

Compliance Annual Report

National Grid Gas plc

Prepared pursuant to paragraphs 7 and 8 of Special Condition C21 of the Gas Transmission Licence treated as granted to National Grid Gas plc (registered in England with number 2006000) 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

1st June 2009

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, as approved by the Gas and Electricity Markets Authority.

This is the annual report in respect of the Period 1st May 2008 to 30th April 2009 (“Period”).

1. Compliance with Relevant Duties

Throughout the Period, NGG has been compliant with the Relevant Duties, as defined in paragraph 1 of Special Condition C21 of the Licence.

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

Managerial independence

NGG’s national transmission system (“NTS”) and gas distribution (“RDN”) businesses have dedicated management boards which are independent of each other. The membership of each of those managerial boards includes at least two directors of National Grid Gas plc and National Grid’s UK Director of Regulation.

The managerial boards of the NTS and RDN businesses report to separate and independent lead directors. The lead director for the NTS business has no responsibilities in respect of the RDN business. The lead director for the RDN business has no responsibilities in respect of the NTS business.

The separate managerial boards of the NTS and RDN businesses are responsible for directing the affairs, and taking all substantial business decisions, in the sole interests of the business for which they have been appointed and as if they are part of separate legally incorporated companies.

The Business Separation Compliance Officer (“BSCO”) reviews the agenda items and minutes from the separate NTS and RDN board meetings to ensure that no conflict of interest is created, or any inappropriate exchange of information arises, through the membership or attendance of the board meetings.

Two Compliance Committees have been appointed, to which the BSCO reports, one to deal with matters relating to the NTS business and one to deal with matters relating to the RDN business. Each Compliance Committee

includes in its membership the relevant lead director and the UK Director of Regulation.

The Compliance Committees have met twice in respect of the Period to oversee the activities of the BSCO and to review the performance of the duties that have been assigned to the BSCO.

Each Compliance Committee reports directly to the board of National Grid Gas plc and to the group Audit Committee of National Grid plc. The Audit Committee includes both non-executive and executive directors of National Grid plc in its membership and is directly responsible to the board of National Grid plc.

The remit of the Audit Committee includes hearing any breaches or potential breaches brought to its attention by the BSCO and a biannual review of the activities of the BSCO.

Operational independence

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"). In particular:

- (i) NTS and RDN system operation activities are conducted in geographically separate locations;
- (ii) NTS and RDN accommodation and information systems are subject to an appropriate degree of targeted separation (described more fully below);
- (iii) a code of conduct ("Compliance Rules") remains in place to guide operational decisions which is:
 - applicable to all NTS staff with the responsibility for making operational decisions; and
 - applicable to staff of the RDN business, which prohibits them from soliciting operational decisions from the NTS which would unduly discriminate in favour of the RDN business or against other NTS users.

NTS accommodation and information systems

To ensure that no unfair commercial advantage arises by RDN staff or agents having access to NTS information, controls are in place which restrict RDN staff and agents from having access to:

- (i) premises occupied by the staff and agents of the NTS business;
- (ii) information systems used by the NTS.

System operation and investment planning activities

Due to the commercial sensitivity of NTS system operation and investment planning activities NGG has:

- located system operation staff for the NTS in separate accommodation from that of the RDN business;
- located NGG's RDN system control centre ("DNCC") and the NTS control centre ("GNCC") at separate sites;
- located NTS and RDN staff performing investment planning functions in separate accommodation to prevent any inadvertent sharing of commercially sensitive information;
- put site 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;
- restricted access to NTS and RDN computer systems to prevent the sharing of commercially sensitive information; and
- ensured that management accounting information about the NTS is not circulated to the RDN business.

Use of equipment, facilities, property and personnel

NGG has implemented a pricing governance policy to ensure that no unfair commercial advantage or cross subsidy is passed between the NTS and RDN businesses. The policy requires that charges for use of equipment, facilities, property and personnel are based on an appropriate rate using a transparent and cost reflective methodology.

Transfer of employees

NGG has introduced a revised policy to manage the transfer of employees from the NTS to the RDN business. The policy ensures that any NTS employee who transfers to NGG's RDN business does not possess commercially sensitive information that was acquired less than three months before the date of any such transfer. It is also a requirement that access to NTS information systems is removed prior to such transfers taking effect.

Emergency assistance

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 emergency procedures. During this time, information about the NTS and NGG's 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 emergency will remain confidential.

Compliance Rules

NGG has implemented a set of Compliance Rules which 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
- Correct process for allocating costs to avoid cross subsidy between NTS and RDN businesses.

The Compliance Rules state that any deliberate breach of the Rules will be treated by NGG as a disciplinary offence.

Service provision between the NTS and RDN businesses

In accordance with paragraph 2 of Special Condition C19 of the NTS Licence, National Grid plc 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.

Services provided between NGG's NTS and RDN businesses, which fall under paragraph 1 of Special Condition C19, are in compliance with paragraph 1(b) of Special Condition C19.

3. Activities of the Business Separation Compliance Officer

National Grid Gas has appointed a BSCO on a permanent basis who performs the duties set out at paragraph 6 of Special Condition C21. Throughout the Period the BSCO has:

- Provided advice to directors, managers, staff and the Compliance Committees to ensure compliance with the Relevant Duties, both proactively and in response to requests;
- Monitored the effectiveness of the practices, procedures and systems as set out in the Compliance Statement;
- Made policy recommendations to NGG's NTS and RDN Boards to further enhance NGG's compliance capabilities;
- Reported regularly to the Compliance Committees (twice in respect of this Period) as to the BSCO's activities;
- Reported regularly to the Audit Committee (twice in respect of this Period);
- Reviewed recommendations made to, and decisions made by, the management boards for NGG's NTS and RDN businesses; and
- Communicated the Compliance Rules to appropriate employees, across NGG's NTS and RDN businesses, to ensure a consistent understanding and a high level of awareness of NGG's business separation obligations.

4. Investigations conducted by the Business Separation Compliance Officer

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.

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

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