Company Registration No. 05167021

Southern Gas Networks plc

Annual Report

For the year ended 31 March 2010

Southern Gas Networks plc

Annual Report 2010

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Southern Gas Networks plc

Report and financial statements 2010

Officers and professional advisers

Directors

Gregor Alexander
Stephen Dowd
Colin Hood
Robert McDonald
James McPhillimy
Michael Rolland
Sebastien Sherman
Olivia Steedman

Secretary

Jonathan Adams

Registered Office

St Lawrence House
Station Approach
Horley
Surrey
RH6 9HJ

Auditors

Deloitte LLP
Chartered Accountants
London

Operating and financial review

This operating and financial review sets out the main trends and factors underlying the development and performance of the Company during the year ended 31 March 2010 as well as those matters which are likely to affect its future development and performance

The Directors in preparing this operating and financial review have sought to comply with the Accounting Standard Board s 2006 Reporting Statement Operating and Financial Review as far as it applies to the circumstances of the Company

The business, its objectives and strategy

The Company operates the regulated gas transportation business for the South and South-East of England gas distribution network, one of eight regional gas distribution networks in the United Kingdom Its gas distribution network comprises approximately 49,000 kilometres of gas mains delivering natural gas to approximately 4 0m domestic, commercial and industrial customers The network stretches from Milton Keynes in the north to Dover in the east and Lyme Regis in the west, including London boroughs to the south of the River Thames

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited (" SGN") SGN is owned by a consortium made up of Scottish and Southern Energy plc, Borealis Infrastructure Europe (UK) Limited which is indirectly wholly owned by OMERS Administration Corporation and OTPPB Investments (U K) Limited which is owned by Ontario Teachers' Pension Plan Board References to the "Group" throughout this Report mean SGN and its subsidiaries (including the Company)

The Company's business is regulated by the Office of Gas and Electricity Markets ("Ofgem")

Objectives and strategy

The Company s principal objectives are to deliver natural gas safely, reliably and efficiently across the gas distribution networks and to provide the highest standard of service to our stakeholders, whilst delivering value to our shareholders Our strategy therefore places the highest emphasis on ensuring activities are carried out safely and that the networks operate in a reliable and efficient manner, so that benchmarks and regulatory targets can be exceeded to the benefit of all of its stakeholders

The Company's overall financial objective is to focus on operational efficiency and the efficient delivery of capital, and, replacement expenditure programmes and therefore financial objectives are set to ensure the regulatory targets are achieved or outperformed

The Company s financing objective is to ensure an efficient capital structure that mitigates interest rate risk through maintaining a minimum of 75% of debt, excluding shareholders' loans, at either fixed rates of interest or index linked In addition the Company has undertaken not to exceed a debt to RAV ratio of 77 5%

External and regulatory environment

The management and operation of the Company's gas transportation assets are subject to a series of legislative requirements to ensure that assets are managed and operated in a safe and reliable manner The Company must also ensure that arrangements are in place to respond to emergency situations and to ensure hazardous work is carried out safely and with minimum disruption

The primary legislation controlling the Company s activities as a gas transporter is the Gas Act 1986 (as amended) Under the Gas Act the Company holds a licence which allows it to operate the gas distribution network it owns The Company is regulated by Ofgem which has established price control mechanisms that govern the amount of revenue that can be earned by regulated businesses, typically covering five year price control periods Ofgem assesses the revenue and investment plans of the Company in order to determine an efficient level of expenditure and the quality of service requirements for the network are also taken into account A cost of capital for the required investment in the networks is also determined

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Operating and financial review

External and regulatory environment (continued)

In December 2007, Ofgem published its final proposals for the five year price control covering the period from 1 April 2008 to 31 March 2013 for the Company The proposals set out allowances for capital investment, operational costs and replacement expenditure, together with the framework for incentives

The Company is also subject to safety legislation which is enforced by the Health and Safety Executive ("HSE") in the UK The organisation's processes and procedures are covered in a safety case which has been accepted by the HSE

Market climate

The UK is in a period where gas supply patterns are moving to a position where more reliance is placed on imported gas The decline in UK continental shelf gas reserves and the UK energy policy taking cognisance of climate change is driving this shift towards greater use of imported gas

Factors affecting the business

The Company's principal activity is the operation of a highly complex gas infrastructure network As a consequence there are a number of factors that may influence the development and performance of the Company and the financial returns that can be achieved The principal factors that influence the Company are as follows

Regulatory price controls

As outlined above, the prices that can be charged for the use of our networks are determined in accordance with regulator approved price controls The outcome of the five-year review baselined the revenues that will be obtained over the five year price control period In addition, targeted incentive schemes were introduced by the regulator whereby the Company is able to earn additional revenues by outperforming the targets, or alternatively penalised if the Company does not meet them

Additionally, the regulatory price controls include an allowed rate of return for the investment the Company makes in the network The level of the allowed rate of return determines the extent to which investment to increase the quality and capacity of the network is economically viable

Safety and reliability of the networks

The Company's ability to operate the networks safely and reliably is of the highest importance Its performance in these areas affects the costs it incurs and the overall financial performance

Efficiency

The Company's objective is to ensure that gas is delivered as efficiently as possible through its network This allows the Company to limit price increases and improve its own financial performance

Interest rates

The costs of financing our operations are affected by changes in interest rates as some of the Company's borrowings are held at floating rates Exposure to changes in interest rates are hedged by holding both fixed rate and index linked borrowings and by holding derivative financial instruments (interest rate swaps) where necessary to achieve the desired profile of interest rate risk

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Operating and financial review

Principal risks and uncertainties

As well as the opportunities the Company has to grow and develop its business, certain risks and uncertainties are faced in achieving its objectives The principal risks and uncertainties identified are as follows

- Regulatory price control treatments of certain costs, and allowed regulatory rate of return on investments,
- Changes in laws or regulation affecting business, for example environmental or health and safety law or regulation,
- Breaches of laws or regulation affecting business, or breaches of licence conditions,
- Credit market conditions, the availability and cost of financing and re-financing,
- Failure of the network or other critical non-network operations,
- Pension scheme funding requirements, and
- Changes in tax allowances or rates

The Board reviews the principal risks and uncertainties facing the business and considers the risk management processes in place which are designed to safeguard assets and to manage, rather than eliminate, material risks to the achievement of business objectives These reviews recognise that any such process can provide only reasonable, and not absolute, assurance against material misstatement or loss Further details of the processes the Board has in place are also set out in the Corporate Governance Statement on pages 15 to 19

Stakeholders

The Company has a range of external stakeholders including gas consumers, employees, suppliers and contractors, its regulator Ofgem and local governments and communities The Company adopts an open and constructive approach, both in terms of the way it operates the services it provides and the impact that its activities have on each of its stakeholders The Company encourages and enables its employees to be active citizens in the communities in which they live and work, through schemes which support staff who are either raising money for or giving their time to, UK charities, local community or youth sports groups The Company matches eligible fund raising by individual members of staff

Operating and financial review

Key performance indicators

The Company measures the achievement of its objectives through the use of quantitative assessments and, where quantitative measures are less relevant, through the use of qualitative assessments The principal key performance indicators ("KPIs") which are used to assess whether principal operating objectives have been achieved are set out below

		2010	2009
EBITDA[1]	Earnings before interest, tax, depreciation and goodwill amortisation	£165 0 m	£173 5 m
Adjusted EBITDA[1]	EBITDA excluding replacement expenditure	£343 7 m	£322 3 m
Capital expenditure	Additions to tangible fixed assets	£106 0 m	£117 6 m
Replacement expenditure	The cost of planned maintenance of mains and services	£178 7 m	£148 8 m
Debt to RAV ratio[2]	The Company's debt to RAV ratio	66 7%	68 3%
Employee lost time incidents	Incidents resulting in employees taking time off work (per 100,000 hours worked)	0 06 [5]	0 13 [5]
Customer satisfaction	Results from customer satisfaction surveys – planned interruptions	7 9 [3]	8 0 [4]
Customer satisfaction	Results from customer satisfaction surveys – unplanned interruptions	8 2 [3]	8 0 [4]
Escapes attendance	Proportion of uncontrolled escapes attended in one hour – percentage (target 97%)	97 9 [5]	98 5 [5]

1 EBITDA is a non-statutory measure, and is calculated by adding back goodwill amortisation and depreciation to operating profit

2 'RAV' is defined as Ofgem Regulatory Asset Value plus additions in excess of current allowances expected to be recovered in future periods Debt for the purposes of the Debt to RAV ratio excludes liabilities arising from derivative financial instruments The percentages stated are as at 31 March 2010 and 31 March 2009 respectively

3 Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2009

4 Based on customer satisfaction survey reports obtained for the nine month period ended 31 December 2008

5 This KPI is measured for the Group, and accordingly the data presented is that for the Group as a whole

In considering financial performance, the Company uses EBITDA and Adjusted EBITDA EBITDA is calculated by adding back goodwill amortisation and depreciation, which are non-cash costs, to operating profit Adjusted EBITDA is calculated by adding back goodwill amortisation, depreciation and 100% of replacement expenditure to operating profit Replacement expenditure that, under UK GAAP, is written off to the profit and loss account as it is incurred, improves the future safety and reliability of the network through the replacement of older gas pipes with modern pipes Ofgem treats 50% of projected replacement expenditure as recoverable during the year and 50% as recoverable over future years Accordingly, the Company believes the use of these adjusted measures best illustrates the underlying performance of the business

Resources

The Company's principal resources are its assets and its people

The Company's distribution network comprises approximately 49,000 kilometres of gas mains, together with associated services, plant and machinery and storage facilities

The Company had 1,071 full time equivalent employees at 31 March 2010 (2009 1 094) It places considerable value on the involvement of employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the Company during the year It continues to invest in the

Operating and financial review

development and training of its people in order to ensure both individual developmental needs and business skill requirements are met

Financial review

The Company sets out below its financial review for the year ended 31 March 2010 The comparative figures presented are for the year ended 31 March 2009 as reported in the audited financial statements, unless otherwise stated

Turnover for the year ended 31 March 2010 was £540 4m (2009 £528 2m) The majority of turnover was earned from charges made for the provision of gas transportation capacity as well as revenue based upon gas volumes transported in the year The increase in turnover reflects the settlement with Ofgem for core allowed revenue plus the inflationary effect on the amount between the two years The increase anticipated higher year on year replacement expenditure During the year the Company transported 107 8 TWh of gas, compared to 114 9 TWh in the year to 31 March 2009 representing a like for like decrease in volumes of 6 2%

Profit for the year before taxation amounted to £ 13 1million (2009 loss of £10 2m) and profit for the year after taxation amounted to £1 1million (2009 loss of £14 1m)

Adjusted EBITDA for the year ended 31 March 2010 was £343 7m (2009 £322 3m) Adjusted EBITDA is calculated by adding back goodwill amortisation of £5 8m (2009 £5 8m) depreciation of £63 7m (2009 £60 1m) and replacement expenditure of £178 7m (2009 £148 8m) to reported operating profit of £95 5m (2009 £107 6m)

The Company did not pay any dividends during the year (2009 £130 0m)

Capital expenditure during the year amounted to £106 0m (2009 £117 6m) Capital expenditure is incurred to ensure that the networks continue to operate at minimum agreed pressures and that sufficient storage capacity is available to meet instances of peak demand, as well as when new connections or increased capacity are added to the networks

Treasury policies and capital structure

The Company s operations are financed by a combination of equity and retained profits bank borrowings and long term bonds The Company's funding and liquidity are managed within a framework of policies and guidelines authorised by the Board of Directors Further details are set out in the Directors' Report on pages 11 to 14

The Company s key treasury policies are that its debt to RAV ratio does not exceed 77 5% and that a minimum of 75% of debt is maintained at either fixed rates of interest or index linked In accordance with these policies a target interest rate profile has been set for long term borrowings of between 80 and 85% of borrowings at either fixed rate or index linked This target is kept under review from time to time Interest rate swaps are used, where necessary, in order to achieve this desired profile

As at 31 March 2010 the Company's total senior debt (before issue costs) amounted to £ 2,240 0m (2009 £2,038 6m) and the debt to RAV ratio was 66 7% (2009 68 3%) Of the total long term borrowings at 31 March 2010 after taking into account the effect of interest rate swaps, 82 6% were at either fixed rates of interest or were index linked (2009 80 0%)

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Pension commitments

A significant proportion of the Company's employees are members of the Scotia Gas Networks Pension Scheme which provides final salary defined benefits for members

In accordance with FRS 17 (Retirement benefits), the Group's balance sheet accounts for any pension asset or liability The net pension liability as on 31 March 2010 increased to £64 6m (2009 £21 9m), following an actuarial valuation carried out by the scheme's actuary as at 31 March 2009 As a result of valuation, with effect from 1 April 2010, the Group agreed to increase annual special pension contributions to repair the pension deficit, from £13 5m (Company's share £8 1m), to £23 5m (Company's share £14 1m) over the next fifteen year period to 31 March 2025 The Group's normal contributions remain 37 3%

Liquidity and cash flows

Liquidity is maintained through a mixture of long term borrowings and short term liquid funds in order that there are sufficient funds available for the Company's current and planned operations Committed facilities are in place in order to provide funding for future capital and replacement expenditure as well as to provide sufficient available facilities to meet the seasonal working capital requirements of the Company At 31 March 2010 the Company's committed undrawn revolving credit facility amounted to £250m (2009 £170 0m) This facility expires in October 2010, beyond this date the Company has negotiated a new facility of £200m until October 2013

The Company issued £300m bond financing in October 2009 to facilitate repayment of the €365m floating rate bond which matures in October 2010 (see directors report for assessment of going concern)

Dividend policy

The Company's policy is to distribute to its shareholder any available surplus funds, after taking into account the cash requirements needed to continue to invest in the business and the Company's level of gearing, and subject to the availability of distributable profits

Accounting policies

The Company's accounting policies are set out in note 1 to the financial statements These accounting policies have been applied consistently during the year and in the preceding year and, as previously highlighted in this report, operating profit is stated after writing off replacement expenditure during the year

Operational review

Organisational development

The Company continued to drive efficiencies from its previous decision to replace its existing functionally-based structure with a geographically-based structure This has enabled a more local and customer-focused management of the business's operations which, it is believed, will lead to improved customer service and has started to deliver cost savings

The group was nominated the 2010 IGEM company of the year and on 27 March 2009, in their 'Gas Distribution Annual Report' for 2007/8, Ofgem reported the Company the 3rd most efficient network in the UK on the basis of "top down" regression of controllable operating costs, an improvement from 4th position in the previous year

During the very severe and prolonged winter period across the UK, our gas transportation assets performed very well in delivering gas to our 5 8m customers During the period there was a significant level of teamwork by SGN's employees in responding to these challenging circumstances, this culminated in achieving all standards of service and the mains replacement programme commitments

The Company also carries out quarterly postal customer satisfaction surveys covering both planned (replacement) and unplanned (emergency and repair) work, which is used to further assess quality of service performance The results of the surveys are highlighted on page 5

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Operating and financial review

Operational review (continued)

Organisational development (continued)

During the year the Company successfully commissioned a 23km pipeline from Farningham to Hadlow in Kent costing £54m In addition to the construction of the pipeline the Company's commitments included restoring an ancient woodland site and surrounding footpaths and farm roads back to their former condition Looking forward, the Company has commenced work on a £21m project to replace the under-sea gas main between the South coast mainland and the Isle of Wight The project involves directional drilling for 3 9km across the Solent between Lepe and Gurnard Two tunnels will be bored to take two 12 inch diameter gas pipes, which will be installed some 30m to 50m below the seabed

SGN is committed to making new gas connections to existing homes that are not on mains gas as affordable as possible and is running a new scheme to help fuel poor customers Already over 4,350 acceptances have been received to provide a mains gas connection to homes under the new Ofgem-approved scheme

Counterparty credit risk

The Company transacts with Banks for the provision of interest rate and currency hedging transactions Whilst the Group maintains a minimum credit rating requirement of "A" or equivalent with its counterparties the Group recognises that at the year end credit conditions for many Banks were unusually tight At the year end the Company had £76 3m receivables and £150 8m payables relating to derivative financial instruments with Bank counter parties

Information systems

During the year further work was done to establish and formalise the Company s IT management processes, leading to greater control of projects and mitigating risks associated with production changes data loss and security threats

Safety

Injury performance

The Company's overriding goal is to distribute gas safely and reliably and to ensure a safe workplace for its workforce with everyone striving towards eliminating injuries This year the Group has reduced its lost time injury performance rate to 0 06 injuries per 100,000 hours (2009 0 13)

The Company also achieved, once again, a Royal Society for the Prevention of Accidents Occupational Health and Safety gold award, which is awarded to recognise and celebrate the achievement of a very high standard of health and safety at work

Gas mains replacement programme

The Company has in agreement with Ofgem and HSE, embarked on an extensive safety led programme of gas mains replacement across its networks to replace all iron pipes that are located within 30 metres of any property, which includes the replacement of the individual services connecting the premises to the mains network The Company has a considerable amount of work to carry out and appreciates that this will inevitably cause some disruption However, the polyethylene pipes being placed in the ground now, if left undisturbed, have a lifespan of at least 80 years so when the work is complete people will be able to enjoy security of supply from a distribution infrastructure perspective for many years to come During the year, the Company has increased its investment in replacement activities to £178 7m (2009 £148 8m)

The Company is committed to working closely with the local authorities and police to plan its work so that the minimum amount of disruption is caused to residents, road users, businesses and traders Wherever possible the Company will also be using modern, minimum-dig techniques, which allow the laying of gas mains without digging long trenches in the road causing less impact on the environment and on the local communities

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Operating and financial review

Gas escapes standards of service

The Company's engineers respond to reports of suspected gas leaks 24 hours a day, 365 days a year, regardless of from whom people buy their gas Its engineers aim to attend all uncontrolled gas escapes within one hour and all controlled gas escapes within two hours A controlled gas escape is one where the person reporting it has confirmed that the gas emergency control valve serving the premises has been turned off and the smell of gas has gone An uncontrolled gas escape covers all others Despite the extreme winter conditions the company's engineers attended 97 9% uncontrolled gas escapes within one hour, exceeding Ofgem targets

The Board has a Safety, Health and Environmental Advisory Committee that is responsible for monitoring the Company's health and safety performance and ensuring that the health and safety policy statement is adhered to The Committee provides the Board with reports on any key areas identified and further details regarding the Committee are set out on page 17 (Corporate Governance Statement)

Environment

The Company is committed to the protection and enhancement of the environment and consideration for the environment is a feature of all its business activities New ways to minimise the environmental impact of its activities are constantly sought

The Company benchmarks its environmental performance, allowing it to identify new opportunities, share best practice and achieve continual improvements During the year a number of employee briefings, campaigns and training events were held with the specific aim of increasing employees' knowledge and awareness of environmental matters, as well as health and safety issues This process of continual development provides staff with the information and competence they need to recognise and manage all significant environmental issues, risks, incidents and opportunities which they are faced with, thereby proactively avoiding pollution to land, air or water and protecting or enhancing the environment

As part of its commitment to the environment, the Company also works in partnership with conservation charities, schools and a wide range of community groups The Safety, Health and Environmental Advisory Committee is also responsible for monitoring the Company's environmental performance and ensuring that the environmental policy statement is adhered to

Targets for 2009/2010 included reducing methane emissions through leakage and active pressure management, reducing paper usage in offices and operational sites, reducing commercial fuel usage and reducing impact on the environment through reusing excavated materials and reducing the use of virgin aggregate Progress to date has been positive

The Company is developing a dynamic environmental strategy and ten year plan which can be revised to meet changes in internal or external policy or public / industry expectations as and when necessary In line with its ambition to achieve environmental excellence, the Company will go beyond legislative compliance by seeking to meet internationally accepted good practice wherever it operates This is reflected in the retention of the ISO 14001 standard (environmental management system standard) which is recognition of continuously reducing the impact on the environment The Company will be setting equally challenging environmental objectives and targets for 2010/11 in accordance with its environmental strategy and ten year environmental improvement plan

Operating and financial review

Future developments

Regulation

The Company is actively involved in Ofgem's current two year review into the current RPI-X price control regime Ofgem recently published its Emerging Thinking document as part of this review and the recommendations to the Authority are expected to be consulted on during Summer

Investment

Longer-term priorities include continued major replacement investment to replace metallic mains with polyethylene mains, a programme which has been developed in consultation with the HSL and Ofgem In addition, continued major investment to upgrade the gas network is expected in order to meet instances of peak demand The efficient and economic delivery of this capital investment will further increase the Company s RAV

Further details

Further details on the long term development plans of the company can be found in the long term development statement (published in accordance with Special Condition D3 of the Gas Transporter Licences) and available on the Company s website - www sgn co uk The long term development plans set out the forecast gas demand over the ten year period and outline the capital investment plan which is required to ensure the continued operation of the network in accordance with the Company's licence conditions

Approved by the Board of Directors and signed on behalf of the Board

Stephen Dowd

Director

27 July 2010

Southern Gas Networks plc

Directors' report

The Directors present their report and the audited financial statements for the year ended 31 March 2010

Principal activities

The Company's principal activity is the development, administration, maintenance and operation of the South and South-East of England gas distribution system and the supply of transportation services It will continue in this activity for the foreseeable future

Review of business

The review of business for the year, including an analysis using key performance indicators, together with a description of the principal risks and uncertainties facing the Company are set out in the operating and financial review on pages 2 to 10

Future developments

The Company's longer-term priorities include continued major replacement investment to replace metallic mains with polyethylene mains, a programme which has been developed in consultation with the HSE and Ofgem In addition, continued major investment to upgrade the gas distribution network is expected in order to meet instances of peak demand The efficient and economic delivery of this capital investment will further increase the Company's Regulated Asset Value

In January 2008, the Company accepted Ofgem's proposals outlined in its five year review that determined revenues and allowances for the five years commencing 1 April 2008

Results and dividends

The profit and loss account is set out on page 22, and is also reviewed on pages 5 and 6

The Company did not pay an interim dividend for the year ended 31 March 2010 (2009 £130 0m) The directors do not propose payment of a final dividend (2009 £nil)

Directors

The Directors of the Company who served during the year ended 31 March 2010, all of whom have been directors for the whole of the year are listed below

Gregor Alexander
Olivia Steedman
Stephen Dowd
Colin Hood
Robert McDonald
James McPhillimy
Michael Rolland
Sebastien Sherman

Directors' insurance and indemnities

The Directors of the Company have the benefit of the indemnity provisions in the Company's Articles of Association The Directors have been granted a qualifying third party indemnity provision which was in force throughout the year In addition, SGN has purchased and maintained throughout the year directors' and officers' liability insurance in respect of itself, the Group, the Directors and other senior executives of the Group

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Directors' report

Financial risk management

The Company's funding, liquidity and exposure to interest rate and foreign exchange risks are managed within a framework of policies and guidelines authorised by the Board of Directors

Interest rate risk

The Company has interest bearing liabilities, and its key treasury policies are that its debt to RAV ratio does not exceed 77 5% and that a minimum of 75% of debt is maintained at either fixed rates of interest or index linked In accordance with these policies a target interest rate profile has been set for long term borrowings of between 80 and 85% of borrowings at either fixed rate or index linked excluding any borrowings from Group undertakings The Company uses interest rate swaps, where necessary, in order to achieve this desired profile

Liquidity risk

The Company maintains a mixture of long term funding and short term liquid funds in order that there are sufficient funds available for the Company s current and planned operations

Foreign exchange risk

The Company has certain borrowings denominated in Euros In accordance with the Company's policy, cross currency swaps have been used to fully hedge the Euro denominated borrowings into Sterling

Credit risk

Counterparty credit risks arising from financial derivatives are managed through the maintenance of financial limits, subject to a minimum credit rating of 'A" or equivalent allocated by a recognised major ratings group In respect of short term cash management counter parties are subject to review and approval according to defined criteria

Trade receivables predominantly relate to transportation income from gas shippers Credit risk arising from the Group's regulated business is managed in accordance with industry standards as set out by the Unified Network Code The Group contracts with shippers having investment grade ratings only, or where suitable collateral or cash prepayments are made Credit risk on amounts receivable from other group companies is considered minimal

Pricing risk

The Company s gas transportation charges are subject to price control formulae set within the regulatory regime The Company's maximum allowed revenue in a given price period is dependent upon a number of factors that are not known in advance and therefore the maximum allowed annual revenue is not known until the end of the relevant period However, transportation tariffs are set on a prospective basis based upon expected transportation volumes, so actual revenue received or receivable in any one year may differ from the maximum allowed revenue Where revenues received or receivable differ from the maximum allowed annual revenue, adjustments are made to future prices to reflect this over or under recovery

Charitable contributions

The Company made charitable donations of £31,780 in the year (2009 £34,800) in support of community and employee initiatives across its operations There were no political donations in either the current year or in the prior year

Directors' report

Employees

The Company places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the Company Participation by employees generally is encouraged through team meetings, briefings, an internal newspaper and an intranet site Employee representatives are consulted regularly on a wide range of matters affecting their current and future interests

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

Creditors payment policy

The Company is committed to maintaining good commercial relationships with its creditors and suppliers and its current policy concerning payment is to

- agree the terms of payment with those creditors/suppliers when agreeing the terms of each transaction,
- ensure that those creditors/suppliers were 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/suppliers for revenue and capital supplies of goods and services without exception

At 31 March 2010, the Company had an average of 25 days (2009 31 days) outstanding in its trade creditors

Going concern

The Company's financial position, cash flows, liquidity position and borrowing facilities together with the factors likely to affect its future performance and the principal risks and uncertainties are set out in the Operating and Financial Review on pages 2 to 10 The financial risk management objectives and risk exposures are set out on page 12

As stated in the Operating and Financial Review the Company operates the regulated gas distribution networks in South of England The revenue of the Company is regulated by Ofgem via established price control mechanisms based on the distribution network capacity The Company has considerable financial resources together with committed financing facilities as discussed in Note 15 to finance the current and future operations The Company's forecasts and projections, taking account of reasonably possible changes in trading performance show that the Company should be able to operate within the level of its current facilities As a consequence, the Directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook After making enquiries, the Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future Accordingly, they continue to adopt the going concern basis in preparing the annual report and accounts

Southern Gas Networks plc

Directors' report

Auditors

Each of the persons who is a director at the date of approval of this report confirms that

- so far as the director is aware there is no relevant audit information of which the company's auditors are unaware, and
- the director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the company's auditors are aware of that information

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006

Deloitte LLP 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

Approved by the Board of Directors and signed on behalf of the Board

Jonathan Adams

Company Secretary

27 July 2010

Southern Gas Networks plc

Corporate governance statement

The Board of Directors is the principal decision making forum for the Company and is committed to the highest standards of corporate governance The Board believes that strong governance improves the performance of the Group and enhances shareholder value This report sets out the key governance principles and practices of the Company and of the Group

The Company, being unlisted, is not subject to the UK Financial Reporting Council's Combined Code on Corporate Governance[1] (the "Combined Code"), and the Board of Directors does not believe that all of the guidance set out in the Combined Code is applicable to the Company However, for the purposes of this statement, the Directors have applied the Combined Code insofar as they believe it to be applicable

Board of directors

The Board of Directors and corporate governance structure is the same for each company within the Group As such, this Corporate Governance Statement describes the Corporate Governance structure as it relates to the Group

As a commercial joint venture, the composition of the Board reflects the shareholders' interests in the consortium Each of the Directors is an employee of a shareholder or an affiliate of a shareholder of the Company As the relationship of the shareholders is governed by a Shareholders' and Governance Agreement, any conflict of interest in the position of the Directors would be addressed in accordance with the provisions of the Shareholders' and Governance Agreement Directors are nominated to the Board in accordance with the terms of the Shareholders' and Governance Agreement The Directors have been briefed on the duties that have been conferred on them under the Companies Act 2006

The powers of the Directors are set out in the Company's Articles of Association To reflect various company law changes made by the Companies Act 2006, the Company adopted a new set of Articles in November 2008 The Board has also adopted a formal schedule of matters detailing key aspects of the Company's affairs reserved to it for decision This schedule is reviewed regularly Furthermore, the Board has established three committees with specific responsibilities to ensure focused and effective leadership Details of the committees are set out on page 17 and 18

The Board meets regularly and held seven meetings during the year

Board Constitution and Appointments

The Board consists of seven non-executive Directors in addition to the non-executive Chairman The Board of Directors is the same for the Company and each company within the Group

Biographical details for the Directors are set out on page 19

Chairman

Stephen Dowd was appointed as Chairman on 27 May 2008 for a three year period, succeeding Colin Hood

Chief Executive Officer and Chief Financial Officer

Below the Board, executive responsibility rests with John Morea Chief Executive Officer ("CEO") and Chris Brook, Chief Financial Officer ("CFO") The CEO and CFO are each employed by the Group and are not Directors of the Company They are supported by an executive committee which meets on a monthly basis and is responsible for managing the day-to-day operations of the Company

Biographical details for the CEO and CFO are set out on page 19

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[1] The Combined Code on Corporate Governance is available on the Financial Reporting Council s website (www frc org uk)

Southern Gas Networks plc

Corporate governance statement

Timeliness and quality of Board information

The Board has sought to ensure that Directors are properly briefed on issues arising at board meetings by establishing procedures for distributing board papers one week in advance of meetings, considering the adequacy of the information provided before making decisions, adjourning meetings or deferring decisions when Directors have concerns about the information available to them and making the Company Secretary responsible to the Board for the timeliness and quality of information

All Directors have access to the advice and services of the Company Secretary

Directors' remuneration

The Directors did not receive any remuneration for their services to the Company, during the year ended 31 March 2010 or in the prior year Accordingly, no further information requires to be disclosed

Conflicts of interest

With effect from 1 October 2008 the Companies Act 2006 introduced a statutory duty on directors to avoid conflicts of interest During the year, the Company Secretary reviewed all of the Directors' reported actual and potential conflicts of interest and the Board then considered and authorised each Director's reported actual and potential conflicts of interest at its meeting in September 2009

The Board has put into place a procedure to consider any future actual or potential conflicts of interest that the Directors may have and will review the position regularly

Attendance at board and board committee meetings

The attendance of the Board of Directors and the Board committees during the year is as set out below

	Board meetings		Audit committee meetings		People and reward committee meetings		Safety, health and environmental committee meetings	
	Attended	Possible	Attended	Possible	Attended	Possible	Attended	Possible
Gregor Alexander	7	7	3	3	-	-	-	-
Stephen Dowd	6	7	-	-	6	6	3	3
Colin Hood	4	7	-	-	5	6	1	1
Robert McDonald	7	7	3	3	-	-	-	-
James McPhillimy	5	7	-	-	6	6	3	3
Michael Rolland	6	7	-	-	6	6	-	-
Olivia Steedman	6	7	2	3	-	-	-	-
Sebastien Sherman	7	7	3	3	-	-	3	3

Board committees

In order to provide effective and focused leadership, the Board has established three committees with specific responsibilities These are the Audit Committee, the People and Reward Committee and the Safety, Health and Environmental Advisory Committee, each of which meets regularly

Each Committee's performance, constitution and terms of reference are reviewed annually to ensure that they are operating effectively The Company Secretary acts as secretary for each committee and further details are set out below

Southern Gas Networks plc

Corporate governance statement

Audit committee

The current members of the Audit Committee are Gregor Alexander (Committee Chairman), Graham Loughland (appointed 1 December 2009 as independent member of the Audit Committee), Sebastien Sherman, Robert McDonald and Olivia Steedman

The principal responsibilities of the Audit Committee are as follows

- Ensuring that the Company's financial reports represent an accurate, clear and balanced assessment of the Company's position and prospects,
- Ensuring the economy, efficiency and effectiveness of the Company's operations and internal controls, the reliability and integrity of information and accounting systems, and the implementation of established policies and procedures,
- Monitoring and reviewing the Company's internal audit function, and
- Maintaining a close relationship with the Company's external auditors and reviewing the effectiveness of the external audit process

As part of its activities, the Audit Committee also reviews and approves key regulatory filings prior to their issue to Ofgem

The Chairman of the Audit Committee reports to the Board of Directors following each committee meeting on the main areas and subjects the Committee has reviewed such as risk management, internal control, internal audit reports and any issues arising from its review of the financial statements

The Board considers that the membership of the Audit Committee as a whole has sufficient recent and relevant financial experience to discharge its functions The Committee met three times during the year

Safety, Health and Environmental Advisory Committee

The current members of the Safety, Health and Environmental Advisory Committee are James McPhillimy (Committee Chairman), Stephen Dowd, Sebastien Sherman, John Morea (Chief Executive Officer) and Gary Barnes (Director of Safety, Customers and Human Resources)

The principal responsibilities of the Safety, Health and Environmental Advisory Committee are as follows

- Ensuring that the health and safety policy statement and environmental policy statement remain fit for purpose and are being adhered to,
- Reviewing and monitoring the safety, health and environmental strategy and action plan, which shall be designed to eliminate, reduce or otherwise control personal and process related data,
- Reviewing and monitoring the safety, health and environmental compliance and assurance plan (and liaising with the internal auditors in relation there to),
- Setting annual health and safety, and environmental performance benchmarks to improve the Group's performance,
- Monitoring health and safety and environmental performance against agreed benchmarks and identified key improvement areas by means of appropriate leading and lagging key performance indicators, and
- Encouraging greater awareness of the importance of health, safety and the environment and higher achievement in performance in these areas

The Chairman of the Safety, Health and Advisory Committee reports to the Board of Directors following each committee meeting on the main areas and subjects the Committee has reviewed Three meetings were held during the year

Corporate governance statement

People and Reward Committee

The current members of the People and Reward Committee are Michael Rolland (Committee Chairman), Stephen Dowd, Colin Hood and James McPhillimy

The principal responsibilities of the People and Reward Committee are as follows

- To determine and agree with the Board of Directors the Group s framework or broad policy for executive and senior management remuneration The Committee has delegated authority for setting the remuneration of the CEO CFO and their direct reports and
- To review the ongoing appropriateness and relevance of the remuneration policy

The Chairman of the People and Reward Committee reports to the Board of Directors following each committee meeting on the remuneration matters which the Committee has reviewed Six meetings were held during the year

Board and committee performance evaluations

During the year, the Board has undertaken a comprehensive evaluation of its own performance and that of its three Committees and individual Directors This was conducted internally using detailed questionnaires which the Chairman then discussed with each Director and the Company Secretary The Board has considered and discussed the outcomes of the evaluations and is satisfied that it is operating well and focused on the correct strategic issues Some areas for improvement were highlighted and these will be progressed during 2010 Performance of the Board and the Directors will continue to be reviewed on an annual basis

Internal controls in relation to the company's financial reporting process

The Board of Directors is ultimately responsible for the Company's internal control systems and risk management The Company s system of internal control and embedded risk management, which has been in place throughout the year, helps to safeguard the assets and is designed to manage, rather than eliminate, material risks to the achievement of the business objectives The Board recognises that these systems can provide only reasonable, and not absolute assurance against material misstatement or loss

Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the business, to the materiality of the risks inherent in the business, and to relative costs and benefits of implementing specific controls

Internal control is maintained through an organisation structure with clearly defined responsibilities, authority levels and lines of reporting the appointment of suitably qualified staff in specialised business areas and continuing investment in high quality information systems These methods of control are subject to periodic review as to their implementation and continued suitability

There were no changes in the Company's internal controls over financial reporting during the period covered by this report that has materially affected or is reasonably likely to materially affect, the Company's internal control over financial reporting

Internal audit

The Board of Directors has established the scope of the internal audit function which is responsible for reviewing the effectiveness of the Company s systems of internal control and reports to the Audit Committee of the Board The internal audit manager reports to the Audit Committee on the audit programme, progress against the programme and any follow-up actions

Southern Gas Networks plc

Directors' and senior executives' biographies and responsibilities

Stephen Dowd, Chairman
Stephen joined the Board of the Company in November 2006 and was appointed Chairman of SGN in May 2008 He is Senior Vice President (Infrastructure) at Ontario Teachers' Pension Plan Board

Gregor Alexander, Director
Gregor joined the Board of the Company at its inception and is also the Chairman of the Audit Committee He is Finance Director of Scottish and Southern Energy plc and previously worked with the accountancy firm Arthur Andersen

Colin Hood, Director
Colin joined the Board of the Company at its inception and was its Chairman from 2005 until 2008 He is Chief Operating Officer of Scottish and Southern Energy plc and is also a Fellow of the Institute of Engineering and Technology Colin is a member of the People and Reward Committee

Robert McDonald, Director
Robert joined the Board of the Company in July 2006 He is Director of Regulation at Scottish and Southern Energy plc and has previously worked with the industry's regulatory body Robert is a member of the Audit Committee

James McPhillimy, Director
Jim joined the Board of the Company at its inception He is Group Services Director at Scottish and Southern Energy plc Jim is Chairman of the Safety, Health and Environmental Advisory Committee and a member of the People and Reward Committee

Michael Rolland, Director
Michael is President & Chief Executive Officer of Borealis Infrastructure Management Inc He is a Chartered Accountant having previously worked with an international accounting firm Michael is Chairman of the People and Reward Committee

Sebastien Sherman, Director
Sebastien joined the Board of the Company in March 2007 He is Senior Vice President at Borealis Infrastructure Management Inc He is a member of the Audit Committee and the Safety, Health and Environmental Advisory Committee

Olivia Steedman, Director
Olivia joined the Board of the Company in July 2008 She is a Director at Ontario Teachers' Pension Plan Board and is a member of the Audit Committee

John Morea, Chief Executive Officer
John joined the Company in May 2005 from Scottish and Southern Energy plc where he was Director of Distribution having previously been Head of Operations for Southern Electric plc He has extensive experience of electricity distribution, managing business change and delivering significant improvements in business efficiency He has twice taken distribution companies to the efficiency frontier, with Southern Electric plc in 1999 and Scottish and Southern Energy plc in 2004 John has over 20 years experience within the utilities industry He is a companion of the Institute of Gas Engineers and Managers, a member of the Institute of Engineering and Technology and hold an MBA

Chris Brook, Chief Financial Officer
Chris joined the Company in September 2008 He spent the previous 11 years with United Utilities where he was Finance Director of United Utilities Contract Solutions between 2003 and 2007, the business responsible for all infrastructure non-regulated activities From 2007, Chris was Finance Director of United Utilities Water, the regulated water business, before joining the Company Chris is a Chartered Accountant having trained and qualified with Touche Ross

Jonathan Adams, Company Secretary
Jonathan was appointed Company Secretary on 30 March 2010 He is also the Group's Commercial Solicitor

Southern Gas Networks plc

Statement of directors' responsibilities

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable law and regulations

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

- select suitable accounting policies and then apply them consistently,
- make judgements and accounting estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 2006 They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

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

The Directors confirm to the best of their knowledge that

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets and liabilities, financial position and profit of Southern Gas Networks plc as at 31 March 2010, and
- the Directors' report includes a true and fair view of the development and performance of the business and the financial position of Southern Gas Networks plc, together with a description of its principal risks and uncertainties

Signed on behalf of the Board of Directors of Southern Gas Networks plc on

Stephen Dowd

Chairman

27 July 2010

Independent auditors' report to the members of Southern Gas Networks plc

We have audited the financial statements of Southern Gas Networks plc for the year ended 31 March 2010 which comprise the profit and loss account, the statement of total recognised gains and losses, the balance sheet and the related notes 1 to 25 The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice)

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' 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

As more fully explained in the Directors' Responsibilities Statements, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view

Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practice Board's (APB's) Ethical Standards for Auditors

Scope of the audit of financial statements

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

Opinion

In our opinion the financial statements

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

Opinion on matters prescribed in the Companies Act 2006

In our opinion the information in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

Matters on which we are required to report by exception

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

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

Makhan Chahal

Makhan Chahal - Senior Statutory Auditor
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditors
London, United Kingdom
27 July 2010

Southern Gas Networks plc

Profit and loss account
Year ended 31 March 2010

	Notes	2010 £m	2009 £m
Turnover	2	540 4	528 2
Net operating costs	3	(444 9)	(420 6)
Operating profit	3	95 5	107 6
Income from fixed asset investments	12	0 3	0 3
Interest receivable and similar income	6	1 8	9 5
Interest payable and similar charges	7	(84 5)	(127 6)
Profit / (Loss) on ordinary activities before taxation	4	13 1	(10 2)
Tax on profit / (loss) on ordinary activities	8	(12 0)	(3 9)
Profit / (Loss) for the financial year	19	1 1	(14 1)

The above results relate to continuing operations in both the current and previous year

Southern Gas Networks plc

Statement of total recognised gains and losses
Year ended 31 March 2010

	Notes	2010 £m	2009 £m
Profit / (Loss) for the financial year	20	1 1	(14 1)
Cash flow hedges (net of deferred tax)	20	(1 3)	(21 9)
Actuarial loss on defined benefit pension scheme	23	(69 4)	(44 8)
Movement on deferred tax relating to pension scheme	23	19 5	12 5
Total recognised losses for the year		(50 1)	(68 3)

Southern Gas Networks plc

Balance sheet
31 March 2010

	Notes	2010 £m	2009 £m
Fixed assets			
Intangible assets – goodwill	10	259 5	268 0
Tangible assets	11	2,379 9	2,337 6
Investments	12	0.2	0 2
		2,639 6	2,605 8
Current assets			
Debtors	13	441 3	333 8
Cash at bank and in hand		0 1	0 1
		441 4	333 9
Creditors, amounts falling due within one year	14	(540 0)	(268 5)
Net current (liabilities)/assets		(98 6)	65 4
Total assets less current liabilities		2,541 0	2,671 2
Creditors· amounts falling due after more than one year	15	(1,905 3)	(2,032 1)
Provisions for liabilities	17	(270 1)	(274 8)
Deferred income	11	(64 7)	(56 0)
Net assets excluding pension liabilities		300 9	308 3
Defined benefit pension liabilities	23	(64 6)	(21 9)
Net assets including pension liabilities		236 3	286 4
Capital and reserves			
Called up share capital	18	160 2	160 2
Hedge reserve	19	(17 8)	(16 5)
Profit and loss account	19	93 9	142 7
Shareholders' funds	20	236 3	286 4

The financial statements of Southern Gas Networks plc registered number 05167021 were approved by the Board of Directors on 27 July 2010

Signed on behalf of the Board of Directors

Stephen Dowd
Chairman

Gregor Alexander
Director

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

1. Principal accounting policies

The financial statements have been prepared in accordance with applicable accounting standards in the United Kingdom and the Companies Act 2006

The financial statements of the Company present the results for the year ended 31 March 2010 The comparative period presented is the year ended 31 March 2009

A summary of the more significant accounting policies, which have been applied consistently in both years, are as follows

Basis of preparation

These financial statements have been prepared under the historical cost convention except that assets and liabilities were stated at fair value when acquired, and certain derivative financial instruments are also recorded at fair value The financial statements have been prepared on a going concern basis as set out in the Directors' Report

Cash flow statement

The Company is a wholly owned subsidiary of Scotia Gas Networks Ltd and the cash flows of the Company are included in the consolidated cash flow statement of Scotia Gas Networks Ltd which are publicly available Consequently, the Company is exempt under the terms of FRS 1 ("Cash flow statements") from publishing a cash flow statement

Turnover

Turnover is stated net of value added tax and is attributable to the continuing activity of transportation of natural gas and the provision of related services Turnover is recognised to the extent that there is a right to consideration and is recorded at the value of the consideration due Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end

Where revenues received or receivable differ from the amount permitted by regulatory agreements, adjustments will be made to future prices to reflect this over or under recovery

Replacement expenditure

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

Taxation

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

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more or a right to pay less tax in the future have occurred at the balance sheet date, with the following exceptions

- provision is made for gains on disposal of fixed assets that have been rolled over into replacement assets only where at the balance sheet date there is a commitment to dispose of the replacement assets with no likely subsequent rollover or available capital losses
- provision is made for gains on revalued fixed assets only where there is a commitment to dispose of the revalued assets and the attributable gain can neither be rolled over nor eliminated by capital losses, and

1 **Principal accounting policies (continued)**

Taxation (continued)

- deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing difference can be deducted

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date Deferred tax is measured on an undiscounted basis

Intangible assets – goodwill

Goodwill is capitalised and amortised on a straight line basis to the profit and loss account over its expected useful life Goodwill represents the excess of the fair value of the consideration paid for the acquisition of businesses over the fair value of the separable net assets acquired

The useful life of goodwill related to the acquired business has been estimated to be 50 years

A review for impairment of goodwill is carried out at the end of each financial year Impairment reviews comprise a comparison of the carrying amount of the goodwill with its recoverable amount (the higher of net realisable value and value in use) To the extent that the carrying amount exceeds the recoverable amount, the goodwill is impaired and an impairment loss is recognised in the profit and loss account

Fixed asset investments

Fixed asset investments are stated at cost less a provision for any impairment in value Costs of the investments include all costs directly related to the acquisition of the investments

Tangible fixed assets

Tangible fixed assets are stated at cost less depreciation and any provision for impairment The cost is the purchase cost of the asset, together with any directly attributable costs of acquisition In respect of assets purchased as part of a business combination, the cost is the fair value of the assets acquired

The carrying values of tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable

Depreciation is provided on all tangible fixed assets other than freehold land, at rates calculated to write off the cost of each asset evenly over its expected useful life, as follows

Freehold buildings	Up to 50 years
Leasehold buildings	Over the shorter of lease term and 50 years
Plant and machinery	
Mains and services	60 to 65 years
Regulating equipment	30 to 50 years
Gas storage	40 years
Motor vehicles and office equipment	3 to 10 years

Grants and contributions

Capital grants and customer contributions in respect of additions to fixed assets are treated as deferred income and released to the profit and loss account over the estimated useful lives of the related assets

Revenue grants and contributions are credited to the profit and loss account in the year to which they relate Deferred income in respect of revenue grants and contributions is included within creditors amounts falling due within one year

1 **Principal accounting policies (continued)**

Finance leases

Assets held under finance leases which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets, and are depreciated over the shorter of the lease terms and their useful lives The capital elements of future lease payments are recorded as liabilities, while the interest elements are charged to the profit and loss account

Operating leases

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

Pensions

Defined benefit pension scheme

The amounts charged to the profit and loss account are the current service costs and gains and losses on settlements and curtailments They are included within staff costs Past service costs are recognised immediately in the profit and loss account if the benefits have vested If the benefits have not vested immediately the costs are recognised over the period until vesting occurs The interest cost and the expected return on the assets are shown as a net amount of other finance costs or credits within interest payable or receivable Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses

The defined benefit scheme is funded, with the assets of the scheme held separately from those of the Company, in separate trustee administered funds Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities The actuarial valuations are obtained at least triennially and are updated at each balance sheet date

The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the balance sheet Any pension asset is recognised in the balance sheet to the extent that the benefits may be derived from the surplus in the form of reduced cash contributions in the future or cash refunds

Defined contribution pension schemes

The Company also operates defined contribution pension schemes The assets of the schemes are held separately from those of the Company in independently administered funds The amounts charged to the profit and loss account represent the contributions payable to the schemes in the period Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet

Provisions

A provision is recognised in the balance sheet when the Company has a present legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation Provisions are discounted where the impact of discounting the expected future cash flows is material

1 **Principal accounting policies (continued)**

Financial instruments

The Company's funding, liquidity and exposure to interest rate risks are managed within a framework of policies and guidelines authorised by the Board of Directors In accordance with these policies financial derivative instruments are used to manage interest rate and currency exposure

Where appropriate these instruments are recorded at fair value and accounted for as described below

Effective interest method

The effective interest method is a method of calculating the amortised cost of a financial asset and of allocating interest income over the relevant period The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial asset, or, where appropriate, a shorter period

Income and expense is recognised on an effective interest basis for debt instruments other than those financial assets designated as 'at fair value through profit or loss' (FVTPL)

Financial assets

Investments are recognised and derecognised on a trade date where the purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at fair value, plus transaction costs, except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value

Financial assets at the balance sheet date are classified into the following specified categories financial assets at FVTPL, 'held-to-maturity' investments, 'available-for-sale' (AFS) financial assets and 'loans and receivables' The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition

Impairment of financial assets

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at each balance sheet date Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade debtors

If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised

Derecognition of financial assets

The Group derecognises a financial asset only when the contractual rights to the cash flows from the asset expire, or when it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity

Trade debtors

Trade debtors are initially recognised at fair value The carrying amount is reduced through the use of an allowance account Appropriate allowances for estimated irrecoverable amounts are recognised where the estimated cash flows are less than the carrying amount Subsequent recoveries of amounts previously written

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

1. **Principal accounting policies (continued)**

off are credited against the allowance account Changes in the carrying amount of the allowance account are recognised in profit or loss

Cash and cash equivalents

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

Financial liabilities

Financial liabilities are classified as either financial liabilities 'at FVTPL' or 'other financial liabilities'

Financial liabilities at FVTPL

Financial liabilities are classified as at FVTPL where the financial liability is either held for trading or it is designated as at FVTPL

A financial liability is classified as held for trading if

- it has been incurred principally for the purpose of disposal in the near future, or
- it is a part of an identified portfolio of financial instruments that the Group manages together and has a recent actual pattern of short-term profit-taking, or
- it is a derivative that is not designated and effective as a hedging instrument

A financial liability other than a financial liability held for trading may be designated as at FVTPL upon initial recognition if

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise or
- the financial liability forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Group's documented risk management or investment strategy, and information about the Group is provided internally on that basis, or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 Financial Instruments Recognition and Measurement permits the entire combined contract (asset or liability) to be designated as at FVTPL

Financial liabilities at FVTPL are stated at fair value, with any resultant gain or loss recognised in profit or loss The net gain or loss recognised in profit or loss incorporates any interest paid on the financial liability

Other financial liabilities

Other financial liabilities including borrowings, are initially measured at fair value, net of transaction costs Other financial liabilities are subsequently measured at amortised cost using the effective interest method with interest expense recognised on an effective yield basis The effective interest method is a method of calculating the amortised cost of a financial liability and of allocating interest expense over the relevant period The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period

Notes to the financial statements
Year ended 31 March 2010

1 Principal accounting policies (continued)

De-recognition of financial liabilities

The Company derecognises financial liabilities when, and only when, the Company's obligations are discharged, cancelled or they expire

Derivative financial instruments

The Company uses interest rate swaps and foreign exchange forward contracts to hedge interest rate and foreign currency risk arising on debt instruments On inception of the hedge relationship the Group documents the relationships between the hedged item and the hedging instrument along with the risk management objectives and its strategy for undertaking various transactions Furthermore, at inception of the hedge and on an ongoing basis the Company documents whether the hedging relationship is highly effective

Changes in fair value of derivatives that are designated and are effective as hedges of future cash flows are recognised directly in equity within the hedge reserve Changes in fair value of derivatives that are designated and are effective as fair value hedges are recognised in the profit and loss account but effectively offset changes in fair value of the hedged item

Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the profit and loss account as they arise

Hedge accounting is discontinued when the hedge instrument expires or is terminated

Financial assets and financial liabilities are offset where they are settled net as a matter of practice and there is legal right to offset

2 Segmental reporting

Turnover arises entirely in the United Kingdom and is attributable to the continuing activity of transportation of natural gas and the provision of related services, which the Directors consider represents a single class of business

3 Operating profit and net operating costs

	2010 £m	2009 £m
Turnover	540.4	528.2
Distribution costs	(446.6)	(421.9)
Profit on disposal of fixed assets	0.3	0.3
Other operating income	1.4	1.0
Net operating costs	(444.9)	(420.6)
Operating profit	95.5	107.6

Distribution costs include all the costs of operating the distribution network together with depreciation, goodwill amortisation and replacement expenditure

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

4 Profit /(loss) on ordinary activities before taxation

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

	2010 £m	2009 £m
Auditors' remuneration	0.2	0.1
Goodwill amortisation	5.8	5.8
Depreciation	63.7	60.1
Profit on disposal of fixed assets	(0.3)	(0.3)
Replacement expenditure	178.7	148.8
Impairment of trade debtors	-	0.5
Rentals under operating leases – other assets	-	0.8

Auditors remuneration comprises £47,500 (2009 £63,500) in respect of statutory and regulatory audit services, £33,000 (2009 £37,000) in respect of other services pursuant to legislation £34 800 (2009 £24,000) in respect of bond issue assurance work and £75,000 (2009 £nil) in respect of IT consultancy services In addition to the above services, the Company's auditors acted as auditors to the Scotia Gas Networks Pension Scheme, and fees of £9,000 (2009 £4 920) have been charged by the auditors to the Company in respect of these services

5. Employee information and directors' emoluments

The Company had 1,071 full time equivalent employees as of 31 March 2010 (2009 1,094) The average monthly number of full time equivalent employees during the year was 1,084 (2009 1,087)

The Directors did not receive any remuneration for their services to the Company during the year, or during the prior year No retirement benefits are accruing in the year or in the prior year to any Directors under money purchase or defined benefit schemes, in respect of their services to the Company

Staff costs for the Company during the year are as follows

	2010 £m	2009 £m
Staff costs		
Wages and salaries	43.3	44.2
Social security costs	3.7	3.8
Pension costs (see note 23)	8.9	8.4
	55.9	56.4

6. **Interest receivable and similar income**

	2010 £m	2009 £m
Interest receivable on loans to other Group undertakings	1 3	7 7
Other finance income		
Movements on Financial Derivatives (see note 16)	0 5	-
Net pension credit (see note 23)	-	1 8
Total Other finance income	0 5	1 8
	1 8	9 5

7. **Interest payable and similar charges**

	2010 £m	2009 £m
Interest payable on loans from other Group undertakings	0 3	1 6
Interest payable on bank loans	0 6	3 4
Index linked bond interest	4 2	30 3
Other interest payable on bonds	70 2	73 5
Other interest payable	1 2	1 8
Unwind of discounts in provisions (see note 17)	5 9	17 0
Net pension charge (see note 23)	2 1	-
	84 5	127 6

8 **Tax on profit/ (loss) on ordinary activities**

(a) **Analysis of the tax charge/(credit) on ordinary activities**

	2010 £m	2009 £m
Current tax		
Corporation tax at 28% (2009 28%)	(0 4)	-
Adjustment in respect of prior period – surrender of tax losses	-	1 2
Total current tax (charge)/credit	(0 4)	1 2
Deferred tax		
Deferred tax charge for the year	(11 6)	(5 0)
Adjustments in respect of prior years	-	(0 1)
Total deferred tax charge for the year	(11 6)	(5 1)
Total tax charge on loss on ordinary activities	(12 0)	(3 9)

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

8 Tax on loss on ordinary activities (continued)

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

	2010 £m	2009 £m
Profit / (loss) on ordinary activities before tax	13 1	(10 2)
Profit / (loss) on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2009 28%)	3 7	(2 8)
Effects of		
Deferred tax on accelerated capital allowances	(7 1)	(6 2)
Deferred tax on unutilised losses	-	6 6
Depreciation on non-qualifying assets	6 2	6 1
Other short term timing differences	(4 3)	(5 5)
Expenses not deductible for tax purposes	1 9	1 8
Adjustment in respect of prior period – surrender of tax losses	-	(1 2)
Current tax charge/(credit)	0 4	(1 2)

There are no legislative changes which materially impact future tax charges

9 Dividends

	2010 £m	2009 £m
Equity shares		
Interim dividends paid £nil per share (2009 81 16134 pence)	-	130 0

No final dividends are proposed in respect of the year ended 31 March 2010

Notes to the financial statements
Year ended 31 March 2010

10 **Intangible fixed assets**

	Goodwill £m
Cost	
At 1 April 2010	290 2
Refund on cost of investment	(2 7)
At 31 March 2010	287 5
Accumulated amortisation	
At 1 April 2010	22 2
Charge for the year	5 8
At 31 March 2010	28 0
Net book value	
At 31 March 2010	259 5
At 31 March 2009	268 0

During the year the company received a refund of £2 7m in relation to the cost of investment in the gas networks from National Grid Plc

The goodwill, which arose on the acquisition of the business by the Company, is being amortised on a straight line basis over 50 years This is the period over which the Directors estimate that the value of the underlying business acquired is expected to exceed the value of the underlying assets

A review for impairment of goodwill is carried out at the end of each financial year No impairment loss has been recorded in either the current year or the prior year

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

11. Tangible fixed assets

	Short leasehold properties £m	Freehold properties £m	Plant and machinery £m	Motor vehicles and office equipment £m	Total £m
Cost					
At 1 April 2009	0.5	39.0	2,438.5	69.0	2,547.0
Additions	-	5.9	83.7	16.4	106.0
Reclassifications	-	(11.2)	11.2	-	-
At 31 March 2010	0.5	33.7	2,533.4	85.4	2,653.0
Depreciation					
At 1 April 2009	0.1	2.1	191.3	15.9	209.4
Charge for the year	-	1.1	54.6	8.0	63.7
At 31 March 2010	0.1	3.2	245.9	23.9	273.1
Net book value					
At 31 March 2010	0.4	30.5	2,287.5	61.5	2,379.9
At 31 March 2009	0.4	36.9	2,247.2	53.1	2,337.6

The reclassification in the year represents the book value of environmental assets reclassified to plant and machinery

The net book value of assets held under finance leases included within motor vehicles and office equipment is £nil (2009 £nil)

The Company has received customer contributions relating to plant and machinery and meters In accordance with the Company's accounting policy the assets are capitalised within fixed assets and the contributions received are recognised as deferred income in the balance sheet The deferred income is released to the profit and loss account over the estimated lives of the related assets The amount deferred under this policy is as follows

	2010 £m	2009 £m
Deferred income		
Customer contributions brought forward	56.0	42.3
Customer contributions received in year	10.1	14.7
Amortisation in year	(1.4)	(1.0)
	64.7	56.0

Notes to the financial statements
Year ended 31 March 2010

12. Fixed asset investments

	2010 £m	2009 £m
Other investments		
Cost and net book value	0 2	0 2

Fixed asset investments relate to an investment in Xoserve Limited, which provides transportation transactional services on behalf of all the major gas network transportation companies The Company holds 16 1% (2009 16 1%) of the ordinary shares of Xoserve Limited

During the year the Company received dividends of £347,000 (2009 £312,000) in relation to this investment

13 Debtors. amounts falling due within one year

	2010 £m	2009 £m
Trade debtors	26 3	31 8
Amounts owed by Group undertakings	336 4	210 8
Prepayments and accrued income	2 3	2 1
Derivative financial instruments	76 3	89 1
	441 3	333 8

Trade debtors are stated net of bad debt provisions of £0 1m (2009 £1 1m) and credit note provisions of £0 8m (2009 £0 4m)

Within amounts owed by Group undertakings are loans amounting to £333 9m (2009 £203 7m) which incur 1 5 % (2009 1 5%) interest and are repayable on demand

14 Creditors amounts falling due within one year

	2010 £m	2009 £m
Trade creditors	21 6	24 5
€365m floating rate loan note due 2010	324 7	-
Amounts owed to Group undertakings	66 7	113 9
Other taxation and social security	12 3	14 1
Other creditors	1 2	0 9
Accrued interest	28 6	24 3
Other accruals	46 9	58 8
Deferred income	10 4	7 3
Derivative financial instruments	27 6	24 7
	540 0	268 5

Amounts owed to Group undertakings comprise trading balances

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

15 Creditors amounts falling due after more than one year

	2010 £m	2009 £m
Bonds		
Fixed rate and index linked:		
£300m 5 125% fixed rate due 2018	297 7	-
£215m 4 875% fixed rate due 2020	214 3	214 2
£150m 2 066% index linked due 2025	169 1	171 0
£375m 4 875% fixed rate due 2029	373 4	373 3
£250m 2 013% index linked due 2035	281 6	284 9
£225m 6 38% fixed rate due 2040	223 4	223 3
£15m 2 580% index linked due 2028	15 2	15 3
	1 574 7	1,282 0
Floating rates		
€365m floating rate loan note due 2010	-	337 7
£233m floating rate note due 2015	232 6	232 6
£100m floating rate note due 2015	99 8	99 8
	332 4	670 1
Total bonds	1,907 1	1 952 1
Revolving credit facility drawn	(1 8)	80 0
	1,905 3	2,032 1

Maturity of bonds

	2010 £m	2009 £m
Due within one year	324 7	-
Between one and five years	-	417 7
After five years	1,905 3	1,614 4
	2,230 0	2,032 1

The current revolving credit facility is £250 0m and expires in November 2010 Beyond this period the facility has been revised to £200m and extended to November 2013

The above borrowings are unsecured and are stated after the deduction of issue costs of £10 0m (2009 £6 5m) These costs together with the interest expense are allocated to the profit and loss account over the term of the borrowings Interest is calculated using the effective interest rate method

Certain interest costs in respect of index linked bonds are not payable until the principal amount of the bond is repaid and are included within the carrying value of the borrowings stated above The amount included in the carrying value of the borrowings at 31 March 2010 is £ 51 9m (2009 £57 2m)

16. Financial instruments

The Company's funding, liquidity and exposure to interest rate, foreign currency exchange and credit risks are managed within a framework of policies and guidelines authorised by the Board of Directors In accordance with these policies and in accordance with covenants set out as part of bond issuances made by the Company, financial derivatives are used to manage financial exposures

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited and accordingly is exempt from the disclosures required under FRS 29 (Financial Instruments Disclosure) as these are detailed in the annual report of Scotia Gas Networks Limited

17. Provisions for liabilities

	Onerous financial instruments £m	Environmental £m	Deferred tax £m	Other provisions £m	Total £m
At 1 April 2009	132 3	12 6	120 7	9 2	274 8
Utilised during the year	(14 2)	-	-	(4 2)	(18 4)
Released during the year	-	(0 1)	-	-	(0 1)
Net movement in deferred tax	-	-	7 9	-	7 9
Unwind of discount	5 1	0 8	-	-	5 9
At 31 March 2010	123 2	13 3	128 6	5 0	270 1

Onerous financial instruments

The onerous financial instruments provision relates to interest rate swap contracts that the Company holds The provision recorded at each balance sheet date represents the aggregate fair value of the swap contracts held The provision will be utilised as cash settlement payments are made over the life of the swaps over the next eighteen years

Environmental provision

The environmental provision represents the Directors' best estimate of environmental restoration costs, where the Company has a legal obligation to restore sites at the balance sheet date The provision has been discounted and is stated at the present value of the expenditure expected to be required to settle the obligation The provision is expected to be utilised over the next twenty years

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

17 Provision for liabilities (continued)

Deferred tax

The net movement on the deferred tax provision has arisen as a result of a surrender of tax losses during the year offset by other movements in the year of which £11 6m is recorded as a charge to the profit and loss account and £3 7m is recorded as a credit to the Statement of Total Recognised Gains and Losses

Deferred taxation recognised in the financial statements (excluding deferred tax recognised in respect of pension liabilities (see note 23)) is as follows

	2010 £m	2009 £m
Accelerated capital allowances	(170 7)	(163 2)
Deferred tax asset on losses	33 6	33 8
Deferred tax on cash flow hedge	7 8	7 0
Other timing differences	0 7	1 7
	(128 6)	(120 7)

The movement in provision for deferred tax is as follows

	£m
At 1 April 2009	(120 7)
Charged to profit and loss account	(11 6)
Charged to statement of recognised gains and losses	3 7
At 31 March 2010	(128 6)

The Company has no unrecognised deferred tax assets or liabilities In accordance with FRS 19 ("Deferred tax"), deferred tax has been measured based upon a corporation tax rate of 28%, being the tax rate substantively enacted at the balance sheet date

Others

Other provisions represent provision for other legal and constructive obligations held by the Company The provision is expected to be utilised over the next fourteen years

18 Called up share capital

	2010 £m	2009 £m
Allotted, called up and fully paid		
160,174,772 ordinary shares of £1 each	160 2	160 2

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

19 Reserves

	Hedge reserve £m	Profit and loss account £m
At 1 April 2009	(16 5)	142 7
Profit for the financial year	-	1 1
Movement on cash flow hedge	(2 1)	-
Deferred tax on cash flow hedge	0 8	-
Actuarial loss on defined benefit pension scheme (net of related tax)	-	(49 9)
At 31 March 2010	(17 8)	93 9

20 Reconciliation of movements in shareholders' funds

	2010 £m	2009 £m
Profit/(loss) for the financial year	1 1	(14 1)
Dividends	-	(130 0)
Cash flow hedge (net of related tax)	(1 3)	(21 9)
Actuarial loss on defined benefit pension scheme (net of related tax)	(49 9)	(32 3)
Net decrease in shareholders' funds	(50 1)	(198 3)
Opening shareholders' funds	286 4	484 7
Closing shareholders' funds	236 3	286 4

21 Operating leases commitments

The Company has lease agreements in respect of properties for which the payments extend over a number of years

	2010 £m	2009 £m
Annual commitments under non-cancellable operating leases expiring:		
After five years	0 2	0 4

22. Capital commitments

Capital projects contracted for by the Company but not provided in the financial statements amounted to £36 5m at 31 March 2010 (2009 £10 3m)

23 Pension commitments

A significant proportion of the Company's employees are members of the Scotia Gas Networks Pension Scheme ("the Scheme") The Scheme provides final salary defined benefits for employees who joined the Lattice Group Scheme prior to 31 March 2002 A defined contribution section was added to the Lattice Group Scheme from 1 April 2002 for employees joining the Lattice Group Scheme from that date Employees of the Group who were previously members of the Lattice Group Scheme transferred to the Scotia Gas Networks Pension Scheme on 1 December 2005

(a) Defined benefit scheme

The Scheme is operated by the Group and is funded with assets held in separate trustee administered funds It is subject to independent valuations at least every three years, on the basis of which the qualified actuary determines the rate of employers contribution, which together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme

The latest full actuarial valuation was carried out as at 31 March 2009 In accordance with FRS 17, a limited actuarial review has been carried out by Hymans Robertson at 31 March 2010 using the projected unit method

The following financial assumptions have been used

	As at 31 March 2010	As at 31 March 2009	As at 31 March 2008
Discount rate	5 5%	6 7%	6 9%
Inflation assumption	3 7%	3 0%	3 5%
Rate of increase of salaries	5 2%	4 5%	5 0%
Rate of increase of pensions payment	3 7%	3 0%	3 5%

The assumptions relating to longevity underlying the pension liabilities reflect the characteristics of the Scheme membership ('VitaCurves') for base mortality with an allowance for further improvements in life expectancy in line with the medium cohort adjustments subject to a 1 5% p a underpin on future improvements The assumed life expectancy in years for a member once they reach age 65 is as follows

	As at 31 March 2010		As at 31 March 2009		As at 31 March 2008	
	Male	Female	Male	Female	Male	Female
Member currently aged 65	21	23	23	26	21	23
Member currently aged 45	24	27	26	28	22	24

Notes to the financial statements
Year ended 31 March 2010

23 Pension commitments (continued)

The fair value of the assets in the scheme, the present value of the liabilities in the scheme and the expected rate of return were

	31 March 2010		31 March 2009		31 March 2008		31 March 2007		31 March 2006	
	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m	Long term rate of return expected	Value £m
Equities	8 0%	185 0	7 7%	116 8	8 0%	137 1	8 0%	143 1	7 7%	134 4
Government bonds	4 5%	37 9	4 2%	38 2	4 5%	41 8	4 5%	39 0	4 2%	41 1
Corporate bonds	5 5%	30 4	6 7%	18 1	6 9%	15 1	5 1%	19 0	4 9%	14 9
Property	5 5%	12 1	5 5%	7 4	5 5%	13 1	5 5%	9 3	5 2%	-
Cash	1 1%	16 0	2 2%	10 4	5 8%	8 5	5 9%	0 6	4 8%	2 7
Total market value of assets		281 4		190 9		215 6		211 0		193 0
Actuarial value of liabilities		(371 1)		(221 3)		(199 7)		(251 7)		(229 1)
(Deficit)/surplus in scheme		(89 7)		(30 4)		15 9		(40 7)		(36 0)
Related deferred tax liability/(asset)		25 1		8 5		(4 4)		12 2		10 8
Net pension (liability)/asset		(64 6)		(21 9)		11 5		(28 5)		(25 2)

The expected return on scheme assets represents the expected return of each major class of assets in which the scheme invests Expected yield on fixed interest instruments are based on gross redemptions yields at the balance sheet date Expected return on equity interests reflect real rates of return experienced in the relevant markets

Movement in the fair value of scheme assets

	2010 £m	2009 £m
At 1 April	190 9	199 7
Transfers	-	5 5
Expected return on scheme assets	13 0	16 1
Contributions from scheme members	1 0	1 1
Contributions from the company	20 7	20 7
Actuarial gains and losses	58 9	(49 7)
Benefits paid	(3 1)	(2 5)
At 31 March	281 4	190 9

Southern Gas Networks plc

Notes to the financial statements
Year ended 31 March 2010

23 Pension commitments (continued)

Movement in fair value of scheme liabilities

	2010 £m	2009 £m
At 1 April	(221 3)	(199 7)
Transfers	-	(5 5)
Current service cost	(8 5)	(8 1)
Interest cost	(15 1)	(14 3)
Contributions from scheme members	(1 0)	(1 1)
Actuarial gains and losses	(128 3)	4 9
Benefits paid	3 1	2 5
At 31 March	(371 1)	(221 3)

The Company's contribution rate during the year was 37 3% of pensionable earnings Additionally, the Group made special pension contributions to repair the deficit amounting to £13 5m, of which the Company's share was approximately £8 1m The expected contributions to be made in the year to 31 March 2011 are 37 3% of pensionable salary

The actual gain on scheme assets was £45 9m (2009 loss of £65 9m)

The cumulative amount of actuarial losses recognised in the statement of total recognised gains and losses since the adoption of FRS 17 is £66 1m (2009 £16 2m)

Analysis of the amounts recognised in the profit and loss account

	2010 £m	2009 £m
Amount charged to operating profit		
Current service cost	(8 5)	(8 1)
Analysis of the amount credited to finance income		
Expected return on pension scheme assets (see note 6 & 7)	13 0	16 1
Interest on pension scheme liabilities (see note 6 & 7)	(15 1)	(14 3)
Net finance (charge)/income	(2 1)	1 8
Net charge to the profit and loss account	(10 6)	(6 3)

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Notes to the financial statements
Year ended 31 March 2010

23 Pension commitments (continued)

Analysis of the amount recognised in the statement of total recognised gains and losses (STRGL)

	2010 £m	2009 £m
Actual return less expected return on pension scheme assets	58 9	(49 7)
Experience gains and losses on scheme liabilities	(12 4)	-
Changes in financial assumptions underlying the present value of the scheme liabilities	(115 9)	4 9
Deferred tax	19 5	12 5
Actuarial (loss)/gain recognised in STRGL	(49 9)	(32 3)

Experience gains and losses	2010	2009	2008	2007	2006
Difference between the expected and actual return on scheme assets	£58 9m	(£49 7m)	(£21 5m)	(£2 1m)	£22 3m
- Percentage of scheme assets at year end	20 9%	(26 0%)	(10 0%)	(1 0%)	11 5%
Experience losses on scheme liabilities	(£12 4m)	-	-	(£19 0m)	-
- Percentage of the present value of scheme liabilities at year end	(3 3%)	-	-	(7 5%)	-
Changes in financial assumptions underlying scheme liabilities	(£115 9m)	£4 9m	£67 0m	£18 8m	(£25 2m)
- Percentage of the present value of scheme liabilities at year end	(31 2%)	2 2%	33 6%	7 5%	(11 0%)
Total actuarial gain/(loss) recognised in the statement of total recognised gains and losses	(£69 4m)	(£44 8m)	£45 5m	(£2 3m)	(£2 9m)
- Percentage of the present value of scheme liabilities at year end	(18 7%)	(20 4%)	22 8%	(0 9%)	(1 3%)

23 **Pension commitments (continued)**

	2010 £m	2009 £m	2008 £m
Movement in (deficit)/surplus during the year			
Surplus/(deficit) in scheme at 1 April	(30 4)	-	(40 7)
Movement in year			
- Current service costs	(8 5)	(8 1)	(11 0)
- Contributions	20 7	20 7	20 5
- Other finance income	(2 1)	1 8	1 6
- Actuarial (loss)/gain	(69 4)	(44 8)	45 5
Restriction of recognised surplus	-	-	(15 9)
Deficit in scheme at end of the year	(89 7)	(30 4)	-

(b) Defined contribution schemes

The amount recognised in the profit and loss account is as follows

	2010 £m	2009 £m
Amount charged in respect of defined contribution schemes	0 3	0 3

24. **Related parties**

In accordance with FRS 8 'Related party disclosures the Company is exempt from disclosing transactions with entities that are part of the Group qualifying as related parties, as it is a wholly owned subsidiary of a parent which prepares consolidated accounts which are publicly available

The Company's parent Scotia Gas Networks Limited is owned by a consortium consisting of Scottish and Southern Energy plc (50%), OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board and Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by OMLRS Administration Corporation The transactions with the shareholders of the parent are disclosed

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Notes to the financial statements
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24 Related parties (continued)

Transactions with shareholders of parent company

Amounts owed to shareholders of the parent company are set out below

	2010 £m	2009 £m
Other amounts owed to shareholders		
Scottish and Southern Energy plc	7 7	19 5

The amounts owed to shareholders mainly comprise amounts payable in respect of a managed service agreement for corporate services and material purchases

The following transactions took place during the year between the company and the Scottish and Southern Energy plc group of companies ('SSE")

	2010 £m	2009 £m
Sales of goods and services	99 8	95 3
Purchase of goods and services	(31 0)	(48 4)
Sale of tax losses	-	0 1

Sales of goods and services to SSE primarily represent gas transportation services At 31 March 2010 an amount of £8 7m was owed by SSE in relation to these services and is included within trade debtors

SSE provides services to the Company in the form of a management services agreement for corporate services The company also purchases certain items such as consumables stock and shrinkage gas from SSE Included within purchases of goods and services are direct costs of £0 7m (2009 £1 1m) recharged by SSE which have been capitalised in the year

25. Parent company

The Company is a wholly owned subsidiary of Scotia Gas Networks Limited, a company registered in England and Wales

Scotia Gas Networks Limited is owned by a consortium consisting of Scottish and Southern Energy plc (50%), OTPPB Investments (UK) Limited (25%), which is owned by Ontario Teachers' Pension Plan Board and Borealis Infrastructure Europe (UK) Limited (25%) which is indirectly wholly owned by OMERS Administration Corporation It is the opinion of the Directors that the parent company, Scotia Gas Networks Limited has no single controlling party as that company is controlled jointly by the consortium

Scotia Gas Networks Limited publishes consolidated financial statements and is the largest and smallest group which consolidate the financial statements of the Company Copies of the financial statements of Scotia Gas Networks Limited may be obtained from the Company Secretary, St Lawrence House, Station Approach, Horley, Surrey, RH6 9HJ