Directors' Report and Operating and Financial Review
Operating and Financial Review

References to adjusted operating profit, adjusted profit before taxation, adjusted earnings (profit/(loss) for the year) and adjusted earnings per share are stated before exceptional items and goodwill amortisation. A reconciliation of operating profit to adjusted operating profit is shown on the face of the profit and loss account on page 60, while a reconciliation of adjusted profit before taxation, adjusted earnings and adjusted earnings per share is shown in note 11 to the accounts on page 73.

The Directors believe that use of the adjusted measures described above give a better indication of the underlying business performance of the Group than the unadjusted measures.

Adjusted total operating profit for 2002/03 was £2,185 million (2001/02: £1,783 million; 2000/01: £1,780 million) and excludes operating exceptional items relating to continuing and discontinued operations and goodwill amortisation. Exceptional items for 2002/03 relating to continuing and discontinued operations amounted to £308 million (2001/02: £285 million; 2000/01: £88 million) and £39 million (2001/02: £1,042 million; 2000/01: £nil) respectively, and goodwill amortisation amounted to £102 million (2001/02: £97 million; 2000/01: £85 million). These items can be seen on the face of the profit and loss account on page 60, reconciling to total operating profit for 2002/03 of £1,736 million (2001/02: £359 million; 2000/01: £1,607 million).

Merger of National Grid and Lattice

On 21 October 2002, the merger of National Grid and Lattice was completed and National Grid was renamed National Grid Transco. In accordance with UK Generally Accepted Accounting Principles (GAAP), the Merger has been accounted for using merger accounting principles, as explained in note 1 to the accounts on page 63. As a consequence, the results of the merged entity together with the financial review associated with the UK GAAP results are presented as if the Group had been in existence for all of the financial years presented. The results for all years are presented on the basis of uniform accounting policies.

Under US GAAP, the business combination of National Grid and Lattice must be accounted for as an acquisition in accordance with acquisition accounting principles ('purchase accounting'). A discussion of the impact of US GAAP accounting principles is shown below, and details of the principal differences between UK and US GAAP are shown in note 34 to the accounts on page 100.

Segmental reporting

As a result of the Merger, National Grid Transco has reported its audited results for the first time and reporting segments have been aligned to reflect the management responsibilities and economic characteristics of the Group's business activities. As an example, management responsibility for 'electricity and gas transmission' in the UK resides with an Executive Director and these activities share long-term economic characteristics. Such characteristics include the fact that they are both subject to similar regulatory environments, and income is derived from the provision of transmission services, with limited exposure to commodity risk.

The choice of segments has also had regard to the level of materiality of some of the Group's activities and to ensure that the disclosures are not overly detailed.

Segmental information is disclosed in note 2 to the accounts on pages 63 to 65, and a review of the performance of these businesses is contained on pages 10 to 20. Additional financial and performance information relating to the reporting segments is also included in the business review.

The presentation of segment information is based on the management responsibilities that existed at 31 March 2003.

The segments that existed at 31 March 2003 comprised UK distribution; UK electricity and gas transmission; US transmission; US electricity distribution (including recovery of stranded costs); US gas; and other activities.

Management responsibilities have changed with effect from 28 April 2003, and, as a result, in future presentations of the Group's results segmental reporting will be aligned to reflect these changes in responsibilities.

Financial year ended 31 March 2003 (2002/03) compared with financial year ended 31 March 2002 (2001/02)

Group turnover

Group turnover for 2002/03 increased by £1,846 million over 2001/02 to £9,400 million, reflecting a full year's turnover being recorded in respect of Niagara Mohawk, which was acquired by the Group on 31 January 2002.

Group operating profit

Group total operating profit rose by £1,377 million to £1,736 million in 2002/03, primarily reflecting a movement in the total operating exceptional net charges relating to both continuing and discontinued operations, which fell from £1,327 million in 2001/02 to £347 million in 2002/03.

A separate discussion of exceptional items is shown below.

Group total adjusted operating profit rose by £402 million to £2,185 million, primarily reflecting increased adjusted operating profit from US electricity transmission and US electricity distribution which have reported a full year's contribution from the acquisition of Niagara Mohawk in January 2002. As a result, the contribution of US electricity transmission and US electricity distribution rose from £353 million in 2001/02 to £641 million in 2002/03, an increase of £288 million, accounting for 72% of the total increase.

Total operating profit from Group undertakings included losses of £194 million relating to discontinued operations compared with £496 million for 2001/02, as a result of the sale of, or exit by the Group from, certain business activities during the year. The principal businesses included The Leasing Group and 186k, a UK-based fibre optic telecommunications company.

Group operating profit also included a profit of £109 million compared with losses of £672 million in 2001/02 relating to the discontinued activities of joint ventures and the associate. A discussion of the impact the activities of discontinued joint ventures and the associate have had on the results is shown below.

Associate and joint ventures

On 16 July 2002, Energis plc ('Energis') went into administration. As a direct result of this event, Energis ceased to be an associate of the Group from that date. The results for 2002/03 have not been affected by this change in status, because the Group's investment in Energis had been fully written down during 2001/02 and Energis had not publicly declared any results since reporting its results for the six months ended 30 September 2001.

The Group ceased equity accounting for Intelig, its Brazilian telecoms joint venture, with effect from 30 September 2002. This arose as a result of the Group's share of net assets falling to zero and the Group declaring its intention not to fund this business any further while pursuing a withdrawal strategy.

The Group's interests in Energis Polska, Manquehue net and Silica Networks have been disposed of or, in the case of Energis Polska, the interest reduced to a level where the Group has no significant influence on the activities of these businesses. As a result, these entities are no longer equity accounted for, and any loss arising from the disposal or reduction in interest has been reflected in exceptional items.

As explained in 'Exceptional items' below, the total operating profit for 2002/03 of joint ventures (discontinued operations) included an exceptional pre-tax credit amounting to £129 million. The £129 million credit represents the partial release of impairment provisions charged in the year ended 31 March 2002 to match the recognition of retained losses arising from these joint ventures, and is recorded within the net £109 million credit relating to the Group's 'share of joint ventures' and associate's operating profit/(loss) – discontinued operations'.

The retained losses of the joint ventures against which the provisions are being released are reflected in the profit and loss account according to their nature, for example: share of operating loss; share of net interest; and share of tax, the principal element being an exceptional net interest charge of £92 million (before and after tax) relating to the Group's share of exchange losses incurred on foreign exchange borrowings at Intelig.

Operating losses of £672 million recorded in 2001/02 in respect of the discontinued activities of joint ventures and associate reflect the very significant level of impairment charges incurred during that year.

Operating results for all the above associate and joint ventures have been reflected in the accounts within 'share of joint ventures' and associate's operating profit/(loss) – discontinued operations'.

Goodwill amortisation
Goodwill amortisation for 2002/03 rose from £97 million to £102 million. This increase reflects a full year's amortisation of goodwill relating to the prior year's acquisition of Niagara Mohawk, partially offset by the following:

- no recognition of the Group's share of goodwill amortisation in the year in respect of Energis; and
- the reduced sterling cost of US dollar denominated goodwill amortisation as a result of the weakening of the US dollar.

Exceptional items
The results for the year ended 31 March 2003 included total net exceptional pre-tax charges of £477 million (£349 million post-tax). Pre-tax charges are made up of pre-tax net charges of £308 million and £39 million of operating exceptional items relating to continuing and discontinued operations respectively; £99 million of non-operating exceptional items (note 4(b) to the accounts on page 66); and £31 million of financing-related exceptional charges. In addition, the Group reflected £28 million of exceptional minority interest charge. These net charges, including minority interest effect, comprise:

- costs arising from the Merger of £184 million (£147 million after tax) relating to transaction costs of the Merger, together with related employee share scheme costs amounting to £79 million and other property and employee costs of £105 million;
- restructuring costs principally arising from business related efficiency programmes of £209 million (£165 million after tax). These costs are mainly severance-related;
- an impairment charge relating to the Group's telecoms assets held by 186k of £168 million (£143 million after tax);
- a £135 million credit (£155 million after tax) in respect of Intelig and other telecoms joint ventures of which £129 million has been reflected in 'share of joint ventures' and associate's operating profit/(loss) – discontinued operations' – see above;
- an exceptional net interest loss of £31 million (before and after tax). This relates to the Group's share of exchange losses incurred on foreign exchange borrowings of £98 million (£92 million of which related to Intelig) partially offset by a gain on net monetary liabilities of £67 million as a result of the adoption of hyper-inflationary accounting, under UK GAAP, relating to Citelec, the Group's Argentinian joint venture – see 'Exchange rates and hyper-inflation' below;
- a £28 million minority interest charge being a share of the £61 million net exceptional credit related to the Argentinian joint venture – see 'Exchange rates and hyper-inflation' below;
- a £68 million loss (before and after tax) arising from the sale of the Group's leasing business, The Leasing Group, and loss on termination of 186k's operations; and
- net profit on the disposal of tangible fixed assets of £48 million (£50 million after tax).

Interest
Net interest rose from £799 million in 2001/02 to £970 million in 2002/03. Both years included exceptional financing costs amounting to £142 million and £31 million in 2001/02 and 2002/03 respectively. A separate discussion of exceptional financing costs is contained in 'Exceptional items' when comparing the results for each year.

Net interest, excluding exceptional items, rose from £657 million in 2001/02 to £939 million for 2002/03, as shown in note 8 to the accounts on page 71. This increase is explained by a full year's interest charge in respect of the acquisition of Niagara Mohawk and foreign exchange movements.

Taxation
The net tax charge for 2002/03 of £245 million included an exceptional tax credit on pre-tax exceptional items of £128 million. Excluding the exceptional tax items from the tax charge, the effective tax rate for 2002/03 based on adjusted profit before taxation was 29.9% compared with the standard corporation tax rate in the UK of 30%. The effective tax rate for 2002/03 based on profit before taxation before exceptional items was 32.6%. Note 9 to the accounts on page 72 shows a reconciliation of the main components giving rise to the difference between the relevant effective tax rate and the UK standard corporation tax rate.

Exchange rates and hyper-inflation
Exchange rate movements have had an adverse effect on the translation of US dollar adjusted operating profit for 2002/03 compared with 2001/02. US dollar adjusted operating profit was translated at a weighted average rate of £1.00 = $1.59 during 2002/03 as compared with £1.00 = $1.44 for 2001/02. If the rate that applied during 2001/02 had been used, sterling operating profit and adjusted operating profit for 2002/03 would have been higher by around £57 million and £74 million respectively.

The above analysis does not take into account the fact that Niagara Mohawk only impacted on Group results for two months in 2001/02. On page 18, taking into account this factor, it is estimated that adjusted operating profit would have been higher by around £34 million.

The reduced adjusted operating profit and operating profit is largely offset by the reduced sterling cost of US dollar debt taken out to finance US dollar denominated investments and the reduced sterling cost of US taxes. As a result, the impact of the higher US dollar rate on National Grid USA's results has not had a significant effect on adjusted earnings per share or earnings per share.

Exchange rates have marginally affected the Group's recognition of operating losses arising in respect of Intelig, the Group's Brazilian telecoms joint venture. This reflected sterling's continued strengthening against the Brazilian currency in the period that the Group equity accounted for Intelig – see 'Associate and joint ventures' above. The Group estimates that, as compared with the average exchange rate for 2001/02, this effect has reduced our share of operating losses by around £2 million.

The Group's joint venture in Argentina, Citelec, is currently considered to be operating within a hyper-inflationary economy. In accordance with UK GAAP, the accounts of the joint venture, which includes Transener, a transmission company, have been prepared using hyper-inflationary accounting principles. This has resulted in all entries in the joint venture's accounts being measured at current purchasing price.

The fall in the Argentinian exchange rate has given rise to the recognition of the Group's share of exchange losses arising on the joint venture's US dollar denominated debt, amounting to £6 million. This loss is more than offset by the Group's share of a gain on net monetary liabilities of £67 million, arising as a result of inflating these liabilities as part of the hyper-inflationary adjustments referred to above. Together with the minority interest's share of these items, all of these effects have been reflected as exceptional in the profit and loss account.

Retirement arrangements
Following the Merger, the Group now operates two major UK occupational pension schemes – the National Grid Company Group of the Electricity Supply Pension Scheme (the National Grid Scheme) and the Lattice Group Pension Scheme (the Lattice Scheme).

The National Grid Scheme is a defined benefit pension scheme. The Lattice Scheme has a defined benefit section which is effectively closed to new entrants and a defined contribution section. There are no current plans to merge the two schemes.

In addition to the UK schemes, employees of National Grid USA are eligible to receive retirement income benefits through defined benefit arrangements. Post-retirement healthcare and life insurance benefit are also provided to qualifying retirees.

The next actuarial valuation of the Lattice Scheme is being carried out as at 31 March 2003, while the National Grid Scheme actuarial valuation will be carried out as at 31 March 2004.

In respect of the US-based pension schemes, the latest full actuarial valuations were carried out as at 31 March 2002. These valuations were updated using assumptions and market values at 31 March 2003.

In respect of the healthcare and life insurance schemes, the latest actuarial valuations were carried out at 31 March 2002 in respect of the New England and New York schemes. Updated valuations of these schemes were carried out at 31 March 2003.

Note 7 to the accounts on pages 68 to 70 provides more information on the Group's retirement arrangements.

Pension accounting
The Group continues to account for pensions under UK GAAP in accordance with Statement of Standard Accounting Practice 24 (SSAP 24) and, consistent with that statement, the Group had been spreading pension surpluses and deficits over the remaining service lives of employees based on the information contained in the last formal actuarial valuations.

The Board is of the view that, in light of the performance of the world's stock markets over the past year, if a formal actuarial valuation of both the UK pension funds were conducted, this would in all likelihood reveal a deficit in both schemes. The continuing recognition of a surplus is incompatible with this position, and until the next formal actuarial valuations are undertaken, the decision to suspend the recognition of any further pension surplus has been taken in respect of both schemes. Consequently, with effect from 1 October 2002, the spreading of pension surpluses in respect of the UK defined benefit schemes, based on their last formal actuarial valuations at 31 March 2001, was suspended.

Adjusted operating profit and net interest included £21 million and £12 million respectively in respect of the recognition of the UK pension schemes' surplus up to 30 September 2002, totalling £33 million (£23 million net of tax). As a result of the suspension of the recognition of any further pension surplus since that date, adjusted operating profit and net interest have been reduced and increased by £21 million and £10 million respectively compared with the ongoing recognition of a surplus. Accordingly, adjusted profit before tax has been reduced by around £31 million (£22 million net of tax).

The Group does not account for pension costs under Financial Reporting Standard 17 'Retirement benefits' (FRS 17), but has provided the required transitional pension scheme disclosures as shown in note 7 to the accounts on pages 68 to 70.

Application of UK GAAP accounting policies
As explained above, the application of UK GAAP to the business combination of Lattice and National Grid has resulted in the transaction being treated as a merger. As a result, the financial information presented for all years has been prepared on the basis of common accounting policies as if the Group had always applied those accounting policies.

There have been no new UK GAAP accounting pronouncements issued during the year that have had any significant impact on the Group.

Accounting policies adopted by Lattice that were changed to accord with the accounting policies adopted by the Group were deferred taxation and the classification of the amortisation of a pension surplus in the profit and loss account. Full details of these changes are given in note 29 to the accounts on page 90.

In addition, National Grid adopted, as a merger adjustment, the accounting treatment relating to capital contributions to the cost of tangible fixed assets ('capital contributions') as previously applied by Lattice. As a result, the net book value of capital contributions included in National Grid's accounts at 31 March 2002 of £90 million has been transferred from tangible fixed assets to creditors as part of the Merger adjustments to arrive at the opening balances for creditors and tangible fixed assets at 31 March 2002 – see note 29 to the accounts on page 90.

Earnings per share
Adjusted basic earnings per share for 2002/03 were 28.3 pence compared with 30.8 pence for 2001/02. Basic earnings per share for 2002/03 rose from a loss per share of 11.3 pence in 2001/02 to earnings of 12.7 pence per share, reflecting a reduction in net exceptional charges between the two years.

A reconciliation of the movement from basic earnings per share to adjusted basic earnings per share is shown in note 11 to the accounts on page 73.

Ordinary dividends
The total ordinary dividend for 2002/03 (£530 million) amounted to 17.20 pence per ordinary share. This represents an increase of 7.2% (5% in real terms) over the previous year's National Grid ordinary dividend per share, as this is the most appropriate dividend comparison for the reason explained in 'Dividend policy' below. The total ordinary dividend per share is covered 1.6 times by adjusted earnings per ordinary share and 0.7 times by basic earnings per ordinary share.

Dividends
The table on the following page ('dividend table') shows the ordinary dividends paid or payable by National Grid Transco or National Grid, as appropriate (see 'Dividend policy' below), for the last five most recent financial years. These dividends do not include any associated UK tax credit in respect of such dividends.

Dividends	2002/03 p	2001/02 p	2000/01 p	1999/00 p	1998/99 p
Interim	**6.86**	6.46	6.05	5.59	5.25
Final	**10.34**	9.58	9.03	8.35	7.82
Total ordinary dividends	**17.20**	16.04	15.08	13.94	13.07

US dollar per ADS	2002/03 $	2001/02 $	2000/01 $	1999/00 $	1998/99 $
Interim	**0.54**	0.47	0.45	0.46	0.44
Final	**0.84**	0.73	0.65	0.63	0.61
Total ordinary dividends	**1.38**	1.20	1.10	1.09	1.05

Dividends expressed in US dollars per ADS in the dividend table reflect the actual amount paid to ADS holders, expressed to two decimal places, with respect to all amounts with the exception of the final ordinary dividend for 2002/03. The final ordinary dividend per ADS for 2002/03 reflects the declared US$ amount expressed to two decimal places.

Dividend policy
As announced on 22 April 2002, on completion of the Merger, National Grid Transco adopted National Grid's dividend policy and, as a consequence, any historical comparison of dividends paid or payable by National Grid Transco in 2002/03 and beyond should be made by reference to National Grid's dividends.

National Grid Transco's dividend policy is to aim to increase dividends per share (as expressed in pounds sterling) by a real rate of 5% in each of the financial years to March 2006.

Financial year ended 31 March 2002 (2001/02) compared with financial year ended 31 March 2001 (2000/01)

Acquisition of Niagara Mohawk
On 31 January 2002, the Group successfully completed the acquisition of Niagara Mohawk, for a consideration of £2,186 million satisfied by the issue of shares amounting to £1,270 million and cash of £916 million, including £45 million relating to the costs of acquisition. The net assets acquired had a provisional fair value of £1,376 million, subsequently revised to £1,294 million resulting in goodwill of £892 million being recognised and amortised over 20 years. Details of the acquisition are contained in note 28 to the accounts on page 89.

Niagara Mohawk contributed £83 million to adjusted operating profit and £2 million to operating profit for the period from the date of acquisition to 31 March 2002.

Group turnover
Group turnover increased from £6,891 million in 2000/01 to £7,554 million in 2001/02, substantially reflecting the acquisition of Niagara Mohawk, which accounted for over 70% of the increase. The remaining increases are substantially explained by higher distribution turnover for National Grid USA as a result of higher energy prices, which are substantially passed through to customers, and EnMo, partially offset by reduced turnover from UK electricity and gas transmission and UK gas distribution.

Group total operating profit
Total operating profit fell from £1,607 million to £359 million in 2001/02, primarily as a result of the high level of exceptional charges incurred during 2001/02. For a separate discussion of the impact of exceptional items on the results for the year, see 'Exceptional items' below.

Total adjusted operating profit rose by £3 million to £1,783 million reflecting higher adjusted contributions from:

- Niagara Mohawk amounting to £83 million. This contribution is reflected in the US electricity transmission, US electricity distribution and US gas segments;
- UK electricity and gas transmission, which increased its contribution to £781 million from £756 million in 2000/01; and
- Intelig, reflecting an adjusted operating loss of £36 million for 2001/02 as compared with £118 million for 2000/01 reflected in discontinued operations of joint ventures and associate.

These were substantially offset by lower adjusted contributions from:

- UK gas distribution, where adjusted operating profit fell by £115 million to £548 million;
- other activities of Group undertakings (continuing operations) where adjusted operating profit fell from £203 million in 2000/01 to £179 million in 2001/02;
- other discontinued operations of Group undertakings that recorded adjusted operating losses of £60 million in 2001/02 compared with £39 million for 2000/01; and
- other discontinued activities of an associate and joint ventures (excluding Intelig) that recorded adjusted losses of £18 million in 2001/02 compared with adjusted profit of £2 million in 2000/01.

Goodwill amortisation
Goodwill amortisation for 2001/02 rose by £12 million to £97 million. This increase mainly reflects the amortisation of goodwill relating to the acquisition of Niagara Mohawk and a full year's amortisation of goodwill relating to the acquisition of Eastern Utilities Associates (EUA).

Exceptional items
The results for 2001/02 included net exceptional pre-tax losses of £1,313 million (£1,147 million post-tax).

Pre-tax net exceptional charges are made up of £285 million and £1,042 million of operating exceptional items relating to continuing and discontinued operations respectively; £142 million of financing-related exceptional charges; partially offset by non-operating exceptional credits of £156 million (note 4b to the accounts on page 66). In addition, the Group reflected £50 million of exceptional minority interest credit. These net charges comprise:

- an impairment of the Group's associate and joint venture investments amounting to £792 million pre-tax (£775 million post-tax);
- an impairment of assets in 186k, a telecoms subsidiary, amounting to £250 million (£175 million post-tax);
- the Group's share of the pre- and post-tax exceptional charge of a telecoms joint venture (SST) amounting to £48 million, reflecting the write-down of an investment and goodwill in that joint venture, prior to the acquisition of all of the issued ordinary share capital of this entity by the Group;
- an impairment of the Group's LNG storage assets of £50 million (£35 million post-tax), reflecting a reduction in the expected future cash flows under the current regulatory arrangements;
- restructuring and integration costs within the UK businesses and the integration of Niagara Mohawk, amounting to £187 million pre-tax (£130 million post-tax); and
- the Group's share of Citelec's foreign exchange pre- and post-tax financing charge amounting to £142 million relating to the devaluation of the Argentine peso.

These exceptional losses were partially offset by:

- pre-tax profits amounting to £94 million (£96 million post-tax) relating to the sale of tangible fixed assets;
- a £31 million pre- and post-tax gain on the sale of BG Group shares by the Lattice 'All Employee Share Ownership Plan';
- an exceptional pre- and post-tax profit of £31 million relating to the gain on disposal of investments; and
- a credit of £50 million relating to the Group's share of the minority interest's share of the foreign exchange financing charge referred to above.

Interest
Net interest rose from £635 million in 2000/01 to £799 million in 2001/02. 2000/01 included exceptional financing costs of £142 million. A separate discussion of exceptional financing costs is contained in 'Exceptional items' above.

Net interest, excluding exceptional items as shown in note 8 to the accounts on page 71, rose from £635 million to £657 million for 2001/02. This increase is a result of the acquisition of Niagara Mohawk and an increase in the Group's share of associated undertakings net interest charge, partially offset by interest rate reductions.

Taxation
The net tax charge of £85 million for 2001/02, includes a net credit relating to exceptional items amounting to £166 million as shown in note 9 to the accounts on page 71. If these exceptional items are excluded, the adjusted tax charge for 2001/02 was £251 million, including a £73 million tax credit arising from an adjustment to prior year's tax. Excluding the exceptional tax items from the tax charge, the effective tax rate on adjusted profit before taxation for 2001/02 was 28.6%. The effective tax rate on profit before taxation before exceptional items for 2001/02 was 24.4%. Note 9 to the accounts on page 72 shows a reconciliation of the main components giving rise to the difference between the relevant effective tax rate and the UK standard corporation tax rate.

Exchange rates
Exchange rate movements had a beneficial effect on the translation of US dollar adjusted operating profit for 2001/02 compared with 2000/01. US dollar adjusted operating profit was translated at a weighted average rate of £1.00 = $1.44 during 2001/02 compared with £1.00 = $1.483 for 2000/01. If the rate that applied during 2000/01 had been used, sterling adjusted operating profit and operating profit for 2001/02 would have been lower by about £11 million and £7 million respectively.

The increased operating profit was largely offset by the increased sterling cost of US dollar debt taken out to finance US dollar denominated investments and the increased sterling cost of US taxes. As a result, the impact of the lower US dollar rate on National Grid USA's results did not have a significant effect on Group earnings per share. Similarly, the impact of exchange rates on US dollar debt and taxes means that there was no significant impact on Group adjusted earnings per share.

Exchange rate movements have favourably impacted on the Group's share of operating losses in Intelig as sterling strengthened against the Brazilian currency during 2001/02. We estimate that, compared with the average exchange rate for 2000/01, this impact reduced our share of operating losses by approximately £10 million.

As a result of the devaluation of the Argentine peso, the Group reflected its share of an exceptional foreign exchange financing charge relating to a joint venture (Citelec) of £142 million, partially offset by the minority interest's share amounting to £50 million as shown in 'Exceptional items' above.

Earnings/(loss) per share
The adjusted basic earnings per share for 2001/02 were 30.8 pence compared with 26.9 pence in the previous year. Basic earnings per share for 2001/02 fell from an earnings per share of 40.5 pence in 2000/01 to a loss of 11.3 pence per share, reflecting the very significant level of net exceptional losses in 2001/02. A reconciliation of the movement from basic earnings per share to adjusted earnings per share is shown in note 11 to the accounts on page 73.

Ordinary dividends
As shown in the dividend table on page 32, the total National Grid ordinary dividend for 2001/02 amounted to 16.04 pence per ordinary share. This represented an increase of 6.4% over the previous year.

Liquidity, resources and capital expenditure

Cash flow
Net cash inflow from operations in 2002/03 was £2,826 million compared with £2,291 million in 2001/02 and £2,353 million in 2000/01. Included within net cash inflow from operations were exceptional cash outflows of £328 million; £103 million; and £129 million in 2002/03; 2001/02; and 2000/01 respectively.

Net cash inflow from operations before exceptional items was £3,154 million in 2002/03 compared with £2,394 million in 2001/02 and £2,482 million in 2000/01. The 2002/03 increase in net cash flow from operations before exceptional items reflected the first full year contribution from Niagara Mohawk. The 2001/02 reduction in net cash flow from operations arose for a number of reasons: reduced adjusted operating profit from UK gas distribution; a special pension payment to the Lattice pension fund of £275 million; with these partially offset by the collection of under-recovered power costs relating to 2000/01 in the US; the recovery of NETA-related development costs in the UK; and the first contribution from Niagara Mohawk.

Details of the components of net cash inflow from operations before exceptional items are set out in note 27(a) to the accounts on page 87.

Exceptional cash flows in 2002/03 principally relate to cash flows arising from restructuring initiatives, Merger-related costs and environmental expenditure. In respect of 2001/02, exceptional cash outflows related to environmental and restructuring costs. In respect of 2000/01, such cash outflows related to environmental, restructuring and other costs relating to the demerger of Lattice from BG Group.

Payments to the providers of finance, in the form of dividends and interest, totalled £1,483 million (net) in 2002/03, compared with £1,183 million in 2001/02 and £1,027 million in 2000/01. Net interest cash outflows increased from £687 million and £696 million in 2000/01 and 2001/02 respectively to £901 million in 2002/03. The increase between 2001/02 and 2002/03 primarily reflects the additional net interest expense incurred for a full year following the acquisition of Niagara Mohawk on 31 January 2002.

Net corporate tax payments amounted to £112 million in 2002/03 compared with £212 million in 2001/02 and £350 million in 2000/01. Net corporate tax payments in 2002/03 were lower than in 2001/02, mainly as a result of:

- the cessation of trade in 186k creating balancing allowances that reduced UK corporation tax payable in 2002/03 by around £60 million; and
- the interaction of the timing of UK corporation tax payments on account and the Lattice Group post-tax exceptional charge in 2002/03 resulting in a reduction of around £40 million as compared with 2001/02.

Net corporate tax payments in 2001/02 were lower than in 2000/01, for two main reasons:

- as a result of the realisation for tax purposes of capital losses arising from Group restructurings, UK corporation tax repayments of approximately £65 million were received in 2001/02 in respect of payments previously made in 1999/2000 on the partial disposal of Energis in that year; and

- UK corporation tax payments in 2000/01 included amounts relating to the previous year of £61 million.

Net purchases of tangible and intangible fixed assets absorbed cash of £1,407 million in 2002/03, compared with £1,543 million in 2001/02 and £1,206 million in 2000/01. The reduction in net cash outflow in 2002/03 primarily reflects reductions in UK gas distribution; UK electricity and gas transmission; the disposal of The Leasing Group which purchased commercial vehicles and other assets for the Group; reduced expenditure on 186k assets; partially offset by increased capital expenditure arising from the acquisition of Niagara Mohawk. The increase in net expenditure in 2001/02 mainly relates to the purchase of new National Transmission System and other high pressure gas pipeline projects.

Cash outflow in 2002/03 relating to the acquisition of Group undertakings and other investments amounted to £165 million, of which £153 million related to expected contractual funding obligations in respect of joint ventures. Cash outflow in 2001/02 relating to the acquisition of Group undertakings and other investments amounted to £1,006 million, of which £932 million (including overdrafts acquired) related to the acquisition of Niagara Mohawk. This compares with cash outflows relating to the acquisition of Group undertakings and other investments amounting to £783 million in 2000/01. The 2000/01 cash outflows substantially related to the acquisition of EUA and an additional investment in Intelig.

Cash inflow from the disposal of investments in 2002/03 amounted to £328 million. This relates primarily to the receipt of £157 million in respect of the full settlement of deferred payment arrangements arising from the sale of nuclear plant conducted before the completion of the acquisition of Niagara Mohawk, £53 million from the sale of other nuclear assets and £92 million from the sale of The Leasing Group.

During 2002/03, the Group purchased for cancellation 24.2 million shares resulting in a cash outflow of £97 million.

Equity shareholders' funds
Equity shareholders' funds fell from £1,690 million at 31 March 2002 to £1,152 million at 31 March 2003. This reduction is primarily explained by net foreign exchange adjustments amounting to £322 million; share buy-backs amounting to £97 million; and retained losses for the year amounting to £139 million.

Capital expenditure
Capital expenditure in 2002/03 was £1,520 million, compared with £1,847 million in 2001/02 and £1,504 million in 2000/01. The lower level of capital expenditure for 2002/03 as compared with 2001/02 reflects a lower level of capital expenditure relating to UK gas distribution and UK electricity and gas transmission and reduced capital expenditure relating to discontinued operations. An analysis of capital expenditure by segment is contained in note 2(d) to the accounts on page 65.

The business review contains details of significant capital expenditure programmes.

Net debt and gearing
Net debt fell from £14,299 million at 31 March 2002 to £13,878 million at 31 March 2003, primarily as a result of exchange adjustments. Gearing at 31 March 2003, calculated as net debt at that date expressed as a percentage of net debt plus net assets shown by the balance sheet amounted to 92%, up from 89% at the start of the year. By comparison, the gearing ratio, adjusted for the inclusion of UK businesses at their estimated regulatory asset values ('adjusted gearing ratio'), amounted to 59%, at both 31 March 2003 and 31 March 2002.

The Group believes this adjusted ratio is a more relevant measure of 'gearing' than one based on book values alone, because the book values do not reflect the economic value of those assets.

A reconciliation of the adjustments necessary to calculate adjusted net assets is shown in the table below:

Adjustments to net assets	2003 £m	2002 £m
Net assets per balance sheet	**1,236**	1,784
Adjustment for increase in UK business regulatory values	**8,570**	8,072
Adjusted net assets	**9,806**	9,856

An analysis of debt is provided in note 20 to the accounts on page 77, and a reconciliation of the movement in net debt from 1 April 2002 to 31 March 2003 is provided in note 27(d)/(e) to the accounts on page 88.

Both short- and long-term cash flow forecasts are produced frequently to assist in identifying the liquidity requirements of the Group. These are supplemented by a financial headroom position that is supplied to the Finance Committee of the Board regularly to demonstrate funding adequacy for at least a 12-month period. The Group also maintains a minimum level of committed facilities in support of that objective.

Credit facilities and unutilised Commercial Paper and Medium Term Note Programmes
As at 31 March 2003, National Grid Transco had a US$2.0 billion US Commercial Paper Programme (US$1.1 billion unutilised); National Grid Company had a £250 million Sterling Commercial Paper Programme (unutilised); and National Grid Transco and National Grid Company had a joint Euro Medium Term Note Programme of €4 billion (€3.6 billion unissued). Transco plc had a US$1.25 billion Euro Commercial Paper Programme (unutilised); a US$2.5 billion US Commercial Paper Programme (unutilised); a US$0.5 billion Extendible Commercial Note Programme (unutilised); and a Euro Medium Term Note Programme of €7.0 billion (€2.3 billion unissued).

At 31 March 2003, the Group had £0.62 billion of short-term (364 day) committed facilities (undrawn); £0.6 billion and $2.1 billion of long-term committed facilities (undrawn); and £1.33 billion (£0.9 billion undrawn) of uncommitted borrowing facilities.

Companies within the National Grid USA group, excluding the Niagara Mohawk sub-group, had committed facilities of $419 million (£264 million), all of which were undrawn at 31 March 2003. Companies within the Niagara Mohawk sub-group had committed bank facilities of $424 million (£267 million) which were also all undrawn at the year-end. Of these undrawn amounts, $843 million was providing support to debt issuance programmes within the US group.

Treasury policy

The funding and treasury risk management of the Group is carried out by a central department operating under policies and guidelines approved by the Board. The Finance Committee, a committee of the Board, is responsible for regular review and monitoring of treasury activity and for approval of specific transactions, the authority for which may be delegated. The Group has a Treasury function that raises all of the funding for the Group and manages interest rate and foreign exchange rate risk.

The Group has separate financing programmes for each of the main Group companies. All funding programmes are approved by the Finance Committee of the Board and the Finance Committee of the appropriate Group undertaking.

The Treasury function is not operated as a profit centre. Debt and treasury positions are managed in a non-speculative manner, such that all transactions in financial instruments or products are matched to an underlying current or anticipated business requirement. The use of derivative financial instruments is controlled by policy guidelines set by the Board. Derivatives entered into in respect of gas and electricity commodities are used in support of the business' operational requirements and the policy regarding their use is explained below.

As a registered holding company, under the US Public Utility Holding Company Act of 1935 (PUHCA), National Grid Transco operates under certain regulatory restrictions applied by the SEC. As a result, the scope of the financing activity of the Group is limited to specific areas which are authorised from time to time, such authorisation being currently set sufficient to cover all normal requirements. In addition, the Company is required to maintain its consolidated common stock equity as a percentage of its total consolidated capitalisation (defined in general, as common stock equity plus preferred stock plus gross debt) measured on a book value US GAAP basis at 30% or above. At 31 March 2003, this ratio stood at 38.4%.

As a result of PUHCA and other US regulatory limits applicable to certain US companies in the Group, the freedom of these companies to provide financing amongst themselves is restricted. Nevertheless, external financings or other arrangements are in place to ensure that Group companies have adequate access to short-term liquidity.

Details of the maturity, currency and interest rate profile of the Group's borrowings as at 31 March 2003 are shown in notes 20 and 21 to the accounts on pages 77 to 81.

The Group's financial position enables it to borrow on the wholesale capital and money markets and most of its borrowings are through public bonds and commercial paper.

The Group places surplus funds on the money markets usually in the form of short-term fixed deposits which are invested with approved banks and counterparties. Details relating to the Group's cash, short-term investments and other financial assets as at 31 March 2003 are shown in note 21 to the accounts on page 80.

There exist within the Group different credit rated entities. For example, National Grid Company has a credit rating of A2/A. Transco has a credit rating of A2/A. Transco Holdings plc has been separately rated A3/A-. It is a condition of the regulatory ring-fences around National Grid Company, Transco and Transco Holdings plc that they use reasonable endeavours to maintain an investment grade credit rating. It is also an SEC requirement that National Grid Transco maintains an investment grade credit rating. By maintaining these ratings the principal borrowing entities of the Group should have ready access to the capital and money markets for future funding when necessary.

The main risks arising from the Group's financing activities are set out below. The Board and the Finance Committee reviews and agrees policies for managing each risk and they are summarised below.

Refinancing risk management
The Board mainly controls refinancing risk by limiting the amount of financing obligations (both principal and interest) arising on borrowings in any 12-month and 36-month period. This policy restricts the Group from having an excessively large amount of debt to refinance in a given time-frame. During the year, a mixture of short-term and long-term debt was issued.

Interest rate risk management
The interest rate exposure of the Group arising from its borrowings and deposits is managed by the use of fixed and floating rate debt, interest rate swaps, swaptions and forward rate agreements. The Group's interest rate risk management policy is to seek to minimise total financing costs (ie interest costs and changes in the market value of debt) subject to constraints so that, even with large movements in interest rates, neither the interest cost nor the total financing cost can exceed pre-set limits. Some of the bonds in issue from National Grid Company and Transco Holdings plc are index-linked, ie their cost is linked to changes in the UK Retail Price Index (RPI). The Group believes these bonds provide a good hedge for revenues which are also RPI-linked under the price control formula.

The performance of the Treasury function in interest rate risk management is measured by comparing the actual total financing costs of its debt with those of a passively-managed benchmark portfolio.

Foreign exchange risk management
The Group has a policy of hedging certain contractually committed foreign exchange transactions over a prescribed minimum size. It covers 75% of such transactions expected to occur up to six months in advance and 50% of transactions in the six to 12 month period in advance. Cover generally takes the form of forward sale or purchase of foreign currencies and must always relate to underlying operational cash flows.

The principal foreign exchange risk to which the Group is exposed arises from assets and liabilities not denominated in sterling. In relation to these, the objective is to match the US dollar proportion of the Group's financial liabilities to the proportion of its cash flow that arises in dollars and is available to service those liabilities.

Foreign exchange fluctuations will affect the translated value of overseas earnings. This translation has no impact on the cash flow of the Group, and accordingly is not hedged other than indirectly through the natural hedge of having foreign currency interest expense arising on currency denominated liabilities. Dividend flows may be hedged through matching with interest flows or by forward foreign exchange deals and options.

The currency composition of the Group's financial assets and liabilities is shown in note 21 to the accounts on pages 79 and 80.

Counterparty risk management
Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Finance Committee has agreed a policy for managing such risk, which is controlled through credit limits, approvals and monitoring procedures.

Derivative financial instruments held for purposes other than trading
As part of its business operations, the Group is exposed to risks arising from fluctuations in interest rates and exchange rates. The Group uses off-balance sheet derivative financial instruments (derivatives) to manage exposures of this type and as such they are a useful tool in reducing risk. The Group's policy is not to use derivatives for trading purposes. Derivative transactions can, to varying degrees, carry both counterparty and market risk.

The Group enters into interest rate swaps to manage the composition of floating and fixed rate debt, and so hedge the exposure of borrowings to interest rate movements. The Group enters into foreign currency swaps to manage the currency composition of borrowings and so hedge the exposure to exchange rate movements. Certain agreements are combined foreign currency and interest rate swap transactions. Such agreements are known as cross-currency swaps.

The Group enters into forward rate agreements to hedge interest rate risk on short-term debt and money market investments. Forward rate agreements are commitments to fix an interest rate that is to be paid or received on a notional deposit of specified maturity, starting at a future specified date.

Valuation and sensitivity analysis
The Group calculates the fair value of debt and derivative instruments by discounting all future cash flows by the market yield curve at the balance sheet date. In the case of instruments with optionality, the Black's variation of the Black-Scholes model is used to calculate fair value.

For debt and derivative instruments held, the Group utilises a sensitivity analysis technique to evaluate the effect that changes in relevant rates or prices will have on the market value of such instruments.

At 31 March 2003, the potential change in the fair value of the aggregation of long-term debt and derivative instruments was £274 million and £474 million respectively assuming a 10% change in the level of interest rates and exchange rates.

Commodity price hedging
In the normal course of business the Group is party to commodity derivatives. These include indexed swap contracts, gas futures, electricity swaps, gas options, gas forwards, gas basis swaps and oil commodity swaps that are principally used to manage commodity prices associated with its gas and electricity delivery operations. This includes the buying back of capacity rights already sold in accordance with the Group's UK Gas Transporters' Licence and Network Code obligations.

These financial exposures are monitored and managed as an integral part of the Group's financial risk management policy. At the core of this policy is a condition that the Group will engage in activities at risk only to the extent that those activities fall within commodities and financial markets to which it has a physical market exposure in terms and volumes consistent with its core business. The Group does not issue or intend to hold derivative instruments for trading purposes, and holds such instruments consistent with its various licence and regulatory obligations in the UK and US.

As a result of the restructuring of the electricity industry in New York State during 1998, Niagara Mohawk entered into indexed swap contracts that expire in June 2008. These contracts replaced the existing power purchase arrangements on terms and conditions that were more favourable to Niagara Mohawk than that allowed under the existing arrangements. Another three swap contracts that expire in June and September 2003 resulted from the sale of Niagara Mohawk's fossil fuel generating stations. The indexed swaps and fossil fuel plant swaps are the subject of regulatory rulings that allow the gains and losses to be passed on to customers.

At 31 March 2003, the Group had liabilities of £502 million in respect of these contracts and has recorded a corresponding regulatory asset. The asset and liability will be amortised over the remaining term of the swaps as nominal energy quantities are settled and will be adjusted as periodic reassessments are made of energy prices. A 10% movement in the market price of electricity would result in a £48 million movement in the value of the indexed swap contracts. There would be no impact on earnings as a result of a corresponding movement in the book value of the related regulatory asset.

Payments made by Niagara Mohawk under indexed swap contracts are affected by the price of natural gas. Niagara Mohawk uses New York Mercantile Exchange (NYMEX) gas futures as hedges to mitigate this impact. The futures contracts are derivative instruments with gains and losses deferred as an offset to the corresponding increases and decreases in the swap payments. Gains relating to these contracts at 31 March 2003 were not material and, as a result of regulatory treatments, have no impact on earnings.

Niagara Mohawk's gas rate agreement allows for collection of the commodity cost of natural gas sold to customers. The regulator also requires that actions be taken to limit the volatility in gas prices passed on to customers. Niagara Mohawk meets this requirement through the use of NYMEX gas futures and combinations of NYMEX call and put options structured as 'collars'. These contracts are hedges of Niagara Mohawk's natural gas purchases. Gains and losses are deferred until the month that the hedged contract settles. At 31 March 2003, deferred gains on these contracts were immaterial in the context of the Group as a whole.

UK transmission is obliged to offer for sale through a series of auctions a pre-determined quantity of entry capacity for every day in the year at pre-defined locations. Where, on the day, the gas transmission system's capability is constrained, such that gas is prevented from entering the system for which entry capacity rights have been sold, then UK transmission is required to buy back those entry capacity rights sold in excess of system capability. Forward and option contracts are used to reduce the risk and exposure to on-the-day entry capacity prices.

UK transmission operations have also entered into electricity options, pursuant to its requirement to stabilise the electricity market in England and Wales through the operation of the new electricity trading arrangements (NETA). The options are for varying terms and have been entered into so that the Group has the ability to deliver electricity as required to meet its obligations under the electricity Transmission Licence. The Group has not and does not expect to enter into any significant derivatives in connection with its NETA role.

Commitments, contingencies and litigation

Commitments and contingencies
The Group's commitments and contingencies outstanding at 31 March are summarised in the table below:

Commitments and contingencies	2003 £m	2002 £m
Future capital expenditure contracted for but not provided	**664**	550
Total operating lease commitments	**476**	387
Power commitments	**6,329**	7,312
Third party contingencies	**27**	455
Other commitments and contingencies	**194**	202

The Group proposes to meet these commitments from operating cash flows and from existing credit facilities, as necessary. Details of the nature of the commitments and contingencies, including an analysis of the ageing of commitments, where they can be reasonably estimated, is shown in note 31 to the accounts on pages 91 to 93.

Details of material litigation to which the Group was a party as at 31 March 2003
As a result of a fatal accident in Larkhall, Lanarkshire in December 1999 in which four people died, the Crown Office in Scotland served an indictment on Transco on 5 February 2003. This charged the company with culpable homicide, with an alternative charge of a contravention of Sections 3 and 33 of the Health and Safety at Work Act 1974. Charging the company with culpable homicide is unprecedented under Scots law and therefore before a full trial can proceed, a number of fundamental legal issues associated with the indictment are required to be resolved. At a preliminary hearing in March 2003 to determine issues as to the competency and relevancy and other associated matters in relation to the charges, judgement was issued in favour of the Crown. Transco has appealed against this decision and the appeal hearing commenced on 20 May 2003. On

indictment, the maximum penalties for both culpable homicide and contravention of Sections 3 and 33 are unlimited fines.

Regulatory authorities from Rhode Island, New Hampshire and Massachusetts have expressed an intent to challenge the reasonableness of a transaction entered into by National Grid USA, in connection with the sale of its interest in the Millstone 3 nuclear unit. Further details of the nature of this intent are contained in note 31 to the accounts on page 92.

The Group has received notification of violations of US air pollution laws relating to the operation of two coal-fired generation plants, formerly owned by Niagara Mohawk. As a consequence, the Group has been notified that US regulatory authorities are seeking substantial fines against the Group and the current owners of these generation plants. The Group is resisting these claims. Further details of this litigation are contained within note 31 to the accounts on page 93.

Critical accounting policies

The Group accounts are prepared in accordance with UK GAAP. The Group's accounting policies are described on pages 57 to 59 of the accounts. Management are required to make estimates and assumptions that may affect the reported amounts of assets, liabilities, revenue, expenses and the disclosure of contingent assets and liabilities in the accounts. The following matters are considered to have a critical impact on the accounting policies adopted by the Group:

Estimated asset economic lives – the adoption of particular asset economic lives in respect of goodwill and tangible fixed assets can materially affect the reported amounts for goodwill amortisation and depreciation of tangible fixed assets.

Goodwill, under UK GAAP, is principally being amortised over 20 years, and the economic lives of tangible fixed assets are disclosed in 'Accounting policies – e) Tangible fixed assets and depreciation'. The adoption of particular economic lives involves the exercise of judgement, and can materially impact on the profit and loss account. For the year ended 31 March 2003, the Group profit and loss account reflected goodwill amortisation and depreciation of tangible fixed assets amounting to £102 million and £851 million respectively.

Goodwill is not amortised under US GAAP, but is subject to regular impairment reviews.

Impairment of fixed assets – goodwill, fixed asset investments and tangible fixed assets are reviewed for impairment in accordance with UK GAAP. Future events could cause these assets to be impaired, resulting in an adverse effect on the future results of the Group.

Reviews for impairments are carried out under UK GAAP in the event that circumstances or events indicate the carrying value of fixed assets may not be recoverable. Examples of circumstances or events that might indicate that impairment had occurred include: a pattern of losses involving the fixed asset; a decline in the market value for a particular fixed asset; and an adverse change in the business or market in which the fixed asset is involved.

When a review for impairment is carried out under UK GAAP, the carrying value of the asset, or group of assets if it is not reasonably practicable to identify cash flows arising from an individual fixed asset, are compared to the recoverable amount of that asset or group of assets. The recoverable amount is determined as being the higher of the expected net realisable value or the present value of the expected cash flows attributable to that asset or assets. The discount rate used to determine the present value is an estimate of the rate the market would expect on an equally risky investment, and is calculated on a pre-tax basis. Estimates of future cash flows relating to particular assets or groups of assets involve exercising a significant amount of judgement.

During the year ended 31 March 2003, reviews for impairments were carried out in respect of goodwill and other assets – telecoms, LNG, interconnector and metering. Net impairment charges were recorded in respect of telecoms assets – shown as 'exceptional' and discussed under Exceptional items on page 30.

Replacement expenditure represents the cost of planned maintenance on gas mains and services assets, the vast majority relating to the Group's UK gas distribution business. This expenditure is principally undertaken to maintain the safety of the gas network in the UK and is written off to the profit and loss account as incurred, because such expenditure does not enhance the performance of those assets. If such expenditure in the future were considered to enhance these assets, it would be capitalised and treated as an addition to tangible fixed assets, thereby significantly affecting the reporting of future results.

The total amount charged to the profit and loss account in respect of replacement expenditure during the year ended 31 March 2003 was £405 million. This accounting policy only materially affects the results of the UK gas distribution segment.

Under US GAAP, this expenditure is capitalised. The US GAAP accounting policy is shown in note 34 to the accounts 'Fixed assets – impact of Lattice purchase accounting and replacement expenditure' on page 104.

Regulatory assets are recorded in the accounts under UK GAAP in accordance with the principles of SFAS 71 'Accounting for the Effects of Certain Types of Regulation', a US GAAP accounting standard. If the principles of SFAS 71 were not applicable, it would result in the non-recognition of these assets, and thereby materially alter the view given by the accounts.

In applying the principles of SFAS 71, UK GAAP measurement principles are followed in the preparation of the Group's UK GAAP results. Regulatory assets under UK GAAP are only recognised if a US GAAP regulatory asset has already been recognised, but UK GAAP measurement principles are followed with only those regulatory assets arising as a result of a past transaction or event being recorded. Regulatory assets are only recognised in respect of US activities, and primarily relate to the US electricity distribution segment.

The total carrying value of regulatory assets, under UK GAAP, at 31 March 2003 amounted to £3,743 million.

Turnover includes an assessment of energy and transportation services supplied to customers between the date of the last meter reading and the year end. Changes to the estimate of the energy or transportation services supplied during this period would have an impact on the reported results of the Group.

Estimates of energy supplied are made based on a combination of known energy purchases and historical pattern of billings information. These estimates only affect US electricity transmission, US electricity distribution and US gas activities.

Turnover in respect of transportation services supplied comprises amounts invoiced to shippers plus an estimate for transportation services supplied but not yet invoiced, which substantially represented the transportation services supplied in respect of the last month of the year. The estimated element of turnover is determined as the total of commodity services supplied, calculated from the actual volume of gas transported at estimated weighted average prices, based on recent history

and the value of capacity services supplied, which are contracted amounts. This estimate affects the UK gas distribution and UK electricity and gas transmission segments.

Under UK GAAP, the Group is not permitted to and has not recognised any liability for amounts received or receivable from customers in excess of the maximum amount allowed for the year under regulatory agreements that will result in an adjustment to future prices. Under US GAAP such liabilities are recognised.

Pensions and other post-retirement benefits – the cost of providing pensions and other post-retirement benefits is charged to the profit and loss account on a systematic basis over the service lives of the employees in the scheme in accordance with SSAP 24. As explained in note 7 to the accounts on page 69, a new UK accounting standard (FRS 17) will replace existing GAAP and significantly change the measurement and disclosure of pension and other post-retirement costs in the Group accounts.

Pension and other post-retirement benefits are inherently long term, and future experience may differ from the actuarial assumptions used to determine the net charge for 'pension and other post-retirement charges'. As explained on page 31 in 'Pension accounting', as a result of the deterioration of world stock markets, illustrating that the Group's actual experience has differed from actuarial assumptions, the Directors have suspended the continuing amortisation of pension surpluses relating to UK pension schemes with effect from 1 October 2002.

Note 7 to the accounts on page 68 describes the principal assumptions that have been used to determine the pension and post-retirement charges in accordance with current UK GAAP. The calculation of any charge relating to 'pensions and other post-retirement benefits' is clearly dependent on the assumptions used, which reflects the exercise of judgement. Management exercises that judgement having regard to independent actuarial advice.

As shown in note 7 to the accounts on pages 69 and 70, the application of the measurement principles of FRS 17 would significantly affect the results of the Group, reducing the pre-exceptional net charge for 'pensions and other post-retirement benefits' by £61 million (pre-tax).

Restructuring costs – the application of UK GAAP measurement principles results in the recognition of restructuring costs, mainly redundancy related, when the Group is irrevocably committed to the expenditure, with the main features of any restructuring plan being communicated to affected employees. If material, these costs are recognised as exceptional.

Restructuring costs recognised by the Group are referred to in 'Exceptional items' for each year discussed above.

Derivative financial instruments – derivatives are used by the Group to manage its interest rate, foreign currency and commodity price risks in respect of expected energy usage. All such transactions are undertaken to provide a commercial hedge of risks entered into by the Group.

With the exception of indexed-linked swap contracts, UK GAAP applies an 'historical cost' and 'hedge accounting' model to these derivatives. Substantially, this model results in gains and losses arising on derivatives being recognised in the profit and loss account or statement of total recognised gains and losses at the same time as the gain or loss on the item being hedged is recognised.

The application of a 'fair value' model would result in derivatives being marked to market. Gains or losses relating to these derivatives may or may not be recognised in the profit and loss account or statement of total recognised gains and losses at the same time as any related gains or losses on underlying economic exposures, depending upon whether the derivatives are deemed to have a hedging relationship.

Note 21 to the accounts on pages 79 to 81 gives a significant amount of detail relating to the Group's financial instruments. This includes the identification of the difference between the 'carrying value' and fair value of the Group's financial instruments, including derivatives.

Environmental liabilities – provision is made for liabilities arising from environmental restoration and remediation costs relating to various sites owned by the Group. The calculation of this provision is based on estimated cash flows relating to these costs discounted at an appropriate rate where the impact of discounting is material. The total costs and timing of cash flows relating to environmental liabilities are based on management estimates, and include the use of external consultants. There may be variances from these amounts that could materially affect future results.

Related party transactions

The Group provides services to and receives services from its related parties. In the year ended 31 March 2003, the Group charged £21 million and received charges of £72 million from its related parties. Amounts charged to and by Energis, the Group's former associate, amounted to £19 million and £20 million respectively.

Amounts charged to Energis were primarily in respect of enhancements to and maintenance of the Energis telecoms infrastructure, while amounts charged by Energis relate to telecoms services provided. Amounts charged to Energis also include £11 million in respect of a finance lease.

On 12 October 2002, the Group sold its subsidiary, The Leasing Group, which consequently became treated as a related party from that date until the year end.

Amounts charged to and by The Leasing Group during this period amounted to £nil and £13 million respectively.

During the year, amounts were paid to or in respect of joint ventures, arising from the Group's obligations from its decision to exit from these investments, totalling £153 million, all of which had been provided for at 31 March 2002.

Further details relating to related parties is contained within note 30 to the accounts on page 91.

Changes and developments

Any significant changes and developments that have occurred since 31 March 2003 have been noted in this Annual Report and Accounts 2002/03. Otherwise, there have been no significant changes or developments since 31 March 2003.

Going concern

Having made enquiries, the Directors consider that the Company and the Group have adequate resources to continue in business for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing the accounts.

US GAAP

The accounts have been prepared in accordance with UK GAAP which differs in certain significant respects from US GAAP. The US GAAP accounting information in note 34 to the accounts on pages 100 to 106 gives a summary of the main differences between the amounts determined in accordance with the Group's accounting policies (based on UK GAAP) and those determined in accordance with US GAAP. In addition, summary income statements, summary balance sheets, summary cash flows and a reconciliation of net income and equity shareholders' funds from UK to US GAAP are provided in note 33 to the accounts on pages 93 to 100.

As referred to earlier, UK GAAP merger accounting principles have been adopted in accounting for the business combination of National Grid and Lattice. Under US GAAP, acquisition accounting principles have been applied to the business combination, which is a fundamentally different method of accounting from merger accounting.

Under US GAAP, National Grid is viewed as the acquirer of Lattice, and as a result the separately identifiable net assets attributable to Lattice have been fair valued at the date of acquisition on 21 October 2002. Note 34 to the accounts on pages 100 and 101 details the fair value of the separately identifiable net assets acquired, together with the principal adjustments made to the book values at that date.

A further consequence of acquisition accounting, in contrast to merger accounting, is that the results of the Group under US GAAP only include the results of Lattice with effect from the date of acquisition. Therefore, under US GAAP, in respect of the Group results for the three years ended 31 March 2003, Lattice results only feature in the period 21 October 2002 to 31 March 2003. In addition, because fair values have been attributed to Lattice's separately identifiable net assets rather than the book values as used in merger accounting, goodwill is recognised.

Net income from continuing operations for 2002/03 under US GAAP was £790 million (2001/02: £690 million; 2000/01: £423 million). The US GAAP results for 2002/03, 2001/02 and 2000/01 include losses (profits) relating to discontinued operations amounting to £39 million; £857 million; and £387 million (profits) respectively. Consequently, net income for 2002/03 under US GAAP was £751 million (2001/02: £167 million (net loss); 2000/01: £810 million). This compares with the net income (loss) under UK GAAP for 2002/03, 2001/02 and 2000/01 of £391 million; £321 million (loss); and £1,124 million respectively. Equity shareholders' funds under US GAAP at 31 March 2003 were £9,426 million (31 March 2002: £3,759 million) compared with £1,152 million (31 March 2002: £1,690 million) under UK GAAP.

Because the application of merger accounting principles under UK GAAP has fundamentally affected the comparison of UK GAAP results with US GAAP results, the following is a discussion of the impact the application of US GAAP has had on the results, which should be read in conjunction with the review of the business results given on pages 10 to 20 and the rest of this financial review.

The treatment of Lattice as an acquisition under US GAAP has significantly impacted on the UK electricity and gas transmission segment, UK gas distribution segment, and 'Other', as compared with the treatment under UK GAAP. The remaining segments are unaffected by differences caused as a result of differences between merger and acquisition accounting principles. Consequently, this has impacted on the results of the segments, as follows:

- The results of the UK electricity and gas transmission segment for 2000/01 and 2001/02 under US GAAP relate solely to UK electricity activities, excluding the impact of any gas transmission activity, which is shown under UK GAAP. UK gas transmission has only impacted on the UK electricity and gas transmission in 2002/03 since the date of acquisition on 21 October 2002 and contributed £96 million to operating profit since that date;

- UK gas distribution is a new segment created as a result of the acquisition of Lattice. As a result, there is no impact on the operating result of UK gas distribution for 2001/02 or 2000/01 but the segment contributed £567 million to operating profit for 2002/03; and

- Similarly, the operating loss for 'Other' in respect of 2000/01 and 2001/02 relates solely to the activities of National Grid, which related primarily to the activities of EnMo, contracting activities and other costs incurred that were not attributable to business segments. In 2002/03, the operating loss of 'Other' amounted to £60 million, including a loss of £26 million arising from the acquisition of Lattice.

A full tabulation of the operating results and other segmental information under US GAAP is shown in note 33 to the accounts on page 98.

Note 33 to the accounts on pages 93 to 100 show a summary income statement for 2002/03; 2001/02; and 2000/01 under US GAAP. These statements have reconciled the impact that all material US GAAP adjustments have had on the UK GAAP income statement, including the impact of the elimination of all merger accounting (pooling of interests) adjustments under UK GAAP, and the inclusion of acquisition (purchase accounting) adjustments under US GAAP. The adjustments eliminating the pre-acquisition UK GAAP results impacting on turnover and operating costs are much larger in 2000/01 and 2001/02 than in 2002/03, as the adjustments do not eliminate post-acquisition results of Lattice since the date of acquisition.

Some of the adjustments included within the US GAAP summary income statements and balance sheet substantially reflect reclassifications of items that are treated differently under UK GAAP and US GAAP, but that do not significantly impact on net income or net assets.

Under UK GAAP, the operating results of discontinued operations are classified as part of total operating profit, whereas under US GAAP these amounts are shown net of any related interest and tax and shown as 'net income from discontinued operations'. Similarly, under UK GAAP, the share of equity affiliate's operating profit/(loss); net interest; taxation; and minority interests are accounted for separately, whereas under US GAAP all these amounts are accounted for within 'interest in equity accounted affiliates'. The principal adjustments to UK GAAP net income that have had a net impact in arriving at US GAAP net income are shown in note 33 to the accounts on page 99. Explanations for the principal reasons giving rise to differences between UK and US GAAP are shown in note 34 to the accounts on pages 100 to 106.

The treatment of the business combination of Lattice as an acquisition by National Grid has resulted in the recognition of provisional goodwill amounting to £3,813 million as a result of allocating provisional fair values to the separately identifiable net assets of Lattice at the date of acquisition. The fair values attributed to the net assets of Lattice, together with a description of the purchase allocation process undertaken, is shown in note 34 to the accounts on pages 100 and 101. The application of acquisition accounting principles explains the vast majority of the increase in equity shareholders' funds at 31 March 2003 from £1,152 million under UK GAAP to £9,426 million under US GAAP.

A summary US GAAP balance sheet at 31 March 2002 and 31 March 2003 is shown in note 33 to the accounts on page 97. The balance sheet at 31 March 2003 reflects the impact of the incorporation of Lattice-related net assets at fair value on the date of acquisition.

During 2002/03, as a result of the decline in the market value of pension scheme assets and in accordance with the requirements of SFAS 87, the Group has recognised an additional minimum pension liability of £1,583 million, of which £1,301 million (pre-tax) has been reflected through other comprehensive income. A reconciliation of the funded status of the Group pension and other post-retirement schemes is shown in note 34 to the accounts on page 103.

During 2002/03, the Group adopted the following US GAAP accounting standards:

- SFAS 144 'Accounting for the Impairment or Disposal of Long-Lived Assets';
- SFAS 145 'Recession of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No.13 and Technical Corrections';
- SFAS 146 'Accounting for Costs Associated with Exit or Disposal Activities';
- SFAS 148 'Accounting for Stock-Based Compensation – Transition and Disclosure – An Amendment of FAS No.123'; and
- FASB Interpretation (FIN) 45 'Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others'.

Details of the effect of adopting these accounting standards can be seen in note 34 to the accounts on page 106.

Other matters

Inflation

In the UK, the Group's operating costs may be affected by inflation both in terms of potential cost increases and in terms of the regulatory revenue control, which is influenced by, amongst other things, movements in the UK Retail Price Index. While higher inflation would tend to increase the Group's cost base, this impact would be more than offset by increased revenue allowed under the Group's regulated revenue controls.

Higher inflation would increase the cost base of the Group's US businesses. However, if there is a significant change in the rate of inflation, as measured by the change in the Gross Domestic Product Implicit Price Deflator, the regulatory settlements in Massachusetts, Rhode Island and New York allow for additional distribution revenue to be recovered from customers.

In recent years, inflation in the UK and US has been relatively stable and has not significantly affected the period under review.

Seasonality

Although demand for electricity and gas can vary on a seasonal basis, the Group's UK transmission turnover and adjusted earnings are not, generally speaking, subject to substantial seasonal variations, because the largest elements of UK transmission turnover relate to customers' use of the transmission systems. Customers are charged for these services in a number of ways, some giving rise to variation in income over a financial year, but overall this typically provides for a relatively constant revenue stream over the course of the financial year.

UK gas distribution is subject to regulatory agreements governing the maximum revenue that should be billed in a financial year. But the timings of the recognition of these revenues are such that typically 60% of total revenue would be recognised in the second half of the year.

US electricity transmission would normally provide for a relatively constant revenue stream over the course of a financial year.

US electricity distribution and US gas would usually expect total revenues in the second half of the year to be higher than the first half, as a result of a higher demand for energy in the winter months.

Euro

In January 2002, the euro was introduced as the cash currency in 12 European Union countries. This has had minimal impact on the operations of the Group. The UK may introduce the euro at a later date requiring sterling to convert irrevocably into the euro. The Group will continue to monitor and upgrade the progress already made on assessing the implications of the introduction of the euro for the Group.

Directors' Report and Operating and Financial Review
Corporate Governance and Internal Control

Corporate Governance

Compliance

Corporate Governance is essentially the way companies are directed and controlled. Shareholders are responsible for appointing the directors and the directors are then responsible for the governance of the company. The Annual Report is the main way the directors can report back to shareholders on the system of corporate governance they have put in place.

The following section should allow shareholders to understand how corporate governance operates at National Grid Transco. This explanation is required by the Listing Rules of the UK Listing Authority and must set out how the Principles of Good Governance of the Combined Code, which is attached to the Listing Rules, have been applied.

As part of the Merger process, the Board carried out a thorough governance review. It considered all procedures, policies and authorities as well as board and committee structures to ensure that these were appropriate for the newly merged Group. The aim of the Board is that the Company has in place the highest standards of corporate governance. The explanation of National Grid Transco's corporate governance (as set out below) relates to the principles adopted following the Merger.

The Combined Code also contains a Code of Best Practice. Companies are required to state whether or not they have complied with its provisions and provide explanations where they have not. National Grid Transco complied with all the provisions during the year except that requiring the appointment of a senior independent director. It was only following the Merger that James Ross, previously Chairman of National Grid Group, was nominated as the Senior Independent Director. Prior to this, it was felt that the Chairman and Group Chief Executive were the appropriate points of contact for shareholders with any concerns. This provides shareholders with a further point of contact in the event they wish to raise issues that they do not wish to discuss with the Chairman or Group Chief Executive.

Shareholders may be aware of the recent 'Review of the role and effectiveness of non-executive directors' by Derek Higgs. The review suggested a number of changes to the Combined Code. National Grid Transco considers that, following a modest number of appropriate changes, it will be well placed to comply with the majority of the recommendations contained in the Higgs Review.

Relations with shareholders

National Grid Transco has regular meetings with institutional investors, fund managers and financial analysts throughout the year. These meetings are used to discuss information made public by the Company.

Twice a year, following the publication of results, the general views of institutional shareholders prepared by the Company's brokers are discussed with the Board. This ensures that each of the Directors, including the Non-executive Directors, is fully aware of shareholders' views and any outstanding issues.

The Annual General Meeting (AGM) is the principal meeting at which National Grid Transco communicates directly with its many individual shareholders. This meeting is used to present the year's results to shareholders and allows any shareholder to ask questions of the Directors, all of whom will normally attend the AGM.

National Grid Transco will also continue the programme offered by National Grid that allowed shareholders to visit the Company, see operations at first hand and speak to senior members of staff and Directors about the business. For more information on Shareholder networking see page 120.

Directors

The Board of Directors is responsible for managing the Company's business and for establishing and overseeing its governance framework. This is based on National Grid Transco's Framework for Responsible Business, which contains statements on sustainable growth, profits with responsibility, investing in the future and behavioural values. This statement ties together elements of National Grid Transco's governance framework which includes Board Committee Terms of Reference, Delegations of Authority and the Share Dealing Code.

National Grid Transco's Board consists of the Chairman, the Group Chief Executive, six Executive Directors and seven Non-executive Directors (including the Deputy Chairman). The biographies of each of the Directors, setting out their current roles and previous experience, are on pages 26 and 27.

The Board considers that each of the Non-executive Directors is independent. This means that in the view of the Board they have no links to the Executive Directors and other managers and no business or other relationship with the Company that could interfere with their judgement.

To ensure its effectiveness, the Board has a number of matters reserved to it. By controlling these selected items, for example approving the Group's financial policy and establishing Board committees, the Board ensures that it maintains control on the corporate governance of the Company. The Board is also in the process of adopting an internal procedure to evaluate the performance of the whole Board, each Committee, the Chairman and each individual Director.

During the year, the Board met formally 15 times, excluding separate strategy meetings. For each scheduled meeting the Company Secretary, on behalf of the Chairman, collates the relevant papers and circulates them to all Directors, aiming to provide papers a minimum of four working days in advance of any meeting. All papers are considered at a senior level, often being considered first by the Group Executive Committee, and must receive support from a relevant Director.

All Directors are required to be re-elected by shareholders at the AGM following their appointment by the Board and then at least once every three years. To ensure that a representative number of Directors are re-elected by shareholders, each year one-third of the Board (excluding new Directors) must stand for re-election at each AGM.

Nominations Committee

The main role of the Nominations Committee is to review the structure, size and composition of the Board, nominating candidates where vacancies arise. It consists of the Chairman and four Non-executive Directors who consider the appointment of any new Director or Company Secretary and make recommendations to the Board. The Nominations Committee, which has clearly defined terms of reference, also considers the periodic re-election of the Non-executive Directors.

Remuneration Committee

A Remuneration Committee, consisting exclusively of Non-executive Directors, ensures that the Company has an appropriate remuneration policy for its Executive Directors and certain senior managers. The Remuneration Committee acts under clear terms of reference and aims to ensure that rewards are linked to performance. A full report on Directors' remuneration, reviewed and approved by the Remuneration Committee, is on pages 44 to 52 of this report.

Audit Committee

An Audit Committee is in place, with clear terms of reference, to keep under review and report to the Board on the effectiveness of the Company's financial reporting, internal control policies and procedures for risk management and internal audit. The Audit Committee consists entirely of independent

Non-executive Directors and meets at least four times during the year. The Audit Committee will also meet separately with the external auditors and is responsible for their appointment and compensation.

The Audit Committee is also responsible for managing the relationship with the external auditors including:

- ensuring the independence and objectivity of the external auditors;
- considering the level of audit fees (value for money) and fees paid to external auditors in respect of non-audit services; and
- discussions with the external auditors concerning compliance issues.

In relation to non-audit work by the external auditors, the Audit Committee must approve all such work in advance. Details of both the audit fees and the fees paid for non-audit services are given in note 3 to the accounts on page 65.

Risk and Responsibility Committee

The Risk and Responsibility Committee consists of three Non-executive Directors, including the Deputy Chairman, and meets at least four times a year.

The main duties of this Committee, as set out in its terms of reference, are to review proactively the strategies, policies, management, initiatives, targets and performance of the Company, and where appropriate our suppliers and contractors, in relation to occupational and public safety, occupational health, environment, equality and diversity, human rights and business ethics and the role of the Company in society.

Finance Committee

The Finance Committee is made up of the Group Chief Executive, the Group Finance Director and two independent Non-executive Directors. It is chaired by a Non-executive Director.

The Finance Committee meets at least four times a year to consider and set finance policies and make recommendations to the Board relating to items such as pensions and Company tax strategy.

Executive Committee

The Board has essentially delegated authority for the day-to-day running of the Company to the Executive Committee. As noted above, the Board retains certain responsibilities but delegates to the Executive Committee tasks such as the development of Group strategy for Board discussion and approval and the implementation of Board strategy.

The Executive Committee is chaired by the Group Chief Executive and comprises each of the other Executive Directors, Fiona Smith, the Group General Counsel and Mike Jesanis, the Chief Operating Officer of National Grid USA. The Executive Committee meets monthly and additionally as necessary.

Internal Control

National Grid Transco's system of internal control helps to safeguard shareholders' investment and the Group's assets and is designed to manage, rather than eliminate, material risks to the achievement of business objectives. The Board is responsible for the Group's system of internal control and for reviewing its effectiveness, recognising that any such system can provide only reasonable, and not absolute, assurance against material misstatement or loss. Following the Merger, the National Grid Transco Board has approved a new governance framework for the new organisation recognising that this is a key element of internal control.

In response to the requirements of the Sarbanes-Oxley Act 2002, National Grid Transco has constituted several disclosure committees. The Group disclosure committee is chaired by the Group Finance Director. The main purpose of the committee is to ensure that when disclosing information the Company represents itself completely, fairly and accurately to its security holders and that it complies with applicable laws and stock exchange requirements.

Up to the point of Merger, both National Grid and Lattice had ongoing processes in place for identifying, evaluating and managing the significant risks faced by the respective groups. Both of these processes were compliant with the Turnbull working party guidance (published September 1999) and the ABI Disclosure Guidelines on Socially Responsible Investment (published October 2001) which focus on Social, Ethical and Environmental risks. While National Grid Transco has continued to utilise those same processes for the remainder of the financial year, work has commenced to identify and pull together the best risk management practices from across the new Group. Subsequently, a new integrated approach that compares favourably with external perspectives of best practice will be rolled out to the new organisation in 2003/04. Notwithstanding this, the risk management process adopted for year-end reporting has promoted both a top-down and bottom-up assessment of risk.

- The top-down assessment has involved the Executive Directors and a number of senior executives from the businesses and Corporate Centre. It has resulted in a balanced and robust identification and consideration of cross-organisation risks that have been clearly aligned to National Grid Transco's key strategic and operational objectives.
- The bottom-up assessment, undertaken in accordance with interim risk assessment and reporting guidance, has resulted in the detailed analysis of risks by the individual businesses and corporate functions captured in the form of risk registers.

Subsequently, both elements have been pulled together through the production of a Schedule of Board-level risks. That Schedule has been presented to and discussed with both the Audit Committee and the Risk and Responsibility Committee.

Any material changes to the risks and associated controls and actions contained in the Schedule of Board-level risks and business risk registers are reported through the monthly operational business performance reports to the Executive Committee. In addition, quarterly meetings are held with Executive Directors specifically to review and discuss key changes in risk profiles.

National Grid Transco recognises that the implementation of risk management is an iterative process and subject to continuing improvement. During the year, National Grid USA and Niagara Mohawk (which was acquired in January 2002) have integrated their risk management practices. After the Merger, the process of introducing a compliance management process that seeks to raise visibility and awareness around the ever-expanding compliance obligations has been introduced. By utilising a top-down view of compliance obligations developed by Group Legal, the businesses have:

- identified their key compliance obligations and the potential impacts of non-compliance;
- identified existing controls, designed and implemented in the first instance to ensure compliance or flag instances of non-compliance should they occur;
- self-assessed the effectiveness of those existing controls and identified improvement actions; and
- discussed their findings with their respective management teams.

The Group is committed to continuing to raise the visibility and robustness of compliance management throughout the organisation.

Following the Merger, the National Grid Transco Board has approved, as part of the new governance framework, its process for reviewing the effectiveness of internal control. That process recognises that assurance over the effectiveness of internal control including risk management flows through two main sources, namely line managers and independent assurance providers. The Board, through the Executive Committee and the Audit Committee (the latter complemented by the Risk and Responsibility Committee), regularly reviews the effectiveness of internal control, including the process for identifying, evaluating and managing significant risks and compliance obligations through the assurance mechanisms detailed below. Any material matters arising are reported to the Board.

Throughout the year:

The Executive Committee considers:

- monthly safety and environmental performance reports;
- monthly operational business performance reports;
- the Group's annual business plan, including the capital programme and the annual operating budget;
- proposals for new business development and significant project expenditure;
- half-yearly self-certifications on the completeness and accuracy of financial statements and associated disclosures;
- half-yearly reviews of risk and compliance registers; and
- on an exceptions basis, reports on the results of internal audits, safety and environmental audits and occupational health reviews.

The Audit Committee considers:

- external and internal audit work plans;
- summary reports from external and internal audit on significant financial matters arising;
- key risks and compliance obligations and the extent to which risk and compliance management is being embedded in the organisation;
- specific reports from management on the actions taken to manage key risk areas and, if applicable, to address material control weaknesses and any instances of ethical misconduct and matters investigated as a result of whistleblowing; and
- the performance of the external auditors and internal audit.

The Risk and Responsibility Committee considers:

- key risks of a non-financial nature;
- safety, health and environmental audit plans;
- summary reports from assurance providers on significant non-financial matters arising; and
- specific reports from management on the actions taken to manage certain key non-financial risk areas and, if applicable, to address relevant material control weaknesses and any instances of ethical misconduct and matters investigated as a result of whistleblowing.

At the end of each financial year:

The Board:

- receives the Group Chief Executive's Letter of Assurance which seeks to confirm compliance with all major internal and external requirements, the existence of appropriate internal controls and risk management processes and provides details of material risks and any control weaknesses; and
- confirms that it has conducted a formal review of the effectiveness of internal control based on the information and assurances provided to it.

The Audit Committee considers:

- the effectiveness of the Annual Letter of Assurance process and the assurances provided by the Group Chief Executive to the Board;
- a report from the Group disclosure committee;
- a report from the Group Head of Audit on internal audit issues and the effectiveness of the control framework including fraud and malpractice occurances;
- specific reports on significant corporate governance and legal issues and risk management; and
- external audit issues.

The Risk and Responsibility Committee considers:

- specific reports on safety, health, environment and corporate responsibility;
- specific reports on significant corporate governance and legal issues and risk management.

Evaluation of disclosure controls and procedures

Within the 90 day period prior to the filing date of this report, the Company carried out an evaluation under the supervision and with the participation of its management, including the Group Chief Executive and Group Finance Director, of the effectiveness of the design and operation of the Group's disclosure controls and procedures. Based upon and as of that evaluation, the Group Chief Executive and Group Finance Director concluded that the disclosure controls and procedures are effective in all material respects to ensure that the information required to be disclosed in the reports that National Grid Transco files and submits under the US Securities Exchange Act of 1934, as amended, is recorded, processed, summarised and reported as and when required.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation.

Directors' Report and Operating and Financial Review
Directors' Remuneration Report

Remuneration Committee

Role of the Remuneration Committee and its Terms of Reference
The Remuneration Committee is responsible for developing Group policy on executive remuneration, and for determining the remuneration of Executive Directors and the executives below Board level who report directly to the Chief Executive. It also monitors the remuneration of other senior employees of the Group and has oversight of the operation of all the Group's share and share option plans. The Remuneration Committee operates within terms of reference agreed by the Board.

The Board has accepted all of the recommendations made by the Remuneration Committee during the year.

Composition of the Remuneration Committee
The Remuneration Committee is made up entirely of independent Non-executive Directors. The members of the Remuneration Committee have been as follows:

John Grant (Chairman of the National Grid Transco Remuneration Committee since the Merger, and member of the National Grid Remuneration Committee until then)

Kenneth Harvey (appointed to the National Grid Transco Remuneration Committee since the Merger)

Dr Bonnie Hill (appointed to the National Grid Transco Remuneration Committee since the Merger)

George Rose (appointed to the National Grid Transco Remuneration Committee since the Merger)

Bob Faircloth (Chairman of the National Grid Remuneration Committee until the Merger)

Richard Reynolds (member of the National Grid Remuneration Committee until the Merger).

The Group Chairman, Deputy Chairman, Chief Executive and Group Director for Human Resources (Pat Fulker) are invited to attend meetings to provide advice on remuneration policies and practices. Mark Johnson, former Director of Human Resources at National Grid, also assisted the National Grid Remuneration Committee in its consideration of Directors' remuneration before the Merger. No Director participates in any discussion on his or her own remuneration.

The Remuneration Committee also drew on advice from the following external independent remuneration consultants:

Ernst & Young LLP – appointed by the Remuneration Committee in February 2003 as independent remuneration advisors to the Committee

New Bridge Street Consultants – appointed by the Company with the agreement of the Remuneration Committee to provide advice on share schemes until the Merger

Towers Perrin UK – appointed by the Company with the agreement of the Remuneration Committee as independent remuneration advisors to it until February 2003.

In the year to 31 March 2003, the advisors to the Remuneration Committee provided other services to the Company in the UK on the following basis:

Ernst & Young LLP: assistance on International Accounting Standard (IAS) 39 'Financial Instruments: Recognition and Measurement' and SFAS 133 – compliance of Treasury Portfolios; corporate finance consultancy; international assignee tax advice; financial modelling. Towers Perrin: incentive scheme advice for non-regulated subsidiary; provision of market remuneration data in the UK – ongoing; provision of market remuneration data in the UK and remuneration consultancy in the US – ongoing.

Remuneration policy

The Remuneration Committee reviewed the Company's executive remuneration policy and practice following the Merger to ensure close alignment with the strategy of the new organisation. The Remuneration Committee determines remuneration policies and practices with the aim of attracting, motivating and retaining high calibre Directors who will deliver success for shareholders and high levels of customer service, safety and environmental performance. It is intended that this policy should conform to best practice standards in the markets in which the Group operates. The policy, which will be applied in 2003/04, and is currently intended to be applied in subsequent years, is framed around the following key principles:

Total rewards should be set at levels that are competitive in the relevant market;

A significant proportion of the Executive Directors' total rewards will be performance-based. Performance-based rewards will be earned through the achievement of demanding targets for short-term business performance and long-term shareholder value creation, consistent with the Group's Framework for Responsible Business (see page 21);

For higher levels of performance, rewards should be substantial but not excessive.

Incentive plans, performance measures and targets should be structured to operate soundly throughout the business cycle. They should be prudent and not expose shareholders to unreasonable risk.

During the year, the Committee Chairman and the relevant consultants acting on his behalf consulted with representatives of the principal investors in the Group on a variety of issues relating to this policy and its implementation.

Executive Directors' remuneration
Remuneration packages for Executive Directors consist of the following elements:

Base salary; annual bonus with share matching plan; long-term incentives; all-employee share plans; pensions; and non-cash benefits.

Excluding pensions and non-cash benefits, the balance of these elements is such that for all Executive Directors achieving 'target performance', base salary represents 49% of the remuneration package while at 'stretch' performance, base salary represents approximately 31% of the package.

The policy relating to each component of remuneration is summarised below:

Base salary: Base salaries are reviewed annually and targeted at the median position against the relevant market. In determining the relevant market, the Committee takes account of the regulated nature of the majority of the Group's operating activities, along with the business' size, complexity and international scope. For UK Executive Directors, a UK market is used, while base salary for US Executive Directors is benchmarked against practice in the appropriate US market. In setting individual base salary levels, the Remuneration Committee takes into account business and personal performance and the employment and salary practices prevailing for other employees in the Group.

Annual bonus and Share Matching Plan:
Annual bonuses are based on a combination of demanding corporate, individual and, where applicable, divisional targets. The principal corporate measures are Earnings Per Share (EPS) and cash flow; the main divisional measure is operating profit. Individual targets are set in relation to key operating and strategic objectives and, where appropriate, include safety and customer service measures. The Remuneration Committee reviews performance against targets at the end of the year and may use its discretion to adjust

payments in view of operating circumstances during the year. For the financial year 2003/04, the target and maximum bonus levels for UK-based Executive Directors are 50% and 75% of salary respectively. Rick Sergel has lower target and maximum bonus levels of 41.7% and 62.5% of base salary respectively. Rick Sergel also participates in the USA Goals Program, an all-employee bonus plan that can pay up to 4.5% of base salary on the achievement of certain earnings and performance targets. In line with US market practice, Rick Sergel's cash bonuses are pensionable.

A predetermined part of each Director's bonus entitlement is automatically deferred (net of tax) into National Grid Transco shares, and a matching award may be made under the Share Matching Plan. Currently, UK-based Executive Directors are required to defer one third of any cash annual bonus into shares in this way. At the end of three years, provided the Director is still employed by the Group, additional matching shares equal in value at the date of deferral to the pre-tax value of the amount of bonus deferred are released to the individual. US executives, including Rick Sergel, participate in this plan on a slightly different basis, in that an award calculated as a proportion of their cash annual bonus (currently 60% for Rick Sergel) is paid under this plan in National Grid Transco shares or American Depository Shares (ADSs) subject to a minimum three-year vesting period. The total target and maximum values of the annual bonus plan, including deferral and matching, are therefore 67% and 100% of base salary respectively for all Executive Directors. The participant also receives a cash payment equal to the dividends that have been paid on the matching shares over the three-year holding period.

The Remuneration Committee believes that operation of the Share Matching Plan as part of the annual bonus plan allows National Grid Transco to maintain competitiveness in annual bonus levels, while ensuring that Executive Directors hold a significant proportion of their remuneration in shares. Requiring Executive Directors to invest in the Group increases the proportion of rewards linked to both short-term performance and longer-term total shareholder returns. The bonus deferral and share match also acts as a retention tool and ensures that Executive Directors share a significant level of personal risk with the Company's shareholders.

Long-term incentives: The long-term incentive plans currently approved by shareholders are the National Grid Transco Performance Share Plan (PSP), the National Grid Executive Share Option Plan (ESOP) and the National Grid Group Share Matching Plan described above. National Grid Transco has made a commitment to shareholders to make grants under no more than two long-term incentive plans to any one Director in any year. For the year to 31 March 2004, the Remuneration Committee has decided to make grants under the PSP and the Share Matching Plan. The PSP has been selected in preference to the ESOP because the Remuneration Committee believes rewards from the PSP are likely to be less volatile, and less influenced by general stock market movements, than would be the case with the ESOP.

Under the PSP, Executive Directors, and certain other employees who have significant influence over the Group's ability to meet its strategic objectives, receive notional allocations of shares worth up to a maximum of 125% of base salary. Shares vest after three years, subject to the satisfaction of the relevant performance criteria, set by the Remuneration Committee at the date of grant. Shares must then be held for a further year, after which they are released, subject to the Executive Director's continuing employment with the Group.

The performance criterion for grants in the year to 31 March 2004 is Total Shareholder Return (TSR) relative to a comparator group as follows:

Ameren Corporation
AWG plc
Centrica plc
Consolidated Edison, Inc.
Dominion Resources, Inc.
E.ON AG
Electrabel SA
Endesa SA
Enel SpA
Exelon Corporation
FirstEnergy Corporation
FPL Group, Inc.
Gas Natural SDG SA
Iberdrola SA
International Power plc
Kelda Group plc
Pennon Group plc
RWE AG
Scottish Power plc
Scottish & Southern Energy plc
Severn Trent plc
The Southern Company, Inc.
Suez SA
United Utilities plc
Viridian Group plc

This comparator group has been selected to include companies in the energy distribution sector, against which National Grid Transco benchmarks its performance for business purposes, and other UK and international utilities. The Remuneration Committee believes that this comparator group sets a stretching target for the long-term performance of the Group. Under the terms of the PSP, the Remuneration Committee may allow shares to vest early to departing executives, and may amend the list of comparator companies if circumstances make this necessary (for example, as a result of takeovers or mergers of comparator companies).

TSR has been chosen for the performance criterion as a direct measure of shareholder value creation. In calculating TSR, it is assumed that all dividends are reinvested. In assessing whether this performance condition has been met, data purchased from Alithos Limited will be used. No shares will be released if the Group's TSR over the three-year performance period, when ranked against that of each of the comparator companies, falls below the median. For TSR at the median, 30% of the shares awarded will be released. 100% of the shares awarded will be released for TSR ranking at the upper quartile or above. For performance between median and upper quartile against the comparator group, the number of shares released is calculated on a straight-line basis.

No grants are planned to be made under the ESOP in 2003/04, unless required for recruitment purposes or to fulfil existing contractual commitments. A commitment outstanding to Edward Astle will be satisfied by a grant of options to the value of 1.5 times his base salary, after the announcement of the final results for 2002/03. Details of outstanding options granted to Directors under the ESOP, including full details of the performance conditions attaching to these options, are set out in table 3 on page 49. The TSR performance condition attaching to these outstanding options was chosen on the same basis as set out for the PSP above and will be calculated in the same way.

All-employee share plans:

- **Sharesave:** Executive Directors resident in the UK are eligible to participate in all-employee Sharesave schemes (subject to eligibility based on service).

- **US Incentive Thrift Plan:** Executive Directors resident in the US are eligible to participate in a tax-advantaged savings plan (commonly referred to as a 401(k) plan) provided for employees of National Grid USA.

- **Share Incentive Plan (SIP):** The Remuneration Committee intends to implement a SIP during the year to 31 March 2004. Employees resident in the UK, including Executive Directors, will be encouraged to participate in the SIP (subject to eligibility).

Pensions: Post-Merger, legacy pension arrangements have continued for Executive Directors. The policy for newly appointed Executive Directors is being reviewed following the recently announced Government proposals on pensions reform.

UK-based Executive Directors who were previously directors of National Grid are members of the National Grid Company Group of the Electricity Supply Pension Scheme, which is a tax-approved pension scheme. Base salary only is pensionable. The provisions for participating Executive Directors are designed to give a pension at normal retirement age of two thirds final salary subject to completion of 20 years' service (although participating Executive Directors may retire early from age 55 with a reduction in pension). Normal retirement age is 60. A spouse's pension is payable on the death in service of a participating Executive Director equal to two thirds of that payable to the participating Executive Director based on potential service to normal retirement age. On death in retirement a spouse's pension is payable equal to two thirds of the participating Executive Director's pension on death prior to exchanging any of it for a cash lump sum. Pensions in payment are increased by price inflation by up to 5% per annum. For participating Executive Directors affected by the 'earnings cap', a restriction on the amount of pay which can be used to calculate pensions due from a tax-approved pension scheme, the Company provides benefits on salary above the cap on a partially funded basis.

US-based former National Grid Executive Directors participate in a qualified pension plan and an executive supplemental retirement plan provided through National Grid USA. These plans are non-contributory defined benefit arrangements.

The qualified plan is directly funded, while the supplemental plan is indirectly funded through a 'rabbi trust'. Participating Executive Directors' benefits are calculated using a formula based on years of service and highest average compensation over five consecutive years. In line with many US plans, the calculation of benefits under the arrangements takes into account salary, bonuses and incentive share awards but not share options. Normal retirement age is 65. The executive supplemental plan, however, provides total unreduced pension benefits from age 55 for specified executives. The plans also provide for a spouse's pension of at least 50% of that accrued by the participating Executive Director unless waived by the spouse. Benefits under these arrangements do not increase once in payment.

Executive Directors who were formerly directors of Lattice Group plc participate in the defined benefit section of the Lattice Group Pension Scheme which is a tax-approved pension scheme. Base salary only is pensionable. All participating Executive Directors are subject to the earnings cap. They also participate in the Lattice Group Supplementary Benefits Scheme, an unfunded unapproved arrangement which increases retirement benefits to at least the level which would otherwise have been provided in the Lattice Group Pension Scheme, had they not been subject to the earnings cap. The provisions for participating Executive Directors are designed to give two thirds of salary (which may be restricted by remuneration averaged over three years) at retirement age, inclusive of any pension rights earned in previous employment. Normal retirement age is 65. With the employer's consent, provided 10 years' service has been completed with National Grid Transco (which includes pensionable service transferred from previous employment), the accrued pension can be paid from age 55 with no actuarial reduction in benefit. A dependant's pension is payable on death in service of a participating Executive Director based on potential service to normal retirement age. On death in retirement, a dependant's pension is payable equal to two thirds of the participating Executive Director's pension, prior to exchanging any of it for a cash lump sum. Pensions in payment are increased in line with price inflation.

Provision has been made in the accounts in respect of unfunded obligations for post-retirement benefits.

Non-cash benefits: The Company provides competitive benefits to Executive Directors, such as a fully expensed car or cash alternative in lieu of car, chauffeur, financial advice, private medical insurance and life assurance. UK-based Executive Directors with less than five years continuous service, who were previously directors of National Grid, are provided with long-term ill health insurance. Business expenses incurred are reimbursed in such a way as to give rise to no material benefit to the Director.

Share ownership guidelines: Executive Directors are encouraged to build up and retain a shareholding of at least one times annual base salary. As a minimum, this should be achieved by retaining 50% of the after-tax gain on any options exercised or shares received through the long-term incentive or all-employee share plans.

Share dilution through the operation of share-based incentive plans: Where shares are issued to satisfy incentives, the aggregate dilution resulting from executive incentives will not exceed 5% in any ten-year period, and dilution resulting from all

	Date of contract	Notice period (i)
Executive Directors		
Roger Urwin	17 November 1995	12 months
Steve Lucas	13 June 2002	12 months
Edward Astle	27 July 2001	(ii)
Steve Holliday	6 March 2001	12 months
Rick Sergel	22 March 2000	12 months
John Wybrew	13 June 2002	12 months
Stephen Box (resigned 21/10/2002)		
William Davis (resigned 21/10/2002)		

	Date of contract/letter of appointment	Notice period (i) End of period of appointment
Non-executive Directors		
Sir John Parker	13 June 2002	12 months
James Ross	24 October 2001	2004 AGM
John Grant	24 October 2001	2004 AGM
Kenneth Harvey	11 June 2002	2006 AGM
Bonnie Hill	11 February 2002	2005 AGM
Paul Joskow	24 October 2001	2005 AGM
Stephen Pettit	11 June 2002	2006 AGM
George Rose	11 June 2002	2006 AGM
Bob Faircloth (resigned 21/10/2002)		
Richard Reynolds (resigned 21/10/2002)		

(i) The contracts for the Chairman, Sir John Parker, and all current Executive Directors are for rolling 12-month periods.
(ii) Edward Astle's contract commenced with effect from 1 September 2001. For the first year, the notice period was two years. For the second year, the notice period declines on a straight-line basis until with effect from 1 September 2003, his notice period will be 12 months.

incentives, including all-employee incentives, will not exceed 10% in any ten-year period. The Remuneration Committee reviews dilution against these limits regularly.

Non-executive Directors' remuneration: Non-executive Directors' fees are determined by the Executive Directors, or by a Committee authorised by the Board, subject to the limits applied by National Grid Transco's Articles of Association. Non-executive Directors' remuneration is built up from an annual fee, a fee for each Board meeting attended (with a higher fee for meetings held outside their country of residence), and an additional fee payable for Committee chairmanship.

Directors' service contracts: Service contracts for Executive Directors are set at one year's notice. The application of longer contract periods at appointment, reducing after an initial period, may be used in exceptional circumstances if considered appropriate by the Remuneration Committee to recruit certain key executives. The service contract of Nick Winser (appointed to the Board with effect from 28 April 2003) will be set at one year's notice.

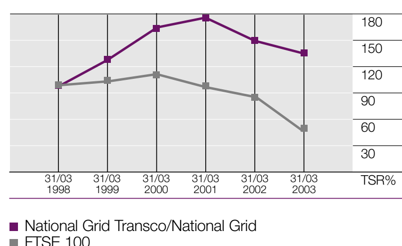
Sir John Parker's contract provides for a liquidated damages payment of one year's salary if his contract is terminated within one year of a change of control of the Company. The contracts of Steve Lucas and John Wybrew provide for a liquidated damages payment of one year's salary plus a credit of one year's pensionable service if their contracts are terminated within one year of a change of control of the Company. Rick Sergel's contract provides for compensation following the termination of his contract either without cause or within two years following a change of control of one year's salary, annual bonus (including share matching) at target level and the maintenance, at the Company's expense, of his benefit programmes for three years.

The Remuneration Committee, in determining any other such payments will give due regard to the comments and recommendations of the Combined Code, the UK Listing Authority's Listing Rules and associated guidance and other requirements of legislation, regulation and good governance.

Directors' letters of appointment: The terms of engagement of Non-executive Directors (excluding Sir John Parker) are set out in letters of appointment. The initial appointment and any subsequent re-appointment is subject to election or re-election by shareholders. The letters of appointment do not contain provision for termination payments.

Performance graph

National Grid Transco/National Grid TSR vs FTSE 100



The graph above represents the comparative TSR performance of the Group from 31 March 1998 to 31 March 2003. For the period before the Merger of National Grid Group and Lattice, the TSR shown is that of National Grid Group.

This graph shows the Group's performance against the performance of the FTSE 100 index, which is considered an appropriate comparator as it is a broad equity market index of which National Grid Transco is a constituent. This graph has been produced in accordance with the requirements of the Directors' Remuneration Report Regulations 2002.

In drawing this graph it has been assumed that all dividends paid have been reinvested. The TSR level shown at 31 March each year is the average of the closing daily TSR levels for the 30-day period up to and including that date.

Remuneration outcomes during the year ended 31 March 2003

Tables 1A, 1B, 2, 3 and 4 comprise the 'auditable' part of the Directors' Remuneration Report, being the information required by part 3 of schedule 7A to the Companies Act 1985.

1. Directors' emoluments

The following tables set out an analysis of the pre-tax remuneration during the years ended 31 March 2003 and 2002, including bonuses but excluding pensions, for individual Directors who held office in National Grid Transco and National Grid during the year ended 31 March 2003.

Table 1A
Executive Directors

	Year ended 31 March 2003					Year ended 31 March 2002
	Base salary £000	Annual bonus £000	Termination payments £000	Benefits in kind (i) £000	Total £000	Total (ii) £000
Roger Urwin	600	300	–	24	924	794
Steve Lucas	315	164	–	18	497	423
Edward Astle (iii)	325	266	–	15	606	284
Steve Holliday	325	169	–	23	517	444
Rick Sergel	519	219	–	17	755	728
John Wybrew	360	176	–	28	564	500
Stephen Box (resigned 21/10/2002) (iv)	233	111	4	13	361	532
William Davis (resigned 21/10/2002)	301	10	–	5	316	139
Totals	2,978	1,415	4	143	4,540	3,844

(i) Benefits in kind comprise benefits such as a fully expensed car or cash alternative in lieu of car, chauffeur, private medical insurance and life assurance.
(ii) Totals for the year ended 31 March 2002 for Steve Lucas and John Wybrew include bonus payments in respect of the 15-month period 1 January 2001 to 31 March 2002.
(iii) Edward Astle's annual bonus figure includes a payment of £50,000 in June 2002 and a further payment of £50,000 in August 2002 in respect of special bonus arrangements agreed at the time of his original contract. He was appointed to the Board of National Grid on 1 September 2001.
(iv) Stephen Box resigned from the Board with effect from 21 October 2002 but remained an employee until 30 November 2002 when he retired on health grounds. He received his salary to 30 November 2002 and his bonus was pro-rated for eight months of the year. An ex-gratia payment of £3,957 will be made to Stephen Box equal to the dividends which would have been earned on those shares subject to his matching options under the Share Matching Plan.

Table 1B
Non-executive Directors

	Year ended 31 March 2003			Year ended 31 March 2002
	Fees £000	Other emoluments £000	Total £000	Total £000
Sir John Parker (i)	386	26	412	343
James Ross	175	22	197	165
John Grant	38	–	38	35
Kenneth Harvey	30	–	30	30
Bonnie Hill (ii)	32	–	32	4
Paul Joskow (iii)	50	–	50	57
Stephen Pettit	25	–	25	10
George Rose	30	–	30	30
Bob Faircloth (resigned 21/10/2002)	21	–	21	42
Richard Reynolds (resigned 21/10/2002) (iv)	32	–	32	55
Totals	819	48	867	771

(i) Sir John Parker's fees include a supplement of £23,000 per month from 22 November 2001 to the date of the Merger while temporarily acting as Chief Executive of Lattice Group plc. This supplement totalled £161,000 (2001/02: £98,000).
(ii) Appointed to the Board of National Grid on 11 February 2002.
(iii) Paul Joskow's fees include US$22,500 (2001/02: US$30,000) paid in respect of strategic advice provided on regulatory issues to National Grid USA.
(iv) Richard Reynolds' fees include a fee at the rate of £25,000 per annum (2001/02: £25,000 per annum) in respect of additional duties as a member of the Supervisory Board of Intelig.

2. Directors' pensions

The table below gives details of the Executive Directors' pension benefits in accordance with both the Directors' Remuneration Report Regulations and the Listing Rules.

Table 2

Executive Directors	Additional benefit earned (excluding inflation) during the year ended 31 March 2003 Pension £000 pa	Accrued entitlement as at 31 March 2003 Pension £000 pa	Transfer value of accrued benefits as at 31 March (i) 2003 £000	Transfer value of accrued benefits as at 31 March (i) 2002 £000	Increase in transfer value less Director's contributions £000	Additional accrued pension earned in the year (excluding inflation) £000 pa	Transfer value of increase in accrued pension (excluding Director's contributions and inflation) £000
Roger Urwin	70	370	6,291	4,717	1,556	65	1,090
Steve Lucas (ii),(iii)	18	99	951	958	(17)	16	147
Edward Astle	11	17	189	65	114	11	112
Steve Holliday	13	22	214	87	116	13	113
Rick Sergel	60	377	2,259	1,454	805	60	360
John Wybrew (ii)	17	105	1,981	1,595	375	16	284
Stephen Box (resigned 21/10/2002) (iv)	92	146	3,297	663	2,627	91	1,977
William Davis (resigned 21/10/2002) (v)	15	37	359	281	78	15	21

(i) The transfer values shown at 31 March 2002 and 2003 represent the value of each Executive Director's accrued pension based on total service completed to the relevant date. The transfer values for the UK Executive Directors have been calculated in accordance with guidance note 'GN11' issued by the Institute of Actuaries and the Faculty of Actuaries. The transfer value given above for Stephen Box at 31 March 2003 relates to his pension after reduction for commutation, plus the commutation lump sum of £329,000 and pension payments of £39,700 made during the year. The transfer values for the US Executive Directors have been calculated using discount rates based on high yield US corporate bonds and associated yields at the relevant dates.

(ii) Steve Lucas and John Wybrew became Executive Directors on 21 October 2002 and were previously Executive Directors of Lattice Group plc. The information provided is for the full year to 31 March 2003.

(iii) Due to clarification of remuneration since 31 March 2002, the accrued annual pension as at 31 March 2002 should have been £81,300 and not £71,400 as previously stated in the Lattice Group accounts.

(iv) The accrued pension figures for Stephen Box are before commutation, although in practice he retired on ill health grounds on 30 November 2002 and took a lump sum of £329,000 by commutation, leaving a residual pension of £119,000 per annum.

(v) William Davis retired on 31 March 2003 with an annual pension of £36,695. His non-qualified benefits under Niagara Mohawk's Supplemental Executive Retirement Plan were paid to him by way of a lump sum payment of £6,265,202 in January 2002.

3. Directors' interests in share options

Table 3

	Options held at 1 April 2002 or on appointment*	Options exercised or lapsed during the year	Options granted during the year	Options held at 31 March 2003 or on resignation†	Exercise price per share (pence)	Normal exercise period	
Roger Urwin							
Executive	169,340	–	–	169,340	280.50	Sep 2000	Sep 2007
	91,656	–	–	91,656	375.75	June 2001	June 2008
	22,098	–	–	22,098	455.25	June 2002	June 2009
	33,867	–	–	33,867	531.50	June 2003	June 2010
	133,214	–	–	133,214	563.00	June 2004	June 2011
	–	–	186,915	186,915	481.50	June 2005	June 2012
Share Match	4,047	–	–	4,047	100 in total	June 2001	June 2005
	3,884	–	–	3,884	100 in total	Jan 2002	June 2006
	3,859	–	–	3,859	100 in total	Jan 2002	June 2007
	5,635	–	–	5,635	100 in total	June 2004	June 2008
	–	–	18,644	18,644	100 in total	June 2005	June 2012
Sharesave	3,692	–	–	3,692	457.00	Sep 2006	Feb 2007
Total	**471,292**	**–**	**205,559**	**676,851**			
Edward Astle							
Executive	193,952	–	–	193,952	479.50	Sep 2004	Sep 2011
	–	–	101,246	101,246	481.50	June 2005	June 2012
	–	–	112,262	112,262	434.25	Dec 2005	Dec 2012
Share Match	–	–	6,553	6,553	100 in total	June 2005	June 2012
Sharesave	–	–	2,392	2,392	397.00	Sep 2005	Feb 2006
Total	**193,952**	**–**	**222,453**	**416,405**			

3. Directors' interests in share options continued

	Options held at 1 April 2002 or on appointment *	Options exercised or lapsed during the year	Options granted during the year	Options held at 31 March 2003 or on resignation †	Exercise price per share (pence)	Normal exercise period	
Stephen Box (resigned from the Board on 21 October 2002)							
Executive	160,427	–	–	160,427†	280.50	Sep 2000	Sep 2007
	93,147	–	–	93,147†	375.75	June 2001	June 2008
	43,931	–	–	43,931†	455.25	June 2002	June 2009
	37,630	–	–	37,630†	531.50	June 2003	June 2010
	93,250	–	–	93,250†	563.00	June 2004	June 2011
Share Match	3,844	–	–	3,844†	100 in total	Jan 2002	June 2006
	4,122	–	–	4,122†	100 in total	Jan 2002	June 2007
	6,134	–	–	6,134†	100 in total	June 2004	June 2008
Total	**442,485**	**–**	**–**	**442,485**			
Steve Holliday							
Executive	150,000	–	–	150,000	540.00	Mar 2004	Mar 2011
	71,936	–	–	71,936	563.00	June 2004	June 2011
	–	–	101,246	101,246	481.50	June 2005	June 2012
Share Match	–	–	10,350	10,350	100 in total	June 2005	June 2012
Sharesave	3,692 (i)	–	4,692 (i)	4,692	350.00	Mar 2008	Aug 2008
Total	**225,628**	**–**	**116,288**	**338,224**			

(i) During the year, Steve Holliday elected to cancel his sharesave option over 3,692 shares at an option price of 457p. He was granted a new sharesave option over 4,692 shares during the year.

	Options held at 1 April 2002 or on appointment *	Options exercised or lapsed during the year	Options granted during the year	Options held at 31 March 2003 or on resignation †	Exercise price per share (pence)	Normal exercise period	
Rick Sergel (ii)							
Executive	201,845	–	–	201,845	566.50	Mar 2003	Mar 2010
	134,321	–	–	134,321	563.00	June 2004	June 2011
	–	–	172,836	172,836	481.50	June 2005	June 2012
Total	**336,166**	**–**	**172,836**	**509,002**			

(ii) Rick Sergel's participation in the Share Matching Plan is in the form of phantom ADSs. He was awarded 5,332 phantom ADSs in June 2002 which vest in June 2005, and 4,240 phantom ADSs in June 2001 which vest in June 2004. The value of an ADS at 31 March 2003 was US$30.75.

	Options held at 1 April 2002 or on appointment *	Options exercised or lapsed during the year	Options granted during the year	Options held at 31 March 2003 or on resignation †	Exercise price per share (pence)	Normal exercise period	
John Wybrew (appointed to the Board on 21 October 2002)							
Executive	–	–	62,262	62,262	434.25	Dec 2005	Dec 2012
Sharesave	3,078* (iii)	–	–	3,078	314.50	Mar 2004	Aug 2004
Total	**3,078***	**–**	**62,262**	**65,340**			

(iii) Pursuant to the Merger proposals, John Wybrew elected to release his existing sharesave option over Lattice Group shares in exchange for a new sharesave option over National Grid Transco shares. The replacement option was granted under the Lattice Group Sharesave Scheme and has the same maturity date as the original option.

	Options held at 1 April 2002 or on appointment *	Options exercised or lapsed during the year	Options granted during the year	Options held at 31 March 2003 or on resignation †	Exercise price per share (pence)	Normal exercise period	
Steve Lucas (appointed to the Board on 21 October 2002)							
Executive	–	–	54,404	54,404	434.25	Dec 2005	Dec 2012
Sharesave	–	–	2,700	2,700	350.00	Mar 2006	Aug 2006
Total	**–**	**–**	**57,104**	**57,104**			
William Davis (iv) (resigned from the Board on 21 October 2002)							
Executive	–	–	179,791	179,791†	481.50	June 2005	June 2012
Total	**–**	**–**	**179,791**	**179,791**			

(iv) William Davis' participation in the Share Matching Plan was in the form of phantom ADSs. He was awarded 1,083 phantom ADSs in June 2002 which vested upon his retirement on 31 March 2003. The value of an ADS at 31 March 2003 was US$30.75.

Executive Share Option Plan (ESOP)

An option will normally be exercisable between the third and tenth anniversaries of its date of grant, subject to performance conditions. The performance conditions attaching to outstanding ESOP options are set out below. If the performance condition is not satisfied after the first three years, it will be re-tested as indicated.

The options granted to Directors in September 1997 and June 1998 have vested. For options granted in June 1999 and March 2000 to become fully exercisable, the Company must achieve EPS growth over three years of RPI plus 3% per annum. Only half the option will be exercisable if EPS growth over three years equals RPI plus 2% per annum. The performance condition will be re-tested throughout the lifetime of the option.

For options granted from June 2000, options worth up to one times an optionholder's base salary will become exercisable in full if Total Shareholder Return (TSR) measured over a period of three years, beginning with the financial year in which the option is granted, is at least median compared with a comparator group of companies (such comparator group being in compliance with the performance condition).

Grants in excess of 100% of salary vest on a sliding scale, becoming fully exercisable if the Company's TSR is in the top quartile. The performance condition attaching to options granted in June 2000 is tested annually throughout the lifetime of the option. For options granted from March 2001 the same TSR test is used but the performance condition can only be re-tested in years 4 and 5.

The comparator group was revised in June 2002 to reflect, inter alia, consolidation in the marketplace, the acquisition of Niagara Mohawk and the proposed Merger with Lattice Group plc. The revised comparator group was used for options granted in June and December 2002 and is set out below.

Allegheny Energy, Inc.
BG Group plc
British Energy plc
Centrica plc
Consolidated Edison, Inc.
Duke Energy Corporation
Energy East Corporation
Exelon Corporation
FirstEnergy Corporation
FPL Group, Inc.
International Power plc
Northeast Utilities Corporation
NSTAR Corporation
Potomac Electric Power Company
Powergen Limited
Progress Energy, Inc.
Public Service Enterprise Group, Inc.
Scottish & Southern Energy plc
Scottish Power plc
The Southern Company, Inc.
TXU, Inc.
United Utilities plc
Xcel Energy, Inc.

Details of the closing price of National Grid Transco shares as at 31 March 2003 and the high and low prices during the year are shown in table 5 Directors' beneficial interests. Details of the 1999 Lattice LTIS awards rolled over into options are set out in table 4 below.

4. Lattice Long Term Incentive Scheme (LTIS)

The following Lattice LTIS awards were rolled over at the time of the Merger by John Wybrew and Steve Lucas and were still held at the end of the last financial year. The market value of National Grid Transco shares on Merger (21 October 2002) was 459.625p.

Table 4

John Wybrew

		Date award vests/option becomes exercisable
1999 award (converted to an option on Merger)	114,380	Oct 2003
Dividend reinvested on shares held in trust	1,799	Oct 2003
2000 award	95,597	Nov 2004
2001 award	112,687	Nov 2005
Total	**324,463**	

Steve Lucas

		Date award vests/option becomes exercisable
1999 award (converted to an option on Merger)	31,237	Oct 2003
Dividend reinvested on shares held in trust	491	Oct 2003
2000 award	79,902	Nov 2004
2001 award	96,589	Nov 2005
Total	**208,219**	

Under the terms of the Lattice LTIS notional allocations of shares were made to key individuals. The allocations were subject to a three-year performance period set out below and a further retention period of one year. The number of shares actually released to participants depends on the Company's TSR compared with that of other regulated utility companies operating in a similar environment.

No awards will be made if the Company's TSR when compared with that of other companies in the comparator group over the performance period falls below the median. Between the median company and the upper quartile of companies the proportion of shares which may be transferred is pro-rated on a straight-line basis between 40% and 100%.

The Remuneration Committee will decide that shares should be released only if the Company's TSR also reflects sound underlying financial performance.

Pursuant to the Merger proposals, John Wybrew and Steve Lucas agreed to roll over their existing LTIS awards over Lattice Group shares for LTIS awards or options over National Grid Transco shares. Consequently, on 21 October 2002, the 2000 and 2001 LTIS awards held by John Wybrew and Steve Lucas continued over the number of National Grid Transco shares shown above and remain subject to the rules of the Lattice LTIS except that (i) since 21 October 2002, the performance target measures the Company's total shareholder return against the original comparator group of each award; and (ii) the awards will not be forfeit on John Wybrew or Steve Lucas ceasing employment unless the Remuneration Committee decides otherwise.

The comparator group for the 2000 and 2001 LTIS awards is set out below:

Powergen Limited
Kelda Group plc
Scottish & Southern Energy plc
BAA plc
Pennon Group plc
United Utilities plc
Severn Trent plc
AWG plc
Centrica plc
Scottish Power plc
Viridian Group plc
International Power plc
British Energy plc
BT Group plc
Railtrack plc (2000 only)
Thames Water plc (2000 only)

For the roll-over of the 1999 LTIS awards, John Wybrew and Steve Lucas have each been granted a £1 option by the Trustee of the Lattice Group Employees Share Trust over the number of shares which would otherwise be subject to their 1999 awards. The options will become exercisable on 1 October 2003, when the shares subject to the original 1999 awards would have been released to John Wybrew and Steve Lucas.

5. Directors' beneficial interests

The Directors' beneficial interests (which include those of their families) in the ordinary shares of National Grid Transco (which from 1 April 2002 to 21 October 2002 was National Grid Group) of 10p each are shown below:

	Ordinary shares at 31 March 2003 (i) or on resignation †	Ordinary shares at 1 April 2002 or on appointment*	Options over ordinary shares at 31 March 2003 or on resignation †	Options over ordinary shares at 1 April 2002 or on appointment*
Sir John Parker	17,429	4,729*	–	–
James Ross	19,000	19,000	–	–
Roger Urwin (ii)	159,518	147,920	676,851	471,292
Edward Astle (ii)	3,932	-	416,405	193,952
Stephen Box	18,459†	18,459	442,485†	442,485
William Davis	11,755†	11,520	179,791†	–
Bob Faircloth	–	–	–	–
John Grant	10,000	10,000	–	–
Ken Harvey	1,874	1,861*	–	–
Bonnie Hill	2,930	2,930	–	–
Steve Holliday (ii)	6,210	–	338,224	225,628
Paul Joskow	5,000	5,000	–	–
Steve Lucas (ii),(iii),(iv),(v)	23,789	23,471*	265,323	207,728*
Stephen Pettit	1,875	1,875*	–	–
Richard Reynolds	10,000†	10,000	–	–
George Rose	5,025	5,025*	–	–
Rick Sergel (ii)	2,928	2,763	509,002	336,166
John Wybrew (ii),(iii),(iv),(v)	62,344	62,025*	389,803	325,742*

(i) There have been no other changes in the beneficial interests of the Directors in the ordinary shares of National Grid Transco between 1 April 2003 and 20 May 2003.
(ii) Each of the Executive Directors of National Grid Transco was, for Companies Act 1985 purposes, deemed to be a potential beneficiary under the National Grid Qualifying Employee Share Ownership Trust ('QUEST') and the National Grid 1996 Employee Benefit Trust and thereby to have an interest in the 9,040,718 National Grid Transco shares held by the QUEST and the 440,618 National Grid Transco shares held by the 1996 Employee Benefit Trust as at 31 March 2003.
(iii) Each of the former Lattice Executive Directors of National Grid Transco (Steve Lucas and John Wybrew) was, for Companies Act 1985 purposes, deemed to be a potential beneficiary in the 1,069,339 National Grid Transco shares held by Mourant and Co. Trustees as Trustee of the Lattice Group Employees Share Trust operated in conjunction with the Lattice LTIS and the 127,992 National Grid Transco shares held by Lattice Group Trustees Limited as Trustee of the Lattice Group Employee Share Ownership Trust.
(iv) Beneficial interest includes shares acquired pursuant to the Lattice AESOP and the BG Group Employee Profit Sharing Scheme.
(v) Including the Lattice LTIS award detailed above.

Nick Winser was appointed to the Board on 28 April 2003 and on that date had a beneficial interest in 17,489 National Grid Transco shares and held options over a further 150,225 National Grid Transco shares.

All of the shares held under the former Lattice AESOP have been allocated and are beneficially owned by participants of the plan. The closing price of a National Grid Transco share on 31 March 2003 was 387.5p. The range during the year was 511.5p (high) and 365.75p (low). Please note the Register of Directors' Interests contains full details of shareholdings and options held by Directors as at 31 March 2003.

On behalf of the Board

Helen Mahy
Group Company Secretary
20 May 2003

Directors' Report and Operating and Financial Review
Risk Factors

National Grid Transco has established an internal process for the review of and response to actual and potential risks facing the Group. More information on this process is set out in the section of this document entitled 'Internal Control' on pages 42 to 43. The following are the significant risks the Group is aware of as a consequence of this process that could have a materially adverse effect on its business, turnover, profits, assets, liquidity, capital resources and/or reputation. Any forward-looking statements contained in this document should be considered in light of these risk factors and the cautionary statement set out on the inside front cover.

Law and regulation
Most of National Grid Transco's businesses are utilities subject to the laws of and regulation by government and/or regulatory authorities in the UK, the US, the European Union or other jurisdictions. Changes in law or regulation in the countries and/or states in which the Group's businesses operate could have an adverse effect on those businesses. Decisions by regulators and/or regulatory authorities concerning, for example, whether licences/concessions/approvals to operate those utilities are renewed or not, the level of permitted revenues, the allowance of pass-through of costs such as the cost of funding pension schemes, allowed rates of return for these businesses, market trading arrangements, the facilitation of competition in markets in which the Group operates and proposed business development activities could have an adverse impact on the Group's results of operations, cash flow, financial condition and the ability to develop those businesses in the future. The introduction of the British Electricity Transmission and Trading Arrangements (BETTA) could affect financial returns for the Group depending upon the terms of the relevant regulations. For more information concerning BETTA, see page 14 of the 'Business Review' section of this document. The requirement for the Group's businesses in the UK, particularly Transco, to conduct working practices so as to comply with the New Road and Streetworks Act 1991 or to meet any liabilities for breach could increase operational costs and thereby affect business performance. The development of GridAmerica is subject to, amongst other things, regulation by the FERC and relevant US state regulators. The timing and content of regulatory decisions by those organisations could adversely affect the development of and/or financial return from GridAmerica's business. The Group is also subject to law and regulation arising from its issue of securities, such as those recently introduced and/or in the course of introduction by the Sarbanes-Oxley Act of 2002.

Safety and environment
Aspects of the Group's business are inherently dangerous, such as the operation and maintenance of electricity lines and the transmission and distribution of natural gas. Electricity and gas utilities typically use and generate in their operations a range of potentially hazardous products and by-products. The Group is subject to numerous laws and regulations in each of the jurisdictions in which it operates relating to pollution, the protection of the environment, the generation, storage, handling, transportation, treatment, disposal and remediation of hazardous substances and waste materials, and the health and safety of employees and the general public. Breach of these laws and regulations, or any safety or environmental incident without a breach, could expose the Group to claims for financial compensation, to adverse regulatory consequences and/or otherwise damage the Group's relationship with its stakeholders. This area of the Group's business is subject to increasing regulation and/or changes in the legal requirements within which it operates.

Operational performance
The Group may suffer a major transmission or distribution network failure and/or may not be able to carry out critical non-network operations. Electricity and gas utilities are subject to certain risks that are largely outside their control such as the weather or possible security breaches. Weather conditions can affect financial performance, particularly in the US. In addition, severe weather that causes outages or damages infrastructure will adversely affect operational and business performance. Terrorist attack or sabotage may also physically damage one or more of the Group's businesses or otherwise significantly affect its corporate activities. Other risks to operational performance could include inadequate record keeping, failure to maintain the health of the system or network and/or inadequate forecasting of demand.

Business performance
Earnings maintenance and growth from the UK regulated gas and electricity industry are dependent upon outperforming regulatory efficiency targets set by Ofgem. Generally, over time, the continued ability to make efficiency improvements will decline. National Grid Transco has published cost and efficiency savings targets for its UK regulated businesses. To meet these targets National Grid Transco must continue to improve management and operational performance. Under the US state rate plans, earnings from the US regulated businesses of the Group will be affected by the ability to deliver integration savings. To meet National Grid Transco's announced savings targets for its acquisition of Niagara Mohawk and in relation to the Merger, the Group must improve the efficiency and reduce the costs of those businesses. US earnings are also dependent on meeting service quality standards set by state regulators. To meet such standards, the Group must improve service reliability and customer service. National Grid Transco's unregulated businesses may also fail to reach the Group's financial targets because of market conditions or other reasons. For example, Gridcom may be adversely affected by a deterioration in the mobile telecommunications market. The achievement of the Group's objectives will be influenced by general economic conditions in the jurisdictions in which the Group operates and, in particular, in the US. Other factors include potential increases in business and property taxes/rates in the US and the UK which could adversely affect the Group's results. The performance of the Group's businesses may also be affected by human resource issues such as the loss of key management or strikes, 'working to rule' and other industrial action by its employees. The insolvency or administration of a key customer, such as Centrica plc, or a key supplier to a core business could have an adverse financial impact on the Group.

Commodity risk and security of supply
The costs incurred by National Grid Transco's electricity businesses in purchasing electricity are subject to movements in underlying commodity prices, particularly of oil and gas. Regulatory arrangements in the UK and US provide the ability to pass through some and in certain cases virtually all the increased costs related to commodity prices by way of higher prices. For more information, see the Business Review section of this document.

In the UK, any shortfall in the availability of gas (unless arising as a result of a failure in the Group's transmission or distribution networks) is not the responsibility of Transco. However, the Group may suffer reputational consequences if consumers of gas suffer disruption to their supply.

Internal controls
The Group's systems and processes, including its internal control policies, are designed to ensure that the operational risks associated with its activities, the risk of loss of focus by management and the other risks that the Group is exposed to are, to the extent reasonably practicable, appropriately controlled, but any

weakness in these systems and processes could have a negative impact on its results of operations.

Business development

The Group is subject to the risk that any business development activity, such as an acquisition, will be based on incorrect assumptions or conclusions or that substantial liabilities will be overlooked. The Group may also fail to achieve its targets for integration savings arising from the Niagara Mohawk merger in the US, the Merger and other subsequent transactions.

Financial management

The Group is subject to certain covenants and limits in relation to its listed debt and bank lending facilities. Such limits may hinder the Group in the servicing of current businesses or the financing of new businesses. The debt of National Grid Transco and certain of its subsidiaries is rated by credit rating agencies and changes in these ratings may affect both the borrowing capacity of the Group as a whole and the cost of those borrowings. The effective rate of tax paid by the Group may be influenced by a number of factors including changes in law and regulation or the Group's approach to such matters the result of which could increase or decrease that rate.

Interest rates

A proportion of National Grid Transco's borrowings is subject to interest rates that may fluctuate with changes to prevailing interest rates. Increases in these interest rates will result in increased costs for the Group. For further information see 'Interest rate risk management' on page 35.

Foreign currency exchange/foreign operations

National Grid Transco has significant international operations and conducts business in a number of currencies. These operations are subject to the risks normally associated with international businesses, including the need to translate foreign currency denominated assets and profits into National Grid Transco's reporting currency. For example, fluctuations in the value of the US dollar could have a significant impact on the Company because of the size of the Group's businesses in the US.

Other risks of international operations include trade barriers, tariffs, exchange controls, national and regional labour strikes, social and political risks, general economic risks, required compliance with a variety of foreign laws, including tax laws, and the need to enforce agreements and collect receivables through foreign legal systems. The Group's investment in Transener, for example, has been and continues to be affected by the devaluation of the Argentine peso and the deterioration of the economy in Argentina. For further information see 'Foreign exchange risk management' on page 35.

Technological change

National Grid Transco's businesses involved in the transmission and distribution of energy are vulnerable to certain types of technological changes. Examples of possible changes are the growth in distributed generation, renewable energy sources, fuel cells and the introduction of an alternative power carrier. Adapting to technological changes may be costly and there is no guarantee that the Group may foresee or be able to adequately respond to such changes.

Joint ventures

The Group's investments in joint ventures are subject to risks normally associated with ventures that are not majority owned. The Group is not able to exercise complete control over a joint venture's operations and may be dependent on the actions of the other parties to a joint venture regarding decisions such as continued funding or interest in the business. The success of any joint venture is also dependent upon the financial health and strategies of the other joint venture partners.

Directors' Report and Operating and Financial Review
General Information

Incorporation
National Grid Transco plc is incorporated in England and Wales with its registered office at 1-3 Strand, London WC2N 5EH (telephone +44 (0) 20 7004 3000). The Company was incorporated on 11 July 2000.

The Company's agent in the US is Lawrence J Reilly, National Grid USA, 25 Research Drive, Westborough, MA 01582.

Dividends
An interim dividend of 6.86 pence per ordinary share (US$0.5352 per ADS) was paid on 21 January 2003. The Directors are recommending a final dividend of 10.34 pence per ordinary share (US$0.8396 per ADS). Subject to approval by shareholders at the Annual General Meeting, the final dividend will be paid on 20 August 2003 and will bring the total dividend for the year to 17.20 pence per ordinary share (US$1.3748 per ADS).

Share buy-back
In common with most other companies, National Grid Transco has shareholder authority to repurchase its own shares. During the year, the Directors used this authority to repurchase and cancel 24,225,000 ordinary shares, each with a nominal value of 10 pence, at an average cost of 401.5 pence per share.

These shares represented approximately 0.8% of the total issued share capital before repurchases. The aggregate value of repurchases was approximately £97 million.

The Directors considered that the repurchases were in the best interests of the Company given market conditions at the time.

Research and development
Expenditure on research and development in 2002/03 was £18.2 million, compared with £16.0 million for 2001/02.

Payment to suppliers
National Grid Transco is a signatory to the Confederation of British Industry (CBI) Prompt Payment Code and has procedures to ensure the payment of bills in accordance with contract terms. Copies of the CBI Prompt Payment Code may be obtained from the CBI, Centre Point, 103 New Oxford Street, London WC1A 1DU.

The average creditor payment period at 31 March 2003 for the Group's operations in the UK was 25 days.

Donations
In the UK, charitable donations of £1,209,500 were made in 2002/03.

In the US, charitable donations of approximately US$3,000,000 (£1,887,000) were made in 2002/03.

In addition to these contributions, National Grid Transco provides financial and in-kind support to many other organisations through its community involvement programme.

No donations were made in the UK and EU for the purposes of the Political Parties, Elections and Referendums Act 2000.

During 2002/03, aggregate contributions of US$86,950 (£54,690) were made in the US to state and national political party and campaign committees and for ballot question advocacy. Of these contributions US$61,950 were made by National Grid USA's political action committees, which are funded entirely by voluntary employee contributions. National Grid USA's contributions are in compliance with US state and Federal law.

Material interests
At no time during the year has any Director had any material interest in a contract within the Group, being a contract of any significance in relation to the Group's business.

Substantial shareholders
Details of substantial shareholdings in National Grid Transco are given on page 119.

Employee policy
Information on National Grid Transco's employee policies is included on page 24, under the heading Our People.

Future developments
An outline of future developments is included in the Chief Executive's Review.

Auditors
During the year, National Grid Transco's Auditors, PricewaterhouseCoopers, converted to a Limited Liability Partnership. PricewaterhouseCoopers therefore resigned on 21 February 2003 and the Board appointed PricewaterhouseCoopers LLP to fill the vacancy. Special notice having been given, a resolution for their reappointment will be proposed at the Annual General Meeting.

Statement of Directors' responsibilities for preparing the accounts
The Directors are required by the Companies Act 1985 to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and of the Group as at the end of the financial year and of the profit or loss of the Group for the financial year.

The Directors consider that in preparing the accounts (detailed in the following sections: Principal Accounting Policies, Accounts and Notes to the Accounts) the Company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates, and all applicable accounting standards have been followed.

The Directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy the financial position of the Company and of the Group and which enable them to ensure that the accounts comply with the Companies Act 1985.

The Directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and to detect fraud and other irregularities.

The Directors, having prepared the accounts, have requested the Auditors to take whatever steps and to undertake whatever inspections they consider to be appropriate for the purposes of enabling them to give their audit report.

The Directors confirm that the Audit Committee continues to review the adequacy of the system of internal financial controls adopted by the Group.

Annual General Meeting
National Grid Transco's Annual General Meeting will be held on Monday 21 July 2003. Details are set out in the separate Notice of Annual General Meeting.

On behalf of the Board

Helen Mahy Group Company Secretary
20 May 2003

Registered office:
1-3 Strand, London WC2N 5EH

Registered in England and Wales
No. 4031152