

Compliance Annual Report

National Grid Gas plc

Prepared pursuant to paragraphs 7 and 8 of Special Condition 10C of the Gas Transmission Licence granted to National Grid Gas plc (registered in England with number 02006000 and whose registered office is at 1-3 Strand, London WC2N 5EH) under section 7 of the Gas Act 1986 (as amended) which was amended and restated by a licensing scheme made by the Secretary of State for Trade and Industry pursuant to paragraph 19 of schedule 7 to the Utilities Act 2000

22 May 2013

1. Introduction

Special Condition 10C of the Gas Transmission Licence (“Licence”), granted to National Grid Gas plc (“NGG”), requires NGG to produce an annual report covering its compliance during the relevant year with its Relevant Duties (as defined by the Licence) and its implementation of the practices, procedures and systems adopted in accordance with the Compliance Statement.

This is the annual report in respect of the period 1 May 2012 to 30 April 2013 (“the period”).

It should be noted that Special Conditions C19, C20 and C21 of the NTS licence were renumbered to Special Conditions 10A, 10B and 10C as part of the RIIO licence modifications effective from 1 April 2013. Similarly, Special Condition E22 of the RDN licence was renumbered to Special Condition 4F. No other changes were made to these conditions other than to update any cross references resulting as a consequence of the renumbering. The Compliance Statement has been updated to reflect the new numbering and this report also uses the new numbering.

2. Compliance with the relevant duties

The Business Separation Compliance Officer (BSCO) has undertaken monitoring during the period to assess the effectiveness of practices, procedures and systems adopted to secure compliance with the licence conditions below which are defined under paragraph 1 of Special Condition 10C as being the relevant duties.

As part of this process, Licence Advisers in Market Operations, Transmission Network Services, Gas Transmission Asset Management, Distribution Network Strategy, Distribution Commercial Distribution, Customer Operations, Finance, IS and Procurement were asked to complete questionnaires describing the controls, frameworks and processes in place within their business areas to secure compliance with the relevant duties. The questions asked and the overall outcome for each relevant duty are detailed below under paragraphs a, b and c.

The Licence Advisers provided positive assurance that the controls, frameworks and processes in place are adequate to secure compliance with the relevant duties and evidence has been provided where necessary to substantiate the statements made. The BSCO has met with the Licence Advisers to challenge and review the questionnaires and share any compliance best practices identified.

As part of the monitoring the BSCO has liaised with the Risk & Compliance and Audit teams to understand whether any key risks/issues were identified through their processes during the period. No issues have been reported.

The BSCO has assessed the overall outcomes of the business separation monitoring to determine the level of compliance which has been achieved during the period as being:

“an effective compliance control framework is in place, no significant non-compliances have occurred during the reporting period.”

a) Standard Condition A35 – Prohibition of Cross Subsidies

To test the effectiveness of controls in place to prevent a cross subsidy, the following questions were asked covering contract management, revenue allocation and pricing of services:

- Are you aware of any services being provided which are not covered by a written agreement?

- Please confirm that all transportation business provided by your directorate is carried out on an arms length basis, normal commercial terms.
- Does your directorate provide any assets or resources free of charge?
- Is your directorate responsible for putting in place contracts with other group businesses and third parties for non transportation business?
 - If yes, has the Pricing Governance Policy been used for services where pricing is not determined through an industry code, licence formula or charging statement?
 - Business areas responsible for setting up contractual arrangements for non transmission business (ie within the scope of the Pricing Governance Policy) are asked to complete a separate spreadsheet detailing the description of services, parties, term, value of service, treatment of revenue and confirmation that pricing proposal has been completed to ensure consistent pricing/commercial terms applied where the same service is applied to group companies and third parties.
- Contracts for Shared Services covered by the Common Services Consent do not fall within the scope of the Governance Policy for Pricing of Intra-business and third party services. Finance are asked to explain the methodology and process in place to ensure that there is no cross subsidy arising between Gas Transmission and Gas Distribution or any other National Grid business through the allocation of costs and revenues for shared services

Based on the information received through the monitoring process, the BSCO has reported that both the NTS and RDN licensees are compliant with the obligation not to give or receive a cross subsidy between each other or any other National Grid business.

b) Standard Special Condition A6 – Conduct of Transportation Business and Special Condition 10A – Undertaking from Ultimate Controller concerning Non Discrimination between the NTS Transportation Owner activity and the Distribution Network Transportation activity

To test the effectiveness of controls in place to prevent an unfair advantage being provided between the NTS and RDN licensees and to affiliates, related undertakings, gas shippers, gas suppliers and DN operators through preferential or discriminatory arrangements the following questions were asked:

- Does your directorate manage contractual arrangements for or deliver any transportation business activities? If yes, please describe the role of your directorate and the particular teams are involved.
- What processes are in place to ensure all customers are treated on an equal basis when:
 - Agreements are put in place
 - When services are delivered?
- What detective measures are in place to identify process failures?
- Please provide evidence to demonstrate processes are being followed in practice.

Based on the information received through the monitoring process, the BSCO has reported that both the NTS and RDN licensees have been compliant with these licence conditions.

c) Special Condition 10B – Separation of NTS and Distribution Network Businesses

A compliance statement is in place as required under paragraph 2 of Special Condition 10B. The detail of the actual arrangements which secure compliance with this licence obligation can be found in paragraph 3. During the reporting period the compliance statement was amended to reflect organisational changes. To test that the arrangements described in the compliance statement remain effective, the following questions have been asked.

- Does your directorate have any interactions with Gas Distribution? If yes, please describe what the role of your directorate is and how you ensure no unfair advantage is provided to RDNs over the IDNs in the way that operational and commercial decisions are made?
- Please describe the arrangements (relevant to your directorate) which ensure Gas Transmission does not provide an unfair advantage through:
 - *governance and decision making structures*
 - *Premises*
 - *Use of equipment facilities and property*
 - *Information & information systems*
 - *Services of persons*
 - *Transfer of employees*
 - *Cross subsidy*
- Please confirm that the compliance statement is an accurate reflection of the arrangements in place to ensure compliance with the obligations for business separation between NTS and RDN.
- Are you aware of any breaches to the Compliance Statement or any of the relevant licence conditions which have not been reported to the Business Separation Compliance Officer?
 - Does your directorate hold information which could potentially provide another group company with an unfair advantage if shared inappropriately? This could be Information held about third parties or information about the licensed business which is not in the public domain and which could potentially provide a group business with an unfair advantage such as information on commercial arrangements, network strategy, operational activities, etc
- If yes, please describe the type of information which is held and which teams manage that information.
- Are there any industry codes or other documents which set out the rules for sharing information? If yes, please identify these particular documents.
- Please explain the processes in place to manage access rights in respect of the systems, SharePoint sites or shared drives which hold commercially sensitive information.
- Please explain how your directorate manages the transfer of employees to ensure that access to systems holding commercially sensitive information is not retained and that the employee does not retain any hard copies of commercially sensitive information.
- Please explain how new starters and existing staff are made aware of the business separation obligations and compliance rules.
- Please provide evidence to demonstrate training and processes are carried out in practice.

Based on the information received through the monitoring process, the BSCO has reported that the Compliance Statement remains an accurate reflection of the arrangements in place and the NTS and RDN licensees have been compliant during the reporting period.

3. Implementation of the practices, procedures and systems adopted in accordance with the Compliance Statement

a) Overview of Compliance Framework

- National Grid recognises that embedding the correct culture and staff training / awareness are key facilitators in equipping National Grid to satisfy business separation licence conditions. The BSCO spends a proportionate amount of time in proactively engaging in these activities.
- The BSCO has ensured a high level of awareness of the licence conditions and Compliance Rules through general awareness communications such as slides via team talk or through targeted briefings to particular teams or new starters. In addition the BSCO has set the requirement for the business separation e-learning module to be completed every two years. The BSCO has provided guidance to NGET employees and management teams on the parameters which it is allowed to operate under, covering topics such as information sharing restrictions, avoiding cross subsidy and business conduct.
- Monitoring has been used to underpin the proactive actions that the BSCO takes to embed the correct processes, training and culture. Monitoring is seen as an important aspect of the compliance framework as it:
 - reinforces the importance of business separation within National Grid,
 - helps focus National Grid's businesses on the key issues,
 - requires positive assurance as to the controls the relevant businesses and departments deploy, and
 - provides a basis for benchmarking best practice and for providing feedback on any improvement actions that are identified.

b) Information & Information Systems separation

- NGG has restricted access to NTS and RDN computer systems to prevent the sharing of commercially sensitive information. Access to systems and filing systems is controlled and managed by the relevant directorates and access rights are periodically reviewed. The BSCO has received confirmation through the monitoring process that reviews of access rights of relevant shared areas take place to ensure only appropriate access rights are retained.
- During the year employees have been reminded through general communication messages of the importance of removing access to systems as they move between roles during times of organisational change.
- There is a separate HR process through which the BSCO is informed of employees moving between National Grid's separate businesses including NTS and RDN. The BSCO actively notifies leaver's managers of business separation obligations. The BSCO requires positive confirmation from the leaver's manager that access to relevant systems has been removed along with any relevant electronic data on the employee's pc and any hard copies of relevant information. Process documents are in place to facilitate this activity.
- A process has been put in place by the BSCO with IS which specifically captures business separation criteria at the point of information system design to ensure that

relevant data/information is ring-fenced. This is designed to ensure that business separation issues are addressed up front.

- In the event of an emergency it may be necessary for the systems of the NTS and RDN businesses to be operated from a single control room for the duration of such emergency and in accordance with the emergency procedures. During this time, information about the NTS and RDN business may be visible to each other. NGG's RDN business has a policy in place to ensure that any commercially sensitive information it receives during such an emergency will remain confidential.

c) Physical Separation & Independent Management

NGG maintains appropriate systems of working for its NTS staff to ensure operational decisions are not made which unduly discriminate in favour of NGG's RDN business over the Independent Distribution Networks ("IDNs"). An appropriate degree of targeted separation is in place due to the commercially sensitive nature of certain activities:

- System operation staff for the NTS are in separate accommodation from that of the RDN business
- The RDN system control centre (DNCC) and the NTS control centre (GNCC) are at separate sites.
- NTS and RDN staff performing investment planning functions are located in separate accommodation to prevent inadvertent sharing of commercially sensitive information.
- Swipe access controls in place so employees may only access their designated building and where employees visit a building that is not their designated place of work they are treated as external visitors.
- A process remains in place with National Grid's office facilities team to ensure consideration is given to business separation licence obligations prior to any office space being reallocated to National Grid's businesses.
- The NTS and RDN businesses continue to operate within separate management structures to reduce the possibility of a conflict of interest and ensure the operational independence of each business.
- The BSCO continues to be independent of the NTS and RDN management structures. The BSCO reports to the National Grid's UK General Counsel and Company Secretary. This ensures the BSCO is not unduly influenced by the NTS or RDN management teams.

d) Legal and Financial.

- Services that are provided between NTS and RDN are on arm's length basis and normal commercial terms ('ALBNCT') and are therefore subject to formal written agreements.
- Pricing of services between NTS and RDN is on a fully absorbed cost basis in line with a formal National Grid policy.
- Where appropriate, separate lawyers are assigned to take instructions from and act on behalf of NTS and RDN respectively. This approach is taken to ensure that any conflict of interest is avoided and ALBNCT arrangements are negotiated and observed.
- NGG has ensured that management accounting information about the NTS is not circulated to the RDN business.

e) *Culture and Training*

- The BSCO continues to maintain a network of Licence Advisers to help promote business separation awareness and engender a culture of compliance within the business. Regular contact is maintained with the licence advisers and workshops are held periodically to ensure consistent interpretation of information sharing restrictions and to identify compliance best practice.
- The BSCO's intranet website has a comprehensive range of business separation compliance educational material, full copies of the licences and codes of conduct. A set of Compliance Rules are all available to all employees via the Licence Management intranet site.
- Briefings are provided monthly to new starters and movers within National Grid's licensed businesses. The purpose of these briefings is to ensure new starters and leavers understand the licence restrictions on information sharing and business separation issues.
- Induction material is provided to new starters to ensure they understand the restrictions around information sharing between Gas Transmission and Distribution. This is one of the means by which the Compliance Rules continue to be communicated.
- The principles of business separation are further reinforced through an e-learning module. Employees who have access to commercially sensitive information or who are involved in the pricing, negotiation or delivery of contracts are required to recomplete the e-learning training every two years.

4. *Activities of the Business Separation Compliance Officer*

a) *Provision of advice*

- During the period the BSCO has provided advice to the NTS and RDN businesses and the Compliance Committee in respect of the relevant duties and the practices, procedures and systems adopted in accordance with the compliance statement.
- Communications took place across the business to raise awareness of the obligations and to refresh knowledge of the existing business separation rules.

b) *Monitoring*

The BSCO has undertaken monitoring during the period to assess the effectiveness of practices, procedures and systems adopted to secure compliance. The monitoring process and the reported outcomes are described fully in paragraph 2 of this report.

c) *Investigations Conducted*

There have been no complaints or representations falling under paragraph 5 of Special Condition 10C during the period and therefore no investigations have been undertaken.

d) *Reporting to the Compliance Committee*

The BSCO has reported to the Compliance Committee twice during the period.

Enquiries regarding this report should be addressed to the Business Separation Compliance Officer at the following address:

National Grid Gas plc
Legal Department
National Grid House
Warwick Technology Park
Gallows Hill
Warwick CV34 6DA