

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)

27 May 2011

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 2010 to 30 April 2011 (“the period”).

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 Customer Support, 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. During the reporting period the compliance statement was amended to reflect the sale of Fulcrum and other organisational changes. 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.

To test that the arrangements described in the compliance statement remain 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 describe any contracts/agreements for services provided by Gas Distribution or received by Gas Distribution from any other National Grid Group business.
- Please explain the framework, processes and controls in place to ensure that there is no undue preference in contractual terms, no cross subsidy and that the agreements are managed on an arms length basis and normal commercial terms
- Please confirm which of the services provided by Gas Distribution are also provided to third parties and explain the framework, processes and the controls in place to ensure that the contracts are negotiated and managed on equivalent terms basis to those provided to National Grid businesses.
- Please describe any instances where Gas Distribution provide use of shared services equipment, facilities, property or personnel to any other National Grid business or vice versa that is not subject to the agreements you have described above and explain the process for allocating costs so there is no unfair commercial advantage/cross subsidy given or received between the Gas Distribution and other National Grid group business.
- In relation to the services described, please explain how the revenues from those services are allocated and summarise how you would be able to demonstrate that this allocation is compliant with the licence requirement for regulatory accounting
- In relation to the services you have described, please explain the basis of the pricing for contracts in place prior to November 2007. Please confirm that the Governance Policy for the Pricing of Intra-business and third party services has been complied with for all services between Gas Distribution and group businesses and attach copies of the relevant pricing proposals as evidence.
- Please provide summary evidence that the framework, controls and processes described are implemented, communicated and adhered to.

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 new licence conditions and code of conduct through communications across the business such as team talk and publications on the infonet such as At a Glance and Straight Talk. 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 codes of conduct. A general code of conduct for business separation has been produced and circulated. The codes of conduct are all 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 Business Separation 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:

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