

Compliance Annual Report

National Grid Gas plc

Prepared pursuant to paragraphs 7 and 8 of Special Condition C21 of the Gas Transmission Licence granted to National Grid Gas plc (registered in England with number 26006000 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

27 May 2011

1. Introduction

Special Condition C21 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 2010 to 30 April 2011 ("the period").

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 C21 as being the relevant duties.

As part of this process, Licence Advisers in Network Operations, Transmission Commercial, Asset Management, Network Strategy, Distribution Customer Services 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, 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:

- Please describe any contracts/agreements for services provided by Gas Transmission or received by Gas Transmission from any other National Grid Group business.
- Please describe any contracts/agreements for services provided by Gas Distribution or received by Gas Distribution from any other National Grid Group business.
- Please describe any instances where Gas Transmission provides 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 and explain the process for allocating costs so there is no unfair commercial advantage/cross subsidy given or received between Gas Transmission and other National Grid group business.

- Please describe any instances where Gas Distribution provides 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 and explain the process for allocating costs so there is no unfair commercial advantage/cross subsidy given or received between Gas Distribution and other National Grid 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 group businesses since November 2007 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 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) Special Condition C19 – Undertaking from Ultimate Controller concerning Non Discrimination between the NTS transportation activity and the Distribution Network transportation activity

In accordance with paragraph 2 of Special Condition C19 of the NTS licence, NGG has given an undertaking to procure that NGG shall conduct its NTS business in a manner that is best calculated to secure that no unfair commercial advantage (including any such advantage from a preferential or discriminatory arrangement) is provided to NGG's RDN business.

To test the effectiveness of controls in place the following questions were asked:

- Please explain the framework, controls and processes in place to ensure Gas Transmission does not 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, contractual terms and conditions); or
 - Discrimination between customers when providing transmission services (ie, standards of service)
- 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 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 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 BSCO has reported that services provided between the NTS and RDN licensees are compliant with the obligations in this licence condition.

c) Special Condition C20 – Separation of NTS and Distribution Network Businesses

A compliance statement is in place as required under paragraph 2 of Special Condition C20. 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.

- Please explain and provide evidence of the framework, controls and processes that are in place in your directorate to ensure to ensure NTS does not provide any unfair advantage to the RDNs through the inequitable sharing of information.
- Please explain and provide evidence of the framework, controls and processes that are in place to ensure NTS does not show undue preference in favour of the RDNs over the IDNs in the way that it makes operational decisions, defined in the Compliance Statement as:
 - allocating offtake rights, including Permitted Maximum Daily Quantity and pressure commitments;
 - contracting for flow rate flexibility and diurnal storage;
 - operational management of flow rate flexibility and diurnal storage; and
 - contracting for and calling interruption and scheduling of maintenance
- 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?
- Please explain the framework, processes and controls that are in place to ensure that no unfair advantage is provided by NTS to another National Grid group business specifically through sharing commercially sensitive information such as:
 - Information about third parties
 - Information relating to NTS's commercial arrangements, network strategy, network operation activities or any other NTS 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 NTS systems is restricted to prevent the access of 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 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 new licence conditions and code of conduct through communications across the business such as a poster campaign, team talk and publications on the infonet such as At a Glance and Straight Talk. 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.
- 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 general code of conduct for business separation ("Compliance Rules") has been produced and circulated. This specifies the correct staff behaviour and reinforces NGG's business separation obligations as set out in the Compliance Statement. The compliance rules include guidance on NTS operational decisions, disclosure and use of commercially sensitive information about the NTS, managing the delivery of NTS commercial agreements and the correct process for allocating costs to avoid cross subsidy between the NTS and RDN businesses. The compliance rules are available to NTS and RDN employees via the Licence Management intranet website.
- 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 which includes the compliance rules specified in the business separation code of conduct.
- 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 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 C21 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:

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 National Grid House
 Warwick Technology Park
 Gallows Hill
 Warwick CV34 6DA