

Chairman's Statement

National Grid Transco, created from the Merger of National Grid and Lattice, brought together two groups with world-leading reputations for operating complex energy networks. Combined, we are the UK's largest investor-owned utility and one of the largest worldwide.

As your Chairman, may I welcome you to this, our first Annual Report for National Grid Transco which was created last October through the Merger of National Grid and Lattice. It brought together two groups, both of which already had world-leading reputations for operating complex energy networks. Combined, we are the UK's largest investor-owned utility and one of the largest worldwide.

Uniquely, our skills and strategy are focused on energy delivery and infrastructure. We own and operate the major part of Britain's gas transmission and distribution systems and the electricity transmission system in England and Wales. We are one of the top ten electricity delivery companies in the US and operate a gas distribution network in upstate New York.

Our vision is to develop a modern, progressive, forward-looking company that benefits all our stakeholders. This means continuing to operate and grow a safe and reliable electricity and gas transmission and distribution business. We do so with the conviction that ever greater levels of safety and efficiency, coupled with high service standards, can be achieved through the application of technology and innovation. In addition, under well-designed regulatory incentives, such gains benefit shareholders and consumers alike. Delivering this vision provides a safely-managed and stimulating environment for all our employees. We will also, very selectively, transfer our network skills to other similar markets when long-term value creation opportunities arise.

Group results and dividend

In our first year as National Grid Transco, we have been keenly focused on delivering against our published targets. We have made excellent progress across the Group in meeting our key operational goals. In both the UK and the US, our core businesses are meeting or outperforming against targets for reducing costs. At the same time, we are maintaining our solid record of delivering energy safely, reliably and with high standards of customer

service as well as effectively implementing our integration plans.

Group turnover increased during the year by 24%, from £7.6 billion to £9.4 billion, largely due to the contribution from the New York operation (Niagara Mohawk) of National Grid USA, which joined the Group on 31 January 2002.

Total operating profit before exceptional items and goodwill amortisation for the year increased 23%, representing strong performance from all our regulated operations in the UK and US and the first full-year contribution from the New York operation.

Adjusted earnings per share was 28.3 pence, down from 30.8 pence in 2001/02, the fall reflecting the benefit of releasing tax provisions last year.

The Board is recommending a final dividend of 10.34 pence per ordinary share. This brings the total dividend for the year to 17.20 pence per ordinary share, a 7.2% increase compared with last year's National Grid payment, in line with our aim to increase dividends per ordinary share by 5% in real terms in each financial year to 31 March 2006.

The final dividend per American Depositary Share (ADS) proposed by the Board is \$0.8396, bringing the total dividend for the year to \$1.3748 per ADS.

Sound governance

On both sides of the Atlantic, corporate governance practice has recently been the subject of considerable review, public debate and new legislation. From the outset of the Merger, the Board has been determined to ensure that the Group has in place the highest standards of corporate governance. We have also taken particular care to ensure that all procedures, policies and authorities, as well as the Board and committee structure, match these objectives.

In the UK, the recent 'Review of the role and effectiveness of non-executive directors' by Derek Higgs proposed a number of changes. It is expected that later this year the Financial Reporting Council will confirm the final modifications to the Combined Code. I am confident that, following a modest number of appropriate adjustments, we will be well placed to comply with the majority of the recommendations contained in the Higgs Review.

In the US, the passage of the Sarbanes-Oxley Act has increased the corporate governance requirements for the Group. Significant work has already been undertaken and will continue to ensure we fully meet our obligations.

We are committed to operating our business and building shareholder value in a sustainable manner. As a responsible business, we work to ensure that high standards of financial performance are matched by social and environmental responsibility. On behalf of the Board, responsibility for oversight of health, safety, environment and social involvement rests with the Risk and Responsibility Committee which is chaired by James Ross, our Deputy Chairman. The Committee works closely with the Audit Committee to provide assurance to the Board that all significant risks within the Group have been thoroughly assessed and are managed through sound systems of internal control.

Above all, safety is our paramount concern. In the UK, we continue to undertake major investment in maintaining the gas distribution infrastructure, spending over £400 million in the year on replacing metallic pipes to ensure we deliver gas safely. It is against this background that we deeply regret that three members of the public died as a result of gas explosions associated with Transco's operations in the UK during the year. Whenever such events occur it is important to understand the reasons and therefore we cooperate fully with the relevant authorities in their investigations and apply any lessons to be learned as soon as possible.

Energy policy

Energy policy continues to be high on the agenda in the UK, Europe and US, especially over issues regarding security and diversity of supply. In February 2003, the UK Government published a White Paper outlining its proposals for future energy policy.

The White Paper rightly recognises the importance of robust and flexible infrastructure for the transmission and distribution of both gas and electricity to realise the Government's policy objectives. In the case of gas, Transco's National Transmission System will need to adapt to the growing proportion of gas and LNG imports from a variety of landing points.

For electricity, the regulatory arrangements for National Grid Company's essential role in connecting the new sources of renewable energy to the market, and balancing their intermittency, will be crucial to delivery of the White Paper's objectives. We are working closely with the Government to meet these new challenges.

In the US, although deliberations are far from complete, Congress is currently considering comprehensive energy legislation which includes a number of provisions that are important to National

Grid USA's ongoing operations and business development efforts. Among other things, Congress is considering the repeal of the Public Utility Holding Company Act, which would streamline regulation in the US, and the enactment of several provisions that would promote electricity transmission infrastructure development.

National Grid Transco people

None of this year's achievements would have been possible without the skills, dedication and enthusiasm of National Grid Transco people. I would therefore like to extend my thanks to all our employees for their commitment to delivering our success and willingness to embrace change.

The Merger saw a number of changes to the Board and I am grateful to all the Directors who have served on the Boards of National Grid and Lattice throughout the year. National Grid Transco is fortunate in having a very strong and committed team of Directors, which was further strengthened by the addition of Nick Winsor to the Board in April 2003 as an Executive Director. He has assumed responsibility for our UK and US transmission operations, having previously been Chief Operating Officer of our transmission operations in the US.

Steve Holliday, previously responsible for our transmission operations, has taken over as Executive Director with responsibility for UK gas distribution. Rick Sergel retains responsibility for our US distribution business. Edward Astle, responsible for our non-regulated businesses, is also now responsible for business development.

Outlook

Our Group-wide cost reduction and synergy creation programmes are exceeding our targets. We are confident that 2003/04 will be another strong year for the Group.



Sir John Parker Chairman



Sir John Parker, Chairman (seated) and **Roger Urwin**, Group Chief Executive

Chief Executive's Review

National Grid Transco's success and reputation as a world-class business depend on the safe, reliable and efficient delivery of energy, around the clock, 365 days a year.

Strategy

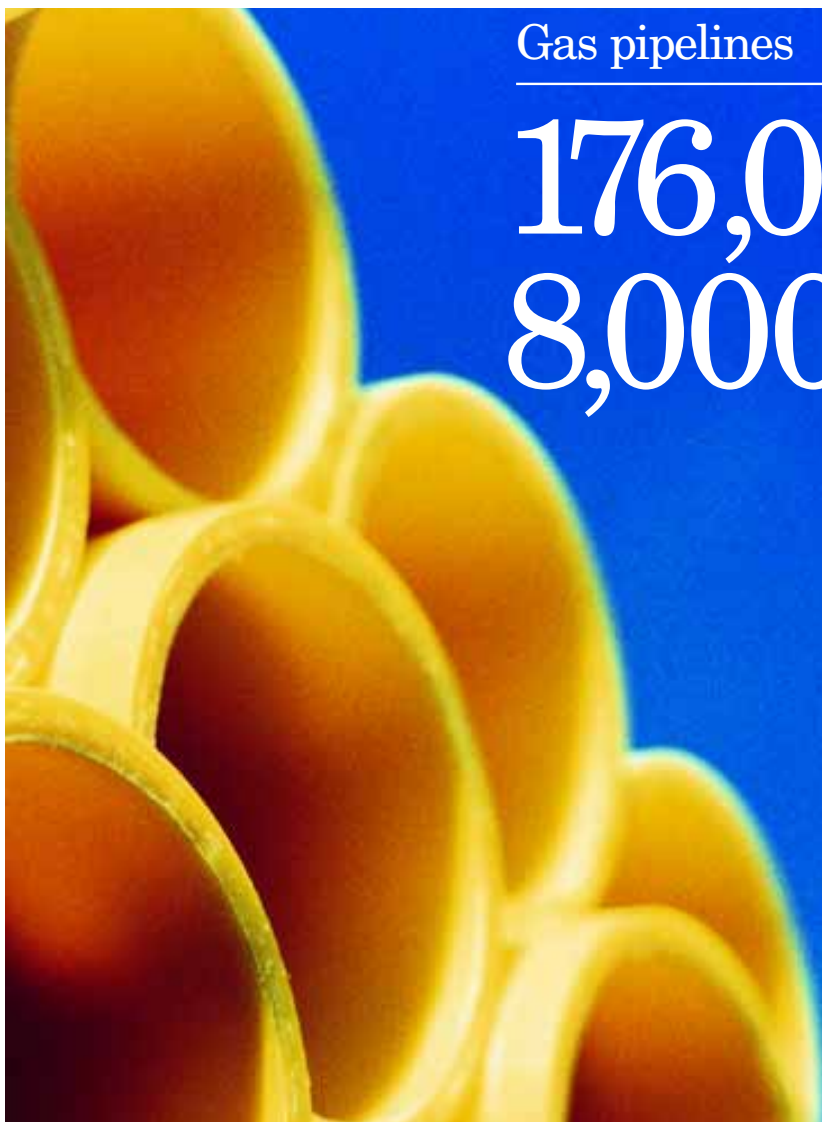
National Grid Transco is one of the world's leading energy delivery companies. Our core skills lie in the design, development, operation and maintenance of complex energy networks under performance-based regulatory incentives. We manage these networks to the highest standards of safety, reliability and customer service.

We have also transferred our network skills to related markets in the UK and US.

We aim to deliver world-class operating and financial performance in order to provide superior returns and grow value for shareholders. To achieve this we must:

Gas pipelines

176,000 miles in Britain
8,000 miles in northeastern US

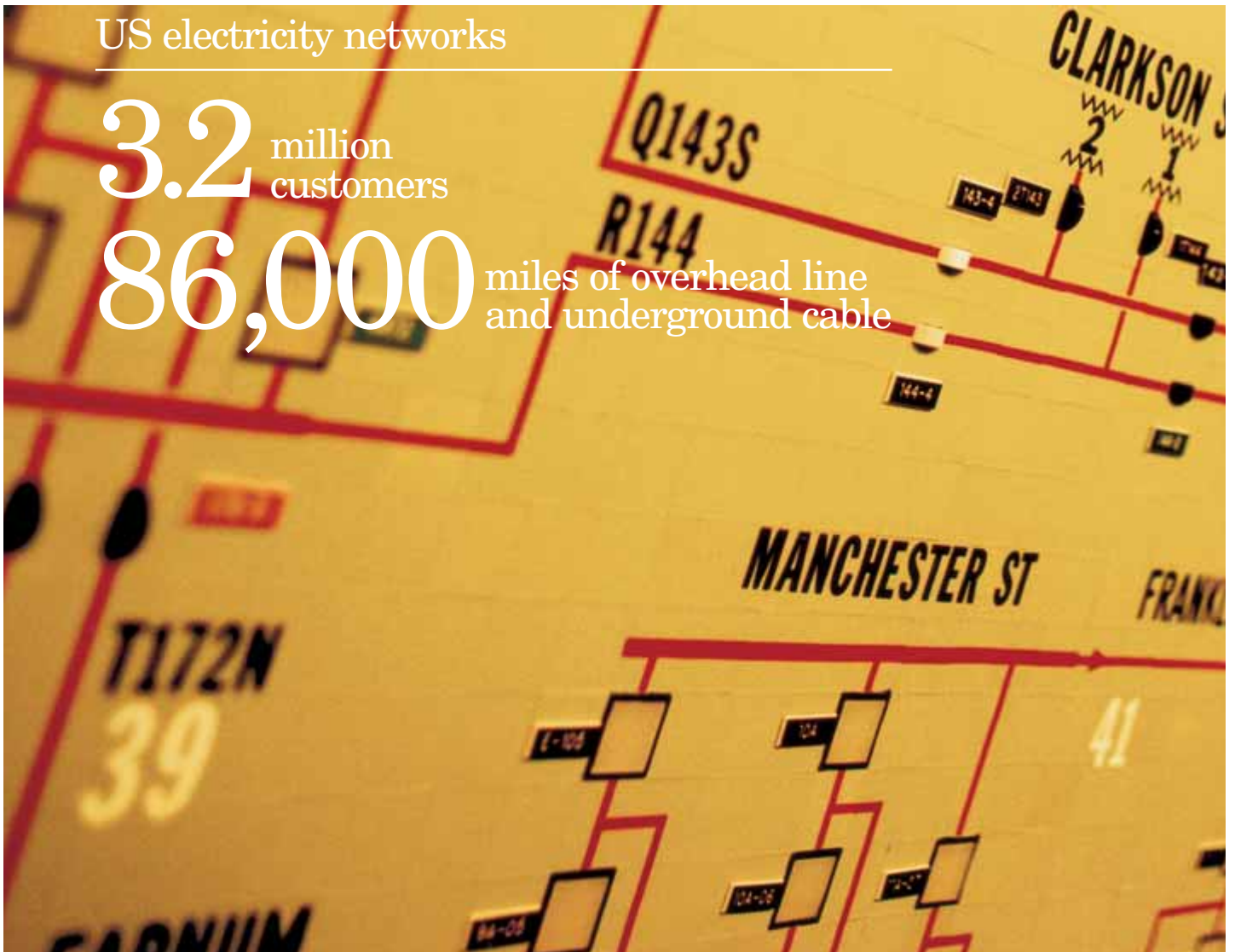


- continue to earn our reputation for innovation and continuous improvement to achieve leading standards of efficiency, safety, reliability and customer service;
- continue the productive and professional conduct of regulatory relationships to deliver innovative, performance-based agreements which provide benefits for investors and consumers;
- continue to develop our unique experience and expertise in providing the infrastructure, commercial arrangements and related systems that provide the essential basis for competitive electricity and gas markets;
- transfer best practices across businesses and functions and realise integration synergies in electricity and gas transmission and distribution;
- exploit our core skills, assets and scale to pursue selected growth opportunities in infrastructure and related services; and
- manage our businesses in accordance with the culture and behavioural values needed for the responsible, long-term stewardship of vital infrastructure assets – our 'Framework for Responsible Business'.

US electricity networks

3.2 million customers

86,000 miles of overhead line and underground cable





Left Transco is responsible for the safety of Britain's national gas pipeline system 24 hours a day, 365 days a year. Around six million telephone calls were made throughout the year to the three national call centres that operate the free national gas emergency number – 0800 111 999*.

Business performance

Last year saw excellent progress in delivering our strategy. Each of our businesses maintained aggressive cost-cutting and improved efficiency, and we delivered over £140 million in real savings for the year ended 31 March 2003 alone. We continue to deliver significant outperformance in the UK electricity business and to date we have achieved real reductions of 22%. In our UK gas business, we met the first-year target to reduce operating costs by 6.3% in real terms. In the US, we are progressing well in integrating the New England and New York operations. We have already achieved a reduction of 6.5%.

The Group has made good progress in securing the savings related to the National Grid and Lattice Merger. The two previous London headquarters were brought together on the day we completed the Merger, and we are in the process of moving to our new operational centre in Warwick.

The combined UK gas and electricity transmission businesses have identified savings and efficiencies above our original targets. We are now confident of achieving at least £135 million annualised synergy savings, the great majority of which will be achieved by March 2004.

UK gas distribution

Our gas distribution business in the UK is organised into eight regional Networks and delivers gas to around 21 million consumers. Adjusted operating profit rose by £6 million to £554 million and controllable costs were £26 million lower than in the previous year. The replacement expenditure ('repex') on UK gas mains totalled £405 million in the year. Our performance under the new repex incentive mechanism has been encouraging, and we earned an estimated £15 million in the first year.

Separation of Transco's distribution price control into eight regional price controls is well advanced, and Ofgem is due to

publish its final proposals shortly. We are also in detailed discussions with Ofgem on the many regulatory issues associated with the separation and potential sale of individual Networks. We expect Ofgem to publish a consultation document on these issues later this summer. However, the process will require extensive consultations across the gas industry, including detailed discussions with the HSE, which are likely to take many months to complete. We are committed to retaining a major presence in the UK gas distribution business but will consider the sale of one or more individual Networks if this were to maximise shareholder value.

UK electricity and gas transmission

The UK electricity and gas transmission business comprises National Grid Company's electricity transmission network in England and Wales as well as Transco's gas transmission network in Britain. The business continued to deliver strong performance, achieving adjusted operating profits of £846 million, an increase of £65 million over the previous year. Operating highlights included further significant reductions in controllable costs and strong performance under the electricity System Operator incentive scheme.

US electricity and gas networks

National Grid USA delivers electricity and gas in the northeastern US. It delivered good results, with cost-cutting and favourable weather conditions offsetting the impact of the sluggish economy, a weakened US dollar and increased pension costs. The US businesses contributed £699 million to adjusted operating profit, compared with £370 million for the previous year, reflecting a full-year contribution from our New York operations. Adjusted operating profit for electricity distribution amounted to £513 million in 2002/03, compared with £266 million in 2001/02; electricity transmission amounted to £128 million in 2002/03, compared with £87 million in 2001/02; and gas distribution amounted to £58 million in 2002/03, compared with £17 million in 2001/02. Operating profit for

2001/02 included two months of results for Niagara Mohawk, which was acquired on 31 January 2002.

The development of regional electricity markets and the associated electricity transmission restructuring in the US continues to make progress. In June 2002, we announced the establishment of GridAmerica, an independent transmission company. Following receipt of the remaining regulatory approvals, we expect it to begin operations in autumn 2003, managing the transmission assets of three midwestern utilities: Ameren, First Energy and Northern Indiana Public Service Company. These assets span over 14,000 miles of transmission lines.

Non-regulated businesses

Our portfolio of non-regulated businesses in the field of infrastructure provision and related services is selectively utilising our core skills and assets in areas such as metering, communications infrastructure, interconnectors, gas connections and property. During the year, we have made real progress in refocusing our non-regulated businesses and improving their safety and operational performance.

Our competitive metering business, OnStream, was awarded four contracts by British Gas Trading (Centrica) to provide metering services for around 11 million domestic gas and electricity customers in Britain.

We continue to make progress in developing Gridcom which provides communications infrastructure and related services to fibre and wireless network operators in the UK and northeastern US.

We are adding to our successful interconnector business the £300 million Basslink project, to build, own and operate an interconnector between the Australian mainland and Tasmania. Final approval for the project from federal and state Government in Australia was received during the year and it is due for completion in late 2005.

* All calls are recorded and may be monitored



Left National Grid USA deals with weather extremes during both the summer and winter. In some areas last year, temperatures ranged from a high of over 37°C during the summer to a low of -24°C during the winter.

Our withdrawal from altnet (alternative telecoms network) investments is nearly complete. During the year, we sold our stakes in Manquehue net and Silica Networks and restructured our shareholding in Energis Polska. We also sold the assets of 186k, our fibre optic network business.

Delivering energy – safely...

The electricity and gas we deliver is essential to the countries and regions in which we operate. It is of paramount importance to us that we do so safely and we work to safeguard the public in all that we do.

Across the Group, we have a goal of zero injuries to employees and, for the year ended 31 March 2003, the rate of injuries resulting in lost time decreased by up to 46% across our major operations compared with 2001/02. In our drive for continuous improvement, we investigate all incidents to ensure that the lessons are learned and communicated. Last year, we also audited the progress made in safety management since the assessment of National Grid's operations in the UK and US by DuPont in 2001. In January 2003, we invited DuPont to carry out a safety assessment of Transco.

In the UK, Transco has successfully completed its demanding programme to replace 1,500 miles of medium pressure mains made of ductile iron. We have also commenced a long-term programme to replace all metallic mains within 30 metres of buildings with modern polyethylene pipes that should reduce further the risk of gas leaks from the system.

In the US, we have a programme under way to replace older bare steel and cast iron gas mains that may be at risk of deteriorating.

...with year-round reliability...

We must also deliver energy reliably, especially during extremes of weather. The winter of 2002/03 saw the highest demands for electricity and gas ever recorded in the UK. The electricity

transmission network in England and Wales carried a record 54.4 GW on 10 December 2002 – up more than 5% from the previous peak and the largest percentage increase in demand since 1995.

The record maximum daily demand for gas in Britain of 450 mcm was met on 7 January 2003. This also represented an increase of over 5% on the previous peak.

In the US, there were extremes of both hot and cold weather, with temperatures that ranged from a high of over 37°C during the summer to a low of -24°C during the winter. The need for summer air conditioning and winter heating increased the demand for energy. In the New England region, all-time peak electricity demand records were set in both the summer and winter.

The weather in the US, however, also included a significant number of ice and snow storms that caused outages, including a very severe ice storm in New York in early April 2003 that cut off power to more than a quarter of a million of our customers. It is a credit to the dedication and professionalism of our employees that we were able to restore power quickly with many tributes received from the customers affected.

...and with high service standards

We have the largest integrated gas system in the European Union. Through some 176,000 miles of pipeline we transport gas on behalf of gas shippers and suppliers to around 21 million consumers. We also operate the national gas emergency service. Safety-related targets continued to be exceeded, with 99% of 'uncontrolled' gas escapes (where the gas leak cannot be controlled by turning the gas supply off at the meter) attended within one hour. 99% of 'controlled' gas escapes (where the gas leak can be controlled at the meter) were attended within two hours.

In the US, we also work towards service quality standards set by the state

regulators. During the year, we had mixed results in the area of reliability, which measures the frequency and duration of outages. While in New York and Rhode Island we met our targets, we fell short in Massachusetts. As a result, major construction efforts are under way to improve reliability in the distribution infrastructure through the upgrade of low-voltage power supply lines (feeders) in New England and the completion of four new substations.

Customer satisfaction is higher and billing accuracy and efficiency have been improved in the US through our Automated Meter Reading (AMR) project. AMR enables us to read up to 15,000 meters a day using a specially equipped van, compared with approximately 400 meters per day by a meter reader. AMR provides accurate reads, which means fewer customer calls about bills and fewer regulatory complaints.

We also work closely with our customers in the US and UK to improve their energy efficiency. Five of the programmes offered in New England were among the 31 nominations selected as the nation's best by the American Council for an Energy-Efficient Economy. In Britain, our Affordable Warmth programme is a leading contributor to the eradication of fuel poverty – a prime Government objective.

Operating responsibly

The past year has seen an increasing emphasis on the way in which companies manage their affairs and the arrangements they have put in place to ensure effective corporate governance.

Our Framework for Responsible Business, developed with the help of our employees and external stakeholders, sets out the principles by which we will manage our business to deliver long-term value. It provides the context for our approach to corporate governance and is supported by Group-wide policies addressing issues such as safety, environment and business ethics.

We are proud of our achievements in this area. This year we have been listed in the top 20% of the UK Business in the Community's Corporate Responsibility Index and the 'Premier League' of the associated environmental index. We have also been rated by certain fund managers as an 'industry leader', for our management of environmental and social issues.

This financial year has also seen us enter the FTSE4Good and Dow Jones Sustainability Indices, at a time when these issues are taking on greater importance for the investment community.

We place great emphasis on the relationships we have with the local communities we serve. We have established the National Grid Transco Foundation to bring our business expertise, knowledge and resources to

bear on social and environmental issues faced by communities. It is also the means through which our UK employees can become actively involved in community activities.

In recent years there has been a shortage of skilled engineers and technicians across the UK. The Foundation has been involved in developing a pilot scheme to address this shortage. We have trained young offenders in gas distribution and streetworks and they have found jobs with National Grid Transco and our engineering contractors.

Most encouragingly, experience shows that there is a dramatically reduced inclination to re-offend among these young people. The UK Government is therefore considering how this scheme might be applied nationwide, under the leadership of Sir John Parker.

Electricity transmission networks

14,000 miles in
northeastern US

4,500 miles in England
and Wales



Last year we gave some £3.4 million (\$5.4 million) to charitable causes in the US. This included support for needy populations through a fuel-assistance programme similar to our Affordable Warmth programme in Britain. It also included an educational services programme that distributed more than 200,000 instructional booklets on various energy topics to students and held more than 2,000 classroom safety presentations reaching more than 50,000 children.

A foundation for the future

We have successfully established National Grid Transco as the world's foremost company specialising in the ownership and operation of the advanced networks that provide the essential basis for competitive electricity and gas markets. Our challenge is to build on this achievement to the benefit of our employees, our shareholders and the millions of customers served by our networks.

Community investment

£5.5m

invested in UK, including award-winning schemes for young offenders

\$5.4m

invested in northeastern US

