

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

31st May 2006

Introduction

Paragraphs 7 and 8 of 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 Relevant Duties (as defined in 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 2005 to 30th April 2006 (“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 has adopted an organisational structure in respect of the gas national transmission system (“NTS”) to secure that Standard Special Condition A6 is not breached through any inappropriate managerial decision in relation to the NTS.

Each of the NTS and NGG’s gas distribution business has management which is independent of each other. Each has a separate lead director, who is responsible solely for the operational and financial performance of the transportation business in respect of which he has been appointed. Each such lead director is part of and supported by a separate managerial board; one for each of the NTS and the gas distribution business.

The managerial boards are responsible for directing the affairs and taking all substantial business decisions relating to the business in respect of which they have been established. Each of those managerial boards contains at least two directors of National Grid Gas plc and each board member fulfils their role in relation to the taking of such decisions as if he or she is a director of a legally incorporated company whose sole business is the business in respect of which the managerial board he or she is a member has been established.

Two separate Compliance Committees have been appointed, to which the Business Separation Compliance Officer (“BSCO”) reports, one to deal with matters relating to the NTS and one to deal with matters relating to NGG’s gas distribution business. Each Compliance Committee includes the Director of Regulation (or equivalent position).

To ensure separate reporting lines, each Compliance Committee reports directly to the board of National Grid Gas plc and each also reports 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 Compliance Committees have met three times in respect of the Period to oversee the activities of and performance of the duties assigned to the BSCO.

The remit of the Audit Committee has been extended to include hearing any breaches or potential breaches brought to its attention by the BSCO and review of the activities of the BSCO twice yearly (three in this Period).

The Audit Committee has conducted three reviews in respect of this Period.

Operational independence

NGG has implemented appropriate systems of working to ensure that its staff involved in the operation of the NTS do not unduly discriminate in favour of NGG's gas distribution business over the Independent Distribution Networks ("IDNs") in the way that they make operational decisions, consistently with paragraph 1 of Standard Special Condition A6. In particular :

- (i) NTS System Operation activities and the system operation activities of NGG's gas distribution business are conducted in geographically separate locations;
- (ii) an appropriate degree of targeted operational separation is in place ;
- (iii) a code of compliance ("Compliance Rules") has been implemented to guide operational decisions:
 - applicable to all NTS staff with the responsibility for making operational decisions which prohibits those staff from taking operational decisions which would unduly discriminate in favour of the gas distribution business and against other system users, in particular the IDNs; and
 - applicable to staff of NGG's gas distribution business, which prohibits them from soliciting operational decisions from NTS which would unduly discriminate in favour of the associated gas transporter business and against other system users.

NTS accommodation and information systems

As part of ensuring that no unfair commercial advantage arises from access by any staff of NGG's gas distribution business (or any of its staff or agents) to Commercially Sensitive Information, as defined in the Compliance Statement), controls are in place so that no such information concerning the NTS becomes available to NGG's gas distribution business as a result of access by the staff or agents of the gas distribution business to:

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

System operation and investment planning activities

For NTS accommodation, NGG has :

- located system operations for the NTS in separate accommodation from that of NGG's gas distribution business;
- located NGG's gas distribution business control centre ("DNCC") and the NTS gas transmission control centre ("GNCC") at separate sites;
- located NTS and gas distribution staff performing investment planning functions in separate accommodation to prevent any inadvertent sharing of Commercially Sensitive Information;
- transferred the NTS system operations staff who operate the DNCC, to NGG's gas distribution business; and
- put in place controls so that where an employee is designated to a particular building he will only have swipe access to that building. Where an employee visits a building that is not his designated place of work they are treated as external visitors.

For NTS information systems, NGG has :

- restricted access to computer systems as required by the provisions of paragraph 4 of Special Condition C20 to prevent the sharing of Commercially Sensitive Information,
- ensured that it does not circulate management accounting information about the NTS to NGG's gas distribution business.

NGG has also reinforced its culture of 'non discrimination' through the adoption of the Compliance Rules, which is applicable to the staff and agents of each of the NTS, the gas distribution business and shared business services.

Use of equipment, facilities, property and personnel employed by NTS

NGG ensures that no unfair commercial advantage and/or cross subsidy is provided to NGG's gas distribution business by the NTS through:

- the transparent and cost reflective allocation of the charges for equipment, property and personnel (together "facilities") employed by the NTS which are utilised for the provision of works or services to NGG's gas distribution business and

- ensuring that any use of facilities owned or operated by the NTS by the gas distribution business are charged at an appropriate rate to avoid any undue discrimination or cross-subsidy in favour of NGG's gas distribution business.

Transfer of employees from NTS

NGG has introduced a policy to manage the transfer of employees from NTS to NGG's gas distribution business to ensure that any NTS employee who transfers to NGG's gas distribution business does not possess Commercially Sensitive Information that was acquired less than three months before the date of any such transfer.

Emergency assistance

In the event of an emergency it may be necessary for the NTS and NGG's gas distribution business system operations to be run from one control room for the duration of such emergency, in accordance with emergency procedures. During this time and for a limited Period while the emergency is being dealt with, information about the NTS and NGG's gas distribution business may be visible to each other. NGG's gas distribution business has in place a policy to ensure that any Commercially Sensitive Information received during such emergency remains confidential. During this time records of emergency duration and staff attendance will be kept in accordance with existing emergency procedures.

Compliance Rules

NGG has put in place a set of Compliance Rules to drive the correct staff behaviour and reinforce business separation as set out in the Compliance Statement. The Scope of the Compliance Rules includes guidance on:

- NTS operational decisions,
- Disclosure and use of Commercially Sensitive Information about the NTS,
- Managing the delivery of NTS commercial agreements, and
- Correct allocation of costs to avoid cross subsidy between NTS and NGG's gas distribution business

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

Service provision between NTS and NGG's gas distribution business

In accordance with paragraph 2 of Special Condition C19 of the Licence, an undertaking has been in place throughout the period.

Services falling under paragraph 1 of Special Condition C19 are in compliance with paragraph 1(b) of that condition.

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. Accordingly, the BSCO has during the Period :

- Provided advice to directors, managers and staff and the Compliance Committees on ensuring compliance with the Relevant Duties, both pro-actively and in response to requests;
- Monitored the effectiveness of the practices, procedures and systems put in place as set out in the Compliance Statement;
- Reported regularly to the Compliance Committees (three times in respect of this Period) as to the BSCO's activities;
- Reported regularly to the Audit Committee (three times in respect of this Period);
- reviewed recommendations to and decisions made by the management boards; and
- Communicated the Compliance Rules to appropriate employees of NGG.

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 made.

Any enquiries regarding the content of this report should be addressed in the first instance to the Business Separation Compliance Officer at the following address :

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31st May 2006