MGN Gas Networks (Junior Finance) Limited

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 MARCH 2006

Registered No. 5149491

CONTENTS:

DIRECTORS AND ADVISORS

Duncan Whyte (R, H) Chairman
Stephen Box (A, H)
James Dickson
Philip Garling
Howard Higgins (H)
Christopher Koski
Wayne Leamon (A, R)
Martin Stanley (R)

Steven Bickerton **(Alternate Director to Philip Garling)**
David Owens **(Alternate Director to Martin Stanley, Wayne Leamon and Howard Higgins)**

(A) Member of the Audit Committee of Wales & West Utilities Ltd
(R) Member of the Remuneration Committee of Wales & West Utilities Ltd
(H) Member of the Health & Safety Committee of Wales & West Utilities Ltd

COMPANY SECRETARY AND REGISTERED OFFICE

Alex Campbell
Level 30, City Point, 1 Ropemaker Street, London EC2Y 9HD

AUDITORS

PricewaterhouseCoopers LLP
1 Kingsway, Cardiff CF10 3PW

PRINCIPAL BANKERS

Barclays Bank plc

REPORT OF THE DIRECTORS

The directors have pleasure in presenting their second annual report to shareholders, together with the audited financial statements for the year ended 31 March 2006 as presented on pages 8 to 34.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The Group is principally engaged in the management of gas transportation assets. The Group provides gas distribution services throughout Wales and the South West of England.

On 31 August 2004, a direct subsidiary of the Company, MGN Gas Networks (Senior Finance) Limited ("MGNSF"), obtained the right to acquire 100% of the operating business of Wales & West Utilities Limited (formerly Blackwater 2 Limited) ("WWU"). Completion of the sale process required the consent of the Office of Gas and Electricity Markets (Ofgem), the Health and Safety Executive and the Secretary of State for Trade and Industry.

On 1 June 2005, MGNSF completed the acquisition of WWU for a total consideration of £1,262.1m, including settlement of group loans of £1,195.4m. Further details relating to the acquisition of WWU can be found in note 25.

During September 2005, the Group cancelled the agreement with Fulcrum Connections Ltd, a subsidiary of National Grid, for the provision of meter connection and relocation services. The Fulcrum Connections Ltd staff who undertook that activity transferred to WWU and who now undertake this work directly.

Overall the Group has performed satisfactorily during the year.

FUTURE DEVELOPMENTS

The Company does not envisage any changes in activity for the foreseeable future. In the opinion of the Directors there were no other significant developments within the Company that occurred during the financial period under review.

Details of the ownership of the Company are included in note 28. Details of movements in the authorised and issued share capital of the Company are included in Note 18.

FINANCIAL RISK MANAGEMENT

The Company's operations expose it to a variety of financial risks that include the effects of changes in debt market prices, credit risk, liquidity risk and interest rate risk. The Company has in place a risk management programme that seeks to limit the adverse effects on the financial performance of the Company by monitoring levels of debt finance and related finance costs. The Company also uses derivative financial instruments to manage interest rate costs.

Given the size of the Company, the directors have not delegated the responsibility of monitoring financial risk management to a sub-committee of the board. The policies set by the board are implemented by the Company's finance department.

Price risk
The Company is exposed to commodity price risk through the purchase of "shrinkage gas" as a result of its operations. This risk is managed through appropriate commodity purchase in the forward market.

Shrinkage gas is that gas which the Group consumes during its operational activity and comprises gas used by the business, the gas which leaks from the distribution network and gas stolen from the network.

FINANCIAL RISK MANAGEMENT (continued)

Credit risk
The Company has implemented policies that require appropriate credit checks on potential customers before sales are made. The amount of exposure to any individual counterparty is subject to a limit, which is reassessed on a regular basis.

The amount of credit given to Gas Shippers is governed by Unified Network Code ("UNC") regulations and guidelines. This provides for defined levels of unsecured credit with Gas Shippers based on Investment Grade Ratings with any excess credit amounts being secured by Letters of Credit, Parental Guarantees or by way of Prepayment.

The value at risk is monitored on a daily basis and is again regulated by UNC criteria allowing a maximum credit limit usage of 85% which, if exceeded, allows the Company to curtail further portfolio growth.

The Company's overall exposure is also monitored and approved having regard to the levels of exposure within each IGR category.

The Company actively maintains long term debt finance that is designed to ensure the Company has sufficient available funds for operations and planned expansions.

Interest rate cashflow risk
The Company has both interest bearing assets and interest bearing liabilities. Interest bearing assets are cash, which bear interest at variable rates. The Company has a policy of hedging debt in order to fix interest rates and give greater certainty over future cashflows.

CONSOLIDATED RESULTS

Loss on ordinary activities before taxation amounted to £92.6m (2005 £1.1m). The loss attributable to shareholders amounted to £92.7m (2005 £1.0m).

DIVIDEND ON ORDINARY SHARES

The directors do not recommend the payment of a dividend in respect of the year.

FIXED ASSETS

Following the acquisition of Wales & West Utilities Limited by the Group, freehold land and buildings are carried in the accounts at fair value of £2.7m (2005 £Nil).

In the opinion of the directors there was no significant difference between the book values of property and market values at 31 March 2006.

DIRECTORS

The names of the current directors of the Company are shown on page 1.

Changes in directors during the year are shown below, all other directors served throughout the year:

Richard Howes (Alternate Director)	Appointed 21 April 2005	Resigned 19 September 2005
Steve Bickerton (Alternate Director)	Appointed 19 September 2005	
Ross Sayers		Died 25 November 2005
Graeme Bevans		Resigned 10 March 2006
James Craig		Resigned 6 February 2006
Christopher Koski	Appointed 16 February 2006	
David Owens (Alternate Director)	Appointed 16 February 2006	
Martin Stanley	Appointed 16 February 2006	
Howard Higgins	Appointed 16 February 2006	
James Dickson	Appointed 10 March 2006	

DIRECTORS REMUNERATION

Details of directors remuneration is set out in note 3(a).

DIRECTORS' INTERESTS

There were no significant contracts subsisting during or at the end of the year with the Company or any of its subsidiaries in which any director is or was materially interested (other than service contracts).

None of the directors has or has had a beneficial interest in the shares of the Company or any subsidiary company. However, a number of the directors of the Company are also employees of companies which have invested in the shares and loan notes of the Company and are directors as a result of those investments.

POLICY ON THE PAYMENT OF CREDITORS

It is Group policy to comply with terms of payment agreed with suppliers. Where payment terms are not negotiated the Group endeavours to adhere with the suppliers standard terms.

EMPLOYMENT POLICIES

The Group recognises that its employees are key to both the present and future success of the Group and supports the fundamental belief that to maximise the potential of every individual there must be:-

- Investment in training and development.
- A supportive working environment.
- Employee participation and involvement in business matters.

To this end the Group is evolving a framework of comprehensive policies and all employees have the opportunity to discuss their individual performance and development in a focused and proactive way.

The Group seeks to maximise staff potential by encouraging employees to consider internal opportunities as part of their personal development. This can only be achieved with knowledge of the Group's business aims and objectives, and keeping employees up to date with Group news and views continues to be a high priority. The in-house newspaper supports this endeavour and provides a wide range of information.

The Group continues to formally consult employees at all levels in the spirit of partnership and co-operation and the use of employee opinion and attitude surveys will provide the Group with valuable information upon which to base future policy decisions.

The Group offers equality of opportunity and support for disabled employees and maintains good links with external organisations to encourage involvement in the workplace of disabled members of the wider community.

CONTRIBUTIONS FOR CHARITABLE AND POLITICAL PURPOSES

During the year, there have been no political donations, and charitable donations amounted to £4,000 (2005 £Nil). Donations in excess of £200 were made to:

Blackwood Alzheimer's' Society	£500
BBC Children in Need	£500
Flint & Holywell Rotary Club	£300
Sports Aid Wales	£590
Ty Hafan Children's Hospice for Wales	£300
St David's Hall & New Theatre Trust	£1,175

GOING CONCERN

The Group's accounts have been prepared on the basis that the Group is a going concern. In arriving at their decision to prepare the accounts on a going concern basis, the directors have reviewed the Group's budget for 2006/07 and medium term business plans for 2007/08 to 2010/11 including capital expenditure plans. This included consideration of the cash flow implications of the plans and comparing these with the Group's cash resources and committed borrowing facilities.

REGULATORY ACCOUNTS

The Gas Transporters Licence under which the Group's regulated gas business operates requires specific accounting statements to be published. Copies of the regulatory accounts for Wales & West Utilities Limited will be available from the Company Secretary after 30 November 2006.

AUDITORS

PricewaterhouseCoopers LLP were appointed as auditors on 7 February 2005.

Pursuant to Section 386 of the Companies Act 1985, an elective resolution was passed on 17 March 2004 resolving that the Company dispense with the requirement to appoint auditors annually.

By Order of the Board

A. Campbell

A Campbell
Company Secretary
21 June 2006

STATEMENT OF DIRECTORS' RESPONSIBILITIES FOR THE FINANCIAL STATEMENTS

The directors are required by the Companies Act 1985 to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit/loss of the Group for the year. In preparing the financial statements, the directors are required to:

- select suitable accounting policies and 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, and
- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company and Group 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 the Group and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By Order of the Board

A. Campbell

A Campbell
Company Secretary

21 June 2006

REPORT OF THE INDEPENDENT AUDITORS TO THE MEMBERS OF MGN GAS NETWORKS (JUNIOR FINANCE) LIMITED

We have audited the group and parent company financial statements (the "financial statements") of MGN Gas Networks (Junior Finance) Limited for the year ended 31 March 2006 which comprise the Group Profit and Loss Account, the Group and Company Balance Sheets, the Group Cash Flow Statement, the Group Statement of Total Recognised Gains and Losses and the related notes on pages 8 to 34. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, 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 other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) 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 judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and 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, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 March 2006 and of the group's loss and cash flows for the year then ended;

- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Cardiff
22 June 2006

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 MARCH 2006

	Note	2006 £m	From 9 June 2004 to 31 March 2005 £m
Turnover:			
Continuing operations		-	-
Acquisitions		208.0	-
Total turnover		208.0	-
Net operating costs	2	(206.2)	(0.1)
Operating profit/(loss):			
Continuing operations		0.2	(0.1)
Acquisitions		1.6	-
Total operating profit/(loss)		1.8	(0.1)
Interest receivable		6.3	-
Other finance income	27	2.8	-
Interest payable and similar charges	4	(103.5)	(1.0)
Loss on ordinary activities before taxation		(92.6)	(1.1)
Taxation	5	(0.1)	0.1
Loss attributable to ordinary shareholders		(92.7)	(1.0)
Dividends on ordinary shares		-	-
Retained loss for the year	19	(92.7)	(1.0)

STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 MARCH 2006

	2006 £m	2005 £m
Loss for the financial year attributable to ordinary shareholders	(92.7)	(1.0)
Actuarial gain on pension scheme	1.1	-
Total recognised gains and losses relating to the year	(91.6)	(1.0)

There are no material differences between the profit on ordinary activities before taxation and the retained loss for the year stated above and their historical cost equivalents.

RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS FOR THE YEAR ENDED 31 MARCH 2006

	2006 £m	2005 £m
Total recognised gains and losses for the year	(91.6)	(1.0)
Net decrease in shareholders' funds	(91.6)	(1.0)
At 1 April	(1.0)	-
At 31 March	(92.6)	(1.0)

BALANCE SHEETS AT 31 MARCH 2006

	Note	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Fixed assets					
Tangible assets	6	**1,370.9**	5.4	-	-
Investments	7	**0.1**	-	-	-
		1,371.0	5.4	-	-
Current assets					
Stocks and work in progress	8	**2.8**	-	-	-
Debtors	9	**36.6**	1.8	**493.6**	0.1
Cash at bank and in hand		**32.0**	-	**1.2**	-
		71.4	1.8	**494.7**	0.1
Current liabilities					
Creditors: amounts falling due within one year	10(a)	**(505.2)**	(8.2)	**(427.0)**	(0.2)
Net current (liabilities)/assets		**(433.8)**	(6.4)	**67.8**	(0.1)
Total assets less current liabilities		**937.2**	(1.0)	**67.8**	(0.1)
Creditors: amounts falling due after more than one year	10(b)	**(951.3)**	-	**(63.6)**	-
Provisions for liabilities and charges	17	**(63.2)**	-	-	-
Net (liabilities)/assets before pension liability		**(77.3)**	(1.0)	**4.2**	(0.1)
Pension liability	27	**(15.3)**	-	-	-
Net (liabilities)/assets including pension liability		**(92.6)**	(1.0)	**4.2**	(0.1)
Capital and reserves					
Called up share capital	18	-	-	-	-
Reserves	19	**(92.6)**	(1.0)	**4.2**	(0.1)
Equity shareholders' funds		**(92.6)**	(1.0)	**4.2**	(0.1)
Total shareholders' funds		**(92.6)**	(1.0)	**4.2**	(0.1)

The financial statements on pages 8 to 34 were approved by the Board of Directors on 21 June 2006 and were signed on its behalf by:

Director

Director

CONSOLIDATED CASHFLOW STATEMENT
FOR THE YEAR ENDED 31 MARCH 2006

	Note	2006 £m	2005 £m
Operating activities			
Net cash inflow from continuing operating activities	20	380.1	6.4
Net cash inflow from acquired operating activities	20	92.8	-
Net cash inflow from operating activities	20	472.9	6.4
Returns on investments and servicing of finance			
Interest received		6.3	-
Interest paid		(56.1)	(1.0)
Interest element of finance leases		(0.1)	-
Net cash outflow from returns on investments and servicing of finance		(49.9)	(1.0)
Taxation			
UK corporation tax paid		-	-
Tax paid		-	-
Investing activities			
Purchase of tangible fixed assets		(54.3)	(5.4)
Grants and contributions received		0.8	-
Purchase of subsidiary undertakings (net of cash and cash equivalents acquired)	25	(66.7)	-
Long term loans repaid on acquisition of Subsidiary	25	(1,195.4)	-
Net cash outflow from investing activities		(1,315.6)	(5.4)
Net cash outflow before financing and treasury activities		(892.6)	-
Financing and treasury activities			
New long term loans	21	924.7	-
Capital payments under finance leases	21	(0.1)	-
Net cash inflow from financing and treasury activities		924.6	-
Increase in cash and cash equivalents	22	32.0	-

PRINCIPAL ACCOUNTING POLICIES

The financial statements have been prepared in accordance with Accounting Standards applicable in the United Kingdom and comply with the Companies Act 1985. A summary of the principal Company accounting policies, which have been consistently applied, is shown below.

CHANGES IN ACCOUNTING POLICY

The Company has adopted FRS 17 'Retirement benefits', FRS 21 'Events after the balance sheet date', FRS 25 'Financial instruments disclosure and presentation' and FRS 28 'Corresponding amounts'. The change in accounting policy to adopt the requirements of these standards has not had an impact on the financial statements for the prior year as the Company did not trade in the prior year and accordingly no adjustments are required.

BASIS OF ACCOUNTING

These financial statements have been prepared in accordance with the historical cost convention as modified for the fair valuation exercise undertaken on the acquisition of the gas distribution business.

The Directors are satisfied that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason they adopt the going concern basis in the preparation of these financial statements.

ACQUISITIONS AND DISPOSALS

The results of businesses acquired during the year are dealt with in the financial statements from the date of acquisition of those businesses. Where appropriate, adjustments are made to bring different accounting policies of newly acquired companies into line with the existing Company accounting policies.

Goodwill arising from the purchase of businesses, representing the excess of the fair value of the purchase consideration (including costs of acquisition) over the fair value of net assets acquired, is amortised over its expected future economic life.

TURNOVER

Turnover represents the sales value derived from the distribution of gas together with the sales value derived from the provision of other services to customers during the year and excludes Value Added Tax.

Turnover from the distribution of gas is partially derived from the value of units supplied during the year and includes an estimate of the value of units supplied between the date of the last meter reading and the year end. No liability is recognised when revenues received or receivable exceed the maximum amount permitted by regulatory agreement and reductions will be made to future prices to reflect this over-recovery.

TANGIBLE FIXED ASSETS AND DEPRECIATION

Tangible fixed assets are included in the balance sheet at their cost less accumulated depreciation. Cost includes payroll and finance costs incurred which are directly attributable to the construction of tangible fixed assets.

Fixed assets acquired with the acquisition of the Wales and West gas distribution business are included at fair value.

Tangible fixed assets include assets in which the Company's interest comprises legally protected statutory or contractual rights of use.

Additions represent the purchase or construction of new assets and extensions or significant increases in the capacity of existing tangible fixed assets. Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight line basis to the profit and loss account over the estimated economic lives of the assets.

No depreciation is provided on freehold land and assets in the course of construction. Other tangible fixed assets are depreciated, principally on a straight line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of tangible fixed assets are, in general, shown below.

Replacement expenditure represents the costs of planned maintenance of mains and services assets by replacing or lining sections of pipe. This expenditure is principally undertaken to repair and to maintain the safety of the network and is written off as incurred. Expenditure which enhances the performance of the mains and services assets is treated as an addition to tangible fixed assets.

Principal depreciation periods are:	
Freehold buildings	up to 50 years
Leasehold properties	over the period of the lease
Gas distribution network assets:	
Mains, services and regulating equipment	30 to 65 years
Storage	40 years
Meters	10 to 33 years
Vehicles, mobile plant and equipment	3 to 10 years

Assets in the course of construction are not depreciated until commissioned.
All assets are depreciated on a straight line basis over their estimated economic life.

IMPAIRMENT OF FIXED ASSETS

Impairments of fixed assets are calculated as the difference between the carrying values of the net assets of income generating units, including, where appropriate, investments and goodwill, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the net amount that can be generated through sale of the assets. Value in use represents the present value of expected future cashflows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit.

Impairment reviews are carried out if there is some indication that an impairment may have occurred, or where otherwise required, to ensure that fixed assets are not carried above their estimated recoverable amounts.

Impairments are recognised in the profit and loss account and, where material, are disclosed as exceptional.

LEASED ASSETS

Where assets are financed by leasing arrangements which transfer substantially all the risks and rewards of ownership of an asset to the lessee (finance leases), the assets are treated as if they had been purchased and the corresponding capital cost is shown as an obligation to the lessor. Leasing payments are treated as consisting of a capital element and finance costs, the capital element reducing the obligation to the lessor and the finance charges being written off to the profit and loss account over the period of the lease in reducing amounts in relation to the written down amount. The assets are depreciated over the shorter of their estimated useful life and the lease period.

All other leases are regarded as operating leases. Rental costs arising under operating leases are charged to the profit and loss account in the year to which they relate.

GRANTS, CUSTOMER CONTRIBUTIONS AND INFRASTRUCTURE CHARGES

Grants, customer contributions and infrastructure charges relating to gas infrastructure assets and expenditure on other fixed assets are treated as deferred income and recognised in the profit and loss account over the expected useful economic lives of the related assets.

Certain contributions noted above are wholly or partially refundable if an agreed volume of gas is distributed to them. Such contributions are included in provisions until there is no further liability to make refunds.

INVESTMENTS

Long term investments held as fixed assets are stated at cost less amounts written off or provided to reflect permanent diminutions in value. Those held as current assets are stated at the lower of cost and net realisable value.

STOCKS AND WORK IN PROGRESS

Stocks are stated at the lower of cost and net realisable value which takes account of any provision necessary to recognise damage and obsolescence.

COSTS OF RAISING FINANCE

Under the provisions of FRS4 "Capital Instruments", costs associated with the raising of relevant finance are accounted for as a deduction from the amount of the consideration received. The costs are then amortised over the life of the instrument.

DECOMMISSIONING AND ENVIRONMENTAL COSTS

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

FINANCIAL INSTRUMENTS

Derivative financial instruments ("derivatives") are used by the Company for the management of interest rate exposures and commodity price risks in respect of expected gas usage. The principal derivatives used include interest rate swaps and forward purchases relating to the purchase of gas.

All transactions are undertaken, or maintained, with a view to providing a commercial hedge of the interest or commodity price risks associated with the Company's underlying business activities and the financing of those activities. Amounts payable or receivable in respect of interest rate swaps are recognised in the profit and loss account over the economic lives of the agreements or underlying position being hedged, either within net interest or disclosed separately where deemed exceptional.

Those derivatives relating to interest rates that are directly associated with a specific transaction and exactly match the underlying cashflows relating to the transaction are accounted for on the basis of the combined economic result of the transaction including the related derivative.

PENSION COSTS

The Company operates defined contribution and defined benefit pension schemes.

The pension costs in respect of the defined contribution pension schemes comprise contributions payable in respect of the period.

The assets of the defined benefit scheme are measured using closing market values. Pension scheme liabilities are measured using the projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

The increase in the net present value of the liabilities of the defined benefit scheme expected to arise from employee service in the period is charged to operating profit. The net of the expected return on the scheme's assets and the increase during the period in the present value of the schemes' liabilities, arising from the passage of time, are included in net interest payable or other finance income, as appropriate.

Actuarial gains and losses are recognised in the statement of total recognised gains and losses.

DEFERRED TAXATION

Provision is made for deferred taxation, using the liability method, on all material timing differences to the extent that it is probable that a liability or asset will crystallise.

Deferred tax assets are only recognised to the extent that they are considered recoverable.

Deferred tax balances are not discounted.

1 Company profit and loss account

As permitted by section 230 of the Companies Act 1985, the profit and loss account of the Company has not been included in these financial statements. The profit after taxation for the year dealt with in the financial statements of the Company was £4.3m (2005 loss £0.1m).

2 Net operating costs

Net operating costs include:

	Note	2006 £m
Acquisitions in year:		
Staff costs	3(b)	41.1
Severance and redundancy costs		0.4
Depreciation:		
Own assets		52.0
Assets held under finance leases		1.5
Replacement expenditure		45.1
Rentals under operating leases:		
Hire of plant and equipment		0.5
Other		0.1
Fees paid to auditors:		
Audit services		0.1
Taxation services		-
Consultancy services		-
Less:		
Own work capitalised		(4.4)
Amortisation of customer contributions		(0.2)

Included in audit services is £10,000 (2005 £5,000) in respect of audit fees incurred by the Company. Other fees paid to the auditors and capitalised were £Nil (2005 £Nil).

	Note	2005 Total £m
Continuing operations:		
Staff costs	3(b)	0.1
Fees paid to auditors:		
Audit services		-
Taxation services		-
Consultancy services		-
Other operating charges		-
		0.1

3 Directors and employees

(a) Directors' emoluments and interests

	2006 £000	2005 £000
Fees	80.0	-
	80.0	-

All directors make their own pension arrangements; accordingly no retirement benefits are accruing to the directors.

No director had any interest over shares in the Company.

Highest paid director:

	2006 £000	2005 £000
Fees	35.0	-
	35.0	-

No other director received any remuneration in respect of their services to the group.

(b) Staff costs

	2006 £m	2005 £m
Wages and salaries	31.4	0.1
Social security costs	2.8	-
Pension costs	6.9	-
	41.1	0.1

Of the above, £3.2m (2005 £Nil) has been charged to capital.

(c) Average monthly number of employees during the year (including directors)

	2006 Number	2005 Number
Regulated gas distribution activities	1,164	-
Other activities	2	4
	1,166	4

The staff numbers above include the weighted average staff numbers for Wales & West Utilities Limited for the ten month period post acquisition. The average monthly staff numbers for Wales & West Utilities Limited for the full year were:

	2006 Number	2005 Number
Regulated gas distribution activities	1,149	-
Other activities	2	-
	1,151	-

4 Interest payable and similar charges

	2006 £m	2005 £m
On loans	103.4	1.0
On finance leases	0.1	-
	103.5	1.0

5 Taxation

(a) Analysis of charge in the year

	2006	2005
The charge for taxation is made up as follows:	**£m**	**£m**
Current taxation		
UK corporation tax on profits of the year	**0.1**	(0.1)
Adjustments in respect of previous periods	-	-
	0.1	(0.1)
Total current tax (note 5(b))	**0.1**	(0.1)
Deferred tax		
Origination and reversal of timing differences	-	-
Total deferred tax (note 17)	-	-
Total tax on profit on ordinary activities	**0.1**	(0.1)

(b) Factors affecting the current tax charge for the year

The current tax assessed for the year is different to the standard rate of corporation tax in the UK of 30%. The differences are explained below:

	2006	2005
	£m	**£m**
Loss before tax	**(92.6)**	(1.1)
Loss multiplied by standard rate of corporation tax in the UK of 30% (2005 : 30%)	**(27.8)**	(0.3)
Effects of:		
Temporary differences between taxable and accounting profit:		
Accelerated capital allowances	-	-
Other timing differences	-	-
Tax losses	-	-
Prior year charge/(credit)	**15.5**	0.2
Permanent differences	**12.4**	-
Current tax charge for the year (note 5(a))	**0.1**	(0.1)

6 Tangible fixed assets

Group	Freehold land and buildings £m	Infrastructure assets £m	Vehicles, plant and equipment £m	Assets under Construction £m	Total £m
Cost or valuation					
At 1 April 2005	-	-	5.4	-	**5.4**
On acquisition of subsidiary	2.7	1,344.0	13.8	-	**1,360.7**
Additions	-	8.2	5.8	44.5	**58.5**
Reclassifications	-	7.3	6.9	(14.2)	-
At 31 March 2006	**2.7**	**1,359.5**	**31.9**	**30.3**	**1,424.4**
Accumulated depreciation					
At 1 April 2005	-	-	-	-	-
Charge for the year	-	49.3	4.2	-	**53.5**
Disposals	-	-	-	-	-
At 31 March 2006	-	**49.3**	**4.2**	-	**53.5**
Net book value					
At 31 March 2006	**2.7**	**1,310.2**	**27.7**	**30.3**	**1,370.9**
At 31 March 2005	-	-	5.4	-	5.4
Analysis of net book value at 31 March 2006					
Owned	2.7	1,310.2	26.0	**30.3**	**1,369.2**
Held under finance lease	-	-	1.7	-	**1.7**
	2.7	**1,310.2**	**27.7**	**30.3**	**1,370.9**

Company

The Company had no tangible fixed assets at 31 March 2006 or at 31 March 2005.

7 Fixed asset investments

Group

	Unlisted investments £m
Cost	
At 1 April 2005	-
On acquisition of subsidiary	0.1
At 31 March 2006	0.1
Amounts written off	
At 1 April 2005	-
On acquisition of subsidiary	-
At 31 March 2006	-
Net book value	
At 31 March 2006	0.1
At 31 March 2005	-

Company

	Interests in Group undertakings £m
Cost	
At 31 March 2005 and 31 March 2006	-
Amounts written off	
At 31 March 2005 and 31st March 2006	-
Net book value	
At 31 March 2005 and 31st March 2006	-

The Company's principal direct subsidiary is MGN Gas Networks (Senior Finance) Limited and comprises 2 shares of £1 each. The Company owns the entire issued share capital of MGN Gas Networks (Senior Finance) Limited.

The Company's principal indirect subsidiary undertaking is Wales & West Utilities Limited, a company incorporated in England & Wales. The Group is the beneficial holder of 100% of the issued share capital of Wales & West Utilities Ltd.

8 Stocks and work in progress

Group

	2006 £m	2005 £m
Raw materials and consumables	2.8	-

The replacement cost of stocks is not materially different from their carrying value.

Company

The Company had no stocks and work in progress at 31 March 2006 or at 31 March 2005.

9 Debtors

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Amounts falling due within one year:				
Trade debtors	3.4	-	-	-
Amounts owed by subsidiary undertakings	-	-	493.6	-
Other debtors	-	0.5	-	-
Prepayments and accrued income	33.2	1.2	-	-
Recoverable corporation tax	-	0.1		0.1
	36.6	1.8	493.6	0.1

10 Creditors

	Note	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
(a) Amounts falling due within one year:					
Payments received on account		27.6	-	-	-
Obligations under finance leases	12	1.4	-	-	-
Trade creditors		13.8	-	-	-
Amounts owed to group undertakings		426.9	7.1	426.9	-
Customer capital contributions		0.3	-	-	-
Other taxation and social security		9.7	-	-	-
Other creditors		0.5	-	-	-
Accruals and deferred income		24.2	1.1	0.1	0.2
Capital grants		0.8	-	-	-
		505.2	8.2	427.0	0.2
(b) Amounts falling due after more than one year:					
Other loans	11	936.9	-	63.6	-
Obligations under finance leases	12	0.7	-	-	-
Customer capital contributions		13.7	-	-	-
		951.3	-	63.6	-

11 Other loans

	Group 2006 £m	Group 2005 £m	Company 2006 £m	Company 2005 £m
Repayable as follows:				
Between two and five years	936.9	-	63.6	-
	936.9	-	63.6	-

Fixed interest rates on these loans range between 2.98% and 5.35% and variable interest rates varied between 0.4% to 2.25% above LIBOR.

The Company's obligations under its loan facility agreement are secured by fixed and floating charges over its assets. A subsidiary company has granted fixed and floating charges over its own assets securing obligations under its loan facility agreements.

12 Finance leases

Group

	2006 £m	2005 £m
Amounts due under finance leases are payable as follows:		
Within one year	1.4	-
Between one and two years	0.7	-
	2.1	-

Company

The Company had no finance lease obligations at 31 March 2006 or at 31 March 2005.

13 Gross borrowings

	2006 £m	2005 £m
Finance leases	2.1	-
Gross value of other loans	944.0	-
	946.1	-

The maturity profile of the group's gross borrowings, excluding bank overdrafts, was as follows:

	2006 £m	2005 £m
In one year or less, or on demand	1.4	-
In more than one year but not more than two years	0.7	-
In more than two years but not more than five years	944.0	-
	946.1	-

14 Financial instruments and risk management

(a) Interest rate swaps

The Group has entered into interest rate swap arrangements in order to manage the interest rate exposure of the Group and not for trading or speculative purposes.

Group

The Group's outstanding interest rate swap arrangements had a notional principal balance of £964m (2005 £Nil), with a termination date of 31 March 2013, and interest rates ranging between 2.98% to 5.35%.

Company

The Company had no interest rate swap arrangements at 31 March 2006 or at 31 March 2005.

(b) Interest rate composition of gross borrowings

After taking account of the interest rate swaps entered into by the Group, the fixed and floating interest rate profile of the Group's gross borrowings, including intra-group indebtedness, was:

	2006 £m	2005 £m
Fixed rate	964.0	-
Floating rate	375.5	-
Total	1,339.5	-

The floating rate loans comprise group borrowings.

(c) Interest rate profile of fixed rate borrowings

After taking account of the interest rate swaps entered into by the Group, the weighted average interest rate profile of the Group's gross borrowings, including intra-group indebtedness, together with the weighted average period for which the rate is fixed was:

	Weighted average interest rate		Weighted average period for which rate is fixed	
Currency	2006 %	2005 %	2006 Years	2005 Years
Sterling	9.09	-	4.2	-

(d) Borrowing facilities

Undrawn committed borrowing facilities were:

	2006 £m	2005 £m
Committed borrowing facilities available	1,217	-
Drawn	(944)	-
Undrawn facilities at 31 March 2006 expire 31 May 2010	273	-

At the Company's option, £1,035m of the committed facilities can be extended to 31 May 2014.

14 Financial instruments and risk management (continued)

(e) Fair values of financial instruments

In the table below, the fair value of short term borrowings, current asset investments, cash at bank and in hand and bank loans and overdrafts approximates to book values due to the short maturity of these instruments.

The fair values of long term instruments have been determined by reference to prices available from the financial markets on which these borrowings are traded. The fair values fundamentally represent the change in anticipated future interest rates, to the dates of maturity of the borrowings, between the date on which those long term borrowings were raised and the year end. This increased liability will only materialise if the group ceases trading and future anticipated interest rates remain at year end levels.

	Book value £m	Fair value £m
Primary financial instruments held or issued to finance the Group's operations:		
Short term borrowings	(2)	(2)
Long term borrowings	(944)	(944)
Cash at bank and in hand	32	32
	(914)	(914)
Derivative financial instruments held to manage the interest rate profile and matched by primary financial instruments:		
Interest rate swaps	(39)	(50)
	(953)	(964)

The fair value of derivative financial instruments matched to primary financial instruments relates to long term borrowings with a book value of £1,041m which have been included within the primary financial instruments issued to finance the Group's operations at a fair value of £1,041m, which is the redemption value of those borrowings.

(f) Losses on derivative financial instruments

The fair value of losses on derivative financial instruments is not recognised in the financial statements. These instruments are held to manage the Group's interest rate exposures and the resultant fixed interest charges are made in the accounting periods to which they relate. The table below analyses the composition of the fair value losses (note 14(e)).

	Total losses £m
At 1 April 2005	-
Acquired with subsidiary	(42.4)
Entered into in the year	(12.6)
Market rate adjustment	4.7
At 31 March 2006	(50.3)
Of which:	
Losses expected to be included in 2006/07	(7.0)
Losses expected to be included in 2007/08 or later years	(43.3)
Losses not expected to be included in 2007/08 or later years	-
	(50.3)

15 Capital commitments

Group

	2006 £m	2005 £m
Contracted for but not provided in the financial statements	4.8	-

In order to meet regulatory and service standards, the Group has longer term capital expenditure obligations within the regulated gas distribution business which include investments to meet shortfalls in performance and condition, and to provide for new demands and growth.

Company
The Company had no capital commitments at 31 March 2006 or at 31 March 2005.

16 Leasing commitments

Group

	Land and buildings		Others	
	2006 £m	2005 £m	2006 £m	2005 £m
At 31 March 2006 there were revenue commitments, in the ordinary course of business in the next year to the payment of rentals on non cancellable operating leases expiring:				
Within one year	0.4	-	0.1	-
Between two and five years	0.4	-	0.7	-
After five years	0.7	-	-	-
	1.5	-	0.8	-

Company
The Company had no operating lease commitments at 31 March 2006 or 31 March 2005.

17 Provisions for liabilities and charges

	Note	2006 £m	2005 £m
Insurance provision	(a)	2.0	-
Environmental and demolition provisions	(b)	18.6	-
Onerous contract provision	(c)	38.7	-
Onerous leases provision	(d)	0.6	-
Wayleaves provision	(e)	2.7	-
Other provisions	(f)	0.6	-
Deferred taxation	(g)	-	-
		63.2	-

(a) Insurance provisions

	2006 £m	2005 £m
On acquisition of business	2.0	-
At 31 March	2.0	-

The insurance provision is the estimate of liabilities in respect of past events incurred by the business. On the transfer of the business to the Company, these liabilities were established at a fair value of £2m. In accordance with insurance industry practice, these estimates were based on experience from previous years and there was, therefore, no identifiable payment date.

(b) Environmental and demolition provisions

	2006 £m	2005 £m
On acquisition of business	18.6	-
At 31 March	18.6	-

The environmental provision represents the estimated environmental restoration and remediation costs relating to a number of sites owned and managed by the Company. The provision has been discounted to its estimated net present value. The anticipated timing of the cashflows for statutory decontamination cannot be predicted with certainty, but it is expected to be incurred over the period 2006 to 2057.

(c) Onerous contracts provision

	2006 £m	2005 £m
On acquisition of business	42.4	-
Utilised in the year	(3.7)	-
At 31 March	38.7	-

On acquisition of the Gas Distribution business, the MGN Gas Networks (UK) Limited group acquired an interest rate swap contract from the National Grid group. The fair value of the contract was calculated on acquisition and will be amortised on a straight line basis over the contract life, which ends in 2013.

(d) Onerous lease provision

	2006 £m	2005 £m
Charge for the year	0.6	-
At 31 March	0.6	-

The onerous lease provision represents the expected costs incurred in relation to vacant properties owned by the Company. The provision is expected to be utilised in the two years ended 31 March 2008.

17 Provisions for liabilities and charges (continued)

(e) Wayleaves provisions

	2006 £m	2005 £m
On acquisition of business	2.7	-
At 31 March	2.7	-

The wayleaves provision is provided to cover the costs associated with rectifying gas distribution assets which are the subject of ineffective easements or wayleaves. The provision is expected to be utilised over the period until 2020.

(f) Other provisions

	2006 £m	2005 £m
On acquisition of business	0.6	-
At 31 March	0.6	-

Other provisions provide for a potential liability in respect of contracts which have repayment clauses in the event that certain future thresholds are achieved. The provision is expected to be utilised over the period until 2016.

(g) *Deferred taxation*

The movement on deferred tax is as follows:

	Group		Company	
	2006 £m	2005 £m	2006 £m	2005 £m
At start of year	-	-	-	-
Profit and loss account	-	-	-	-
At end of year	-	-	-	-
Deferred tax provided is made up as follows:				
Accelerated capital allowances	-	-	-	-
Other timing differences	-	-	-	-
Tax losses carried forward	-	-	-	-
	-	-	-	-

A deferred tax asset has not been recognised in respect of total tax losses with a tax value of £10.5 million as there is insufficient evidence that the asset will be recoverable.

18 Called up share capital

	2006 £	2005 £
Authorised:		
Ordinary shares of £1 each	2	2
Allotted, called up and fully paid:		
Ordinary shares of £1 each	2	2

19 Reserves ~ Profit and loss account

	Group £m	Company £m
At 1 April 2005	(1.0)	(0.1)
(Loss)/profit retained for the year	(92.7)	4.3
Actuarial gain on pension scheme	1.1	-
Movement on deferred tax relating to pension scheme	-	-
At 31 March 2006	(92.6)	4.2
Pension liability recorded in reserves	(1.1)	-
Profit and loss reserves excluding pension liability	(93.7)	4.2

20 Net Cash inflow from operating activities

	2006 £m	2005 £m
Continuing operations:		
Operating profit	0.2	(0.1)
Net (increase)/decrease in debtors	1.7	(1.7)
Net (decrease)/increase in creditors	378.2	2.9
Net cash inflow from continuing operating activities	380.1	1.1
Acquisitions:		
Operating profit	1.6	-
Depreciation of tangible fixed assets	53.5	-
Net increase in stocks	(1.8)	-
Net increase in debtors	(25.6)	-
Net increase in creditors	62.8	-
Pension provisions	1.7	-
Onerous contracts provisions	0.6	-
Net cash inflow from acquired operating activities	92.8	-
Net cash inflow from operating activities	472.9	1.1

21 Analysis of changes in financing in the year

	Share capital (including premium)		Long term loans & finance lease obligations	
	2006 £m	2005 £m	2006 £m	2005 £m
At 1 April	-	-	-	-
Long term loans	-	-	924.7	-
Long term loan issue costs written back	-	-	12.2	-
Finance leases acquired with Subsidiary	-	-	2.2	-
Finance lease repayments	-	-	(0.1)	-
At 31 March	-	-	939.0	-

22 Analysis of changes in cash and cash equivalents in the year

	2006 £m	2005 £m
At 1 April	-	-
Net cash inflow	32.0	-
At 31 March	32.0	-

23 Analysis of cash and cash equivalents

	2006 £m	2005 £m	2006 Change in year £m	2005 Change in year £m
Cash at bank and in hand	32.0	-	32.0	-
	32.0	-	32.0	-

24 Reconciliation of net cash flow to increase in net cash

	2006 £m	2005 £m
Increase in cash as per cash flow statement	32.0	-
Increase in loans and finance lease obligations	(936.9)	-
Increase in net debt resulting from cash flows	(904.9)	-
Finance leases acquired with subsidiary	(2.2)	
Finance lease principal repayments	0.1	-
Increase in net debt	(907.0)	-
At 1 April	-	-
At 31 March	(907.0)	-

25 Purchase of subsidiary undertaking

On 1 May 2006, National Grid transferred into Wales & West Utilities Limited the business, operational assets and liabilities of its gas distribution business relating to Wales and the South West of England. On the transfer, Wales & West Utilities Limited applied fair values to the assets and liabilities which it acquired.

On 1 June 2006 the Group acquired the entire issued share capital of Wales & West Utilities Limited (formerly Blackwater 2 Limited) from National Grid plc via MGN Gas Networks (Senior Finance) Limited ("MGNSF").

The book values of the assets and liabilities of Wales & West Utilities Limited immediately prior to the acquisition by MGNSF and the fair value adjustments required in recognition of the change in ownership are as follows:

	Book value on acquisition £m	Onerous contract acquired £m	Fixed asset Revaluations £m	Fair value to the Group £m
Fixed assets:				
Tangible	1,273.6	-	87.1	**1,360.7**
Investments	0.1	-	-	**0.1**
Stocks	1.0	-	-	**1.0**
Debtors	7.3	-	-	**7.3**
Creditors due within one year	(18.7)	-	-	**(18.7)**
Creditors due after one year	(3.1)	-	-	**(3.1)**
Provisions for liabilities and charges	(41.4)	(42.4)	-	**(83.8)**
Deferred income	(1.4)	-	-	**(1.4)**
Net operational assets acquired	**1,217.4**	**(42.4)**	**87.1**	**1,262.1**
Inter-company loan acquired	(1,195.4)	-	-	**(1,195.4)**
Net assets acquired	**22.0**	**(42.4)**	**87.1**	**66.7**

25 Purchase of subsidiary undertaking (continued)

	Total £m
Consideration:	
Cash (including costs of acquisition)	66.7
Fair value of net assets acquired:	
Fair value of net assets acquired (as above)	66.7
Goodwill	-

The fair values attributed to certain assets and liabilities are provisional and will be adjusted, if necessary, in the year ending 31 March 2007 with a consequential adjustment to goodwill.

Subsequent to deal completion, in September 2005, the Company cash settled the inter-company loan, which then amounted to £1,195.4m, with the National Grid group.

In the period since acquisition, Wales & West Utilities Limited contributed £91.2m to the Group's net operating cash flows.

The results of Wales & West Utilities Limited prior to acquisition were as follows:

	1 May 2005 to 31 May 2005 £m
Turnover	16.2
Operating loss	(3.8)
Net interest (payable)/receivable	(5.1)
Loss on ordinary activities before taxation	(8.9)
Tax on profit on ordinary activities	-
Loss for the period	(8.9)

26 Directors' and officers' loans and transactions

No loans or credit transactions with any directors, officers or connected persons subsisted during the year or were outstanding at the end of the year.

27 Pension schemes

The Group operates one defined contribution and one defined benefit pension scheme.

Defined benefit scheme

The Group operates the Wales & West Utilities Pension Scheme ("the Scheme"). The Scheme funds are administered by trustees and are independent of the Group's finances. The Scheme includes both a defined benefit section, providing benefits relating to final salary, and a defined contribution section. The Scheme was set up with effect from 1st June 2005 and new employees were eligible to join the defined contribution section from this date.

Former employees of National Grid Transco continued their membership of the Lattice Group Pension Scheme (National Grid Transco's scheme) until December 2005. During this time the Group paid contributions to the Lattice Group Pension Scheme.

In December 2005 the past service benefits of 77 defined contribution members and 959 defined benefit members were transferred into the Wales & West Scheme from the Lattice Group Pension Scheme. These members are now contributing to the Wales & West Scheme.

The balance sheet figures relate only to the defined benefit section of the Scheme and therefore exclude the assets and liabilities of the defined contribution section. This does not affect the reported deficit.

The liabilities of the Scheme were calculated as at 1 May 2005 and 31 March 2006 based on calculations and data as at 31 May 2005 and 31 March 2006. These calculations were carried out by an independent qualified actuary in accordance with FRS17. The value of the defined benefit liabilities has been measured using the projected unit method.

The key FRS17 assumptions used for the Scheme are set out below, along with the fair value of assets, a breakdown of the assets into the main asset classes, the present value of the FRS17 liabilities and the deficit of assets below the FRS17 liabilities (which equals the gross pension liability).

Assumptions	**31 March 2006**	**1 May 2005**
Price inflation	2.9% pa	2.8% pa
Discount rate	5.0% pa	5.4% pa
Pension increases (LPI)	2.9% pa	2.8% pa
Salary growth	3.9% pa	3.8% pa

27 Pension schemes Defined benefit scheme (continued)

On the basis of the assumptions used for life expectancy, a male pensioner currently aged 60 would be expected to live for a further 24 years. Allowance is made for future improvements in life expectancy.

Asset distribution and expected return

	31 March 2006		1 May 2005	
	Expected return	**Fair value £m**	**Expected return**	**Fair value £m**
Equities	8.4% pa	133.8	8.5% pa	127.9
Bonds/cash	4.2% pa	17.3	n/a	-
Property	6.3% pa	13.7	n/a	-
Total		164.8		127.9

Balance sheet	**31st March 2006 £m**	**1st May 2005 £m**
Total fair value of assets	164.8	127.9
FRS17 value of liabilities	(180.1)	(145.4)
Gross pension liability	(15.3)	(17.5)

The scheme is represented on the balance sheet at 31 March 2006 as a liability under FRS17 which amounts to £15.3m.

Over the period to 31 March 2006, contributions by the Group of £4.7m were made in total to the Wales & West Scheme and the Lattice Group Pension Scheme in relation to members of the defined benefit section. A further £0.2m has been set aside outside of the Wales & West Scheme in order to meet the Scheme's expenses. Including also member contributions of £0.7m gives a total of £5.6m.

The employer paid a further £0.3m during the accounting period in respect of defined contribution members.

A formal valuation as at 31 March 2006 is in progress. Until that valuation has been completed, it has been agreed that future employer contributions to the defined benefit section will be at a rate of 20.7% of pensionable salaries, plus an allowance for expenses. Future contributions are to be reviewed during 2006.

The FRS17 deficit in the defined benefit section under FRS17 moved over the period as follows:

	2005/06 £m
Post retirement deficit on acquisition	(17.5)
Current service cost (employee and employer)	(7.3)
Contributions (employee and employer)	5.6
Other net finance income	2.8
Actuarial gain	1.1
Post retirement deficit at end of year	(15.3)

The following amounts have been included within operating profit under FRS17 for the defined benefit section:

	2005/06 £m
Current service cost (employer's part only)	6.6
Past service cost	-
Total operating charge	6.6

27 Pension schemes Defined benefit scheme (continued)

The following amounts have been included as net finance income under FRS17:

	2005/06 £m
Expected return on pension scheme assets	10.2
Interest on post retirement liabilities	(7.4)
Net return to credit/(charge) to finance income	2.8

The defined benefit section of the scheme is closed to new entrants and, under the method used to calculate pension costs in accordance with FRS17, the cost as a percentage of covered pensionable payroll will tend to increase as the average age of the membership increases.

The following amounts have been recognised within the statement of total recognised gains and losses ("STRGL") under FRS17:

	2005/06 £m
Actual return less expected return on scheme assets	21.9
Experience gains and (losses) arising on scheme's liabilities	-
Gain or (loss) due to changes in assumptions underlying the FRS17 value of scheme liabilities	(20.8)
Actuarial gain/(loss) recognised in the STRGL	1.1

The history of experience gains and losses is:

	2005/06
Actual return less expected return on scheme assets (£m)	21.9
Percentage of scheme's assets	13%
Experience gains and (losses) arising on scheme's liabilities (£m)	-
Percentage of the FRS17 value of the scheme's liabilities	-
Total amount recognised in the STRGL (£m)	1.1
Percentage of the FRS17 value of the scheme's liabilities	1%

Defined contribution scheme

The Group also operates a defined contribution scheme for staff who have joined the Group since November 2005.

The total pension cost for the period was £0.3m (2005 £Nil).

28 Parent company

The immediate and ultimate parent company is MGN Gas Networks (UK) Ltd. Copies on the annual accounts of MGN Gas Network (UK) Ltd may be obtained from The Company Secretary, MGN Gas Networks (UK) Ltd, Level 30, City Point, 1 Ropemaker Street, London EC2Y 9HD.

29 Related party transactions

(a) Gas purchases
Under its license condition, the Company is required to purchase gas to cover certain "own use" activities including own consumption in operating the gas distribution network and shrinkage due to estimated losses from the network.

The Company has contracted with Macquarie Bank Limited ("MBL") to purchase the gas it requires to fulfil these commitments. The contract was awarded to MBL after it won a competitive tender process. These transactions are carried out on an arms length basis and the prices charged are compared to available quoted gas purchases prices to ensure they are competitive. The cost of purchasing this gas amounted to £10.6m in respect of the year.

(b) Xoserve Limited
The Company owns 10% of the issued share capital of xoserve Limited ("xoserve"). Xoserve is owned jointly by the UK Gas Distribution companies and National Grid group as owner of the gas transmission business in the UK.

Xoserve provides gas throughput (meter reading) and billing information to the Company which is used in the Company in setting its regulated gas distribution charges to the gas transporters. The cost to the Company of xoserve providing these services was £2.9m in respect of the year.

(c) Transitional Services Agreement
Under the Transitional Services Agreement, Macquarie Investment Management (UK) Limited (a controlled entity of MBL, an indirect shareholder in MGN Gas Networks (UK) Limited) is entitled to recover a flat fee in relation to activities it has agreed to provide for the period to August 2006. The total amount chargeable under this agreement is £3.0m of which £0.2m will be charged in the year ended 31 March 2007.

(d) Recharge of costs relating the acquisition of WWUL
MBL has recharged to MGN Gas Networks (Senior Finance) Limited ("MGNSF") costs which it has incurred in relation to MGNSF acquiring WWUL. These costs amounted to £10.2m.

A further amount of £11.5m was charged by MBL in respect of its work in setting up the investment structure within the MGN Gas Network (UK) Limited group. Of this amount, £2.9m is related to the equity structure and has been treated as part of MGNSF's investment in WWUL. The balance of £8.6m relates to the raising of debt and is being amortised over the life of the underlying instruments.