# SCOTTISHPOWER ENERGY MANAGEMENT LIMITED
# ANNUAL REPORT AND ACCOUNTS
# for the year ended 31 December 2018

Registered No. SC215843

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CONTENTS

# SCOTTISHPOWER ENERGY MANAGEMENT LIMITED
# STRATEGIC REPORT

The directors present an overview of ScottishPower Energy Management Limited's business structure, 2018 performance *and strategic outlook including principal risks and uncertainties.*

## STRATEGIC OUTLOOK

The principal activities of ScottishPower Energy Management Limited ("the company"), registered company number SC215843, are the wholesale purchase and sale of electricity and gas and the optimisation of gas storage facilities. The company will continue with this activity for the foreseeable future.

The ultimate parent of the company is Iberdrola, S.A. ("Iberdrola") which is listed on the Madrid stock exchange and the immediate parent of the company is Scottish Power Retail Holdings Limited ("SPRH"), formerly known as Scottish Power Generation Holdings Limited. Scottish Power Limited ("SPL") is the United Kingdom ("UK") holding company of the Scottish Power Limited group ("ScottishPower"), of which the company is a member.

The company is subject to the requirements of the European Market Infrastructure Regulation, as a Non-Financial Counterparty. This is a European Union ("EU") regulation on Over-The-Counter ("OTC") derivatives, central counterparties and Trade Repositories. The regulation requires counterparties, who have entered into derivative contracts, to externally report these to an authorised Trade Repository, and to implement risk management standards for all bilateral OTC derivatives.

The company is part of ScottishPower's Energy Wholesale business function ("Energy Wholesale"). Until the 31 December 2018 Energy Wholesale's operations were focused on managing the complex market conditions in relation to the operation of ScottishPower's generation asset base (except for those technologies managed by ScottishPower's Renewables business) and managing ScottishPower's exposure to the UK wholesale electricity and gas markets. On 16 October 2018, Energy Wholesale agreed to sell the ScottishPower Generation group to Drax Smart Generation HoldCo Limited ("Drax"). The sale, which completed on 31 December 2018, means that all of ScottishPower's generation capacity is now from renewable energy sources. Going forward Energy Wholesale, and therefore the company, will focus on managing ScottishPower's exposure to the UK wholesale electricity and gas markets for Retail and Renewables generation. On 1 July 2018 mainly gas storage assets were transferred from the company to ScottishPower Generation Limited. *On 30 November 2018, as part of the Drax transaction, certain gas storage and other assets and liabilities were* transferred from ScottishPower Generation Limited to the company.

## 2018 OPERATIONAL PERFORMANCE

The table below provides key financial information relating to the company's performance during the year.

| | Revenue* | | Operating loss* | | Capital investment** | |
|---|---|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 | **2018** | 2017 |
| **Financial key performance indicators** | **£m** | £m | **£m** | £m | **£m** | £m |
| **ScottishPower Energy Management Limited** | **4,837.3** | 5,248.3 | **(11.3)** | (31.5) | **1.5** | 0.6 |

* Revenue and operating loss presented on page 12.
** Capital investment as presented in Note 3 pages 26 and 27.

Revenue decreased by £411.0 million to £4,837.3 million during the year. This was primarily due to decreased sales from *lower generation output and lower retail demand, and a decrease in sell trades transacted during certain market* windows in which the company is required to stand ready to sell under industry regulations.

Operating loss reduced by £20.2 million to £11.3 million in 2018. This primarily reflected the increase in gross margin due to favourable mark-to-market movements and an increase in other operating income received for services provided to other group companies. These favourable movements were partially offset by an increase in staff costs due to reorganisation and restructuring and impairment of gas storage facilities.

## LIQUIDITY AND CASH MANAGEMENT

*Cash and net debt*

Net cash flows from operating activities increased by £21.4 million (refer to cash flow statement on page 14). Net debt increased by £64.1 million to £108.7 million. This movement comprised an increase in current group loans payable.

The company is funded by a combination of debt and equity. All equity is held by the company's immediate parent undertaking, SPRH. SPL grants all of the loan facilities to the company. Treasury services are provided by SPL. Further details of the treasury policy for ScottishPower, and how it manages it is included in Note 5.

**HEALTH AND SAFETY**

The company has a clear strategy to continue to improve health and safety performance using ScottishPower health and safety standards. A more extensive description of how ScottishPower, and therefore the company, addresses health and safety requirements can be found in the most recent Annual Report and Accounts of SPL.

**UK DECISION TO LEAVE THE EU (BREXIT)**

The UK was originally scheduled to leave the EU on 29 March 2019. Following intensive negotiations on the subjects of a separation payment, mutual recognition of citizens' rights and avoiding a hard border between Northern Ireland and the Republic of Ireland, two key documents were approved by the EU Council on 25 November 2018: the EU Withdrawal Agreement (a legally binding document setting out the terms of the UK's exit from the EU, including citizens' rights and the Irish 'backstop'); and the Political Declaration (setting out the basis for a future negotiation of the future UK-EU relationship after Brexit, including UK-EU trade and security). As at the date of signing these accounts this deal has not been approved by the UK Parliament. The EU and the UK have now agreed a delay to Brexit until 31 October 2019 at the latest.

If the EU Withdrawal Agreement is not approved by the UK Parliament within the EU timelines the risk of a 'no-deal' Brexit exists. This would probably mean that the trade relationship between the UK and EU would revert to World Trade Organisation ("WTO") rules. The UK Government has published a series of technical papers covering some of the key areas of concern in the event of 'no-deal' scenario. Essentially these papers seek to minimise the impacts as much as possible, including by limiting the scale of the changes to existing arrangements.

Nevertheless, WTO rules would mean that trade between the UK and EU which is currently frictionless, would become cross-border trade subject to customs checks and tariffs. In the event of a 'no-deal' scenario some economic disruption is expected in the UK and thus ScottishPower is preparing to mitigate any negative impacts arising from this outcome. A cross-party operational working group has been co-ordinating ScottishPower's preparations to mitigate the impact of a 'no-deal' Brexit. Some of the key risks considered are explained in the table below.

| **SCOTTISHPOWER - BREXIT RISKS** | |
|---|---|
| **RISK** | **RESPONSE** |
| Impacts arising from the UK decision to leave the EU or market, reactions to events during the negotiation. These impacts could include movements in the value of Sterling and other financial instruments. In the longer term there could be positive or negative changes in the UK economy and in the political and regulatory environment in which the company operates. | In addition to monitoring ongoing developments related to Brexit the treasury risk management policy is in place to hedge financial risks which are the most prevalent in the short term. Any longer term impact on the UK economy and its impact on ScottishPower and therefore the company will be managed in line with developments. A ScottishPower wide regulatory group is monitoring any potential risks arising from a regulatory perspective and is engaging with governments and regulators to minimise any disruption. |
| Foreign exchange rate exposure and additional tariffs if WTO rules apply. | Exchange rate hedged on existing orders and contracts. Legal review of all critical contracts to determine potential exposure to additional tariffs. |
| Contractual risk for existing non-trading contracts including the risk of contract re-openers, clauses such as force majeure/material adverse change clauses and jurisdiction. | Legal review of all critical contracts to determine potential exposure and mitigation specific to each contract. |
| Contractual risk for existing trading contracts including master trading agreements and broker and exchange contracts. | Risk based assessment of all contracts although some are UK only contracts and are therefore unaffected and the majority of brokers and exchanges are UK-based. |

**UK DECISION TO LEAVE THE EU (BREXIT)** ***continued***

| SCOTTISHPOWER - BREXIT RISKS | |
|---|---|
| **RISK** | **RESPONSE** |
| Free movement of labour – potential restrictions on EU nationals working in the UK or international assignees from elsewhere in the Iberdrola group, not currently in the UK but wishing to enter the UK. | Recent announcements by the UK Government confirmed EU nationals in the UK will be part of an EU settlement scheme. Workplace audit underway to assess impact and support staff affected through the process. |
| Data Protection – impact of General Data Protection Regulation ("GDPR") rules and status of UK post Brexit could impact transfer of data between group companies and suppliers in the normal course of business. | All intercompany contracts reviewed to update contractual clauses. High risk suppliers identified and where appropriate discussions commenced to amend contractual terms. |

Even in the event of an agreement being concluded, Brexit may have both risks and opportunities for ScottishPower and therefore the company. Until the terms of exit and the nature of the future relationship are clear, it is not possible to be definitive about these.

Many of the risks described above relating to a 'no-deal' scenario arise from so-called 'horizontal' issues where there could be issues affecting businesses in many sectors of the economy. UK official forecasts are for a negative impact on the UK economy as a whole; in the event of a 'no-deal' scenario it might be sharply negative, at least for the short/medium term. ScottishPower, and therefore the company, will continue to monitor the impact of Brexit and take appropriate action to protect operations as the outcome of the Brexit deal becomes clearer.

**PRINCIPAL RISKS AND UNCERTAINTIES**

ScottishPower's strategy is to conduct business in a manner benefiting customers through balancing cost and risk while delivering shareholder value and protecting ScottishPower's performance and reputation by prudently managing the risks inherent in the business. To maintain this strategic direction ScottishPower develops and implements risk management policies and procedures, and promotes a robust control environment at all levels of the organisation. Further details of the risk management practices can be found in Note 5.

The principal risks and uncertainties of ScottishPower (other than those specific to Brexit already discussed), and so those of the company, that may impact current and future operational and financial performance and the management of these risks are described below.

| SCOTTISHPOWER - GLOBAL | |
|---|---|
| **RISK** | **RESPONSE** |
| Material deterioration in the relatively stable and predictable UK regulatory and political environment, including any sudden changes of policy, or interventions outside established regulatory frameworks. | Positive and transparent engagement with all appropriate stakeholders to ensure that long-term regulatory stability and political consensus is maintained and public backing is secured for the necessary investment in the UK energy system. Providing stakeholders with evidence of the risks of ad hoc intervention in markets. |
| A major health and safety incident in the course of operations could impact staff, contractors, communities or the environment. | ScottishPower's Health and Safety function provides specialist services and support for the businesses in relation to health and safety. A comprehensive framework of health and safety policy and procedures, alongside audit programmes, is established throughout ScottishPower, which aim to ensure not only continuing legal compliance but also drive towards best practice in all levels of its health and safety operations. |

**PRINCIPAL RISKS AND UNCERTAINTIES *continued***

| SCOTTISHPOWER - GLOBAL | |
|---|---|
| RISK | RESPONSE |
| Breach in cyber security and unwanted infiltration of the ScottishPower IT infrastructure by internal and external parties. | Implementation of a cyber-risk policy which provides the framework for mitigation. Proactive approach to identifying where ScottishPower is vulnerable and addressing these points through technical solutions. Educating company employees as to how behaviour can reduce this risk. Embedding cyber security in all projects where appropriate. |

The principal risk and uncertainty of the Energy Wholesale business, and so that of the company, that may impact the current and future operational and financial performance and the management of this risk is described below:

| ENERGY WHOLESALE | |
|---|---|
| RISK | RESPONSE |
| Inability to efficiently hedge the exposure to power prices due to the complexity of the price cap pricing mechanism. | Continuous assessment of the wholesale energy markets and constant monitoring of the impact of market movements across seasons. |

**ON BEHALF OF THE BOARD**

**Neil Stainton**
**Director**
**16 July 2019**

The directors present their report and audited Accounts for the year ended 31 December 2018.

**INFORMATION CONTAINED WITHIN THE STRATEGIC REPORT**
The directors have chosen to disclose information on the following, required by the Companies Act 2006 to be included in the Directors' Report, within the Strategic Report, found on pages 1 to 4:

- information on financial risk management and policies; and
- information regarding future developments of the business.

**RESULTS AND DIVIDENDS**
The net loss for the year amounted to £9.2 million (2017 £25.8 million). A dividend of £20.0 million was paid during the year (2017 nil).

**ENVIRONMENTAL MANAGEMENT AND REGULATION**
Throughout its operations, ScottishPower strives to meet, or exceed, relevant legislative and regulatory environmental requirements and codes of practice. A more extensive description of how ScottishPower addresses environmental requirements can be found in the most recent Annual Report and Accounts of SPL.

**EMPLOYEES**
***Employment regulation***
ScottishPower has well-defined policies in place throughout its businesses to ensure compliance with applicable laws and related codes of practice. These policies cover a wide range of employment issues such as disciplinary, grievance, harassment, discrimination, stress, anti-bribery and 'whistleblowing' and have been brought together in the Code of Ethics of Iberdrola and its group of companies (which also outlines expectations for employees' conduct).

***Training***
ScottishPower has a continuing commitment to training and personal development for its employees with 3,061 (2017 2,900) training events in the year. Much of the training is focused on health and safety and technical training ensuring field staff are safe and competent. In addition ScottishPower recruits over 100 craft and engineering trainees annually who undertake a formal, structured training programme leading towards a recognised apprenticeship or formal engineering qualification. Team leaders and managers also participate in core management skills training and there are management development programmes and modules aimed at increasing leadership capability.

***Employee feedback and consultation***
In 2018, ScottishPower carried out its annual employee engagement survey, 'The LOOP' as part of an Iberdrola group engagement survey framework. The survey provides key insight on what employees feel about working for ScottishPower. The response rate in 2018 equalled 2017, with 75% of employees providing feedback. The results of the survey highlighted a number of strengths and opportunities and overall 61% of employees feel proud to work for ScottishPower. Areas of strength highlighted were in relation to collaboration, performance management and safety. The opportunities identified as part of the feedback where the ScottishPower businesses have the opportunity to respond to challenges are around providing more clarity on ScottishPower's future strategy, enabling employees to carry out their role and supporting employees to develop and grow through the organisation. These areas are a focus for the ScottishPower action plan going forward.

In addition to employee feedback, ScottishPower regularly consults with employees and their representatives via a variety of channels, including monthly team meetings, business conferences, health and safety committees and employee relations forums.

***Inclusion and diversity***
Inclusion and diversity fosters innovation and creativity, driving better business performance. ScottishPower is working hard to create an inclusive and diverse workplace that is open to change; where employees feel they can be themselves.

**EMPLOYEES *continued***

***Inclusion and diversity continued***

In March 2018, ScottishPower welcomed the steps the UK Government has taken to introduce legislation on gender pay gap reporting. ScottishPower is committed to pay for performance equally and fairly, and is focused on breaking down barriers across the employee lifecycle as over time this will improve the Gender Pay Gap position whilst widening the inclusion of other under-represented groups. Key activities during 2018 included the design and roll out of e-learning and training on diversity and unconscious bias for recruiting managers and newly appointed managers.

In addition, in 2018 ScottishPower welcomed six females into Science, Technology, Engineering and Mathematics ("STEM") based placements as part of the Women Returners programme to support women returning to work after a lengthy career break. The programme aims to help women grow their career after a career break from the STEM sector, offering the time and support needed to refresh and redevelop their skills to help them in returning to employment on a more permanent basis.

As part of its commitment to closing the gender pay gap the ScottishPower Senior Leadership Team have set two aspirational targets to break down the barriers for women:

- Increase the number of women in ScottishPower's senior leadership population to exceed 30% (currently 21%).
- Increase the number of women in ScottishPower's middle management population to exceed 40% (currently 29%).

For more information on ScottishPower's gender pay gap please go to
https://www.scottishpower.com/pages/gender_pay.aspx

ScottishPower continues to forge links with a number of recognised organisations to grow its commitment to diversity and inclusion. These include: Business Disability Forum, Employers Network for Equality & Inclusion, Equate, Working Families, ENABLE, POWERful Women and Stonewall. ScottishPower expects all employees to be treated with respect and has supporting policy guidance on People with Disabilities to help ensure equality of employment opportunity for people with disabilities. ScottishPower have obtained the Disability Confident standard and are accredited to an 'engaged level' with Carers Scotland. In addition, in 2018 ScottishPower was part of an inspirational programme, called Breaking Barriers. The programme aimed to raise aspirations for young people who have learning disabilities and provide equal opportunities to access university. Between January and June 2018 eight learners aged 18 to 24 studied for a Certificate in Applied Business Skills at the University Of Strathclyde Business School. As part of this experience the learners gained valuable skills and work experience as part of an eight week placement with ScottishPower.

***Employee health and wellbeing***

ScottishPower promotes and supports the physical and mental health and wellbeing of its employees through a programme of health promotion and information run by its occupational health department.

***Employee volunteering***

ScottishPower prides itself in being a good corporate neighbour, providing support to the communities it serves in each of its businesses. Volunteering is central to community involvement and ScottishPower has an excellent track record in this area. ScottishPower's company-wide Volunteering Policy has been actively utilised by employees during 2017. This policy gives all registered volunteers, on an annual basis, an opportunity to take an additional one day's paid leave, to be used as a volunteering day.

***Modern Slavery Statement***

ScottishPower is committed to human and labour rights and to eliminating modern slavery that could in any way be connected to its business. ScottishPower welcomed the introduction of the Modern Slavery Act 2015. ScottishPower published its most recent Modern Slavery Statement in May 2018 which was approved by the Board of Directors of Scottish Power Limited and signed by Keith Anderson, Chief Executive Officer.

ScottishPower's Modern Slavery Statement is published on the ScottishPower's website at;
www.scottishpower.com/pages/scottishpowers_modern_slavery_statement.aspx.

**DIRECTORS**
The directors who held office during the year were as follows:

| | |
|---|---|
| Julián Calvo Moya | |
| Heather Chalmers White | |
| Richard Hyde | (resigned 31 January 2018) |
| Carlos Pombo Jiménez | |
| Neil Stainton | (appointed 25 April 2018) |

Heather Chalmers White resigned as a director of the company on 31 January 2019. Douglas Ness was appointed as a director of the company on 30 May 2019.

**DIRECTORS' INDEMNITY**
In terms of the company's Articles of Association, a qualifying third party indemnity provision is in force for the benefit of all the directors of the company and has been in force during the financial year.

**STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND ACCOUNTS**
The directors are responsible for preparing the Annual Report and Accounts in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with International Financial Reporting Standards as adopted by the EU as at the date of approval of these Accounts and which are mandatory for the financial year ended 31 December 2018 ("IFRSs as adopted by the EU") 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 estimates that are reasonable, relevant and reliable;
- state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- assess the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate or to cease operations, or have no realistic alternative but to do so.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that their financial statements comply with the Companies Act 2006. They are responsible for such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a Strategic Report and Directors' Report that complies with that law and those regulations.

***Disclosure of information to auditor***
Each of the directors in office as at the date of this Annual Report and Accounts confirms that:
- so far as he is aware, there is no relevant audit information of which the company's auditor is unaware; and
- he has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

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

**AUDITOR**
KPMG LLP were re-appointed as the auditor of the company for the year ended 31 December 2018.

**BY ORDER OF THE BOARD**

**Neil Stainton**
**Director**
**16 July 2019**

## INDEPENDENT AUDITOR'S REPORT
## TO THE MEMBER OF SCOTTISHPOWER ENERGY MANAGEMENT LIMITED

**Opinion**

We have audited the financial statements of ScottishPower Energy Management Limited ("the company") for the year ended 31 December 2018 which comprises the Balance Sheet, Income Statement, Statement of Comprehensive Income, Statement of Changes in Equity, Cash Flow Statement, and related notes, including the accounting policies in Note 2.

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2018 and of its loss for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

**Basis for opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the company in accordance with, UK ethical requirements including the Financial Reporting Council ("FRC") Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

**The impact of uncertainties due to the UK exiting the European Union on our audit**

Uncertainties related to the effects of Brexit are relevant to understanding our audit of the financial statements. All audits assess and challenge the reasonableness of estimates made by the directors, such as the recoverability of trade receivables, property plant and equipment and related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the company's future prospects and performance.

Brexit is one of the most significant economic events for the UK, and at the date of this report its effects are subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown. We applied a standardised firm-wide approach in response to that uncertainty when assessing the company's future prospects and performance. However, no audit should be expected to predict the unknowable factors or all possible future implications for a company and this is particularly the case in relation to Brexit.

**Going concern**

The directors have prepared the financial statements on the going concern basis as they do not intend to liquidate the company or to cease operations, and as they have concluded that the company's financial position means that this is realistic. They have also concluded that there are no material uncertainties that could have cast significant doubt over its ability to continue as a going concern for at least a year from the date of approval of the financial statements ("the going concern period").

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least a year from the date of approval of the financial statements. In our evaluation of the directors' conclusions, we considered the inherent risks to the company's business model, including the impact of Brexit, and analysed how those risks might affect the company's financial resources or ability to continue operations over the going concern period. We have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the company will continue in operation.

**Strategic report and directors' report**

The directors are responsible for the strategic report and the directors' report. Our opinion on the financial statements does not cover those reports and we do not express an audit opinion thereon.

## INDEPENDENT AUDITOR'S REPORT
## TO THE MEMBER OF SCOTTISHPOWER ENERGY MANAGEMENT LIMITED *continued*

**Strategic report and directors' report *continued***

Our responsibility is to read the strategic report and the directors' report and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work:

- we have not identified material misstatements in the strategic report and the directors' report;
- in our opinion the information given in those reports for the financial year is consistent with the financial statements; and
- in our opinion those reports have been prepared in accordance with the Companies Act 2006.

**Matters on which we are required to report by exception**

Under the Companies Act 2006, we are required 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.

We have nothing to report in these respects.

**Directors' responsibilities**

As explained more fully in their statement set out on page 7, the directors are responsible for: the preparation of the financial statements and for being satisfied that they give a true and fair view; such internal control as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting unless they either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

**Auditor's responsibilities**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

**The purpose of our audit work and to whom we owe our responsibilities**

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

**Philip Charles (Senior Statutory Auditor)**
**for and on behalf of KPMG LLP, Statutory Auditor**
*Chartered Accountants*
319 St. Vincent Street
Glasgow
G2 5AS
22 July 2019

## SCOTTISHPOWER ENERGY MANAGEMENT LIMITED
## BALANCE SHEET
## at 31 December 2018

| | Notes | 2018 £m | 2017 £m |
|---|---|---|---|
| **ASSETS** | | | |
| **NON-CURRENT ASSETS** | | | |
| **Intangible assets** | 3 | **7.6** | 1.4 |
| **Property, plant and equipment** | 4 | **17.7** | 11.7 |
| **Financial assets** | | **31.2** | 20.1 |
| Derivative financial instruments | 5 | 31.2 | 20.1 |
| **Trade and other receivables** | 6 | **55.9** | 39.1 |
| **NON-CURRENT ASSETS** | | **112.4** | 72.3 |
| **CURRENT ASSETS** | | | |
| **Inventories** | 7 | **16.2** | 10.9 |
| **Trade and other receivables** | 6 | **517.6** | 573.0 |
| **Current tax asset** | | **1.3** | 2.1 |
| **Financial assets** | | **146.2** | 99.1 |
| Derivative financial instruments | 5 | 146.2 | 99.1 |
| **CURRENT ASSETS** | | **681.3** | 685.1 |
| **TOTAL ASSETS** | | **793.7** | 757.4 |
| | | | |
| **EQUITY AND LIABILITIES** | | | |
| **EQUITY** | | | |
| **Of shareholders of the parent** | | **182.9** | 202.4 |
| Share capital | 8, 9 | 50.0 | 50.0 |
| Hedge reserve | 9 | 59.2 | 48.8 |
| Retained earnings | 9 | 73.7 | 103.6 |
| **TOTAL EQUITY** | | **182.9** | 202.4 |
| | | | |
| **NON-CURRENT LIABILITIES** | | | |
| **Provisions** | | **1.2** | - |
| Other provisions | 10 | 1.2 | - |
| **Bank borrowings and other financial liabilities** | | **3.6** | 0.5 |
| Derivative financial instruments | 5 | 3.6 | 0.5 |
| **Trade and other payables** | 11 | **56.0** | 39.2 |
| **Deferred tax liabilities** | 12 | **17.1** | 15.0 |
| **NON-CURRENT LIABILITIES** | | **77.9** | 54.7 |
| **CURRENT LIABILITIES** | | | |
| **Provisions** | 10 | **1.0** | 0.1 |
| **Bank borrowings and other financial liabilities** | | **208.1** | 108.2 |
| Loans and other borrowings | 13 | 108.7 | 44.6 |
| Derivative financial instruments | 5 | 99.4 | 63.6 |
| **Trade and other payables** | 11 | **323.8** | 392.0 |
| **CURRENT LIABILITIES** | | **532.9** | 500.3 |
| **TOTAL LIABILITIES** | | **610.8** | 555.0 |
| **TOTAL EQUITY AND LIABILITIES** | | **793.7** | 757.4 |

Approved by the Board and signed on its behalf on 16 July 2019.

**Neil Stainton**
Director

The accompanying Notes 1 to 25 are an integral part of the balance sheet as at 31 December 2018.

**SCOTTISHPOWER ENERGY MANAGEMENT LIMITED**
**INCOME STATEMENT**
**for the year ended 31 December 2018**

| | Notes | 2018 £m | 2017 £m |
|---|---|---|---|
| Revenue | 14 | 4,837.3 | 5,248.3 |
| Procurements | | (4,835.2) | (5,265.8) |
| **GROSS MARGIN** | | **2.1** | (17.5) |
| **NET OPERATING EXPENSES** | | **(8.5)** | (11.5) |
| Staff costs | 15 | (14.7) | (8.5) |
| **Net external income/(expenses)** | | **6.2** | (3.0) |
| External services | | (24.8) | (27.8) |
| Other operating income | | 31.0 | 24.8 |
| **Taxes other than income tax** | 16 | **(0.5)** | (1.0) |
| **GROSS OPERATING LOSS** | | **(6.9)** | (30.0) |
| Reversal of impairment losses on trade and other receivables | | 0.1 | - |
| Depreciation and amortisation charge, allowances and provisions | 17 | (4.5) | (1.5) |
| **OPERATING LOSS** | | **(11.3)** | (31.5) |
| Finance income | 18 | 1.1 | 3.2 |
| Finance costs | 19 | (1.3) | (3.5) |
| **LOSS BEFORE TAX** | | **(11.5)** | (31.8) |
| Income tax | 20 | 2.3 | 6.0 |
| **NET LOSS FOR THE YEAR** | | **(9.2)** | (25.8) |

Net loss for the current and prior year are wholly attributable to the equity holder of ScottishPower Energy Management Limited.

All results relate to continuing operations.

The accompanying Notes 1 to 25 are an integral part of the income statement for the year ended 31 December 2018.

## SCOTTISHPOWER ENERGY MANAGEMENT LIMITED
## STATEMENT OF COMPREHENSIVE INCOME
## for the year ended 31 December 2018

| | Note | 2018 £m | 2017 £m |
|---|---|---|---|
| **NET LOSS FOR THE YEAR** | | **(9.2)** | (25.8) |
| **OTHER COMPREHENSIVE INCOME** | | | |
| **Items that may be subsequently reclassified to the income statement:** | | | |
| Cash flow hedges: | | | |
| Change in the value of cash flow hedges | 9 | **12.8** | 29.2 |
| Tax relating to cash flow hedges | 9 | **(2.4)** | (5.5) |
| **OTHER COMPREHENSIVE INCOME FOR THE YEAR** | | **10.4** | 23.7 |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | | **1.2** | (2.1) |

Total comprehensive income for both years is wholly attributable to the equity holder of ScottishPower Energy Management Limited.

## STATEMENT OF CHANGES IN EQUITY
## for the year ended 31 December 2018

| | Ordinary share capital £m | Hedge reserve £m | Retained earnings £m | Total £m |
|---|---|---|---|---|
| At 1 January 2017 | 50.0 | 25.1 | 129.4 | 204.5 |
| Total comprehensive income for the year | - | 23.7 | (25.8) | (2.1) |
| At 1 January 2018 | 50.0 | 48.8 | 103.6 | 202.4 |
| Adjustments due to IFRS 9 (Refer to Note 1B1.2) | - | - | (0.7) | (0.7) |
| Adjusted balance at 1 January 2018 | 50.0 | 48.8 | 102.9 | 201.7 |
| Total comprehensive income for the year | - | 10.4 | (9.2) | 1.2 |
| Dividends | - | - | (20.0) | (20.0) |
| **At 31 December 2018** | **50.0** | **59.2** | **73.7** | **182.9** |

The accompanying Notes 1 to 25 are an integral part of the statement of comprehensive income and the statement of changes in equity for the year ended 31 December 2018.

# SCOTTISHPOWER ENERGY MANAGEMENT LIMITED
# CASH FLOW STATEMENT
# for the year ended 31 December 2018

| | 2018 £m | 2017 £m |
|---|---|---|
| **Cash flows from operating activities** | | |
| Loss before tax | **(11.5)** | (31.8) |
| Adjustments for: | | |
| Depreciation, amortisation and impairment | **4.4** | 1.4 |
| Change in provisions | **1.1** | 0.1 |
| Finance income and costs | **0.2** | 0.3 |
| Write-off of non-current assets | **0.1** | 0.1 |
| Net fair value (losses)/gains on operating derivatives | **(6.6)** | 23.9 |
| Changes in working capital: | | |
| Change in trade and other receivables | **37.7** | (29.0) |
| Change in inventories | **6.0** | (1.8) |
| Change in trade payables | **(51.3)** | (4.9) |
| Provisions paid | **(0.2)** | - |
| Income taxes received | **2.1** | 2.3 |
| Interest received | **0.1** | 0.1 |
| **Net cash flows from operating activities (i)** | **(17.9)** | **(39.3)** |
| **Cash flows from investing activities** | | |
| Net transfers from Iberdrola group companies | **(24.3)** | - |
| Investments in intangible assets | **(1.5)** | (0.6) |
| **Net cash flows from investing activities (ii)** | **(25.8)** | **(0.6)** |
| **Cash flows from financing activities** | | |
| Increase in amounts due to Iberdrola group companies - current loans payable | **64.1** | 40.5 |
| Dividends paid to company's equity holder | **(20.0)** | - |
| Interest paid | **(0.4)** | (0.6) |
| **Net cash flows from financing activities (iii)** | **43.7** | 39.9 |
| **Net increase in cash and cash equivalents (i)+(ii)+(iii)** | **-** | - |
| **Cash and cash equivalents at beginning of year** | **-** | - |
| **Cash and cash equivalents at end of year** | **-** | - |

The accompanying Notes 1 to 25 are an integral part of the cash flow statement for the year ended 31 December 2018.

## 1 BASIS OF PREPARATION

### A COMPANY INFORMATION

ScottishPower Energy Management Limited ("the company"), registered company number SC215843, is a private company limited by shares, incorporated in Scotland and its registered address is 320 St. Vincent Street, Glasgow, Scotland, G2 5AD.

### B BASIS OF PREPARATION OF THE ACCOUNTS

The company is required by law to prepare Accounts and to deliver them to the Registrar of Companies. The Accounts have been prepared in accordance with International Financial Reporting Standards as adopted by the EU as at the date of approval of these Accounts and which are mandatory for the financial year ended 31 December 2018 (IFRS as adopted by the EU). The Accounts are prepared in accordance with the Accounting Policies set out in Note 2. Monetary amounts are presented in pounds Sterling and are rounded to the nearest hundred thousand unless otherwise indicated.

### B1. EFFECT OF INITIAL APPLICATION OF IFRS 15 AND IFRS 9

This is the first set of the company's annual financial statements in which IFRS 15 'Revenue from Contracts with Customers' and IFRS 9 'Financial Instruments' have been applied. The nature and effect of the changes as a result of the implementation of these standards is described below.

### B1.1 EFFECT OF INITIAL APPLICATION OF IFRS 15

The company has applied IFRS 15 for the first time using the cumulative effect method i.e. by recognising the cumulative effect of initially applying IFRS 15 as an adjustment to the opening balance of equity at 1 January 2018. Therefore, the comparative information has not been restated and continues to be reported under IAS 18 'Revenue' and the IFRS 15 disclosure requirements have not been applied to comparative information.

The application of IFRS 15 has not had a significant impact on the company's revenue recognition and therefore there is nothing to disclose in relation to the impact on the opening balances at 1 January 2018, the balances at and the results for the year ended 31 December 2018.

### B1.2 EFFECT OF INITIAL APPLICATION OF IFRS 9

IFRS 9 'Financial Instruments' replaces IAS 39 'Financial Instruments: Recognition and Measurement' for annual periods beginning on or after 1 January 2018, bringing together all three aspects of the accounting for financial instruments: classification and measurement; impairment; and hedge accounting.

With the exception of hedge accounting, which the company applied prospectively, the company has applied IFRS 9 retrospectively, with the initial application date of 1 January 2018. In line with consequential amendments to IFRS 7 'Financial Instruments: Disclosures', the company has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the company's previous accounting policy under IAS 39.

The table below illustrates the impact of the initial application of IFRS 9 on the opening balances at 1 January 2018.

| | Adjustments due to IFRS 9 £m |
|---|---|
| **Retained earnings** | |
| Recognition of Expected Credit Losses ("ECLs") under IFRS 9 | (0.9) |
| Related tax | 0.2 |
| **Impact at 1 January 2018** | **(0.7)** |

**1 BASIS OF PREPARATION *continued***
**B BASIS OF PREPARATION OF THE ACCOUNTS *continued***
**B1. EFFECT OF INITIAL APPLICATION OF IFRS 15 AND IFRS 9 *continued***
**B1.2 EFFECT OF INITIAL APPLICATION OF IFRS 9 *continued***
**(a) Classification and measurement of financial assets and financial liabilities**

IFRS 9 contains three principal classification categories for financial assets: measured at amortised cost, fair value through other comprehensive income ("FVOCI") and fair value through profit or loss ("FVTPL"). The classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. IFRS 9 eliminates the previous IAS 39 categories of held to maturity, loans and receivables and available for sale. IFRS 9 largely retains the existing requirements in IAS 39 for the classification and measurement of financial liabilities. As stated above, with the exception of hedge accounting, the company has applied the classification and measurement requirements retrospectively, with initial application on 1 January 2018, thus the figures for comparative periods have not been restated.

**Financial assets**

The company has classified its financial assets, excluding derivatives, as being held at amortised cost. A description of the amortised cost category of financial assets can be found in Note 2G1.1.

The following table and the accompanying notes explain the original measurement categories under IAS 39 and the new measurement categories under IFRS 9 for each class of the company's financial assets at 1 January 2018. The effect of adopting IFRS 9 on the carrying amounts of financial assets at 1 January 2018 relates solely to the new impairment requirements.

| Financial asset | Original classification under IAS 39 | New classification under IFRS 9 | Notes | Original carrying value under IAS 39 £m | New carrying value under IFRS 9 £m |
|---|---|---|---|---|---|
| Derivative financial instruments | Fair value-hedging instrument | Fair value-hedging instrument | (i) | 119.2 | 119.2 |
| Current receivables | Loans and receivables | Amortised cost | (ii), (iii) | 559.9 | 559.0 |
| Non-current receivables | Loans and receivables | Amortised cost | (ii) | 39.1 | 39.1 |
| **Total financial assets** | | | | **718.2** | **717.3** |

(i) Derivative financial instruments continue to be held at fair value. Within derivative financial instruments there are hedging derivatives with a fair value of £66.6 million and non-hedging derivatives with a fair value of £300.0 million. These balances are offset by a netting adjustment of £247.4 million.

(ii) Current and non-current receivables comprise trade receivables (including accrued income) and trade receivables due from Iberdrola group companies (refer to Notes 5(a) and 6). Balances that were classified as Loans and receivables under IAS 39 are now classified as Amortised cost.

(iii) An increase of £0.9 million in the allowance for impairment over these balances was recognised in the opening retained earnings at 1 January 2018 on transition to IFRS 9 (refer to footnote 1B1.2(b)).

Refer to Note 5 for details of the company's financial assets in the current year. The classification and measurement requirements of IFRS 9 did not have a significant impact on the company. Most financial assets continue to be valued at amortised cost and derivative financial instruments continue to be valued at fair value as was the case under the previously applied IAS 39.

**Financial liabilities**

The classification of the company's financial liabilities has not undergone any changes with respect to the application of IFRS 9. Consequently the application of IFRS 9 has not had a significant effect on the company's accounting policies related to financial liabilities and derivative financial instruments (for derivatives that are used as hedging instruments refer to 1B1.2(c) overleaf)). For an explanation of how the company classifies and measures financial liabilities and accounts for related gains and losses under IFRS 9, refer to Note 2G1.2.

**(b) Impairment of financial assets**

The application of IFRS 9 has changed the company's accounting for impairment losses for financial assets by replacing IAS 39's incurred loss approach with a new ECL approach. This new impairment model applies to financial assets measured at amortised cost. Under IFRS 9, credit losses are recognised earlier than under IAS 39 (refer to Note 2G1.1).

**1 BASIS OF PREPARATION *continued***

**B BASIS OF PREPARATION OF THE ACCOUNTS *continued***

**B1. EFFECT OF INITIAL APPLICATION OF IFRS 15 AND IFRS 9 *continued***

**B1.2 EFFECT OF INITIAL APPLICATION OF IFRS 9 *continued***

**(b) Impairment of financial assets *continued***

The company applies the simplified approach for calculation of ECLs. The loss allowance is measured at an amount equal to a lifetime ECL. The company has adopted the practical expedient whereby it calculates the ECL on trade receivables using a provision matrix based on its historical credit loss experience and where possible readily available forecast information.

Additional information about how the company measures the allowance for impairment is described in Note 5. The company has adopted the impairment requirements retrospectively, with initial application on 1 January 2018, thus opting not to restate the figures for comparative periods.

The company has determined that the application of IFRS 9's impairment requirements at 1 January 2018 results in an additional allowance for impairment as follows:

| | £m |
|---|---|
| **Loss allowance at 31 December 2017 under IAS 39 (trade and other receivables)** | - |
| Additional impairment recognised at 1 January 2018 on current trade receivables as at 31 December 2017 | 0.9 |
| **Loss allowance at 1 January 2018 under IFRS 9** | **0.9** |

**(c) Hedge accounting**

The company has elected to apply the new general hedge accounting model in IFRS 9. This requires the company to ensure that hedge accounting relationships are aligned with its risk management objectives and strategy and to apply a more qualitative and forward-looking approach to assessing hedge effectiveness.

The company uses forward contracts to hedge the variability in cash flows arising from changes in foreign exchange rates and commodity prices. There has been no change to the accounting treatment of forward contracts used to hedge commodity purchases. At the date of initial application, all of the company's existing hedging relationships were eligible to be treated as continuing hedging relationships. For an explanation of how the company applies hedge accounting under IFRS 9, refer to Note 2G1.3.

**C ACCOUNTING STANDARDS**

**C1. IMPACT OF NEW IFRS**

In preparing these Accounts, the company has applied all relevant International Accounting Standards ("IAS"), International Financial Reporting Standards ("IFRSs") and International Financial Reporting Interpretations Committee ("IFRIC") (collectively referred to as IFRS) that have been adopted by the EU as of the date of approval of these Accounts and that are mandatory for the financial year ended 31 December 2018.

For the year ended 31 December 2018, the company has applied the following amendments for the first time:

| **Standard** | **Notes** |
|---|---|
| • Annual Improvements to IFRS Standards 2014 –2016 Cycle | (a), (b) |
| • IFRS 15 'Revenue from Contracts with Customers' (including 'Amendments to IFRS 15: Effective date of IFRS 15' and 'Clarifications to IFRS 15 Revenue from Contracts with Customers') | (c) |
| • IFRS 9 'Financial Instruments' | (d) |
| • Amendments to IAS 40 'Investment Property: Transfers of Investment Property' | (a) |
| • Amendments to IFRS 2 'Share-based Payments: Clarification and Measurement of Share-based Payment Transactions' | (a) |
| • Amendments to IFRS 4 'Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts' | (a) |
| • IFRIC 22 'Foreign Currency Transactions and Advance Consideration' | (a) |

(a) The application of these pronouncements has not had a material impact on the company's accounting policies, financial position or performance.

(b) This pronouncement includes amendments to three standards. The amendments to IFRS 1 'First-time Adoption of International Financial Reporting Standards' and IAS 28 'Investments in Associates and Joint Ventures' have been applied by the company effective 1 January 2018. The amendments to IFRS 12 'Disclosure of Interests in Other Entities' were applied by the company effective 1 January 2017.

(c) Refer to Note 1B1.1 for further information.

(d) Refer to Note 1B1.2 for further information.

**1 BASIS OF PREPARATION *continued***
**C ACCOUNTING STANDARDS *continued***
**C1. IMPACT OF NEW IFRS *continued***

The following new standards and amendments to standards have been issued by the International Accounting Standards Board ("IASB") but have an effective date after the date of these financial statements or have not been endorsed by the EU, thus have not been implemented by the company:

| Standard | Notes | IASB effective date (for periods commencing on or after) | Planned date of application by the company |
|---|---|---|---|
| • IFRS 16 'Leases' | (e) | 1 January 2019 | 1 January 2019 |
| • IFRIC 23 'Uncertainty over Income Tax Treatments' | (f) | 1 January 2019 | 1 January 2019 |
| • Amendments to IFRS 9 'Financial Instruments: Prepayment Features with Negative Compensation' | (f) | 1 January 2019 | 1 January 2019 |
| • Amendments to IAS 28 'Investments in Associates and Joint Ventures: Long-term Interests in Associates and Joint Ventures' | (f) | 1 January 2019 | 1 January 2019 |
| • Annual Improvements to IFRS Standards 2015-2017 Cycle | (f) | 1 January 2019 | 1 January 2019 |
| • Amendments to IAS 19 'Employee Benefits: Plan Amendment, Curtailment or Settlement' | (f) | 1 January 2019 | 1 January 2019 |
| • Amendments to References to the Conceptual Framework in IFRS Standards | (f), (g) | 1 January 2020 | 1 January 2020 |
| • Amendments to IFRS 3 'Business Combinations' | (f), (g) | 1 January 2020 | 1 January 2020 |
| • Amendments to IAS 1 'Presentation of Financial Statements' and IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors': 'Definition of Material' | (f), (g) | 1 January 2020 | 1 January 2020 |
| • IFRS 17 'Insurance Contracts' | (f), (g) | 1 January 2021 | 1 January 2021 |
| • IFRS 14 'Regulatory Deferral Accounts' | (f), (g), (h) | 1 January 2016 | To be decided |
| • Amendments to IFRS 10 'Consolidated Financial Statements' and IAS 28 'Investments in Associates and Joint Ventures': 'Sale or Contribution of Assets between an Investor and its Associate or Joint Venture' | (f), (g), (i) | Deferred indefinitely | To be decided |

(e) Details of the impact of implementing IFRS 16 'Leases' is described at Note 1C2 overleaf.
(f) The future application of this pronouncement is not expected to have a material impact on the company's accounting policies, financial position or performance.
(g) This pronouncement has not yet been endorsed by the EU.
(h) The endorsement process of this interim standard has not been launched as the EU has decided to wait for the final standard to be issued.
(i) The IASB set the effective date of this pronouncement as for periods commencing on or after 1 January 2016. However, in December 2015, the IASB postponed the effective date indefinitely pending the outcome of its research project on the equity method of accounting. The EU endorsement process for this pronouncement has been postponed, awaiting a revised exposure draft from the IASB. The effective date will be amended in due course.

**C2. IMPACT OF FUTURE IMPLEMENTATION OF IFRS 16**

IFRS 16 'Leases' is effective for the company as from 1 January 2019. The impact of implementing this standard is detailed below. The impact of this standard will have no effect on the recorded cash flows.

From the lessors' perspective, IFRS 16 does not introduce any significant change. From the lessees' perspective, IFRS 16 removes the current classification of operating and finance leases and requires, for any lease agreements, that the lessee recognises the present value of the lease on the balance sheet as a right-of-use asset and a liability.

The company will transition to IFRS 16 applying the modified retrospective method which does not require comparative periods to be restated but recognises the effect of the initial application of IFRS 16 on the date it is implemented i.e. 1 January 2019. Therefore, for lease agreements in which the company is the lessee, the lease liability will be measured at the present value of the remaining lease payments, applying an appropriate discount rate as at the date of initial application. Generally, right-of-use assets will be measured as the same amount as the corresponding liabilities; both these assets and liabilities will be recognised on the balance sheet.

**1 BASIS OF PREPARATION *continued***

**C ACCOUNTING STANDARDS *continued***

**C2. IMPACT OF FUTURE IMPLEMENTATION OF IFRS 16 *continued***

The right-of-use assets will be depreciated and the charge recorded within Depreciation and amortisation charge, allowances and provisions in the income statement; similarly the discount on the liabilities will unwind over the term of the lease and charged to Finance costs in the income statement. The expense in the year relating to minimum lease payments under operating leases will no longer be recognised in the income statement; a charge of less than £0.1 million as recognised in 2018 (refer to Note 4b(i)).

Based on the scope exemptions available under IFRS 16, in line with the Iberdrola group, the company has opted not to apply it to lease agreements for intangible assets and short-term leases i.e. leases with a term of twelve months or less (which will continue being accounted for as now under IAS 17 'Leases').

A contract may include multiple lease components, not all of which would qualify as a lease under IFRS 16. In line with the Iberdrola group, the company has opted to not separate multiple components for accounting purposes but will recognise them as a single component, except for certain agreements for which the separation may have a significant impact on the financial statements.

As at 1 January 2019, IFRS 16 will give rise to an increase in current and non-current liabilities totalling an estimated £0.7 million relating to land leases. This liability is presented on a discounted net present value basis. As at the date of initial application, the range of discount rates used to calculate the above pertaining to Sterling were in the range of between 2.62% and 4.59%.

In comparing the future minimum lease payments under non-cancellable operating leases under the scope of IAS 17 as at 31 December 2018 (refer to Note 4) to the lease liabilities to be recognised as at 1 January 2019 under IFRS 16 (see above), the reconciling item is the application of different discount rate assumptions.

The company will continue to refine its accounting policies and monitor emerging industry practice in relation to this standard.

**2 JUDGEMENTS, ESTIMATION UNCERTAINITIES AND ACCOUNTING POLICIES**

In determining and applying accounting policies, judgement is often required in respect of items where the choice of specific policy to be followed could materially affect the reported amounts of revenues, expenses, assets and liabilities of the company, should it later be determined that a different choice would be more appropriate. The company has no such policies. At 31 December 2018, there are no items which have significant risk of resulting in a material adjustment to the carrying amount of assets and liabilities in the next financial year.

The principal accounting policies applied in preparing the company's Accounts are set out below:

A REVENUE
B PROCUREMENTS
C INTANGIBLE ASSETS
D PROPERTY, PLANT AND EQUIPMENT
E IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS
F LEASED ASSETS
G FINANCIAL INSTRUMENTS
H INVENTORIES (EXCLUDING EMISSIONS ALLOWANCES)
I EMISSIONS ALLOWANCES
J FOREIGN CURRENCIES
K TAXATION
L RETIREMENT BENEFITS

**A REVENUE**

The company has applied IFRS 15 for the first time from 1 January 2018. Information about the company's accounting policies and estimates in relation to contracts with customers is provided in Note 14. The effect of the initial application of IFRS 15 is disclosed in Note 1B1.1.

**B PROCURMENTS**

Procurements comprises the value of units of wholesale energy purchased from the external market on behalf of Iberdrola group companies during the year and excludes Value Added Tax. The company also purchases wholesale energy during certain market windows in which the company is required to stand ready to buy under industry regulations.

**C INTANGIBLE ASSETS**

The costs of acquired computer software are capitalised on the basis of the costs incurred to acquire and bring to use the specific software and are amortised on a straight-line basis over their operational lives. Costs directly associated with the development of computer software programmes that are expected to generate economic benefits over a period in excess of one year are capitalised and amortised, on a straight-line basis, over their estimated operational lives. Costs include employee costs relating to software development and an appropriate proportion of relevant overheads directly attributable to bringing the software into use. Amortisation of computer software costs is over periods of up to seven years.

Licences are stated at cost and are depreciated on a straight-line basis over the estimated useful life of 50 years.

**D PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment is stated at cost and is generally depreciated on a straight-line basis over the estimated operational lives of the assets. Property, plant and equipment includes where appropriate capitalised employee costs, interest and other directly attributable costs. Borrowing costs directly attributable to the acquisition, construction or production of major qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. Reviews of the estimated remaining lives and residual values of property, plant and equipment are undertaken annually. Residual values are assessed based on prices prevailing at each balance sheet date.

**2 JUDGEMENTS, ESTIMATION UNCERTAINITIES AND ACCOUNTING POLICIES *continued***
**D PROPERTY, PLANT AND EQUIPMENT *continued***
Land is not depreciated. The main depreciation periods used by the company are as set out below:

| | Years |
|---|---|
| Gas storage facilities | 35 |
| Other items of property, plant and equipment | 4 |

**E IMPAIRMENT OF PROPERTY, PLANT AND EQUIPMENT AND INTANGIBLE ASSETS**
At each balance sheet date, the company reviews the carrying amount of its property, plant and equipment and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the company estimates the recoverable amount of the cash generating unit to which the asset belongs.

**F LEASED ASSETS**
The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date; whether fulfilment of the arrangement is dependent on the use of a specific asset(s) or the arrangement conveys a right to use the asset(s), even if that right is not explicitly specified in the arrangement. For arrangements entered into prior to 1 April 2004, the date of inception is deemed to be 1 April 2004 in accordance with the transitional requirements of IFRIC 4 'Determining Whether an Arrangement Contains a Lease'.

The company classifies leases as finance leases whenever the lessor transfers substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the period of the lease.

**G FINANCIAL INSTRUMENTS**
A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

**G1 ACCOUNTING POLICIES UNDER IFRS 9**
**G1.1 FINANCIAL ASSETS**
**(a) Recognition and initial measurement**
Financial assets excluding derivative financial assets are classified, at initial recognition, as subsequently measured at amortised cost.

Trade receivables without a significant financing component and for which the company has applied the simplified ECL model are measured at the transaction price determined under IFRS 15 (refer to Note 14).

**(b) Classification and subsequent measurement**
*(i) Classification*
Financial assets are not reclassified subsequent to their initial recognition unless the company changes its business model for managing financial assets in which case all affected financial assets are reclassified on the first day of the first reporting period following the change in the business model. These are expected to be infrequent and no other reclassifications are permitted.

The company's business model for managing financial assets refers to how it manages its financial assets in order to generate cash flows. The business model determines whether cash flows will result from collecting contractual cash flows, selling the financial assets, or both. The business model of the company does not depend on the intentions of management for an individual instrument. Therefore, it is not an instrument-by-instrument classification approach and should be determined from a higher level of aggregation.

**2 JUDGEMENTS, ESTIMATION UNCERTAINITIES AND ACCOUNTING POLICIES *continued***
**G FINANCIAL INSTRUMENTS *continued***
**G1 ACCOUNTING POLICIES UNDER IFRS 9 *continued***
**G1.1 FINANCIAL ASSETS *continued***
**(b) Classification and subsequent measurement *continued***
A financial asset is measured at amortised cost if it meets both of the following conditions:

- it is held within a business model whose objective is to hold assets to collect contractual cash flows; and
- its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. This assessment is referred to as the 'SPPI' test.

*(ii) Subsequent measurement and gains and losses*
Financial assets at amortised cost are subsequently measured at amortised cost using the effective interest method. The amortised cost is reduced by impairment losses. Interest income, foreign exchange gains and losses and impairment losses are recognised in the income statement. Any gain or loss on derecognition is recognised in the company income statement.

The company's financial assets measured at amortised cost include trade receivables and trade receivables due from Iberdrola group companies.

*Derecognition*
A financial asset (or, where applicable, a part of a financial asset) is primarily derecognised (i.e. removed from the company's balance sheet) when the rights to receive cash flows from the asset have expired.

*(iii) Impairment of financial assets*
Disclosures relating to impairment of financial assets are provided in Note 5. The company has adopted the simplified ECL model for its trade receivables measured at amortised cost.

In applying the simplified model, loss allowances for trade receivables are always measured at an amount equal to lifetime ECL. For each grouping the company has established a provision matrix that is based on its historical credit loss experience, adjusted for, where possible, forward-looking factors specific to the debtors and the economic environment.

The company considers a financial asset to be in default when:

- internal or external information indicates that the company is unlikely to receive the outstanding contractual amounts in full before taking into account any credit enhancements held by the company; or
- the financial asset is more than 90 days past due.

*Measurement of ECLs*
ECLs are a probability-weighted estimate of credit losses. Lifetime ECLs are the ECLs that result from all possible default events over the expected life of a financial instrument. The maximum period considered when estimating ECLs is the maximum contractual period over which the company is exposed to credit risk.

Credit losses are measured as the present value of all cash shortfalls (i.e. the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the company expects to receive). ECLs are discounted at the effective interest rate of the financial asset.

*Credit-impaired financial assets*
At each reporting date, the company assesses whether financial assets carried at amortised cost are credit-impaired. A financial asset is 'credit-impaired' when one or more events that have a detrimental impact on the estimated future cash flows of the financial asset have occurred.

*Write-offs*
The gross carrying amount of a financial asset is written off (either partially or in full) to the extent that there is no realistic prospect of recovery.

**2 JUDGEMENTS, ESTIMATION UNCERTAINITIES AND ACCOUNTING POLICIES *continued***
**G FINANCIAL INSTRUMENTS *continued***
**G1 ACCOUNTING POLICIES UNDER IFRS 9 *continued***
**G1.2 FINANCIAL LIABILITIES**
**(a) Recognition and initial measurement**
The company's financial liabilities include trade and other payables, loans and borrowings, and derivative financial instruments. All financial liabilities are recognised initially at fair value and, in the case of loans and borrowings and payables, net of directly attributable transaction costs.

**(b) Classification and subsequent measurement**
Financial liabilities excluding derivative financial instruments are classified as measured at amortised cost.

Financial liabilities are subsequently measured at amortised cost using the effective interest method. Interest expense and foreign exchange gains and losses are recognised in the income statement. The reference to foreign exchange gains can be removed if the company does not have derivatives. Any gain or loss on derecognition is also recognised in the income statement.

Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the effective interest rate. The effective interest method is included as Finance costs in the income statement.

The company derecognises a financial liability when the obligation under the liability is discharged or cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in the income statement.

**G1.3 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING**
**(a) Derivative financial instruments**
The company uses derivative financial instruments, such as forward foreign currency contracts and forward commodity contracts, to hedge its foreign currency risks and commodity price risks respectively. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative.

The gain or loss on remeasurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

At the inception of a hedge relationship, the company formally designates and documents the hedge relationship to which it wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge.

Under IFRS 9 the hedge documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the company will assess whether the hedging relationship meets the hedge effectiveness requirements (including the analysis of sources of hedge ineffectiveness and how the hedge ratio is determined). A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- There is 'an economic relationship' between the hedged item and the hedging instrument.
- The effect of credit risk does not 'dominate the value changes' that result from that economic relationship.
- The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the company actually hedges and the quantity of the hedging instrument that the company actually uses to hedge that quantity of hedged item.

Hedge accounting is applied when certain conditions required by IFRS 9 are met. The accounting for cash flow hedges is discussed at (b) below.

**2 JUDGEMENTS, ESTIMATION UNCERTAINITIES AND ACCOUNTING POLICIES *continued***
**G FINANCIAL INSTRUMENTS *continued***
**G1 ACCOUNTING POLICIES UNDER IFRS 9 *continued***
**G1.3 DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING *continued***
**(b) Cash flow hedges**
For all forward contracts the company designates all of the forward contract (spot and forward element) as the hedging instrument.

The portion of gain or loss of the hedging instrument that was determined to be an effective hedge is recognised directly in equity and forms part of the hedge reserve. The ineffective portion of the change in fair value of the hedging instruments is recognised in the income statement within Procurements for hedges of underlying operations.

The company discontinues hedge accounting when the hedge instrument expires or is sold, terminated or exercised, when the hedge relationship no longer qualifies for hedge accounting or when the designation is revoked. In the case of cash flow hedging, any gain or loss that has been recognised in equity until that time remains separately recognised in equity until the forecast transaction occurs. If the transaction is no longer expected to occur, related cumulative gains and losses which have been previously deferred in equity are recognised in the income statement.

**(c) Valuation of financial instruments**
In those circumstances where IFRS 9 requires financial instruments to be recognised in the balance sheet at fair value, the company's valuation strategies for derivatives and other financial instruments utilise as far as possible quoted prices in an active trading market.

In the absence of quoted prices for identical or similar assets or liabilities, it is sometimes necessary to apply valuation techniques where contracts are marked using approved models. Models are used for developing both the forward curves and the valuation metrics of the instruments themselves where the instruments are complex combinations of standard or non-standard products. All models are subject to rigorous testing prior to being approved for valuation, and subsequent continuous testing and approval procedures are designed to ensure the validity and accuracy of the model assumptions and inputs.

All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, the details of which are described in Note 5.

**(d) Offsetting of financial assets and financial liabilities**
The company offsets a financial asset and a financial liability and reports the net amount only when the company has a legally enforceable right to set off the amounts and intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

**G2. ACCOUNTING POLICIES UNDER IAS 39**
As detailed in Note 1B1.2 on initial application of IFRS 9 the company has elected not to restate comparative information. The accounting policies for the company under IAS 39 have therefore been presented below.

(a) Financial assets categorised as trade and other receivables are recognised and carried at original invoice amount less a provision for impairment of doubtful debts. Allowance for doubtful debts has been estimated by management, taking into account future cash flows, based on past experience and assessment of the current economic environment within which the company operates.
(b) Financial liabilities categorised as trade and other payables are recognised and carried at original invoice amount.
(c) All interest bearing loans and borrowings are initially recognised at fair value, net of directly attributable transaction costs. Interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method, except where the loan or borrowing is a hedged item in an effective fair value hedging relationship.
(d) The company enters into sale and purchase transactions for gas and electricity in the normal course of its energy business. Most of these contracts are entered into for the purposes of the company's expected business requirements. These contracts are outside the scope of IAS 39 and are accounted for on an accruals basis.

**2 JUDGEMENTS, ESTIMATION UNCERTAINITIES AND ACCOUNTING POLICIES *continued***

**G. FINANCIAL INSTRUMENTS *continued***

**G2 ACCOUNTING POLICIES UNDER IAS 39 *continued***

Certain physical commodity purchase and sale contracts are within the scope of IAS 39 because they are net settled or are capable of net settlement. All such contracts are classified as derivative financial instruments in accordance with IAS 39. The company also enters into treasury-related derivatives to manage its financial risk. The company's policies and management with respect to risks are discussed in the Strategic Report.

IAS 39 requires all derivatives to be recognised on the balance sheet at fair value. Embedded derivatives in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value through the income statement.

Unrealised gains or losses on remeasurement of derivatives and embedded derivatives are reported in the income statement except when hedge accounting is applied. Fair value gains and losses on derivatives used in ScottishPower's energy management activities are recognised in the income statement within Procurements and fair value gains and losses on derivatives used in ScottishPower's treasury activities are recognised in the income statement as Finance income or Finance costs as appropriate.

**G2.1 HEDGE ACCOUNTING**

Hedge accounting is applied when certain conditions required by IAS 39 are met. The categories of hedge accounting are consistent with those of IFRS 9.

**G2.2 CASH FLOW HEDGES**

Accounting for cash flow hedges is consistent under IFRS 9 treatment.

**G2.3 DISCONTINUING HEDGE ACCOUNTING**

Both the circumstances that cause hedge accounting to be discontinued and the accounting treatment of such hedges are consistent with IFRS 9.

**G2.4 VALUATION OF FINANCIAL INSTRUMENTS HELD AT FAIR VALUE**

Valuation of financial instruments held at fair value is consistent with IFRS 9.

**G3 OFFSETTING OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES**

This is consistent with the policy under IFRS 9.

**H INVENTORIES (EXCLUDING EMISSIONS ALLOWANCES)**

Inventories are valued at the lower of cost and net realisable value. Costs include all directly attributable costs incurred in bringing the inventories to their present location and condition.

**I EMISSIONS ALLOWANCES**

Energy Wholesale participates in the EU Emissions Trading Scheme. The company purchases emissions allowances and then transfers them to other companies within the Energy Wholesale business function. As there are no specific rules under IFRS dealing with the treatment of emissions allowances, the company, in alignment with group accounting policy, classifies purchased emissions allowances as inventories as they are consumed in the production process within the Energy Wholesale business function. Such allowances are recognised at their acquisition cost.

**J FOREIGN CURRENCIES**

Transactions in foreign currencies are translated at the spot rate at the date of the transaction. At the year end, monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange ruling at the balance sheet date, with exchange gains and losses recognised in the income statement.

**K TAXATION**

The company's assets for current tax are calculated using the tax rates that have been enacted or substantively enacted at the balance sheet date.

**2 JUDGEMENTS, ESTIMATION UNCERTAINITIES AND ACCOUNTING POLICIES *continued***

**K TAXATION *continued***

Deferred tax is the tax expected to be payable or recoverable on the difference between the carrying amounts of assets and liabilities in the balance sheet and the corresponding tax bases used in the computation of taxable profits (temporary differences), and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profit will be available against which deductible temporary differences, unused tax losses or credits can be utilised.

Deferred tax is calculated on a non-discounted basis at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised based on tax rates and laws enacted or substantively enacted at the balance sheet date. Deferred tax is charged to the income statement, except where it relates to items charged or credited to equity (via the statement of comprehensive income), in which case the deferred tax is also dealt with in equity and is shown in the statement of comprehensive income.

**L RETIREMENT BENEFITS**

ScottishPower operates two defined benefit schemes and one defined contribution retirement benefit scheme in the UK. ScottishPower Energy Management Limited is a participating company in these group arrangements, and the contributions for the defined benefit schemes are based on pension costs across all the participating companies. The company is unable to identify its share of the underlying assets and liabilities in the defined benefit schemes, as the scheme administrators do not calculate these separately for each of the various companies participating in the schemes and therefore treats these schemes as if they were defined contribution schemes. The amount charged to the income statement in respect of pension costs is the contributions payable in the period.

**3 INTANGIBLE ASSETS**

| Year ended 31 December 2017 | Computer software (Note (i)) £m |
|---|---|
| Cost: | |
| At 1 January 2017 | 16.0 |
| *Additions* | 0.6 |
| Disposals | (4.1) |
| At 31 December 2017 | 12.5 |
| Amortisation: | |
| At 1 January 2017 | 14.4 |
| Amortisation for the year | 0.8 |
| Disposals | (4.1) |
| At 31 December 2017 | 11.1 |
| Net book value: | |
| At 31 December 2017 | 1.4 |
| At 1 January 2017 | 1.6 |

## 3 INTANGIBLE ASSETS *continued*

| Year ended 31 December 2018 | Computer software (Note (i)) £m | Licences (Note (ii)) £m | Total £m |
|---|---|---|---|
| **Cost:** | | | |
| At 1 January 2018 | 12.5 | - | 12.5 |
| Additions | 1.5 | - | 1.5 |
| Transfers from Iberdrola group companies | - | 9.5 | 9.5 |
| Disposals | (2.9) | - | (2.9) |
| **At 31 December 2018** | **11.1** | **9.5** | **20.6** |
| **Amortisation:** | | | |
| At 1 January 2018 | 11.1 | - | 11.1 |
| Amortisation for the year | 0.8 | - | 0.8 |
| Transfers from Iberdrola group companies | - | 3.9 | 3.9 |
| Disposals | (2.8) | - | (2.8) |
| **At 31 December 2018** | **9.1** | **3.9** | **13.0** |
| **Net book value:** | | | |
| **At 31 December 2018** | **2.0** | **5.6** | **7.6** |
| At 1 January 2018 | 1.4 | - | 1.4 |

(i) The cost of fully amortised computer software still in use at 31 December 2018 was £6.9 million (2017 £9.5 million).
(ii) Licences with a gross cost of £9.5 million and amortisation of £3.9 million were transferred into the company from ScottishPower Generation Limited, a fellow Iberdrola group company.

## 4 PROPERTY, PLANT AND EQUIPMENT

### (a) Movements in property, plant and equipment

| Year ended 31 December 2017 | Gas storage facilities £m | Other items of property, plant and equipment in use (Note (i)) £m | Total £m |
|---|---|---|---|
| Cost: | | | |
| At 1 January 2017 | 23.8 | 1.1 | 24.9 |
| Disposals | (0.1) | (0.4) | (0.5) |
| At 31 December 2017 | 23.7 | 0.7 | 24.4 |
| Depreciation: | | | |
| At 1 January 2017 | 12.1 | 0.4 | 12.5 |
| Depreciation for the year | 0.6 | - | 0.6 |
| Disposals | - | (0.4) | (0.4) |
| At 31 December 2017 | 12.7 | - | 12.7 |
| Net book value: | | | |
| At 31 December 2017 | 11.0 | 0.7 | 11.7 |
| At 1 January 2017 | 11.7 | 0.7 | 12.4 |

## 4 PROPERTY, PLANT AND EQUIPMENT *continued*

### (a) Movements in property, plant and equipment *continued*

| Year ended 31 December 2018 | Gas storage facilities £m | Other items of property, plant and equipment in use (Note (i)) £m | Total £m |
|---|---|---|---|
| **Cost:** | | | |
| At 1 January 2018 | 23.7 | 0.7 | 24.4 |
| Transfers to Iberdrola group companies (Note (ii)) | (23.7) | (0.7) | (24.4) |
| Transfers from Iberdrola group companies (Note (iii) | 35.5 | 1.0 | 36.5 |
| **At 31 December 2018** | **35.5** | **1.0** | **36.5** |
| **Depreciation:** | | | |
| At 1 January 2018 | 12.7 | - | 12.7 |
| Depreciation for the year | 0.4 | - | 0.4 |
| Transfers to Iberdrola group companies (Note (ii)) | (13.0) | - | (13.0) |
| Transfers from Iberdrola group companies (Note (iii)) | 15.5 | - | 15.5 |
| Impairment (Note (iv)) | 3.2 | - | 3.2 |
| **At 31 December 2018** | **18.8** | - | **18.8** |
| **Net book value:** | | | |
| **At 31 December 2018** | **16.7** | **1.0** | **17.7** |
| At 1 January 2018 | 11.0 | 0.7 | 11.7 |

(i) The category 'Other items of property, plant and equipment in use' principally comprises computer equipment and land.
(ii) On 1 July 2018, the company transferred gas storage facilities to ScottishPower Generation Limited, a fellow Iberdrola group company. The assets were transferred at a gross cost of £24.4 million and accumulated depreciation of £13.0 million.
(iii) On 30 November 2018, ScottishPower Generation Limited, a fellow Iberdrola group company, transferred gas storage facilities (including cushion gas) and other items of property, plant and equipment to the company at a gross cost of £36.5 million and accumulated depreciation of £15.5 million.
(iv) The impairment charge of £3.2 million made during the year ended 31 December 2018 comprised write offs of gas storage assets.
(v) Included within the cost of property, plant and equipment at 31 December 2018 are assets in use not subject to depreciation, being land and cushion gas, of £7.0 million (2017 £1.3 million).

### (b) Operating lease arrangements

| (i) Operating lease payments | 2018 £m | 2017 £m |
|---|---|---|
| Minimum lease payments under operating leases recognised as an expense in the year | - | 0.1 |

The operating lease charge for the current year was £20,000.

The future minimum discounted lease payments under non-cancellable operating leases are as follows:

| (ii) Operating lease commitments | 2018 £m | 2017 £m |
|---|---|---|
| Within one year | **0.1** | 0.1 |
| Between one and five years | **0.2** | 0.3 |
| More than five years | **0.5** | 0.8 |
| | **0.8** | 1.2 |

The company leases various property, plant and equipment under non-cancellable operating lease agreements. The leases have varying terms, escalation clauses and renewal rights.

## 5 FINANCIAL INSTRUMENTS

The effect of initially applying IFRS 9 on the company's Accounts is detailed in Note 1B1.2. Due to the transition method chosen, comparative information has not been presented to reflect the new requirements.

### (a) Carrying value of financial instruments

The table below sets out the carrying amount and fair value of the company's financial instruments that are within the scope of IFRS 9.

| | | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|---|
| | Notes | Carrying amount £m | Fair value £m | Classification under IFRS 9 | Carrying amount £m | Fair value £m | Classification under IAS 39 |
| **Financial assets** | | | | | | | |
| Derivative financial instruments | (i) | **177.4** | **177.4** | **Fair value hedging instrument** | 119.2 | 119.2 | Fair value hedging instrument |
| Receivables | (ii) | **563.3** | **563.3** | **Amortised cost** | 599.0 | 599.0 | Loans and Receivables |
| **Financial liabilities** | | | | | | | |
| Derivative financial instruments | (i) | **(103.0)** | **(103.0)** | **Fair value hedging instrument** | (64.1) | (64.1) | Fair value hedging instrument |
| Loans and other borrowings | (iii) | **(108.7)** | **(108.7)** | **Amortised cost** | (44.6) | (44.6) | Loans and Receivables |
| Payables | (ii) | **(379.6)** | **(379.6)** | **Amortised cost** | (431.0) | (431.0) | Loans and Receivables |

*The carrying amount of these financial instruments is calculated as set out in Note 2G. The carrying value of financial* instruments is a reasonable approximation of fair value.

(i) Further detail on derivative financial instruments is disclosed in Note 5(c).
(ii) Balances outwith the scope of IFRS 7 and IFRS 9 have been excluded, namely prepayments, other tax receivables and other taxes and social security.
(iii) The fair value of loans and borrowings is calculated using a discounted cash flow.

### (b) *Measurement of financial instruments*

The company holds certain financial instruments which are measured in the balance sheet at fair value as detailed in Note 5(a) above. The company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: Quoted (unadjusted) prices in active markets for identical assets or liabilities.
Level 2: Other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.
Level 3: Techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

In both the current and prior year all derivatives held by the company are Level 2. Included in Level 2 liabilities of £103.0 million (2017 £64.1 million) are inseparable third-party credit enhancements. These have been reflected in the fair value measurement of the liability.

Level 2 commodity derivatives are fair valued by comparing and discounting the difference between the expected contractual cash flows for the relevant commodities and the quoted prices for those commodities in an active market. Level 2 foreign exchange derivatives comprise forward foreign exchange contracts. Forward foreign exchange contracts are fair valued using forward exchange rates that are quoted in an active market.

The company recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change occurred. There were no transfers in the current or prior year.

## 5 FINANCIAL INSTRUMENTS *continued*

### (c) Analysis of derivative financial instruments – carrying value

| | 2018 | | | | 2017 | | | |
|---|---|---|---|---|---|---|---|---|
| | Assets | | Liabilities | | Assets | | Liabilities | |
| | Current £m | Non-current £m | Current £m | Non-current £m | Current £m | Non-current £m | Current £m | Non-current £m |
| **Hedging derivatives** | | | | | | | | |
| Commodity derivatives | 112.4 | 37.3 | (68.3) | (8.6) | 46.2 | 20.4 | (10.6) | (1.2) |
| **Non-hedging derivatives** | | | | | | | | |
| Foreign exchange rate derivatives | 0.1 | - | - | - | - | - | - | - |
| Commodity derivatives | 326.7 | 0.4 | (324.1) | (1.5) | 298.3 | 1.7 | (298.4) | (1.3) |
| **Total gross derivatives** | **439.2** | **37.7** | **(392.4)** | **(10.1)** | 344.5 | 22.1 | (309.0) | (2.5) |
| Impact of netting | (293.0) | (6.5) | 293.0 | 6.5 | (245.4) | (2.0) | 245.4 | 2.0 |
| **Total net derivatives** | **146.2** | **31.2** | **(99.4)** | **(3.6)** | 99.1 | 20.1 | (63.6) | (0.5) |

(i) Certain derivative financial instruments are presented net on the balance sheet. A reconciliation between the gross and net position is provided in Note 5(d).

### (d) Offsetting of financial assets and financial liabilities

The company is eligible to present financial assets and financial liabilities net on the balance sheet as described in Note 2G1.3(d). The following table provides information on the impact of offsetting on the company balance sheet as well as the financial impact of the netting of certain instruments in the event of default or similar agreements.

| | 2018 | | | | | |
|---|---|---|---|---|---|---|
| | | | | Related amounts not offset in balance sheet | | |
| | Gross amounts of recognised financial assets/ (liabilities) £m | Gross amounts of recognised financial (liabilities)/ assets set off in the balance sheet £m | Net amounts of financial assets/ (liabilities) presented in the balance sheet £m | Financial instruments (Note (i)) £m | Cash collateral (held)/posted (Notes (ii) and (iii)) £m | Net amount £m |
| **Financial assets** | | | | | | |
| Receivables | 906.2 | (342.9) | **563.3** | (34.6) | (29.9) | 498.8 |
| Derivative financial instruments | 476.9 | (299.5) | **177.4** | (48.2) | - | 129.2 |
| **Financial liabilities** | | | | | | |
| Payables | (722.5) | 342.9 | **(379.6)** | 34.6 | 29.9 | (315.1) |
| Derivative financial instruments | (402.5) | 299.5 | **(103.0)** | 48.2 | - | (54.8) |

| | 2017 | | | | | |
|---|---|---|---|---|---|---|
| | | | | Related amounts not offset in balance sheet | | |
| | Gross amounts of recognised financial assets/ (liabilities) £m | Gross amounts of recognised financial (liabilities)/ assets set off in the balance sheet £m | Net amounts of financial assets/ (liabilities) presented in the balance sheet £m | Financial instruments (Note (i)) £m | Cash collateral (held)/posted (Notes (ii) and (iii)) £m | Net amount £m |
| **Financial assets** | | | | | | |
| Receivables | 940.1 | (341.1) | 599.0 | (31.1) | (7.4) | 560.5 |
| Derivative financial instruments | 366.6 | (247.4) | 119.2 | (34.2) | - | 85.0 |
| **Financial liabilities** | | | | | | |
| Payables | (772.1) | 341.1 | (431.0) | 31.1 | 7.4 | (392.5) |
| Derivative financial instruments | (311.5) | 247.4 | (64.1) | 34.0 | - | (30.1) |

**5 FINANCIAL INSTRUMENTS *continued***

**(d) Offsetting of financial assets and financial liabilities *continued***

(i) Certain contracts for derivatives, receivables, and payables in relation to the purchase of gas do not currently meet the offsetting criteria within IAS 32 'Financial Instruments: Presentation' ("IAS 32"), however in the event of default would be required to be offset per the requirements of the contract. The balances on the previous page show the effect on the company if these contracts were also offset. Due to the nature of certain contracts, it is not possible to split accurately the effect of offsetting these balances across the derivatives, receivables and payables categories. For presentational purposes the impact has been allocated to receivables and payables as appropriate.

(ii) The company enters into standard netting agreements with its commodity trading counterparties in order to mitigate the credit risk exposure of the business. In addition, the company utilises collateral support agreements with derivative counterparties to manage its credit exposure. All collateral is settled in cash. These forms of collateral include margining for trading with exchanges, cash collateral used for bilateral and brokering trading as well as letters of credit.

(iii) At 31 December 2018, the value of letters of credit held amounted to £7.0 million (2017 £27.0 million) and letters of credit posted amounted to £29.0 million (2017 £50.5 million). At 31 December 2018 the company also posted cash collateral of £29.9 million (2017 £7.4 million) in respect of payables, of which £29.9 million (2017 £7.4 million) can be offset against financial liabilities.

**(e) Financial risk management**

The company's principal financial liabilities, excluding derivative financial instruments, comprise loans and borrowings and trade and other payables. The main purpose of these financial liabilities is to finance the company's operations. The company has trade and other receivables that arise directly from its operations. The company also enters into derivative contracts.

The company has exposure to the following risks arising from the above financial instruments:

i. Credit risk;
ii. Energy market risk; and
iii. Treasury risk (comprising both liquidity and market risk).

An extensive description of this risk management framework of ScottishPower, and therefore the company, can be found in the most recent Annual Report and Accounts of SPL.

***(i) Credit risk***

Credit risk is the risk that a counterparty will not meet its contractual obligations under a financial instrument or customer contract, leading to a financial loss. The company is exposed to credit risk from its operating activities (primarily trade receivables and derivative financial instruments) and from foreign exchange transactions and other financial instruments.

The carrying amount of financial assets represent the maximum credit exposure to the company.

***Credit risk management***

The company is exposed to both settlement risk (defined as the risk of a counterparty failing to pay for energy and/or services which have been delivered), as well as replacement risk (defined as the risk of incurring additional costs in order to replace a sale or purchase contract following a counterparty default).

Further details on the credit risk management strategy adopted for significant types of financial asset are set out below.

- Credit risk in respect of external customers is mitigated by contracting with multiple counterparties and limiting exposure to individual counterparties to clearly defined limits based upon the risk of counterparty default.
- Credit risk from Iberdrola group companies is considered to be low as the company is part of the Iberdrola group's centralised treasury function and no Iberdrola group company has a credit rating lower than BBB+ (in line with Standard and Poor's external credit ratings).
- The company considers that 100% of its credit risk associated with energy-related derivatives can be considered to be with counterparties in related energy industries, financial institutions operating in energy markets or fellow Iberdrola group companies. At the counterparty level the company employs specific eligibility criteria in determining appropriate limits for each prospective counterparty and supplements this with netting and collateral agreements including margining, guarantees, letters of credit and cash deposits where appropriate.

***Trade receivables (including trade receivables due from Iberdrola group companies)***

The company uses the simplified model to measure ECLs for all trade receivables. The provision rates represent a lifetime ECL and are based on the Iberdrola groups historical loss experience and default rates.

**5 FINANCIAL INSTRUMENTS *continued***
**(e) Financial risk management *continued***
**(i) Credit risk *continued***
**Credit risk management *continued***
***Trade receivables (including trade receivables due from Iberdrola group companies) continued***
The table below illustrates the ECL on Trade receivables:

| | Ageing of trade receivables | | |
|---|---|---|---|
| | **0-6 months** | **Greater than 6 months** | **Total** |
| **As at 31 December 2018** | **£m** | **£m** | **£m** |
| **Weighted Average Expected Loss Rate (%)** | **0.2%** | **-** | **0.2%** |
| **Gross carrying value** | **508.2** | **55.9** | **564.1** |
| Loss allowance | (0.8) | - | (0.8) |
| **Net carrying value** | **507.4** | **55.9** | **563.3** |

| | Ageing of trade receivables | | |
|---|---|---|---|
| | 0-6 months | Greater than 6 months | Total |
| As at 1 January 2018 | £m | £m | £m |
| Weighted Average Expected Loss Rate (%) | 0.2% | - | 0.2% |
| Gross carrying value | 559.9 | 39.1 | 599.0 |
| Loss allowance | (0.9) | - | (0.9) |
| Net carrying value | 559.0 | 39.1 | 598.1 |

Trade receivables are written off when there is no reasonable expectation of recovery. Indicators that there is no reasonable expectation of recovery include, amongst others, the failure of a debtor to engage in a repayment plan with the company.

Refer to the table below reconciling the movement in the opening to the closing loss allowance.

***Security for trade receivables***
For some trade receivables the company may obtain security in the form of guarantees, or letters of credit which can be called upon if the counterparty is in default under the terms of the agreement (refer to Note 5(d)). The company does not otherwise require collateral in respect of trade and other receivables.

***Reconciliation of opening to closing loss allowance***
The closing loss allowances for all financial assets measured at amortised cost as at 31 December 2018 reconciles to the opening loss allowances as follows:

| | **Trade receivables £m** |
|---|---|
| Balance as at 31 December 2017 under IAS 39 | - |
| Adjustment on initial application of IFRS 9 | 0.9 |
| Balance as at 1 January 2018 under IFRS 9 | 0.9 |
| Decrease in loss allowance recognised in the income statement | (0.1) |
| **At 31 December 2018** | **0.8** |

The decrease in the loss allowance of £0.1 million from 1 January 2018 to 31 December 2018 is directly related to the fall in the gross carrying value of trade receivables.

**5. FINANCIAL INSTRUMENTS *continued***

**(e) Financial risk management *continued***

***(ii) Energy market risk***

Throughout 2018 and the prior year the company was exposed to market risk associated with fluctuations in the market price of electricity and generation fuel compounded by volumetric risk caused by unplanned changes in the load and output of the portfolio of generation assets. Going forward the company will continue to be exposed to market risk, however given the sale of the generation assets volumetric risk will no longer be impacted by fluctuations in anticipated plant output.

***Energy market risk management***

The risk management policies are implemented at the business level with the oversight of the group's Boards, management teams and the independent risk management function. ScottishPower and therefore the company uses a number of risk measurement procedures and techniques to ensure that risk is kept within pre-approved limits. The key measures are stop loss limits and volume exposure by tenor limits. All valuation models are reviewed and approved by the independent group Risk Management function on an ongoing basis, including changes to assumptions and model inputs. Changes that could have had significant impact on the Accounts required additional review and approval by the appropriate Boards.

During 2018 and the prior year the Risk Management function employed additional techniques such as VaR, to assist in measuring risk within the volume exposure by tenor limits. VaR is a key measure of the potential financial loss on a price exposure position over a defined period to a given level of confidence. VaR computations for ScottishPower's energy commodity portfolios were based on a historical simulation technique, which utilised historical energy market forward price curve changes to estimate the potential unfavourable impact of price changes in the portfolio positions. The quantification of market risk using VaR provided a consistent measure of risk and sensitivity across ScottishPower's continually changing portfolio, however, VaR was not necessarily indicative of actual results that may occur. Future changes in markets inconsistent with historical data or assumptions used could cause variation in actual results to exceed predicted ranges. ScottishPower's VaR computations for its energy commodity portfolio utilised several key assumptions, including a 99% confidence level for the resultant price changes and a holding period of five business days. VaR, while sensitive to changes in portfolio volume, does not account for commodity volume risk. Commodity volume risk is defined as the possibility that a change in the supply of, or demand for, the commodity will create an unexpected imbalance and change the requirements for the commodity.

The application of the VaR methodology evolved to include the total forecasted volumes for the generation assets and retail contracts to provide a more accurate measure of the risk associated with the volume exposure by tenor limits. ScottishPower's VaR measures are shown in the table below.

| | **2018** | 2017 |
|---|---|---|
| | **£m** | £m |
| VaR | **20.3** | 28.5 |
| Average VaR over prior year | **21.9** | 31.1 |
| Maximum VaR over prior year | **33.6** | 46.6 |
| Minimum VaR over prior year | **11.8** | 16.3 |

***Hedging of energy market risk***

The strategy of the business is to mitigate the economic risks associated with purchase of fuel and supply of electricity and natural gas to end users in both the wholesale (up until 31 December 2018) and retail markets. From a reporting perspective the objective is to report earnings results that are consistent with its operational strategies and hence recognise the earnings effect of financial and non-financial derivative transactions executed to hedge economic business risks in the same period in which the hedged operational activity impacts earnings. The aim is to minimise earnings volatility, which would otherwise be present as a result of fair valuing all derivative contracts under IFRS 9. To achieve this objective, where effectiveness documentation and reporting requirements are met, cash flow hedge accounting is applied by designation of a series of derivative trades and deferring in equity the fair value changes of open derivative positions until the period in which the forecast transactions occur.

**5 FINANCIAL INSTRUMENTS *continued***
**(e) Financial risk management *continued***
***(ii) Energy market risk continued***
***Hedging of energy market risk continued***
Cash flow hedging strategies are developed for each of the electricity, natural gas, and carbon allowances portfolios to hedge the variability in cash flows associated with changes in the market price of each commodity. Forward (fixed price/fixed volume) contracts are designated as hedging instruments in the electricity, gas, and carbon hedges.

***Commodity cash flow hedges***
Certain commodity derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instrument that does not qualify for hedge accounting are recognised immediately in the income statement and are included in Procurements. For an analysis of the split of the carrying value of hedging and non-hedging commodity derivatives refer to Note 5(c). The amounts relating to commodity derivatives designated as hedging instruments during the year are detailed in the table below:

| | Notes | **2018 Hedging derivatives £m** | 2017 Hedging derivatives £m |
|---|---|---|---|
| Notional amount | | **1,844.4** | 519.5 |
| Carrying amount - asset | (a) | **149.7** | 66.6 |
| Carrying amount - liability | (a) | **(76.9)** | (11.8) |
| Changes in the value of the hedging instrument recognised in OCI | (b) | **(18.0)** | (8.5) |
| Hedge ineffectiveness income/(cost) recognised in the income statement | (c) | **2.2** | (0.2) |
| Amount reclassified from cash flow hedge reserve to income statement | (d) | **(135.6)** | 5.4 |

(a) The carrying amount of derivative assets and liabilities are recorded within Derivative financial instruments.
(b) This is consistent with the change in the fair value of the hedging instrument used to calculate ineffectiveness.
(c) The hedge ineffectiveness income/(cost) recognised through the income statement of £2.2 million (2017 (£0.2) million) is included within Procurements.
(d) The amount reclassified from the cash flow hedge reserve to the income statement of £135.6 million (2017 (£5.4) million) is recorded within Gross margin.

The amounts at the reporting date relating to commodity items designated as hedged items were as follows.

| | **Change in fair value used for calculating hedge ineffectiveness** | | **Cash flow hedge reserve balance** | |
|---|---|---|---|---|
| **Line item in the Accounts in which the hedged item is/will be included** | **2018 £m** | 2017 £m | **2018 £m** | 2017 £m |
| Gross margin | **18.0** | 8.5 | **73.5** | 60.8 |

The assessment of effectiveness of all hedging relationships currently in place is carried out on a monthly basis as part of the financial reporting cycle. Prospective assessment is carried out at inception of the hedge and on an ongoing basis to verify that the hedge remains effective.

The company determines that the economic relationship between the hedging instrument (the commodity derivative) and the hedged item (the commodity purchases) will virtually always achieve 100% effectiveness. This is because the forecast commodity transaction is implicit within the derivative itself.

Ineffectiveness will arise if the trade has been cancelled, in which case there would be no future transaction. In such circumstances, the trade and the hedge would be eliminated from the Accounts. Ineffectiveness will also arise if the company receive notification that the business have been unable to obtain a reliable price forecast from market sources or if there is a change to the group Risk Management Strategy.

**5 FINANCIAL INSTRUMENTS *continued***
**(e) Financial risk management *continued***
**(ii) Energy market risk *continued***
***Sensitivity analysis on commodity prices***
The sensitivity on the company's results to changes in the market prices of the main commodities are as follows:

| Commodity | 2018 Variation in price | 2018 Impact on profit before taxes £m | 2018 Impact on equity before taxes £m | 2017 Variation in price | 2017 Impact on profit before taxes £m | 2017 Impact on equity before taxes £m |
|---|---|---|---|---|---|---|
| Gas | **+5%** | **0.1** | **24.2** | +5% | (0.1) | 12.0 |
| | **-5%** | **(0.1)** | **(24.2)** | -5% | 0.1 | (12.0) |
| Electricity | **+5%** | **-** | **41.5** | +5% | 1.6 | 8.4 |
| | **-5%** | **-** | **(41.5)** | -5% | (1.6) | (8.4) |
| Carbon Dioxide ($CO_2$) | **+5%** | **-** | **-** | +5% | - | 0.2 |
| | **-5%** | **-** | **-** | -5% | - | (0.2) |

***(iii) Treasury risk***
Treasury risk is comprised of liquidity risk and market risk. ScottishPower's cash management and short-term financing activity, and therefore that of the company, is integrated with Iberdrola's. The company produces short-term rolling cash-flow requirements and if necessary any required funding is obtained via the group's credit facilities already in place.

**Treasury liquidity risk management**
ScottishPower's liquidity position and short-term financing activities, and therefore that of the company, are integrated and aligned with Iberdrola's. Liquidity risk, the risk that the company will have insufficient funds to meet its liabilities, is managed by Iberdrola group Treasury, who are responsible for arranging banking facilities on behalf of ScottishPower, and therefore the company. SPL is the counterparty for the loan balance due from the company.

The tables below summarise the maturity profile of the company's financial liabilities as at 31 December based on contractual undiscounted payments.

***Financial liabilities (excluding commodity derivatives)***

**2018**

| Cash outflows | Notes | 2019 £m | 2020 £m | 2021 £m | 2022 £m | 2023 £m | 2024 and thereafter £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| Derivative financial instruments (excluding commodity derivatives) | (a) | 5.1 | - | - | - | - | - | **5.1** |
| Loans and other borrowings | | 108.9 | - | - | - | - | - | **108.9** |
| Payables | (b) | 323.4 | 5.8 | 50.2 | - | - | - | **379.4** |
| | | **437.4** | **5.8** | **50.2** | - | - | - | **493.4** |

2017

| Cash outflows | Notes | 2018 £m | 2019 £m | 2020 £m | 2021 £m | 2022 £m | 2023 and thereafter £m | Total £m |
|---|---|---|---|---|---|---|---|---|
| Derivative financial instruments (excluding commodity derivatives) | (a) | 0.2 | - | - | - | - | - | 0.2 |
| Loans and other borrowings | | 45.0 | - | - | - | - | - | 45.0 |
| Payables | (b) | 391.4 | 8.7 | 5.2 | 25.3 | - | - | 430.6 |
| | | 436.6 | 8.7 | 5.2 | 25.3 | - | - | 475.8 |

(a) The above liquidity analysis is stated after the impact of counterparty netting (refer to Note 5(d)).
(b) Contractual cash flows exclude accrued interest as these cash flows are included within loans and other borrowings.

**5 FINANCIAL INSTRUMENTS** ***continued***
**(e) Financial risk management** ***continued***
**(iii) Treasury risk** ***continued***
**Financial liabilities (excluding commodity derivatives)** ***continued***
The interest payments on variable interest rate loans in the table on the previous page reflect market forward interest rates at the reporting date and these amounts may change as market interest rates change.

The future cash flows on derivative instruments (including commodity derivatives below) may be different from the amounts in the table as interest rates and exchange rates or the relevant conditions underlying the calculation change. Except for these financial liabilities, it is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

***Commodity derivatives***
The company believes the liquidity risk associated with commodity derivatives needs to be considered in conjunction with the profile of payments in relation to all derivative contracts rather than only those in a liability position. It should be noted that cash flows associated with future energy sales and commodity contracts which are not IFRS 9 financial instruments are not included in this analysis, which is prepared in accordance with IFRS 7.

| | **2019 £m** | **2020 £m** | **2021 £m** | **2022 £m** | **2023 £m** | **2024 and thereafter £m** | **Total £m** |
|---|---|---|---|---|---|---|---|
| **Net cash outflows** | 891.0 | 265.4 | 50.6 | 2.3 | - | - | **1,209.3** |

| | 2017 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 2018 £m | 2019 £m | 2020 £m | 2021 £m | 2022 £m | 2023 and thereafter £m | Total £m |
| Net cash outflows | 191.8 | 140.9 | 38.9 | 4.5 | - | - | 376.1 |

Details of the company's contractual commitments are given in Note 22.

**Treasury market risk management**
Market risk is the risk of loss that results from changes in market rates (interest rates and foreign currency). Within the Treasury function ScottishPower, and therefore the company, utilises a number of financial instruments to manage interest rate and foreign currency exposures.

**Interest rate risk**
In order to adequately manage and limit this risk, the Iberdrola group annually determines the desired structure of the debt between fixed and floating interest rate, taking into account the indexing of income either interest rate or price index. ScottishPower Treasury then take actions over the course of the year to work towards these desired Iberdrola group ratios. Actions to be carried out over the course of a year may include obtaining new sources of financing (at a fixed, floating or indexed rate) and/or utilising interest rate derivatives.

All of the company's loans and borrowings are classified as variable rate debt and are held at amortised cost. The reference interest rate for the floating rate borrowings of £108.7 million (2017: £44.6 million) is the Bank of England Base Rate ("Base").

**5 FINANCIAL INSTRUMENTS *continued***
**(e) Financial risk management *continued***
**(iii) Treasury risk *continued***
**Interest rate risk *continued***
***Sensitivity analysis on interest rate changes***
The table below illustrates the impact on the annual interest rate charge considering various rate changes. The analysis assumes all other factors remain constant.

| Debt Category | Interest Rate | Change in rate | Impact on interest rate charges in 2018 £m | Impact on interest rate charges in 2017 £m |
|---|---|---|---|---|
| Short-term variable rate | Base | + 0.25% | 0.3 | 0.1 |
| | | - 0.25% | (0.3) | (0.1) |
| | | + 0.50% | 0.5 | 0.2 |
| | | - 0.50% | (0.5) | (0.2) |

**Foreign currency risk**
The company is exposed to transactional foreign currency risk to the extent that there is a mismatch between the currencies in which purchases are denominated. The currency in which these transactions are primarily denominated is Euro. ScottishPower board policy stipulates that there should be no significant exposure to foreign currency balances and therefore Treasury will hedge all foreign currency payments which have a (cumulative) value greater than a sterling equivalent of a quarter of a million pounds.

***Hedging of foreign currency risk***
The company uses foreign currency forwards to hedge its exposure to foreign currency risk. Under the company's policy the critical terms of the forwards must align with the hedged items. For such items the company designates the entire value of the foreign currency forward in the hedge relationship.

Some foreign exchange contracts do not satisfy the requirements for hedge accounting (economic hedges) under IFRS 9. These foreign currency forwards are subject to the same risk management policies as all other derivative contracts. However, they are accounted for as held for trading with gains (losses) recognised in the income statement.

***Foreign exchange rate cash flow hedges***
Hedging of commodity purchases: Where commodities are priced in a currency other than Sterling, the foreign exchange risk may be hedged using forward foreign exchange contracts. These are designated as cash flow hedges where they comply with the requirements of IFRS 9.

| | Notes | 2018 Hedging derivatives £m | 2017 Hedging derivatives £m |
|---|---|---|---|
| Notional amount | | **2.5** | 3.1 |
| Carrying amount - asset | (a) | **-** | - |
| Changes in the value of the hedging instrument recognised in OCI | (b) | **-** | 0.1 |
| Amount reclassified from cash flow hedge reserve to income statement | (c) | **0.3** | (0.5) |

(a) The carrying amount of derivative assets are recorded within Derivative financial instruments. The value of foreign exchange contracts classified as hedging derivatives was less than £0.1 million in both years.
(b) This is consistent with the change in the fair value of the hedging instrument used to calculate ineffectiveness.
(c) The amount reclassified from the cash flow hedge reserve to the income statement is recorded within Gross margin £0.3 million (2017 (£0.5 million)).

**5 FINANCIAL INSTRUMENTS *continued***
**(e) Financial risk management *continued***
**(iii) Treasury risk *continued***
***Foreign exchange rate cash flow hedges continued***
The amounts at the reporting date relating to foreign exchange items designated as hedged items were as follows:

| | Change in fair value used for calculating hedge ineffectiveness | | Cash flow hedge reserve balance | |
|---|---|---|---|---|
| | **2018** | 2017 | **2018** | 2017 |
| **Line item in the Accounts in which the hedged item is/will be included** | **£m** | £m | **£m** | £m |
| Gross margin | - | (0.1) | **(0.4)** | (0.3) |

The company determines that the economic relationship between the hedging instrument (the foreign exchange rate forward contract) and the hedged item (the commodity purchase) will virtually always achieve 100% effectiveness. This is because the company compares movements in the fair value of the expected highly probable forecast foreign currency cash flows, with movements in the fair value of the expected changes in cash flows from the hedging instrument. Forecast future foreign currency cash flows are largely based upon contractual obligations.

Ineffectiveness will arise if the forward contract has been cancelled, in which case there would be no future transaction. Ineffectiveness will also arise if the company receive notification that the business has been unable to obtain a reliable price forecast from market sources or if there is a change to the group Risk Management Strategy.

***Hedge assessment on foreign currency derivatives***
Hedge assessment on foreign currency derivatives is done prospectively to verify that the forecast transactions are still highly probable of occurring (for cash flow hedges) as well as retrospectively, to assess the effectiveness in the period under review. Prospective assessment is performed using sensitivity analysis and critical terms matching.

***Sensitivity analysis on foreign currency cash flows***
No sensitivity analysis has been performed in relation to changes in foreign exchange rates as almost all foreign currency purchases are hedged. Therefore there is immaterial financial exposure. Any movement in the value of the hedged item would be compensated for by movement in the value of the hedging instrument.

**6 TRADE AND OTHER RECEIVABLES**

| | Notes | **2018** **£m** | 2017 £m |
|---|---|---|---|
| **Current receivables:** | | | |
| Receivables due from Iberdrola group companies - trade | (a), (c) | **357.2** | 475.0 |
| Trade receivables and accrued income | (a), (b), (c) | **150.2** | 84.9 |
| Prepayments | | **0.2** | 0.1 |
| Other tax receivables | | **10.0** | 13.0 |
| | | **517.6** | 573.0 |
| **Non-current receivables:** | | | |
| Receivables due from Iberdrola group companies - trade | (a) | **55.9** | 39.1 |
| | | **55.9** | 39.1 |

(a) Information about the company's exposure to credit and market risks, and impairment losses for trade receivables is included in Note 5.
(b) Certain trade receivables are presented net on the balance sheet when the offsetting criteria under IAS 32 are met (refer to Note 2G1.3(d)). A reconciliation between the gross and net position is provided in Note 5(d).
(c) Trade and other receivables include £409.8 million of IFRS 15 receivables (refer to Note 14(c)).
(d) Trading terms are governed by Industry Standard agreements which typically provide for interest to be charged where payments are not made on the specified settlement date.

## 7 INVENTORIES

| | Notes | 2018 £m | 2017 £m |
|---|---|---|---|
| Fuel stocks | (a), (b) | **15.4** | 10.6 |
| Emissions allowances | | **0.8** | 0.3 |
| | | **16.2** | 10.9 |

(a) Inventories with a value of £11.3 million (2017 £13.6 million) were recognised as an expense during the year.
(b) On 1 July 2018 the company transferred inventories with a value of £4.0 million to ScottishPower Generation Limited, a fellow Iberdrola group company. On the 30 November 2018, ScottishPower Generation Limited transferred inventories of £15.3 million to the company.

## 8 SHARE CAPITAL

| | 2018 £m | 2017 £m |
|---|---|---|
| **Allotted, called up and fully paid shares:** | | |
| 50,000,000 ordinary shares of £1 each (2017 50,000,000) | **50.0** | 50.0 |

(a) Holders of these ordinary shares are entitled to dividends as declared from time to time; amounts on the capitalisation of profits and reserves; and notice and attendance at general meetings of the company, with every member entitled to one vote on a show of hands and on a poll one vote for every share held.

## 9 ANALYSIS OF MOVEMENTS IN EQUITY ATTRIBUTABLE TO EQUITY HOLDER OF SCOTTISHPOWER ENERGY MANAGEMENT LIMITED

| | Share capital £m | Hedge reserve (Note (a)) £m | Retained earnings (Note (b)) £m | Total £m |
|---|---|---|---|---|
| At 1 January 2017 | 50.0 | 25.1 | 129.4 | 204.5 |
| Loss for the year attributable to equity holder of ScottishPower Energy Management Limited | - | - | (25.8) | (25.8) |
| Changes in the value of cash flow hedges | - | 29.2 | - | 29.2 |
| Tax relating to cash flow hedges | - | (5.5) | - | (5.5) |
| At 1 January 2018 | 50.0 | 48.8 | 103.6 | 202.4 |
| Adjustments due to IFRS 9 | - | - | (0.7) | (0.7) |
| Adjusted balance at 1 January 2018 | 50.0 | 48.8 | 102.9 | 201.7 |
| Loss for the year attributable to equity holder of ScottishPower Energy Management Limited | - | - | (9.2) | (9.2) |
| Changes in the value of cash flow hedges | - | 12.8 | - | 12.8 |
| Tax relating to cash flow hedges | - | (2.4) | - | (2.4) |
| Dividends | - | - | (20.0) | (20.0) |
| **At 31 December 2018** | **50.0** | **59.2** | **73.7** | **182.9** |

(a) The hedge reserve represents the balance of gains and losses on cash flow hedges (net of taxation) not yet transferred to the income statement or the carrying amount of a non-financial asset.
(b) Retained earnings comprise the cumulative balance of profits and losses recognised in the financial statements as adjusted for transactions with shareholders, principally dividends.
(c) The changes in the hedge reserve arising from valuation adjustments to hedging derivatives are set out overleaf:

## 9 ANALYSIS OF MOVEMENTS IN EQUITY ATTRIBUTABLE TO EQUITY HOLDER OF SCOTTISHPOWER ENERGY MANAGEMENT LIMITED *continued*

| Cash flow hedges | Commodity hedges £m | Foreign exchange rate hedges £m | Gross value of hedges £m | Tax effect £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2017 | 31.4 | (0.2) | 31.2 | (6.1) | 25.1 |
| Effective cash flow hedges recognised | 23.8 | 0.3 | 24.1 | (4.6) | 19.5 |
| De-designated cash flow hedges | 0.2 | - | 0.2 | - | 0.2 |
| Removed from equity and recognised in income statement | 5.4 | (0.5) | 4.9 | (0.9) | 4.0 |
| At 1 January 2018 | 60.8 | (0.4) | 60.4 | (11.6) | 48.8 |
| Effective cash flow hedges recognised | 150.5 | (0.2) | 150.3 | (30.1) | 120.2 |
| De-designated cash flow hedges | (2.2) | - | (2.2) | 0.4 | (1.8) |
| Removed from equity and recognised in income statement | (135.6) | 0.3 | (135.3) | 27.1 | (108.2) |
| Changes in future tax rates | - | - | - | 0.2 | 0.2 |
| **At 31 December 2018** | **73.5** | **(0.3)** | **73.2** | **(14.0)** | **59.2** |

(d) The maturity analysis of amounts included in the hedge reserve is as follows:

| | **2018 £m** | 2017 £m |
|---|---|---|
| Less than 1 year | **35.9** | 33.1 |
| 1-2 years | **21.1** | 13.0 |
| 2-3 years | **2.3** | 2.4 |
| 3-4 years | **(0.1)** | 0.3 |
| | **59.2** | 48.8 |

## 10 PROVISIONS

| Year ended 31 December 2017 | Note | At 1 January 2017 £m | New provisions £m | At 31 December 2017 £m |
|---|---|---|---|---|
| Reorganisation and restructuring | (a) | - | 0.1 | 0.1 |

| **Year ended 31 December 2018** | Notes | At 1 January 2018 £m | New provisions £m | Transfers from Iberdrola group companies £m | Utilised during year £m | **At 31 December 2018 £m** |
|---|---|---|---|---|---|---|
| Reorganisation and restructuring | (a) | 0.1 | 1.1 | - | (0.2) | **1.0** |
| Decommissioning and environmental | (b) | - | - | 1.2 | - | **1.2** |
| | | 0.1 | 1.1 | 1.2 | (0.2) | **2.2** |

| **Analysis of total provisions** | **2018 £m** | 2017 £m |
|---|---|---|
| Non-current | **1.2** | - |
| Current | **1.0** | 0.1 |
| | **2.2** | 0.1 |

(a) The provision for reorganisation and restructuring in 2017 was utilised in 2018. The new provision of £1.1 million for reorganisation and restructuring in 2018 is expected to be utilised in 2019.
(b) The decommissioning and environmental provision of £1.2 million was transferred to the company from ScottishPower Generation Limited on 30 November 2018 and is expected to be utilised by 2035.

## 11 TRADE AND OTHER PAYABLES

| | Notes | 2018 £m | 2017 £m |
|---|---|---|---|
| **Current trade and other payables:** | | | |
| Payables due to Iberdrola group companies - trade | | **9.5** | 124.4 |
| Payables due to Iberdrola group companies - interest | | **0.2** | 0.4 |
| Trade payables | (a), (b) | **312.7** | 265.9 |
| Other taxes and social security | | **0.2** | 0.2 |
| Capital payables and accruals | | **0.2** | 0.1 |
| Other payables | | **1.0** | 1.0 |
| | | **323.8** | 392.0 |
| **Non-current other payables:** | | | |
| Payables due to Iberdrola group companies - trade | | **55.9** | 39.1 |
| Other payables | | **0.1** | 0.1 |
| | | **56.0** | 39.2 |

(a) Trade payables include amounts due on commodity activities.
(b) Certain trade payables and receivables are presented net on the balance sheet when offsetting criteria under IAS 32 are met (refer to Note 2G1.3(d)). A reconciliation between the gross and net provision is provided at Note 5(d).
(c) *On 30 November 2018 £0.1 million of trade and other payables were transferred into the company from ScottishPower Generation Limited.*

## 12 DEFERRED TAX

Deferred tax provided in the Accounts is as follows:

| | Notes | Property, plant and equipment £m | Derivative financial instruments £m | Other temporary differences £m | Total £m |
|---|---|---|---|---|---|
| At 1 January 2017 | | 1.6 | 11.8 | - | 13.4 |
| Credit to the income statement | | - | (3.9) | - | (3.9) |
| Recorded in the statement of comprehensive income | | - | 5.5 | - | 5.5 |
| At 1 January 2018 | | 1.6 | 13.4 | - | 15.0 |
| Adjustments due to IFRS 9 | | - | - | (0.2) | (0.2) |
| Adjusted balance at 1 January 2018 | | 1.6 | 13.4 | (0.2) | 14.8 |
| Credit to the income statement | | (0.7) | (0.1) | (0.2) | (1.0) |
| Recorded in the statement of comprehensive income | | - | 2.4 | - | 2.4 |
| Transfers to Iberdrola group companies | (a) | (1.4) | - | - | (1.4) |
| Transfers from Iberdrola group companies | (b) | 2.3 | - | - | 2.3 |
| **At 31 December 2018** | | **1.8** | **15.7** | **(0.4)** | **17.1** |

(a) *On 1 July 2018 the company transferred a deferred tax liability of £1.4 million to ScottishPower Generation Limited.*
(b) On 30 November 2018 the company acquired a deferred tax liability of £2.3 million following the transfer of assets and liabilities from ScottishPower Generation Limited.

Legislation has been enacted to reduce the rate of UK Corporation Tax to 17% on 1 April 2020. This reduces the tax rates expected to apply when temporary differences reverse and impacts the deferred tax charge.

## 13 LOANS AND OTHER BORROWINGS

### (a) Analysis of loans and other borrowings by instrument and maturity

| Instrument | Interest rate* | Maturity | 2018 £m | 2017 £m |
|---|---|---|---|---|
| Loans with Iberdrola group companies | Base + 1% | On demand | **108.7** | 44.6 |

*Base - Bank of England Base Rate

## 13 LOANS AND OTHER BORROWINGS *continued*

### (b) Reconciliation of movements of liabilities to cash flows arising from financing activities

| | Current liabilities | | |
|---|---|---|---|
| | Loans and other borrowings £m | Interest payable £m | Total £m |
| At 1 January 2017 | 4.1 | 0.6 | 4.7 |
| Increase in amounts due to Iberdrola group companies | 40.5 | - | 40.5 |
| Interest paid | - | (0.6) | (0.6) |
| Total movements from financing cashflows | 40.5 | (0.6) | 39.9 |
| Other movements | - | 0.4 | 0.4 |
| Total liability-related movements | - | 0.4 | 0.4 |
| At 31 December 2017 | 44.6 | 0.4 | 45.0 |

| | **Current liabilities** | | |
|---|---|---|---|
| | **Loans and other borrowings £m** | **Interest payable £m** | **Total £m** |
| **At 1 January 2018** | **44.6** | **0.4** | **45.0** |
| Increase in amounts due to Iberdrola group companies | 64.1 | - | 64.1 |
| Interest paid | - | (0.4) | (0.4) |
| **Total movements from financing cash flows** | **64.1** | **(0.4)** | **63.7** |
| Other movements | | 0.2 | 0.2 |
| **Total liability-related movements** | **-** | **0.2** | **0.2** |
| **At 31 December 2018** | **108.7** | **0.2** | **108.9** |

### (c) Borrowing facilities

The company has no undrawn committed borrowing facilities at 31 December 2018 (2017 £nil).

## 14 REVENUE

The effect of initially applying IFRS 15 on the company's Accounts is detailed in Note 1B1.1.

### (a) Disaggregation of revenue for the year ended 31 December 2018

| | Note | **2018 £m** |
|---|---|---|
| Commodity derivative income | (i) | 2,847.9 |
| Supply of wholesale electricity | | 910.0 |
| Supply of wholesale gas | | 995.2 |
| Other | | 84.2 |
| | | **4,837.3** |

(i) Commodity derivative income within the scope of IFRS 9 comprises the sale value of units of wholesale energy and other related services and excludes VAT. Units are based on energy volumes that can actually be sold on the wholesale market and are recorded using industry wide trading and settlement systems. The company also performs limited proprietary trading, the results of which are shown net within Revenue and sells wholesale energy during certain market windows in which the company is required to stand ready to sell under industry regulations.

All revenue is recognised over time and arises from operations within the UK.

## 14 REVENUE *continued*

### (b) Accounting policies

The company recognises revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and services.

#### (i) Supply of wholesale electricity and gas

The company's performance obligations are the supply of wholesale gas and/or electricity to customers. These performance obligations are both satisfied over time as the customer simultaneously receives and consumes the benefits of the company's performance as it supplies wholesale gas and electricity. The customers benefit from the company's service as the service is provided and therefore cost (an input method) is used to measure progress towards complete satisfaction of the performance obligation. This is appropriate as all costs are recharged to the customers. Revenue is therefore recognised as the costs are incurred at the contracted rate.

#### (ii) Other revenue

Other revenues are recognised based on the consideration specified in a contract with a customer, to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur in the future. The company recognises revenue either at a specific point in time or over a period of time based on when control is transferred to the customer based on the performance obligations in the contract.

### (c) Contract balances

| | Note | **31 December 2018** £m | 01 January 2018 £m |
|---|---|---|---|
| Receivables | (i) | **409.8** | 488.5 |

(i) Included within Trade and other receivables (refer to Note 6).
(ii) £0.1 million of impairment reversals were recognised during the year on receivables arising from the company's contracts with customers.

## 15 EMPLOYEE INFORMATION

### (a) Staff costs

| | **2018** £m | 2017 £m |
|---|---|---|
| Wages and salaries | **5.6** | 5.7 |
| Social security costs | **0.6** | 0.6 |
| Pension and other costs | **8.5** | 2.2 |
| **Total staff costs** | **14.7** | 8.5 |

### (b) Employee numbers

The year end and average numbers of employees (full and part-time) employed by the company, including UK based directors, where appropriate, were:

| | **Year end 2018** | **Average 2018** | Year end 2017 | Average 2017 |
|---|---|---|---|---|
| Administrative staff | **58** | **64** | 67 | 67 |
| Operations | **28** | **20** | 21 | 22 |
| **Total** | **86** | **84** | 88 | 89 |

The year end and average numbers of employees of full-time equivalent staff employed by the company, including UK based directors, were:

| | **Year end 2018** | **Average 2018** | Year end 2017 | Average 2017 |
|---|---|---|---|---|
| **Total** | **82** | **82** | 86 | 87 |

**15 EMPLOYEE INFORMATION *continued***

**(c) Retirement benefits**

The company's contributions payable in the year were £1.6 million (2017 £1.5 million). The company contributes to the ScottishPower group's defined benefit and defined contribution schemes in the UK and the contributions payable in the year reflect the contributions payable in respect of active participants in the group schemes who are employed by the company. Full details of these schemes are provided in the most recent Annual Report and Accounts of SPL.

As at 31 December 2018, the deficit in the ScottishPower group's defined benefit schemes in the UK amounted to £512.7 million (2017 £564.8 million). The employer contribution rate for these schemes in the year ended 31 December 2018 was 45.0% to 48.0%.

**16 TAXES OTHER THAN INCOME TAX**

| | 2018 £m | 2017 £m |
|---|---|---|
| Property taxes | **0.5** | 1.0 |

**17 DEPRECIATION AND AMORTISATION CHARGE, ALLOWANCES AND PROVISIONS**

| | 2018 £m | 2017 £m |
|---|---|---|
| Property, plant and equipment depreciation charge | **0.4** | 0.6 |
| Intangible asset amortisation | **0.8** | 0.8 |
| Charges and provisions, allowances and impairment of assets | **3.3** | 0.1 |
| | **4.5** | 1.5 |

**18 FINANCE INCOME**

| | 2018 £m | 2017 £m |
|---|---|---|
| Interest on bank and other deposits | **0.1** | 0.1 |
| Foreign exchange gains | **0.4** | 0.4 |
| Fair value and other gains on financing derivatives | **0.6** | 2.7 |
| | **1.1** | 3.2 |

**19 FINANCE COSTS**

| | 2018 £m | 2017 £m |
|---|---|---|
| Interest on amounts due to Iberdrola group companies | **0.2** | 0.4 |
| Foreign exchange losses | **0.4** | 0.2 |
| Fair value and other losses on financing derivatives | **0.7** | 2.9 |
| | **1.3** | 3.5 |

**20 INCOME TAX**

| | 2018 £m | 2017 £m |
|---|---|---|
| Current tax: | | |
| UK Corporation tax | **(1.3)** | (2.1) |
| **Current tax credit for the year** | **(1.3)** | (2.1) |
| Deferred tax: | | |
| Origination and reversal of temporary differences | **(1.0)** | (4.0) |
| Impact of tax rate change | **-** | 0.1 |
| **Deferred tax credit for the year** | **(1.0)** | (3.9) |
| **Income tax credit for the year** | **(2.3)** | (6.0) |

### 20 INCOME TAX *continued*

The tax credit on loss before tax for the year varied from the standard rate of UK Corporation Tax as follows:

| | **2018** | 2017 |
|---|---|---|
| | **£m** | £m |
| Corporation tax at 19.0% (2017 19.25%) | **(2.2)** | (6.1) |
| Impact of tax rate change | **-** | 0.1 |
| Other permanent differences | **(0.1)** | - |
| **Income tax credit for the year** | **(2.3)** | (6.0) |

Legislation has been enacted to reduce the rate of UK Corporation Tax to 17% on 1 April 2020. This reduces the tax rates expected to apply when temporary differences reverse and impacts the deferred tax charge.

### 21 DIVIDENDS

| | **2018** | 2017 | **2018** | 2017 |
|---|---|---|---|---|
| | **£ per ordinary share** | £ per ordinary share | **£m** | £m |
| Interim dividend paid | **0.40** | - | **20.0** | - |

### 22 FINANCIAL COMMITMENTS

**Contractual commitments**

ScottishPower manages its energy resource requirements by integrating long-term firm, short-term and spot market purchases with its own generating resources (up until 31 December 2018) to manage volume and price volatility and maximise value across the energy value chain. As part of its energy resource portfolio the company is committed under long-term purchase contracts summarised in the table below.

| | | | | **2018** | | | |
|---|---|---|---|---|---|---|---|
| | **2019** | **2020** | **2021** | **2022** | **2023** | **2024 and thereafter** | **Total** |
| | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** | **£m** |
| Long-term energy purchase contract commitments | 3,854.8 | 717.4 | 111.0 | 3.4 | - | - | **4,686.6** |
| Other contractual commitments | 163.1 | 38.6 | 2.7 | 2.8 | 2.9 | 15.9 | **226.0** |

| | | | | 2017 | | | |
|---|---|---|---|---|---|---|---|
| | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 and thereafter | Total |
| | £m | £m | £m | £m | £m | £m | £m |
| Long-term energy purchase contract commitments | 3,711.0 | 616.7 | 59.9 | 4.5 | - | - | 4,392.1 |
| Other contractual commitments | 78.3 | 84.1 | 38.8 | 2.7 | 2.8 | 18.4 | 225.1 |

## 23 RELATED PARTY TRANSACTIONS

### (a) Transactions and balances arising in the normal course of business

| | 2018 | | | | 2017 | | |
|---|---|---|---|---|---|---|---|
| | Ultimate parent (Iberdrola, S.A.) £m | UK parent (SPL) £m | Immediate parent (SPRH) £m | Other Iberdrola group companies £m | Ultimate parent (Iberdrola, S.A.) £m | UK parent (SPL) £m | Other Iberdrola group companies £m |
| **Types of transaction** | | | | | | | |
| Sales and rendering of services | - | - | - | 2,114.6 | - | - | 2,284.2 |
| Purchases and receipt of services | - | (1.0) | - | (475.3) | (0.1) | (1.1) | (594.4) |
| Net transfer of Intangible assets | - | - | - | 5.6 | - | - | - |
| Net transfer of Property, plant and equipment | - | - | - | 9.6 | - | - | - |
| Transfer of provisions | - | - | - | (1.2) | - | - | - |
| Transfer of inventories | - | - | - | 11.3 | - | - | - |
| Transfer of trade and other payables | - | - | - | (0.1) | - | - | - |
| Transfer of deferred tax liability | - | - | - | (0.9) | - | - | - |
| Emissions allowances sold | - | - | - | 27.6 | - | - | 13.4 |
| Interest costs | - | (0.2) | - | - | - | (0.4) | - |
| Net gains/(losses) on financing derivatives | (0.2) | 0.1 | - | - | - | (0.1) | - |
| Changes in the value of cash flow hedge reserve | - | - | - | - | - | (0.1) | - |
| Dividends paid | - | - | (20.0) | - | - | - | - |
| **ECLs recognised in respect of** | | | | | | | |
| Trade and other receivables | - | - | - | 0.5 | - | - | - |
| **Balances outstanding** | | | | | | | |
| Trade and other receivables | - | - | - | 413.1 | - | - | 514.1 |
| Derivative financial assets | - | 0.1 | - | 0.7 | - | 0.1 | 1.8 |
| Loans payable | - | (108.7) | - | - | - | (44.6) | - |
| Trade and other payables | - | - | - | (65.4) | - | (1.1) | (162.4) |
| Interest payable | - | (0.2) | - | - | - | (0.4) | - |
| Derivative financial liabilities | - | - | - | (1.6) | - | - | (0.4) |
| **ECLs on** | | | | | | | |
| Trade and other receivables | - | - | - | (0.3) | - | - | - |

(i) The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received.

(ii) During the year ended 31 December 2018, Scottish Power UK plc ("SPUK") made pension contributions of £1.6 million (2017 £1.5 million) on behalf of the company.

### (b) Remuneration of key management personnel

The remuneration of the key management personnel of the company is set out below. As all of the key management personnel are remunerated for their work for the SPRH group, it has not been possible to apportion the remuneration specifically in respect of services to this company. Of the ten key management personnel (2017 ten) four (2017 three) were remunerated directly by the company and this is included within staff costs in Note 15(a). The remaining key management personnel were remunerated by other SPRH companies in both years.

| | 2018 £m | 2017 £m |
|---|---|---|
| Short-term employee benefits | 1,049 | 1,077 |
| Post-employment benefits | 125 | 199 |
| Termination benefits | 501 | - |
| Share-based payments | 499 | 518 |
| | 2,174 | 1,794 |

### (c) Directors' remuneration

The remuneration of the directors of the company is set out overleaf. As all of the directors are remunerated for their work for the SPRH group, it has not been possible to apportion the remuneration specifically in respect of services to this company. Of the five directors (2017 six) three (2017 three) were remunerated directly by the company and this is included within staff costs in Note 15(a). The remaining directors were remunerated by other SPRH group companies in both years.

**23 RELATED PARTY TRANSACTIONS *continued***

**(c) Directors' remuneration *continued***

| Executive directors | 2018 £m | 2017 £m |
|---|---|---|
| Aggregate remuneration in respect of qualifying services | **355** | 300 |
| Aggregate compensation for loss of office | **501** | - |
| Number of directors who exercised share options | **2** | 2 |
| Number of directors who received shares under a long-term incentive scheme | **1** | 1 |
| Number of directors accruing retirement benefits under a defined benefit scheme | **3** | 2 |

| Highest paid director | 2018 £m | 2017 £m |
|---|---|---|
| Aggregate remuneration | **241** | 244 |
| Accrued pension benefits | **105** | 103 |

(i) The highest paid director received shares under a long-term share incentive scheme in both years.
(ii) The highest paid director exercised share options during both years.

**(d) Ultimate parent company and immediate parent company**

The immediate parent company is SPRH. The registered office of SPRH is 320 St. Vincent Street, Glasgow, G2 5AD.

The directors regard Iberdrola, S.A. as the ultimate parent company, which is also the parent company of the largest group in which the results of the company are consolidated. The parent company of the smallest group in which the results of the company are consolidated is ScottishPower UK plc ("SPUK").

Copies of the consolidated Accounts of Iberdrola, S.A. may be obtained from Iberdrola, S.A., at its registered office, Torre Iberdrola, Plaza Euskadi 5, 48009, Bilbao, Spain. Copies of the consolidated Accounts of SPUK may be obtained from ScottishPower UK plc, at its registered office, 320 St. Vincent Street, Glasgow, G2 5AD.

The company has no other related undertakings in addition to the parent undertakings disclosed above.

**24 AUDITOR REMUNERATION**

| | 2018 £m | 2017 £m |
|---|---|---|
| Audit of the company's annual Accounts | **0.2** | 0.2 |

KPMG LLP were re-appointed auditor of the company during 2018.

**25 GOING CONCERN**

The company's business activities together with the factors likely to affect its future development and position are set out in the Strategic Report on pages 1 to 4.

The company has recorded a loss after tax in both the current and previous financial year and the company's balance sheet shows that it has net current assets of £148.4 million and net assets of £182.9 million at its most recent balance sheet date.

The company is ultimately owned by Iberdrola, S.A. and it participates in the Iberdrola group's centralised treasury arrangements and so shares banking facilities with its parent companies and fellow subsidiaries. As a consequence, the company depends, in part, on the ability of the Iberdrola group to continue as a going concern. The directors have considered the company's funding relationship with Iberdrola to date and have considered available relevant information relating to the Iberdrola's ability to continue as a going concern. In addition, the directors have no reason to believe that the Iberdrola group does not have the ability to and will not continue to fund the company, should it become necessary, to enable it to continue in operational existence.

On the basis of these considerations, the directors have a reasonable expectation that the company will be able to continue in operational existence for the foreseeable future. Therefore, they adopt the going concern basis of accounting in preparing the Accounts.