

Compliance Annual Report

National Grid Gas plc

Prepared pursuant to paragraphs 6 and 7 of Special Condition A34 of the Gas Transporter Licence granted to National Grid Gas plc (registered in England with number 2006000 and whose registered office is at 1-3 Strand, London WC2N 5EH) under section 7 of the Gas Act 1986 (as amended in respect of its distribution networks)

21 May 2012

1. Introduction

Paragraphs 6 and 7 of Standard Special Condition A34 of the Gas Transporter Licence (“Licence”) granted to National Grid Gas (“NGG”) in respect of the RDNs, require NGG to produce an annual report covering compliance during the reporting period with the relevant duties (as defined in 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 2011 to 30 April 2012 (“the period”).

During the course of the year, the licensee appointed a new CO (Dianne Burke) following consultation with Ofgem in accordance with paragraph 1 of Standard Special Condition A34 of the RDN Licence. The new CO was in post from 5 September 2011.

2. Compliance with the relevant duties

The Compliance Officer (CO) 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 Standard Special Condition A34.

As part of this process, Licence Advisers in Commercial, Customer Operations, Network Strategy and Finance 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 and b.

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 CO 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 CO has liaised with the Risk & Compliance and Audit teams to understand whether any key risks/issues have been identified through their processes. No issues have been reported.

The CO 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 Special Condition A33 – Restriction on Use of Certain Information and Independence of the Transportation Business*

The licence has a compliance statement in place as required under paragraph 4 of Standard Special Condition A33 which describes the practices, procedures and systems adopted by NGG to secure compliance with its obligations under that condition. The obligations under paragraphs 2 and 3 of Special Condition A33 require that NGG:

- Shall maintain managerial and operational systems which prevent any meter related services business (MRSB) or meter reading business (MRB) from having access to confidential information other than as permitted by paragraphs 2(a) and 2(b) of Standard Special Condition A33; and

- Shall at all times manage and operate the transportation business in a way best calculated to ensure that it does not restrict, prevent or distort competition in the supply of meter related services or meter reading business.

During the reporting period, the MRB, Utility Metering Services Ltd (known as Onstream) was sold and a revised Compliance Statement is attached as an appendix to this report for approval by Ofgem. As the change occurred during the reporting period, the MRB is included in this Compliance Report.

To test that the arrangements described in the compliance statement are effective, the following questions have been asked:

- Please explain and provide evidence of the framework, controls and processes that are in place in your directorate to ensure Gas Distribution does not provide any unfair advantage to the Metering or Onstream businesses
- Please also provide evidence that the relevant framework, processes and controls have been communicated periodically to Gas Distribution employees
- Please confirm that the Compliance Statement is an accurate reflection of the arrangements in place to ensure compliance with obligations for business separation.
- Are you aware of any breaches to the Compliance Statement or any of the relevant licence conditions which have not been reported to the Compliance Officer?
- Please explain the framework, controls and processes that are in place to ensure Gas Distribution do not obtain or provide an unfair advantage to any National Grid business joint venture or third party through:
 - any means, in particular, from a preferential or discriminatory arrangement (ie, in contractual terms and conditions); or
 - discrimination between customers when delivering services (ie, standards of service)
- Please explain the framework, processes and controls that are in place to ensure that no unfair advantage is provided by Gas Distribution to another National Grid business through sharing commercially sensitive information such as:
 - Information about third party businesses
 - Information relating to Gas Distribution's commercial arrangements, network strategy, network operation activities or any other Distribution data that is not in the public domain or shared with other relevant parties.
- Please explain the framework, processes and controls in place to ensure that access to Gas Distribution systems is restricted to prevent access to commercially sensitive information by other National Grid businesses.
- Please explain the framework, processes and controls in place to ensure your directorate manages the transfer of employees to ensure no commercially valuable information is transferred illegitimately as a consequence of employees moving to another National Grid business. In particular, please describe the measures that are taken to ensure access rights to the relevant systems and shared areas are removed at an appropriate time.

- Please explain how you would be able to demonstrate that new starters and existing staff are refreshed on the business separation rules.
- Please provide summary evidence that the framework, controls and processes are implemented, communicated and adhered to.

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

b) Standard Special 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.

- Please provide details of any contracts/agreements for services provided by Gas Distribution or received by Gas Distribution from any other National Grid Group business which fall into the scope of the Governance Policy for the Pricing of Intra-business and third party services.
- Please provide details of any services provided by Gas Distribution to third parties which fall into the scope of the Governance Policy for Pricing of Intra-business and third party services.
 - Note that for the above questions, relevant areas are asked to complete a spreadsheet with the following information; description of services, parties, term, confirmation that pricing proposal has been completed, value of service, and treatment of revenue.
- How do you ensure that there is a consistent pricing methodology and commercial terms applied, where the same service is applied to group companies and third parties
- For all new business or renewal/extensions of existing contracts, please confirm that you have processes and controls in place to ensure that the pricing governance policy (or the equivalent alternative) is applied.
- Please explain the framework, processes and controls in place to ensure that there is no cross subsidy arising between NTS, RDN, NGET 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 CO has reported that Gas Distribution have been compliant with the obligations in this condition.

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 CO spends a proportionate amount of time in proactively engaging in these activities.
- The CO has ensured a high level of awareness of the licence conditions and Compliance Rules through general awareness communications, targeted briefings and the business separation e-learning module. The CO has provided guidance to 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 CO 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

- Employees from the Metering and Onstream businesses do not have access to information systems and filing systems containing confidential information about the gas distribution business. The CO 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.
- There is a separate HR process through which the CO is informed of employees moving between National Grid's separate businesses. The CO actively notifies leaver's managers of business separation obligations. The CO 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 CO 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.

c) Physical Separation & Independent Management

- Pursuant to the written consent of Ofgem, NGG is relieved of its obligation to implement separate branding for the transportation business to the branding used for National Grid Metering.
- The gas distribution business is located in separate accommodation from the Metering and Onstream businesses.
- A process is 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 gas distribution business maintains a separate and independent management structure for the transportation business from the management of the Metering and Onstream businesses.
- The CO continues to be independent of the transportation, Metering and Onstream business management structures. The CO reports to National Grid's UK General Counsel and Company Secretary. This ensures the CO is not unduly influenced by the management teams of those businesses.

d) Legal and Financial

- NGG is a separate legal entity from the Metering and Onstream businesses.
- NGG continues to have separate statutory accounts which are subject to relevant accounting standards and underpin separation of function, costs and revenues.
- Services that are provided between NGG and Metering and Onstream businesses, are on arm's length basis and normal commercial terms ('ALBNCT') and are therefore subject to formal written agreements.
- Pricing of services between NGG and affiliates are 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 to behalf of the transportation, Metering and Onstream businesses respectively. This approach is taken to ensure that any conflict of interest is avoided and ALBNCT arrangements are negotiated and observed.

e) Culture and Training

- The CO 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 CO's intranet website has a comprehensive range of business separation compliance educational material, full copies of the licences and the Business Engagement Compliance Rules. The Compliance Rules are available to employees via the Licence Management intranet site.
- Briefings are provided monthly to new starters and leavers 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. This is one of the means by which the business separation Code of Conduct continues to be communicated.
- The principles of business separation are further reinforced through an e'learning module.

4. Activities of the Compliance Officer

a) Provision of advice

- During the period the CO has provided advice to NGG and the Compliance Committee in respect of the relevant duties and the practices, procedures and systems adopted in accordance with the compliance statement.
- Briefings have been provided by the CO to Directors and management teams to ensure business separation compliance issues are considered as part of day to day business.

- During the reporting period general communications took place across the business to raise awareness and refresh knowledge of the existing business separation rules.

b) *Monitoring*

The CO 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 during the reporting period which have resulted from complaints/representations arising from Standard Special Condition A33 and therefore no investigations have been conducted.

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

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Warwick CV34 6DA