium relief would not be payable.

Factors affecting the current tax charge for the period

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Profit on ordinary activities before taxation	<u>29.9</u>	<u>67.2</u>
Profit on ordinary activities multiplied by the standard rate of corporation tax in the UK of 30%	(9.0)	(20.2)
Accelerated capital allowances	(1.6)	2.8
Other timing differences	0.1	0.5
Expenses not allowable for tax purposes	(1.2)	(0.2)
Non-taxable income	9.3	0.6
Gain on disposal of non qualifying assets	0.2	-
Adjustments relating to prior years	3.5	4.4
Total current tax credit/(charge)	<u>1.3</u>	<u>(12.1)</u>

Future tax charges may be impacted by changes in regulations.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

9 Dividends

	<u>Year ended</u> <u>31 December 2002</u> £m	<u>Nine months ended</u> <u>31 December 2001</u> £m
Interim dividends paid of 9.669p per ordinary share (period ended 31 December 2001: 1.248p)	48.0	6.2
Final dividend proposed of nil p per ordinary share (31 December 2001: 1.710p)	-	8.5
	<u>48.0</u>	<u>14.7</u>

11 Intangible assets

	Goodwill £m
Cost	
At 1 January 2002	-
Additions	0.8
At 31 December 2002	<u>0.8</u>
Amortisation	
At 1 January 2002 and at 31 December 2002	<u>-</u>
Net book value	
At 31 December 2002	<u>0.8</u>
At 31 December 2001	<u>-</u>

The intangible asset has arisen on the acquisition of the business of a metering services company.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

12 Tangible fixed assets

	Non- operational Land & Buildings £m	Fixtures & Equipment £m	Total £m
Cost			
At 1 January 2002	33.4	37.3	70.7
Additions	0.6	4.4	5.0
Disposals	(2.3)	(1.6)	(3.9)
At 31 December 2002	<u>31.7</u>	<u>40.1</u>	<u>71.8</u>
Depreciation			
At 1 January 2002	6.9	27.0	33.9
Charge for the period	0.6	3.2	3.8
Disposals	(1.0)	(0.5)	(1.5)
At 31 December 2002	<u>6.5</u>	<u>29.7</u>	<u>36.2</u>
Net book value			
At 31 December 2002	<u>25.2</u>	<u>10.4</u>	<u>35.6</u>
At 31 December 2001	<u>26.5</u>	<u>10.3</u>	<u>36.8</u>

The net book value of non-operational land and buildings comprises:

	<u>31 December 2002</u> £m	<u>31 December 2001</u> £m
Freehold	25.1	26.2
Long leasehold	0.1	0.3
	<u>25.2</u>	<u>26.5</u>

Included in fixed assets are assets in the course of construction at 31 December 2002 amounting to £0.3m (31 December 2001: £4.2m) and land with a cost of £4.6m (31 December 2001: £4.7m) which is not depreciated.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

13 Fixed asset investments

	Subsidiary Undertakings £m
Cost	
At 1 January 2002	186.4
Disposals	(4.3)
At 31 December 2002	<u>182.1</u>
Provision for diminution in value	
At 1 January and 31 December 2002	-
Net Book Value	
At 31 December 2002	<u>182.1</u>
At 31 December 2001	<u>186.4</u>

The loans of £2.3m previously included in Investments in subsidiary undertakings were paid in the year.

The principal subsidiary undertakings are as follows:

Subsidiary undertakings	Country of incorporation or registration	Percentage of ordinary shares held	Nature of business
Aquila Networks Plc (formerly GPU Power Networks (UK) Plc)	Great Britain	100%	Electricity distribution
Aquila Networks Services Ltd (formerly GPU Power UK Limited)	Great Britain	100%	Electricity services
Midlands Power International Ltd	Great Britain	100%	Investment
MEB Corporate Insurance Ltd	Isle of Man	100%	Insurance
Aquila Power Investments Ltd	Great Britain	100%	Investment
MEB Manx Ltd	Isle of Man	100%	Vehicle leasing

14 Stocks

	2002 £m	2001 £m
Raw materials and consumables	0.1	0.1
Work in progress	2.5	2.1
	<u>2.6</u>	<u>2.2</u>

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

15 Debtors

	<u>2002</u> £m	<u>2001</u> £m
Amounts falling due after more than one year:		
Amounts due from group undertakings	149.6	131.3
Other debtors	-	1.5
	<hr/> 149.6	<hr/> 132.8
Amounts falling due within one year:		
Trade debtors	7.6	8.3
Amounts due from parent undertakings	-	-
Amounts due from group undertakings	428.8	854.3
Other debtors	14.5	21.5
Prepayments and accrued income	8.6	7.1
	<hr/> 459.5	<hr/> 891.2
	<hr/> <u>609.1</u>	<hr/> <u>1,024.0</u>

Amounts due from Group undertakings, within one year and in more than one year, comprise an interest bearing loan to Aquila Networks Plc of £251.7m on normal commercial terms, an interest free loan of £212.1 to Avon Energy Partners Holdings and other loans and current accounts which do not bear interest and have no fixed terms of repayments. £102.1m of the amount due from Aquila Networks Plc is repayable on 3 months notice.

16 Short term deposits

	<u>2002</u> £m	<u>2001</u> £m
Money market deposits	<hr/> -	<hr/> 10.8

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

17 Creditors

	<u>2002</u> £m	<u>2001</u> £m
Amounts falling due within one year:		
Bank overdraft	58.1	268.7
Short term borrowings repayable within three months	-	65.0
Payments received on account	1.0	1.8
Trade creditors	7.4	10.1
Amounts due to group undertakings	97.5	249.6
Dividends payable	-	8.5
Corporation tax	10.8	16.9
Other tax and social security	9.0	8.6
Other creditors	4.1	3.5
Accruals and deferred income	30.5	22.3
Other loans	-	-
	<u>218.4</u>	<u>655.0</u>
Amounts falling due after more than one year:		
Amounts due to parent undertakings	-	2.5
Amounts due to associated undertakings (see note 26)	-	30.7
7.375% Eurobonds repayable 2007	149.6	149.5
Accruals and deferred income	1.1	-
	<u>150.7</u>	<u>182.7</u>

The Eurobonds are not redeemable prior to 14 November 2007 except at the occurrence of specified events.

The Company has entered into guarantees in respect of the trading obligations of subsidiary undertakings in the normal course of business.

Amounts due by the Company to group undertakings comprise current accounts, which do not bear interest and have no fixed terms of repayment.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

18 Provisions for liabilities and charges

	<u>2002</u> £m	<u>2001</u> £m
Opening balance	53.5	185.7
Transferred under Transfer scheme	-	(138.1)
Transferred from profit and loss account	(3.2)	0.1
Applied during the period	(0.1)	5.8
Closing balance	<u>50.2</u>	<u>53.5</u>
Provisions consist of:		
Insurance	1.6	-
Welfare and frozen holiday pay	0.1	0.1
Deferred taxation (note 20)	1.7 <u>48.5</u>	0.1 <u>53.4</u>
	<u>50.2</u>	<u>53.5</u>

The insurance provision is the uninsured element of legal liabilities to third parties.

Welfare and frozen holiday pay represents provisions for past entitlements of staff in relation to holiday pay, payable either on demand or when the employee leaves the Company.

19 Financial instruments

Treasury activities

Treasury activities are carried out by the centralised Group Treasury department and are governed by policies and procedures approved by the Board which are set out in a Treasury Board Resolution. Hedging and significant funding transactions are agreed and approved by a treasury committee. No speculative use of financial instruments or derivatives is permitted. There has been no significant change in treasury policies or the role of financial instruments during the financial period.

The Company finances its operations through a mixture of retained profits, bank overdraft, amounts due from group undertakings and capital market issues. Surplus funds are placed on short term deposit with banks having high investment grade ratings.

The main risks arising from the Company's financial instruments are interest rate risk, liquidity risk, foreign currency risk and credit risk. The nature of these risks and the policies applied towards managing them are summarised in the paragraphs below.

Interest rate risk

The Company's exposure to interest rate risk is in relation to its bank balances and overdrafts and is not considered material.

Liquidity risk

The Group's objective is to maintain a range of funding sources and maturities. Funding is achieved through a mixture of short term uncommitted facilities, medium and long term bank and capital markets funding.

Currency risk

The Company's principal currency risk is exposure to fluctuations in the US Dollar exchange rate that arises through the Company's overdraft. This exposure is not considered significant and is not hedged.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

19 Financial instruments (continued)

Credit risk

The Company manages credit risk by entering into financial instruments only with highly credit rated authorised counterparties. Counterparty exposures are monitored regularly.

Short term debtors and creditors

As permitted by Financial Reporting Standard No. 13 short term debtors and creditors have been excluded from the numerical analysis given in the remainder of this note.

Interest rate risk profile of financial liabilities

Currency	Total £m	Floating rate financial liabilities £m	Fixed rate financial liabilities £m	Weighted average fixed interest rate %	Weighted average period for which rate is fixed Years
Sterling	204.7	55.1	149.6	7.4	4.87
US Dollar	3.0	3.0	-	-	-
At 31 December 2002	207.7	58.1	149.6	7.4	4.87
At 31 December 2001	483.2	208.6	274.5	6.8	3.97

The floating rate financial liabilities comprise overdraft funding bearing interest related to HSBC Bank Base Rate in the case of Sterling, and the Fed Funds Rate in the case of US Dollars together with short term bank borrowings bearing interest at rates fixed at the time of draw down and loans bearing interest related to LIBOR. For the purposes of calculating Company overdraft interest the overdraft balance is set off against credit balances held at the bank and interest computed on the net balance.

The Company has floating rate financial assets of £5.4m (31 December 2001: £10.8m) and financial assets on which no interest is received of £nil (31 December 2001: £28.5m). All its assets are sterling denominated.

The floating rate financial assets comprise of cash held in bank deposit accounts bearing interest at an interest rate fixed monthly. Cash held in bank current accounts does not bear interest but is set off against debit balances held at bank for the purpose of calculating overdraft interest.

Maturity profile of financial liabilities

	2002 £m	2001 £m
In one year or less, or on demand	58.1	333.7
In more than one year but not more than two years	-	-
In more than two year but not more than five years	149.6	-
In more than five years	-	149.5
	207.7	483.2

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

19 Financial instruments (continued)

Fair value of financial assets and liabilities

	Book value £m	2002 Fair value £m	Book value £m	2001 Fair value £m
Financial instruments held or issued to finance the Company's operations				
Short term borrowings	(58.1)	(58.1)	(333.7)	(333.7)
Long term borrowings	(149.6)	(158.5)	(149.5)	(159.5)
Short term deposits and cash at bank	5.4	5.4	39.2	39.2
Derivative financial instruments held to manage the interest rate profile				
Interest rate swaps	-	(2.0)	-	(2.3)

The fair values of borrowings and interest rate swaps and options were calculated by marking each transaction to market at prices and interest rates prevailing at 31 December 2002. The carrying value of short term borrowings, short term deposits and cash at bank approximates to fair value due to the short maturity of the instruments.

Statement of recognised and unrecognised gains and losses on hedges

	Year ended 31 December 2002			Nine months ended 31 December 2001		
	Gains £m	Losses £m	Total net gains/ (losses) £m	Gains £m	Losses £m	Total net gains/ (losses) £m
Opening balance	-	(2.3)	(2.3)	-	(2.4)	(2.4)
Arising in previous years and recognised in the period	-	2.4	2.4	-	0.8	0.8
Not recognised in the period	-	0.1	0.1	-	(1.6)	(1.6)
Current period gains and losses not recognised	-	(2.1)	(2.1)	-	(0.7)	(0.7)
Closing balance	-	(2.0)	(2.0)	-	(2.3)	(2.3)
Of which:						
Expected to be recognised within twelve months	-	(2.0)	(2.0)	-	(2.0)	(2.0)
Expected to be recognised after more than twelve months	-	-	-	-	(0.3)	(0.3)

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

20 Deferred taxation

The total potential liability and amount provided for the Company for deferred tax computed at the corporation tax rate of 30% (31 December 2001: 30%) is as follows:

	<u>2002</u> £m	<u>2001</u> £m
Opening balance	53.4	172.4
Transferred to subsidiary companies	-	(124.8)
Movement in period	(4.9)	5.8
Closing balance	<u>48.5</u>	<u>53.4</u>

Deferred tax computer at the corporation tax rate of 30% (31 December 2001: 30%) is as follows:

Accelerated capital allowances	5.4	7.3
Short term timing differences	45.6	49.1
Undiscounted provision for deferred tax	51.0	56.4
Discount	(2.5)	(3.0)
	<u>48.5</u>	<u>53.4</u>

No deferred tax asset has been recognised for tax losses which are not expected to be utilised in the foreseeable future. The total amount unprovided in respect of these losses is £3.4m (31 December 2001: £3.4m).

21 Called up share capital

	<u>2002</u> £m	<u>2001</u> £m
Authorised:		
600,000,000 ordinary shares of 25p each	<u>150.0</u>	<u>150.0</u>
Allotted, called up and fully paid:	Number of	Nominal
Ordinary shares of 25p each:	Shares	Value
		£m
At 1 January and 31 December 2002	<u>496,655,789</u>	<u>124.2</u>

22 Reserves

	Share Capital £m	Share Premium Account £m	Capital Redemption Reserve £m	Profit and Loss Account £m	Total £m
Company					
At 1 January 2002	124.2	11.7	10.6	251.0	397.5
Profit for the financial period	-	-	-	66.8	66.8
Dividends	-	-	-	(48.0)	(48.0)
At 31 December 2002	<u>124.2</u>	<u>11.7</u>	<u>10.6</u>	<u>269.8</u>	<u>416.3</u>

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

23 Reconciliation of movements in equity shareholders' funds

	<u>2002</u> £m	<u>2001</u> £m
Company		
Profit for the financial period	66.8	49.3
Transfer of reserves	-	(90.0)
Dividends	(48.0)	(14.7)
Net movement in shareholders' funds	18.8	(55.4)
Opening shareholders' funds as restated	397.5	452.9
Closing shareholders' funds	<u>416.3</u>	<u>397.5</u>

24 Pension commitments

The Company's employees are members of the Group Pension arrangements, details of which can be found in the Aquila Sterling Limited's financial statements. The total pension charge to the Company for the period in relation to both the ESPS and the MEPS was £1.7m (year ended 31 December 2001: £1.0m).

25 Lease obligations

The Company has the following annual commitments under operating leases for land and buildings which expire:

	<u>2002</u> £m	<u>2001</u> £m
In the second to fifth year inclusive	0.1	0.1
In more than five years	0.7	0.7
	<u>0.8</u>	<u>0.8</u>

26 Restrictions on subsidiary undertakings

Midlands Electricity Plc requires cash transfers from other group companies in order to meet the interest liabilities as they fall due on its borrowings. On 24th December 2002, Ofgem issued a consent under standard licence condition 47 of the Electricity Distribution Licence for Aquila Networks Plc, a wholly owned subsidiary of Midlands Electricity Plc.

The consent places restrictions on Aquila Network Plc's ability to make transfers, including paying dividends, to Midlands Electricity Plc. Aquila Networks Plc is specifically permitted to:

- make payments to Midlands Electricity Plc in accordance with the terms and conditions of the £150m inter-company loan from Midlands Electricity Plc which mirror payments Midlands Electricity Plc is to make on its £150m 7.375% bonds 2007.
- Payments of interest and repayments of principal when due and payable in accordance with terms and conditions, previously established, of the working capital loans provided by Midlands Electricity Plc to Aquila Networks Plc.

A copy of the full text of the consent has been placed on the public register of Ofgem.

The Directors of the Company are of the opinion that, despite the restrictions put in place by Ofgem in respect of Aquila Networks Plc, the Company and Group will be able to meet its liabilities, including interest payment, as they fall due for a period not less than 12 months after the signing date of these accounts.

Midlands Electricity Plc
NOTES TO THE ACCOUNTS (continued)

27 Ultimate controlling party

At 31 December 2002 the Company's intermediate holding company was Aquila Sterling Limited. Copies of the intermediate holding company's consolidated financial statements may be obtained from The Secretary, Aquila Sterling Limited, Whittington Hall, Whittington, Worcester, WR5 2RB.

The Directors regard Aquila, Inc. and FirstEnergy Corp. both incorporated in the USA, as the ultimate holding companies and controlling parties by virtue that each has a 50% voting interest in Aquila Sterling Limited. Copies of Aquila, Inc's consolidated financial statements may be obtained from The Secretary, Aquila, Inc., 20 West Ninth Street, Kansas City, Missouri 64105, USA and copies of FirstEnergy Corp's consolidated financial statements may be obtained from The Secretary, FirstEnergy Corp., 76 South Main Street, Akron, Ohio 44308, USA.