National Grid Company plc
Annual Report and Accounts 2003/04

National Grid

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Introduction

Overview of National Grid Company

The principal activities of National Grid Company plc (NGC) are the operation of the high-voltage electricity transmission system in England and Wales, the procurement of balancing services and the operation of the interconnectors with Scotland and France.

History and development of the business

On the restructuring of the electricity industry in England and Wales in 1990, NGC assumed ownership and control of the transmission network and certain parts of the interconnectors with Scotland and France from the Central Electricity Generating Board. The predominant shareholders in NGC were the 12 Regional Electricity Companies (RECs) which owned and operated the local distribution systems. In 1995, NGC's shares were listed on the London Stock Exchange and by 1996 each REC had disposed of substantially all of its respective shareholdings.

In October 2002 NGC's then ultimate parent, National Grid Group plc, merged with Lattice Group plc to form National Grid Transco plc ('the merger'). Immediately following the merger, the Group combined the management of NGC's UK electricity and Transco's gas transmission operations. 2003/04 has seen the continuation of the process integration.

Business Overview

Background information

The electricity transmission business comprises the high-voltage electricity transmission system in England and Wales and the interconnectors with Scotland and France.

It owns and operates electricity assets consisting of approximately 4,500 miles of overhead line, about 410 miles of underground cable and some 341 substations at around 243 sites. Day-to-day operation of the electricity transmission system involves the continuous matching of generation output with demand, ensuring the stability and security of the power system and the maintenance of satisfactory voltage and frequency.

The UK Government introduced the Energy Bill into the House of Lords in November 2003. Provisions of interest to NGC include the legislative frameworks for the British Electricity Trading and Transmission Arrangements (BETTA), the introduction of a licensing regime for gas and electricity interconnectors and a Special Administration Regime for electricity networks.

The Energy Bill is expected to be granted Royal Assent by July 2004 and meeting this deadline is necessary if the implementation of BETTA is to be achieved by the Government's target date of April 2005.

Under BETTA a Great Britain electricity market would be created. Our System Operator role would be extended to include managing the Scottish transmission networks, in addition to our England and Wales network. The Scottish interconnectors (currently outside of the regulated business) would no longer be operated under the current commercial agreements but would form part of the regulated businesses of the current interconnector owners NGC and Scottish Power. The method for recovery of costs associated with the establishment of BETTA have been agreed in principle with Ofgem.

Regulation

NGC is regulated by the Office of Gas and Electricity Markets (Ofgem). Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority (GEMA), which makes all major decisions and sets policy priorities for Ofgem.

NGC is the sole holder of an electricity transmission licence for England and Wales. It has a statutory duty under the Electricity Act 1989 (as amended by the Utilities Act 2000) to develop and maintain an efficient, coordinated and economical system of electricity transmission and to facilitate competition in the supply and generation of electricity.

Under the terms of the transmission licence, NGC receives income through charges to generators, distributors, suppliers and directly-connected customers for use of and connection to the transmission system. Use of system charges are levied in respect of the provision of transmission assets/infrastructure (Transmission Owner activity) and for operating the system (System Operator activity).

Over the last year and as part of its consultations concerning network monopoly price controls and the electricity distribution price review, Ofgem has proposed changes to the regulatory framework that applies to all energy network monopolies, including NGC. Proposed developments include the introduction of a five year retention of benefits from savings in operating costs, capital expenditure efficiencies and asset disposals,

irrespective of when they occur during a price control period (currently, the benefits of cost saving initiatives are returned to customers when a price control is reset). In respect of pension costs, Ofgem has indicated that it sees these as a normal operating cost of the business.

Furthermore, Ofgem has suggested that, with effect from 1 April 2002, any over or underfunding by NGC of its pension schemes as compared to those assumptions made by Ofgem when its price controls were set, will ultimately be passed to consumers. It is expected that the details of how this mechanism will work, together with any adjustments that Ofgem may wish to make in respect of historic pensions issues, will be clarified later in 2004.

The transmission business comprises two separately regulated activities:

1. Transmission Owner

The Transmission Owner (TO) owns and maintains the physical assets, develops the network to accommodate new connections/disconnections, manages a programme of asset replacement and investment to ensure the long-term reliability of the systems.

Revenue from charges for using the transmission network and charges for connections made before March 1990 is controlled by a revenue restriction condition set out in the transmission licence. This revenue restriction, known as a price control, takes into account, among other factors, operating expenditure, capital expenditure and cost of capital, which for the current price control, is at a real pre-tax rate of 6.25%. In addition, pass-through is given in respect of non-domestic rates and Ofgem's licence fees attributable to the electricity transmission business.

NGC is permitted to set charges for connections to the transmission system made since March 1990 to recover the costs directly or indirectly incurred in providing connections, together with a reasonable rate of return on such costs.

The current price control was introduced on 1 April 2001. It was expected to remain in force until 31 March 2006, but is likely to be extended to 31 March 2007. Discussions on the detail of the extension to the price control are ongoing and are expected to conclude during 2005.

An amended charging methodology for the Transmission Owner, known as 'Plugs', was introduced from 1 April 2004. The total revenue recoverable by NGC under its licence remains unchanged. The changes modified the ownership boundary between what was part of the transmission network, shared by all users, and what were separate connection assets attributable to specific users. This required NGC to make repayments to connected parties associated with relevant assets that have been subject to capital contributions or other accelerated payment terms. In total these repayments will be in the region of £70 million of which the majority will be treated as capital expenditure and included in the regulatory asset base.

2. System Operator

The System Operator ('SO') undertakes a range of activities necessary for the successful delivery in real time of secure, reliable and efficient delivery of electricity and the continuous balancing of supply and demand.

Revenue from charges for provision of balancing services is regulated under an incentive scheme, where benefits of cost savings in system operation compared to targets are shared with customers. The external costs incentive scheme for fiscal year 2004/05 has been set with a maximum benefit or loss of £40 million, consistent with fiscal year 2003/04. As part of this regulatory settlement we accepted a reduced sharing factor, reduced from 50% in fiscal year 2003/04 to 40% for fiscal year 2004/05.

Financial performance

Total operating profit, before exceptional items, for the year ended 31 March 2004 was £526 million, compared with £571 million in 2002/03.

Electricity transmission operating profit for the year ended 31 March 2004, before exceptional reorganisation costs, was £486 million, compared with £551 million in 2002/03. The £65 million reduction in operating profit in 2003/04 was mainly as a result of a £22 million one-off charge relating to the implementation of the 'Plugs' charging methodology; £15 million lower System Operator incentive profits; £17 million higher depreciation, reflecting our significant investment in the network; and £11 million lower Transmission Owner income.

Interconnectors operating profit for the year ended 31 March 2004 was £29 million compared to £21 million in 2002/03 and other businesses operating profit for the year ended 31 March 2004 was £11 million compared to a loss of £1 million in 2002/03.

Exceptional Items – Costs of £12 million were charged to operating profit during the year ended 31 March 2004 (2003: £32 million), as the business continued the 'Staying Ahead' programme and integrate activities with Transco plc.

Interest – The net interest payable by NGC in the 12 months ended 31 March 2004 was £82 million (2003: £100 million).

Taxation – NGC's tax charge for the year ended 31 March 2004 was £81 million (2003: £136 million). The reduction over 2003 is largely because of a release of £52 million of tax provisions in 2003/04.

Employee numbers – The average number of employees during the year ended 31 March 2004 was reduced to 2,345 from 2,737 in the prior period, as a result of restructuring the business as part of the 'Staying Ahead' programme and the merger.

Operating performance

The winter of 2003/04 saw demand for electricity from the transmission network in England and Wales hit a peak of 52.97 gigawatts (GW) on 8 December 2003. This compared to the previous year's record breaking peak of 54.4 GW that occurred on 10 December 2002.

Over the course of the last fiscal year we have maintained our average annual availability of the electricity network at 95.2% compared to 95.8% in 2002/03, 95.4% in 2001/02 and our five-year average of 95.6% in 2003/04. System availability at winter peak demand was 98.0% in 2003/04 compared with 98.8% in 2002/03 and 98.3% in 2001/02 and our five-year average of 98.6% in 2003/04.

During 2003/04, 99.9997% of the energy demanded was delivered by the transmission system compared to our 10-year average for 2003/04 of 99.9999%. There were two significant loss of supply incidents. One affected around 400,000 retail customers across parts of South London, where restoration of the transmission system took 37 minutes, however, regrettably disruption to rail services continued for some time afterwards. The second incident affected around 200,000 retail customers across parts of the West Midlands, and restoration of the transmission system was completed within 42 minutes.

Following the investigation, the Department of Trade and Industry Engineering Inspectorate considered that prosecution was not appropriate. It made a number of recommendations, which we have accepted, and actions are well advanced to implement them.

Ofgem is also investigating the incidents to determine whether there was a breach of statutory duties or licence obligations by NGC. We expect the outcome during the coming summer.

Investment in the network

Capital investment on the replacement, reinforcement and extension of the UK electricity transmission network in 2003/04 was £426 million, compared with £391 million in 2002/03. There is a general trend for increasing capital expenditure on the transmission network as the assets commissioned in the 1960s begin to fall due for replacement.

Fixed Assets

Agreements with landowners or occupiers are required for the overhead lines and underground cables which make up our electricity network in England and Wales. Approximately 80% of agreements are in the form of terminable wayleaves. The remaining 20% are in the form of perpetual easements under which rights have been granted in perpetuity in return for a lump sum payment. The sites at which we have electricity substations are split between freehold and leasehold. Of the leasehold sites, the large majority are substations located on the premises of generators and are held on very long-term leases for nominal rental payments. Of the remaining sites, the majority are held as ground rents (market price payable for land only) from the respective landlords, who include electricity distribution companies.

NGC also owns the freehold of its control centre in Berkshire and the learning and development centre at Eakring in Nottinghamshire. NGC has major offices in Warwick (leasehold) and Leeds (freehold).

Regulatory Asset Base
The Directors' calculation of the regulatory value (RAB value) of the Transmission activity at the end of March 2004 was £5,154 million, £1,250 million greater than the historic cost net assets value.

A safe way of working

Our management of safety
We believe that safety is paramount and that all work-related injuries and illnesses are preventable. We strive to safeguard the public in all we do. We believe a healthy workforce is an important factor in being a productive and competitive business. We have reviewed our approaches to occupational health with a view to ensuring support is available to employees on a local basis.

During 2003/04, we completed safety leadership training for our Directors and senior management team. This training is now being cascaded throughout the Company. We have a published safety vision, reinforcing our commitments to deliver our goal of zero injuries and create a culture where everyone is able to constructively challenge unsafe behaviours wherever they occur.

Over the course of the last fiscal year our employee Lost Time Injuries have reduced by 14% and the number of days lost to injuries fell by 94% from 242 in 2002/03 to only 14 in 2003/04.

Working with contractors
Contractors are selected from an approved vendor list that requires submission to a safety and environment review.

For the purposes of safety management, contractors are treated like, and receive safety briefings alongside, direct employees. Our contractors recognise that we have high safety standards and safety is at the forefront from tender to project completion. We encourage the sharing of best practice between our major engineering contractors and have, during the financial year, removed contractors from jobs where we were unable to satisfy ourselves of their ability to operate safely.

Environment

Our approach to environmental management
Our environmental management systems continue to help us manage our activities in a manner that protects and, where appropriate, improves the environment. All of NGC's sites and operations have ISO14001 certified environmental management systems which aim to comply with or better all of the relevant environmental regulations. We have not been prosecuted by any environmental regulatory body for an environmental offence during this fiscal year.

In the last fiscal year we have reduced the number of significant environmental incidents related to substation sites and have continued to reduce our SF6 gas losses, which is used as an electrical insulant in high-voltage switchgear, and is a greenhouse gas which contributes to global warming, in line with our ongoing programme.

Electric and magnetic fields
Electric and magnetic fields (EMFs) can be generated from a variety of sources, including household appliances and our power lines. The balance of scientific evidence is against EMFs resulting in adverse health effects. However, the perception that EMFs may do so is evident in parts of society, and we take this very seriously. We look to government and regulators to identify any precautionary measures that may be necessary, as they can evaluate the science and weigh costs and benefits on behalf of society as a whole.

We recognise that some people have concerns about EMFs and we make information available whenever requested. We comply with the standards, guidelines and regulations in force on EMFs in the regions in which we operate.

Contaminated land
We continue to manage our inherited portfolio of potentially contaminated land. This contamination has mainly arisen from older electrical substations where there is a risk that the ground may have been contaminated with oil in the past through accidental spillage or leakage from equipment.

Financial Outlook
The areas of main focus for the year to 31 March 2005 are to continue to invest in network reliability and system security and to take out unnecessary cost from the business wherever it arises.

NGC is also working closely with Ofgem and other industry participants regarding the development of BETTA.

Directors’ Report

The NGC (‘the Company’) Directors present their report and the audited accounts for the year ended 31 March 2004.

Principal activities
The principal activities of NGC and its subsidiary undertakings (together the ‘Group’ or ‘National Grid’), are the operation of the electricity transmission system in England and Wales, the procurement of balancing services, and the operation of the interconnectors with Scotland and France.

Results and Developments
See Financial Performance section in the Business Review.

Dividends
The directors recommend payment of a final dividend of £350 million (2003: £nil). An ordinary dividend of £240 million (2003: £nil) and preference dividends of £2.1 million 2003: £2.2 million) were paid during the year.

Directors
The Directors of the Company, who served throughout the year unless otherwise stated, are:
S J Holliday
S Lucas
N Moore
Dr R J Urwin
N P Winser (Appointed 28 April 2003)

Directors' interests
The interests of Directors who are also Directors of the ultimate parent undertaking, National Grid Transco plc (NGT), in shares of Group companies at 31 March 2004 are disclosed in the NGT annual report and accounts.

The interests of Neil Moore, who is not also a director of NGT, in NGT ordinary shares, are as follows:

N Moore	Executive Share Options	Performance Share Plan Awards	Shares Beneficially Owned
1 April 2003	11,974	–	12,382
Granted	–	16,656	n/a
Exercised	–	–	n/a
31 March 2004	11,974	16,656	12,382

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 business of NGC or its subsidiaries.

Biographies

Roger Urwin (58)
Chairman
A Director of the Company since 1995, Roger Urwin is also Group Chief Executive of NGT. He was previously Chief Executive of London Electricity plc and prior to this he held a number of appointments within the Central Electricity Generating Board before joining the Midlands Electricity Board as Director of Engineering. He is a Non-executive Director of Utilico Investment Trust plc and is a Fellow of the Royal Academy of Engineering.

Nick Winser (43)
Nick Winser became the NGT Group Director responsible for UK and US Transmission operations, and Chief Executive of NGC, on 28 April 2003. He was previously Chief Operating Officer of US Transmission for NGT. Nick joined National Grid Company in 1993, becoming Director of Engineering in 2001. Prior to this he had been with PowerGen since 1991 as principal negotiator on commercial matters having joined the Central Electricity Generating Board in 1983, where he served in a variety of technical engineering roles.

Steve Lucas (50)
Steve Lucas is also Group Finance Director of NGT, following the merger of Lattice group plc with National Grid Group plc in October 2002. He had been Executive Director, Finance of Lattice Group plc since its demerger from BG Group in 2000. Previously he was Treasurer of BG Group having joined British Gas plc in 1994. A Chartered Accountant, Steve Lucas worked in private practice in the City of London until 1983. He then joined Shell International Petroleum Company, occupying a number of finance management positions and treasury roles, including seven years in Africa and the Far East.

Steve Holliday (47)
Steve Holliday is also Executive Director of NGT responsible for the NGT Group’s UK gas distribution and business services. He was formerly an Executive Director of British Borneo Oil and Gas. Previously he spent nineteen years with the Exxon Group, where he held senior positions in the international gas business and operational areas such as refining and shipping. His international experience includes a four-year spell in the US. He also worked developing business opportunities in countries as diverse as China, Australia, Japan, Brazil and the former Soviet Union.

Neil Moore (40)
Neil Moore joined British Gas in 1995 as Finance Manager of Power Generation. He went on to work in a number of senior finance positions in Downstream Gas and Engineering and Technical Consultancy, before becoming Managing Director of The Leasing Group plc. Following the successful sale of this business he became Finance Director, Transmission within National Grid Transco and Finance Director of National Grid Company. Prior to joining British Gas, Neil spent six years with Racal Electronics plc, mainly in Financial Controller roles in the Far East.

Alison Kay
Company Secretary
Alison Kay has been Company Secretary since October 2002. She is also Company Secretary of Transco plc.

Corporate Governance
The NGT Group is committed to the highest standards of corporate governance and the Board of NGC shares that commitment. The NGT Report and accounts contains a detailed review of the NGT Group's arrangements.

Employee Involvement
We have established, through e-mails, intranets, cascade briefings and in-house magazines, effective methods for communicating with employees on matters of concern to them. Regular consultation with staff and their trade union representatives takes place using both formal and informal mechanisms.

NGC remains committed to fair treatment of people with disabilities in relation to job applications, training, promotion and career development. Every effort is made to find appropriate alternative jobs for those who are unable to continue in their existing job due to disability.

NGC takes a positive approach to equality and diversity. We promote equality in the application of reward policies, employment and development opportunities, and aim to support employees in balancing work and personal lifestyles.

Employees are encouraged to become shareholders in NGT and we operate a Sharesave Scheme.

Pension arrangements
With the merger of National Grid Group and Lattice Group, National Grid Transco 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). There are no current plans to merge the two schemes.

The next actuarial valuation of the National Grid Scheme, which is a defined benefit scheme, is being carried out as at 31 March 2004.

Research and development
Expenditure charged in 2003/04 on research and development was £3.0 million, compared with £4.0 million in 2002/2003.

Payment to suppliers
National Grid is a signatory to the CBI Code of Prompt Payment and has procedures to ensure the payment of bills in accordance with contractual terms. Copies of the CBI Code of Prompt Payment may be obtained from the CBI, Centre Point, 183 New Oxford Street, London WC1A 1DU.

The average creditor payment period at 31 March 2004 for NGC was 15 days (2003: 19 days).

Charitable and other donations
During the year, charitable donations of £23,760 (2003: £326,500) were made to local UK charities. In addition, National Grid provides financial and in kind support to many other organisations through its community involvement programme.

No donations were made in the UK or EU for the purposes of the Political Parties Elections and Referendums Act 2000 (2003: £nil).

Treasury and financing
Both short and long-term cash flow forecasts are produced on a frequent basis to assist in identifying the liquidity requirements of the Group. The Group seeks to ensure that all of its forecast cash needs for a period of at least twelve months ahead are covered. The Group maintains a minimum level of committed facilities in support of that objective, and beyond twelve months a prudent level of committed availability is also maintained.

The company has access to sources of liquidity through a US$1.0 billion US commercial paper programme (unutilised), a US$1.0 billion Euro commercial paper programme (unutilised), a joint Euro medium term note programme of €6.0 billion (€3.8 billion unissued), £460 million of committed bank facilities and the ability to demand repayment of the inter-company loan to the parent company. The bank facilities are being held as a backup to commercial paper.

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 Directors of the ultimate parent undertaking. The Finance Committee, a committee of the Board, is responsible for regular review and monitoring of treasury activity and for approval of specific transactions. NGT has a Treasury department which raises all the funding for the Group and manages interest rate and foreign exchange rate risk.

The Group has separate financing programmes for each of the rated companies. All funding is approved by the Finance Committee and in respect of its own activities, and the use of derivative financial instruments is controlled by policy guidelines set by the Board.

The treasury department 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. As part of its business operations, the Group is exposed to risks arising from fluctuations in interest rates and exchange rates. The Group uses 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.

National Grid Company'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. These borrowings contain no restrictive covenants.

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 of the Group's short-term investments as at 31 March 2004 are shown in note 16 to the financial statements, page 22.

The Company has a long term credit rating of A2 and A and short term ratings of P1 and A1 from Moody's and Standard & Poor's respectively. These ratings mean that the Company and 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 reviews and agrees policies for managing each risk and they are summarised below.

Risk Management

Refinancing risk management
The Board principally 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, and by specifying a minimum average duration for

borrowings. 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 debt 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 are index-linked; ie their cost is linked to changes in the UK Retail Price Index (RPI). The Board believes that these bonds provide a good hedge for revenues which are also RPI linked under the price control formula.

Foreign exchange risk management
The Company has predominantly sterling assets and liabilities and cash flows, as swap instruments are in place to manage the currency risks on non-sterling denominated debt. The exposure to currency risk is therefore minimal.

Counterparty risk management
At the year end the Group had £27 million of cash and deposits. The Group is exposed to the credit risk of the counterparties to these investments of surplus funds and from the use of derivative instruments. The Board 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. The Group uses 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. In addition, the Group enters into bought and written option contracts on interest rate swaps. These contracts are known as 'swaptions'. The Group also 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, commencing at a future specified date.

Changes
During the year, the Company raised £454 million of new finance through the issue of two long term bonds.

Going Concern
The Board has reviewed the Group's budget and cash flow forecasts for the year ending 31 March 2005 and the outline projections for the three subsequent years. The Directors confirm that they have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, the Directors continue to adopt the going concern basis in preparing the Group's consolidated financial statements.

Auditors
A resolution for the re-appointment of PricewaterhouseCoopers LLP will be proposed at the Annual General Meeting.

Annual General Meeting
Notice of the NGC Annual General Meeting for 2004 will be issued separately to shareholders.

On behalf of the board

A B Kay
Company Secretary
20 May 2004

Registered Office
1-3 Strand London WC2N 5EH

Registered in England and Wales No. 2366977

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 trueand 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: 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 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.

Independent Auditors' Report to the members of National Grid Company plc

We have audited the accounts which comprise the Group profit and loss account, the balance sheet of the Group and the Company, the Group Cash Flow Statement and the related notes.

Respective responsibilities of Directors and auditors
The Directors' responsibilities for preparing the accounts in accordance with applicable United Kingdom law and accounting standards are set out in the statement of Directors' responsibilities.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board. This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the accounts, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions is not disclosed.

We read the other information contained in the Annual Report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. The other information comprises only the Directors' Report and the Business Review.

Basis of audit opinion
We conducted our audit in accordance with auditing standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

Opinion
In our opinion the accounts give a true and fair view of the state of affairs of the Group and Company as at 31 March 2004 and of the profit and cashflows of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and
Registered Auditors
Birmingham
20 May 2004

Accounting Policies

a) Basis of preparation of accounts
The accounts have been prepared under the historical cost convention, in accordance with the Companies Act 1985 and applicable UK accounting and financial reporting standards.

The preparation of accounts in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

The Group is following the transitional arrangements of FRS 17 'Retirement Benefits'. The required disclosures are shown in note 6. Full adoption of the standard is required by the year ended 31 March 2006.

An 'International Accounting Standards Regulation' was adopted by the Council of the European Union in June 2002. This regulation requires all EU companies listed on an EU stock exchange to use 'endorsed' International Financial Reporting Standards (IFRS), published by the International Accounting Standards Board (IASB), to report their consolidated results with effect from 1 January 2005. The IASB published 15 revised standards in December 2003 and issued 4 new standards and 2 revised standards in the first quarter of 2004. This completes the set of standards which are likely to be required to be adopted in 2005. A process of endorsement of IFRSs has been established by the EU for completion in sufficient time to allow adoption by companies in 2005. The Group's first full financial statements to be produced under IFRS will be for the year ending 31 March 2006. The Group has established a plan to achieve a smooth transition to IFRS. This plan involves examining all implementation aspects, including changes to accounting policies, systems impacts and the wider business issues that arise from such a change. We expect that the Group will be fully prepared for the transition in 2005. However, the adoption of particular standards is dependent upon the completion of the standard-setting process by the IASB and the endorsement of such standards by the EU.

b) Basis of consolidation
The Group accounts include the accounts of National Grid Company plc ('the Company') and all its subsidiary undertakings ('Group undertakings') (note 11).

The accounts of Group undertakings used for consolidation are made up to 31 March.

The results of newly acquired Group undertakings are included in the Group accounts from the date the Group acquires control. The results of Group undertakings are included in the Group accounts up to the date that control is relinquished.

c) Tangible fixed assets and depreciation
Tangible fixed assets are included in the balance sheet at their cost less accumulated depreciation. Cost includespayroll and finance costs incurred which are directly attributable to the construction of tangible fixed assets.

No depreciation is provided on freehold land and assets in the course of construction. Other tangible fixed assets are depreciated, principally on a straight line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of tangible fixed assets are as follows:

	Years
Plant and machinery	
Transmission plant	
– Towers	40 or 60
– Substation plant, overhead lines and cables	40 or 50
– Protection, control and communication equipment	15 or 25
Cross-Channel link	15 to 60
Freehold and leasehold properties	up to 40
Motor vehicles and office equipment	3 or 5

During the year the asset life of the Cross-Channel link plant and machinery was reviewed and revised to a maximum asset life of 60 years.

d) Deferred taxation
Deferred taxation is provided in full on all material timing differences, with certain exceptions. No provision is made for any timing differences on non-monetary assets arising from fair value adjustments, except where there is a binding agreement to sell the assets concerned. No provision is made where it is more likely than not that any taxable gain will be rolled over into replacement assets.

Deferred tax assets are only recognised to the extent that their recovery is considered more likely than not.

Deferred tax balances have not been discounted.

e) Stocks
Stocks, which primarily comprise consumable stores and strategic spares, are stated at cost less provision for obsolescence.

f) Turnover
Turnover primarily represents the amounts derived from the transmission of electricity and the provision of related services. It excludes intra-Group and inter-company transactions, and is stated net of value added tax. Where revenues received exceed the maximum allowed by regulatory formula no liability is recognised.

g) Pensions
The cost of providing pensions is charged to the profit and loss account on a systematic basis over the service lives of the employees in the scheme. Variations from the regular pension cost are allocated over the estimated average remaining service lives of current employees, with the interest component of any variation being reflected in net interest and the other component reflected through staff costs.

h) Employee share option schemes
Employee benefit trusts have been established which result in the cost of delivering shares in the Company's ultimate parent undertaking (National Grid Transco plc) to employees under the terms of the relevant share option scheme being charged to the profit and loss account on a straight line basis over the remaining period of the relevant scheme. This charge is determined as being the difference between the option price payable by the employee and the total purchase cost of the shares.

Shares held by employee benefit trusts are carried at cost less provision for amortisation.

i) Research and development
Research and development expenditure is charged to the profit and loss account in the period in which it is incurred.

j) Leases

Finance lease income is allocated to accounting periods so as to give a constant rate of return on the net investment in the lease. The net investment in a finance lease is included in debtors and represents the total rentals receivable, net of finance charges, relating to future periods.

Operating lease payments are charged to the profit and loss account on a straight line basis over the term of the lease.

k) Financial instruments

Derivative financial instruments ('derivatives') are used by the Group mainly for the management of its interest rate and foreign currency exposures.

The principle derivatives used include interest rate swaps, currency swaps and forward foreign currency agreements.

All transactions are undertaken or maintained to provide a commercial hedge of the interest or currency risk associated with the Group's underlying business activities and the financing of those activities. Amounts payable or receivable in respect of interest rate swaps are recognised in the profit and loss account over the economic lives of the agreements or underlying position being hedged, either within net interest or disclosed separately where deemed exceptional.

Those derivatives, relating both to interest rates and/or currency exchange, that are directly associated with a specific transaction and exactly match the underlying cash flows relating to the transaction are accounted for on the basis of the combined economic result of the transaction including the related derivative.

Other currency swaps and forward currency agreements are retranslated at the rate of exchange prevailing at the balance sheet date with the corresponding exchange adjustment being dealt with in reserves or the profit and loss account as appropriate.

Group Profit and Loss Account for the years ended 31 March

	Notes	2004 £m	2003 £m
Turnover	1	**1,368.8**	1,397.3
Operatiing costs	2	**(855.0)**	(858.3)
Operating profit			
– Before exceptional reorganisation costs		**525.8**	571.3
– Exceptional reorganisation costs	2	**(12.0)**	(32.3)
Total operating profit	1	**513.8**	539.0
Profit on sale of fixed assets	3	**–**	2.2
Net interest payable	7	**(82.0)**	(99.7)
Profit on ordinary activities before taxation		**431.8**	441.5
Taxation			
– Excluding exceptional items		**(84.5)**	(143.4)
– Exceptional items		**4.0**	7.5
	8	**(80.5)**	(135.9)
Profit on ordinary activities after taxation		**351.3**	305.6
Equity dividends	9	**(590.0)**	–
Dividends in respect of non-equity shares	9	**(2.1)**	(2.2)
(Loss)/retained profit	19	**(240.8)**	303.4

All activities relate to continuing operations.

The Group has no recognised gains and losses other than those included in the profit and loss account and therefore no separate statement of total recognised gains and losses has been presented.

Balance Sheets at 31 March

	Notes	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Fixed assets					
Tangible assets	10	**4,141.2**	3,898.6	**4,135.6**	3,892.3
Investments	11	**32.4**	37.5	**32.5**	37.6
		4,173.6	3,936.1	**4,168.1**	3,929.9
Current assets					
Stocks		**13.9**	19.2	**13.9**	19.2
Debtors	12	**1,712.3**	1,738.6	**1,720.8**	1,746.7
Current asset investments		**12.0**	0.9	**12.0**	0.9
Cash at bank and in hand		**15.1**	12.9	**15.1**	12.9
		1,753.3	1,771.6	**1,761.8**	1,779.7
Creditors (amounts falling due within one year)					
Borrowings		**(20.4)**	(292.2)	**(25.3)**	(295.5)
Other creditors		**(1,215.3)**	(712.8)	**(1,213.5)**	(704.8)
	13	**(1,235.7)**	(1,005.0)	(1,238.8)	**(1,000.3)**
Net current assets		**517.6**	766.6	**523.0**	779.4
Total assets less current liabilities		**4,691.2**	4,702.7	**4,691.1**	4,709.3
Creditors (amounts falling due after more than one year)					
Exchangeable bonds		**–**	(502.5)	**–**	(502.5)
Other borrowings		**(2,809.1)**	(2,149.9)	**(2,809.1)**	(2,149.9)
Other creditors		**(145.1)**	(111.4)	**(145.1)**	(111.4)
	14	**(2,954.2)**	(2,763.8)	**(2,954.2)**	(2,763.8)
Provisions for liabilities and charges	17	**(854.0)**	(815.1)	**(854.0)**	(815.1)
Net assets employed		**883.0**	1,123.8	**882.9**	1,130.4
Capital and reserves					
Called up share capital	18	**43.4**	43.4	**43.4**	43.4
Share premium account	19	**454.1**	454.1	**454.1**	454.1
Capital redemption reserve	19	0.1	0.1	0.1	0.1
Special reserve	19	**28.8**	28.8	**28.8**	28.8
Profit and loss account	19	**356.6**	597.4	**356.5**	604.0
Equity shareholders' funds		**839.6**	1,080.4	**839.5**	1,087.0
Non-equity shareholders' funds		**43.4**	43.4	**43.4**	43.4
Total shareholders' funds	20	**883.0**	1,123.8	**882.9**	1,130.4

The accounts on pages 8 to 26 inclusive were approved by the Board of Directors on 20 May 2004 and were signed on its behalf by:

N Winser Director

N Moore Director

Group Cash Flow Statement for the years ended 31 March

	Notes	2004 £m	2003 £m
Net cash inflow from operating activities before exceptional items	21(a)	**789.6**	771.5
Expenditure relating to exceptional items		**(12.0)**	(32.3)
Net cash inflow from operating activities		**777.6**	739.2
Returns on investments and servicing of finance			
Interest received and similar income		**64.5**	23.5
Interest paid and similar charges		**(169.2)**	(182.2)
Non-equity dividends paid to shareholders		**(8.6)**	–
Net cash outflow for returns on investments and servicing of finance		**(113.3)**	(158.7)
Taxation			
Corporate tax credit received		**–**	4.1
Capital expenditure and financial investment			
Net payments to acquire intangible and tangible fixed assets		**(412.2)**	(401.3)
Receipts from disposals of tangible fixed assets		**1.5**	7.3
Net cash outflow for capital expenditure and financial investment		**(410.7)**	(394.0)
Acquisitions and disposals			
Receipts from disposals of investments		**4.9**	8.6
Net cash inflow for acquisitions and disposals		**4.9**	8.6
Equity dividends paid to shareholders		**(240.0)**	–
Net cash inflow before the management of liquid resources and financing		**18.5**	199.2
Management of liquid resources			
(Increase)/decrease in short-term deposits		**(11.1)**	0.1
Net cash (outflow)/inflow from the management of liquid resources	21(b)(c)	**(11.1)**	0.1
Financing			
(Decrease)/increase in borrowings	21(b)(c)	**(120.7)**	806.3
Increase/(decrease) in amounts due to or from Group undertakings		**133.5**	(1,035.2)
Net cash inflow / (outflow) from financing		**12.8**	(228.9)
Movement in cash and overdrafts	21(b)(c)	**20.2**	(29.6)

Liquid resources comprise money market deposits and gilts.

Notes to the Accounts

1. Segmental analysis

	Turnover					
	Total sales 2004 £m	**Sales between businesses 2004 £m**	**Sales to third parties 2004 £m**	Total sales 2003 £m	Sales between businesses 2003 £m	Sales to third parties 2003 £m
Continuing operations:						
Electricity transmission	1,306.7	27.4	1,279.3	1,341.2	29.6	1,311.6
Interconnectors	64.7	0.6	64.1	60.9	0.5	60.4
Other activities	44.2	18.8	25.4	30.3	5.0	25.3
Turnover	1,415.6	46.8	1,368.8	1,432.4	35.1	1,397.3

Group turnover is, with minor exceptions, in respect of Europe, both in terms of origin and destination. Other activities turnover primarily comprises contracting activities and provision of support services.

	Operating profit				Net assets	
	Before exceptional items		After exceptional items			
	2004 £m	2003 £m	**2004 £m**	2003 £m	**2004 £m**	2003 £m
Continuing operations:						
Electricity transmission	**485.8**	550.9	**476.7**	524.2	**3,903.7**	3,427.0
Interconnectors	**28.8**	21.0	**28.8**	21.0	**167.0**	138.2
Other activities	**11.2**	(0.6)	**8.3**	(6.2)	**8.1**	(0.2)
Operating profit	**525.8**	571.3	**513.8**	539.0		
Unallocated net liabilities					**(3,195.8)**	(2,441.2)
Net assets employed					**883.0**	1,123.8

Operating profit arises within Europe.

The analysis of net assets by business segment excludes inter-business balances. Unallocated net liabilities include net borrowings, amounts owed to and from group undertakings, taxation, interest, dividends, certain provisions, pensions and an investment in shares in the Company's ultimate parent undertaking.

Net assets employed are located within Europe.

2. Operating costs

	2004 £m	2003 £m
Total operating costs comprise:		
Depreciation	**202.7**	192.0
Payroll costs (note 4)	**76.1**	100.9
Other operating charges:		
– Rates	**92.0**	97.0
– Balancing Services Incentive Scheme direct costs	**279.0**	251.6
– Exceptional reorganisation costs (see below)	**12.0**	32.3
– Other non-exceptional operating charges	**193.2**	184.5
	576.2	565.4
	855.0	858.3

	2004 £m	2003 £m
Operating costs include:		
Research and development costs	**3.0**	4.0
Non-plant and machinery operating lease rentals	**3.1**	0.7
Auditors' remuneration:		
– Statutory audit fees (Company: £265,000 (2003: £275,000))	**0.3**	0.3
– Regulatory related services	**0.1**	0.3
– Other	**–**	0.1
	0.1	0.4

Exceptional reorganisation costs of £12.0m (2003: £32.3m) were charged to operating profit in 2003/04 as the Transmission business implemented its restructuring plans.

3. Exceptional items

The exceptional profit on sale of fixed assets in 2003 was £2.2m (before and after taxation) mainly in respect of the disposal of properties and represented the cash consideration received less the net book value of the assets.

4. Payroll costs and employees

	2004 £m	2003 £m
a) Payroll costs:		
Wages and salaries	**80.7**	101.0
Social security costs	**8.5**	9.5
Other pension costs	**7.7**	8.0
Employee share option costs	**1.3**	1.6
	98.2	120.1
Less: amounts capitalised	**(22.1)**	(19.2)
	76.1	100.9

	2004 Number	2003 Number
b) Average number of employees	**2,345**	2,737

The vast majority of the employees are employed either directly or indirectly in the transmission of electricity in the UK.

In addition to the payroll costs above there was a restructuring costs includiong severance costs of £5.4m (2000: £12.2m), which have been included with other operating charges – exceptional reorganisation costs.

5. Directors' emoluments

Total emoluments of the Directors of the Company for the year ended 31 March 2004 were as follows:

	2004 £000	2003 £000
Salaries and benefits	**460**	688
Performance related bonus	**215**	285
	675	973

The emoluments of the highest paid Director were £223,800 (2003: £387,800). The amount of accrued pension at 31 March 2004 for the highest paid Director was £81,000 (2003: £22,000). The highest paid Director did not exercise any options in respect of shares in National Grid Transco plc (the ultimate parent undertaking) during the year (2003: none).

The Directors emoluments include amounts in respect of accrued bonus which had not yet been approved at the date of these accounts.

One Director (2003: No Directors) exercised share options in National Grid Transco plc during the year.

Retirement benefits at 31 March 2004 are accruing in respect of five Directors (2003: four Directors) under a defined benefit scheme.

6. Pensions

Substantially all the Group's employees are members of the Electricity Supply Pension Scheme.

The Electricity Supply Pension Scheme provides final salary defined benefits on a funded basis. The assets of the scheme are held in a separate trustee administered fund. The scheme is divided into sections, one of which is the Group's section. It is subject to independent valuations at least every three years, on the basis of which the qualified actuary certifies the rate of employers' contributions which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme. The latest full actuarial valuation of the Group's section of the scheme was carried out by Bacon & Woodrow, Consulting Actuaries (now Hewitt, Bacon and Woodrow), at 31 March 2001.

The projected unit method was used for the last valuation and for the purposes of accounting under Statement of Standard Accounting Practice (SSAP) 24 and the principal actuarial assumptions adopted were that the real annual rates of return on investments held in respect of pre retirement members would average 4.5% and on investments held in respect of post retirement members would average 3.5%; that the annual rate of inflation would average 2.3%; that the real annual increase in salary would average 1.0%; and that pensions would increase at a real annual rate of 0.2%. The market value of the assets relating to the Group's section of the scheme at 31 March 2001 was £1,336m and the actuarial value of the assets represented approximately 118.3% of the actuarial value of the benefits that had accrued to members measured on a past service basis. The current agreed employers' and employees' contribution rates for the forthcoming year are 12% and 6% respectively. These contribution rates will be reviewed when the next independent actuarial valuation is completed based on the position at 31 March 2004. The valuation is in the process of being carried out and therefore the outcome is currently unknown.

The pension cost for the year ended 31 March 2004 charged to operating profit of £7.7m (2003: £8.0m) represents the regular pension cost of £9.2m (2003: £11.3m) less a variation from the regular pension cost totalling £1.5m (2003: £3.3m), which represents a credit of £1.5m (2003: £1.5m) relating to the partial release of a pension provision. In addition, net interest includes a credit of £0.3m (2003: £4.0m) in respect of the notional interest element of the variation from the regular pension cost.

During 2003/2004, whilst a valuation of the National Grid Group of the Electricity Supply Pension Scheme was not carried out, this would in all likelihood have revealed a deficit. The continuing recognition of a surplus in these circumstances is incompatible with this position. Consequently, the Group has suspended the recognition of any further pension surplus amortisation with effect from 1 October 2002. As a result of this action, operating profit and net interest charge are reduced by £4.1m and £7.4m respectively compared with the ongoing recognition of such a surplus.

Included in debtors is a net pension prepayment of £6.5m (2003: £4.9m).

Included within provisions for liabilities and charges at 31 March 2004 is a pension provision of £7.7m (2003: £9.2m) (note 17).

FRS 17 Retirement benefits

On 20 November 2000, the Accounting Standards Board introduced a new accounting standard, FRS 17 'Retirement Benefits', replacing SSAP 24 'Accounting for Pension Costs'. FRS 17 is fully effective for periods beginning on or after 1 January 2005, though disclosures are required in the financial years prior to its full implementation. Disclosures showing the impact on the Group's profit and loss account and balance sheet, together with other disclosures required by FRS17, are set out below. The disclosures have been prepared by updating the results of the aforementioned valuation by qualified independent actuaries using the projected unit method of valuation on the basis of the following assumptions.

	2004	2003	2002
Rate of increase in salaries*	**3.9%**	3.5%	3.8%
Rate of increase in pensions in payment	**3.0%**	2.6%	2.9%
Discount rate	**5.5%**	5.4%	6.0%
Rate of increase in RPI	**2.9%**	2.5%	2.8%

*A promotional age related salary scale has also been used.

6. Pension (continued)

An analysis of the assets held in the scheme and the expected rates of return at 31 March 2004, 31 March 2003 and 31 March 2002 were as follows:

	Long term rate of return expected at 31 March 2004	**Value at 31 March 2004 £m**	Long term rate of return expected at 31 March 2003	Value at 31 March 2003 £m	Long term rate of return expected at 31 March 2002	Value at 31 March 2002 £m
Equities	**8.0%**	**665.0**	8.5%	583.0	7.8%	848.9
Bonds	**5.0%**	**336.0**	4.6%	285.9	5.3%	290.0
Property	**6.5%**	**90.0**	6.5%	84.6	6.3%	82.9
Other	**4.0%**	**15.0**	4.0%	13.6	3.8%	38.9
Total market value of assets		**1,106.0**		967.1		1,260.7
Present value of scheme liabilities		**(1,537.0)**		(1,399.7)		(1,312.2)
Deficit in the scheme		**(431.0)**		(432.6)		(51.5)
Related deferred tax asset		**129.0**		129.8		15.5
Net pension liability		**(302.0)**		(302.8)		(36.0)

The net pension liability comprises net pension liabilities relating to funded schemes in deficit of £295m (2003: £297m) and net pension liabilities relating to unfunded schemes in deficit of £7m (2003: £6m).

If the above amounts had been recognised in the financial statements, the Group's net assets employed at 31 March would have been as follows:

	2004 £m	2003 £m	2002 £m
Net assets employed excluding net SSAP24 pension asset	**885.2**	1,131.0	818.6
Net FRS17 pension liability	**(302.0)**	(302.8)	(36.0)
Net assets employed including net FRS17 pension liability	**583.2**	828.2	782.6

The impact of the implementation of FRS17 on net assets employed, as shown above, would be reflected within the profit and loss account reserve.

The net pension deficit has moved during the year ended 31 March as set out below:

	2004 £m	2003 £m
At 1 April	**(432.6)**	(51.5)
Current service cost	**(14.0)**	(16.5)
Past service cost	**–**	–
Net loss on settlements or curtailments	**(9.0)**	(16.7)
Contributions	**18.6**	12.1
Other financial income	**(7.0)**	9.0
Actuarial losses	**13.0**	(369.0)
At 31 March	**(431.0)**	(432.6)

If FRS17 had been implemented for the year ended 31 March, the following amounts would have been charged to the profit and loss account for the year:

	2004 £m	2003 £m
Operating charge		
Current service cost	**14.0**	16.5
Past service cost	**–**	–
Net loss on settlements or curtailments	**9.0**	16.7
Total charge to operating profit	**23.0**	33.2
Other financial (income)/costs		
Expected return on scheme assets	**67.0**	86.0
Interest on scheme liabilities	**(74.0)**	(77.0)
Impact on financial income	**(7.0)**	9.0
Net profit and loss charge before taxation	**30.0**	24.2

6. Pension (continued)

In addition, the following amounts would have been recognised in the statement of total recognised gains and losses:

	2004 £m	2003 £m
Difference between actual and expected return on scheme assets	**127.0**	(316.6)
Experience gains arising in scheme liabilities	**11.0**	7.3
Changes in assumptions	**(125.0)**	(59.7)
Actuarial losses	**13.0**	(369.0)

History of experience gains and losses that would be recognised on an FRS17 basis:

Difference between actual and expected return on scheme assets (£m)	**127.0**	(316.6)
– percentage of scheme assets	**11.5%**	(32.7%)
Experience gains arising on scheme liabilities (£m)	**11.0**	7.3
– percentage of present value of scheme liabilities	**0.7%**	0.5%
Actuarial losses (£m)	**13.0**	(369.0)
– percentage of present value of scheme liabilities	**0.8%**	(26.4%)

7. Net interest payable

	2004 £m	2003 £m
Bank loans and overdrafts	**26.5**	25.1
Interest payable to group undertakings	**0.5**	1.2
Other interest payable	**164.7**	160.8
Interest payable and similar charges	**191.7**	187.1
Interest capitalised	**(35.6)**	(27.4)
Interest payable and similar charges (net of interest capitalised)	**156.1**	159.7
Interest receivable from group undertakings	**(64.2)**	(42.0)
Other interest receivable and similar income	**(9.9)**	(18.0)
	82.0	99.7

Interest on the funding attributable to assets in the course of construction was capitalised during the year at a rate of 5.9% (2003: 6.0%).

8. Taxation

	2004 £m	2003 £m
United Kingdom corporation tax at 30% (2003: 30%)	**–**	–
Adjustment to corporation tax in respect of prior years	**(76.9)**	–
Payable to group undertakings for the surrender of tax losses	**108.7**	116.6
Total current tax	**31.8**	116.6
Deferred tax: timing differences	**23.9**	20.1
Adjustment to deferred tax in respect of prior years	**24.8**	(0.8)
Total deferred tax	**48.7**	19.3
Total tax	**80.5**	135.9

Reconciliation of the UK corporation tax rate to the effective rate of the Group:

	2004 (% of profit before taxation)	2003
UK corporation tax rate	30.0	30.0
Effect on tax charge of:		
Origination and reversal of timing differences	(5.3)	(4.3)
Permanent differences	0.6	0.6
Current tax charge	25.3	26.3
Origination and reversal of timing differences	5.3	4.3
Effective tax rate before prior year adjustments and exceptional items	30.6	30.6
Adjustment in respect of prior years	(11.7)	(0.2)
Effective tax rate before exceptional items	18.9	30.4
Exceptional items	(0.3)	0.4
Effective tax rate after exceptional items	18.6	30.8

9. Dividends

	2004 per share £m	2003 per share £m	2004 £m	2003 £m
Dividends on ordinary shares:				
Paid dividend	**7,531**	–	**240.0**	–
Proposed dividend	**10,982**	–	**350.0**	–
	18,513	–	**590.0**	–
Dividends and appropriations in respect of non-equity shares	**0.0484**	0.0514	**2.1**	2.2
			592.1	2.2

10. Tangible fixed assets

Group	Land buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2003	101.7	5,230.6	616.2	123.8	6,072.3
Capital expenditure	0.3	15.0	424.9	6.5	446.7
Disposals	–	(44.0)	–	(11.4)	(55.4)
Reclassifications	(1.1)	338.4	(389.3)	52.0	–
Cost at 31 March 2004	100.9	5,540.0	651.8	170.9	6,463.6
Depreciation at 1 April 2003	14.1	2,069.1	–	90.5	2,173.7
Charge for the year	1.1	181.5	–	20.1	202.7
Disposals	–	(44.1)	–	(9.9)	(54.0)
Depreciation at 31 March 2004	15.2	2,206.5	–	100.7	2,322.4
Net book value at 31 March 2004	**85.7**	**3,333.5**	**651.8**	**70.2**	**4,141.2**
Net book value at 31 March 2003	87.6	3,161.5	616.2	33.3	3,898.6

Company	Land buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2003	101.7	5,230.6	616.2	114.0	6,062.5
Capital expenditure	0.3	15.0	424.9	4.0	444.2
Disposals	–	(44.1)	–	(8.0)	(52.1)
Reclassifications	(1.1)	338.4	(389.3)	52.0	–
Cost at 31 March 2004	100.9	5,539.9	651.8	162.0	6,454.6
Depreciation at 1 April 2003	14.1	2,069.1	–	87.0	2,170.2
Charge for the year	1.1	181.4	–	18.3	200.8
Disposals	–	(44.1)	–	(7.9)	(52.0)
Depreciation at 31 March 2004	15.2	2,206.4	–	97.4	2,319.0
Net book value at 31 March 2004	**85.7**	**3,333.5**	**651.8**	**64.6**	**4,135.6**
Net book value at 31 March 2003	87.6	3,161.5	616.2	27.0	3,892.3

The cost of tangible fixed assets of the Group and Company at 31 March 2004 includes £366.8m (2003: £331.4m) relating to interest capitalised.

The net book value of land and buildings comprises:

	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Freehold	**78.9**	79.9	**78.9**	79.9
Long leasehold (over 50 years)	**2.7**	2.7	**2.7**	2.7
Short leasehold (under 50 years)	**4.1**	5.0	**4.1**	5.0
	85.7	87.6	**85.7**	87.6

11. Fixed asset investments

	Group		Company	
	Other investments £m	Group undertakings £m	Other investments £m	Total £m
Cost at 1 April 2003	41.8	0.1	41.8	41.9
Disposals	(7.2)	–	(7.2)	(7.2)
Cost at 31 March 2004	34.6	0.1	34.6	34.7
Amortisation at 1 April 2003	4.3	–	4.3	4.3
Charge for the year	0.2	–	0.2	0.2
Disposals	(2.3)	–	(2.3)	(2.3)
Amortisation at 31 March 2004	2.2	–	2.2	2.2
Net book value at 31 March 2004	**32.4**	**0.1**	**32.4**	**32.5**
Net book value at 31 March 2003	37.5	0.1	37.5	37.6

Other investments relate to 7.9m 10p ordinary shares (2003: 9.5m 10p ordinary shares) in National Grid Transco plc (the ultimate parent undertaking), held by employee share trusts for the purpose of satisfying certain obligations under the various share option schemes. The carrying value of £32.4m (market value £34.0m (2003: £36.7m)) represents the cost of these shares less provision for amortisation. Funding is provided to the trusts by the Company. The trusts have waived their rights to dividends on these shares.

Group subsidiary undertakings

Investments in Group undertakings represent ordinary shares at cost. The principal Group undertaking included in the Group accounts, the issued share capital of which is held by the Company, is NGC Leasing Limited. This undertaking, whose principal activity is that of a leasing company, is wholly-owned and is incorporated in Great Britain.

A full list of all Group undertakings will be attached to the Company's Annual Return to be filed with the Registrar of Companies.

12. Debtors

	Group 2004 £m	Group 2003 £m	**Company 2004 £m**	Company 2003 £m
Amounts falling due within one year:				
Trade debtors	**47.1**	27.6	**47.1**	27.6
Amounts owed by other group undertakings	**1,499.9**	1,545.3	**1,508.3**	1,553.2
Other debtors	**46.2**	66.6	**46.2**	66.7
Prepayments and accrued income	**68.4**	50.8	**68.5**	50.9
	1,661.6	1,690.3	**1,670.1**	1,698.4
Amounts falling due after more than one year:				
Other debtors	**50.7**	48.3	**50.7**	48.3
	1,712.3	1,738.6	**1,720.8**	1,746.7

13. Creditors (amounts falling due within one year)

	Group 2004 £m	Group 2003 £m	**Company 2004 £m**	Company 2003 £m
Borrowings (note 15)	**20.4**	292.2	**25.3**	295.5
Trade creditors	**176.3**	212.0	**176.0**	211.6
Accruals and deferred income	**125.5**	51.2	**125.5**	51.2
Amounts owed to ultimate parent company	**10.5**	2.7	**10.5**	2.7
Amounts owed to group undertakings	**374.4**	295.8	**373.1**	288.4
Amounts owed to related parties	**1.3**	7.0	**1.3**	7.0
Corporation tax	**5.1**	–	**4.9**	–
Social security and other taxes	**17.5**	26.8	**17.5**	26.7
Dividends	**350.5**	7.1	**350.5**	7.1
Other creditors	**154.2**	110.2	**154.2**	110.1
	1,235.7	1,005.0	**1,238.8**	1,000.3

14. Creditors (amounts falling due after more than one year)

	Group 2004 £m	Group 2003 £m	**Company 2004 £m**	Company 2003 £m
Borrowings (note 15)	**2,809.1**	2,652.4	**2,809.1**	2,652.4
Accruals and deferred income	**133.5**	95.3	**133.5**	95.3
Other creditors	**11.6**	16.1	**11.6**	16.1
	2,954.2	2,763.8	**2,954.2**	2,763.8

15. Borrowings

	Group 2004 £m	Group 2003 £m	**Company 2004 £m**	Company 2003 £m
Amounts falling due within one year:				
Bank loans and overdrafts	**20.4**	292.2	**25.3**	295.5
	20.4	292.2	**25.3**	295.5
Amounts falling due after more than one year:				
4.25% exchangeable bonds 2008	**–**	502.5	**–**	502.5
Bank loans	**407.0**	200.0	**407.0**	200.0
Other bonds	**2,402.1**	1,949.9	**2,402.1**	1,949.9
	2,809.1	2,652.4	**2,809.1**	2,652.4
Total borrowings	**2,829.5**	2,944.6	**2,834.4**	2,947.9
Amounts falling due after more than one year:				
In more than one year, but not more than two years	**250.6**	–	**250.6**	–
In more than two years, but not more than five years	**661.0**	752.9	**661.0**	752.9
In more than five years – other than by instalments	**1,897.5**	1,899.5	**1,897.5**	1,899.5
	2,809.1	2,652.4	**2,809.1**	2,652.4

The 4.25% exchangeable Bonds were redeemed in whole at the option of the Group on 29th September 2003. The bonds were redeemed for their principal amount, including the redemption premium, except where the holder elected to exchange their bonds for ordinary shares of the parent company. There was a nil gain or loss on redemption.

Included in other bonds are the following instruments that were issued during the year:

EUR 600m 4.125% Fixed rate instrument due 2008 GBP 40m Floating rate instrument due 2007

GBP 40m Floating rate instrument due 2007

For these items gross consideration equates to the notional principal of the issue.
The notional amount at maturity of the Group's debt portfolio is £2,804.1m (2003: £2,904.9m).

16. Financial instruments

A description of the policies relating to financial instruments is set out in the Directors' report. Short term debtors and creditors, where permitted by the financial reporting standard on derivatives and other financial instruments (FRS 13), have been excluded from the following disclosures, which relate to the Group and are after taking into account interest rate and currency swaps where applicable. It is assumed that because of short maturities, the fair value of short term debtors and creditors approximate to their book values.

Currency and interest rate composition of financial liabilities

				Fixed rate liabilities	
At 31 March 2004	Total £m	Variable rate £m	Fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings (sterling)	**2,829.5**	**1,674.9**	**1,154.6**	**5.8**	**10.2**
Preference shares of £1 each	**43.4**	**43.4**	**–**	**–**	**–**
Other financial liabilities (sterling)	**11.8**	**11.8**	**–**	**–**	**–**
	2,884.7	**1,730.1**	**1,154.6**	**5.8**	**10.2**
At 31 March 2003					
Borrowings (sterling)	2,944.6	805.0	2,139.6	6.5	11.0
Preference shares of £1 each	43.4	43.4	–	–	–
Other financial liabilities (sterling)	16.1	–	16.1	5.3	2.7
	3,004.1	848.4	2,155.7	6.5	10.9

At 31 March 2004, the weighted average interest rate on short term borrowings of £20.4m (2003: £292.2m) was 5.0% (2003: 7.49%).

Other financial liabilities predominately relate to other creditors due after more than one year.

Substantially all of the variable rate borrowings and preference shares are subject to interest rates or coupons which fluctuate with LIBOR, or RPI, for the appropriate currency at differing premiums.

In calculating the weighted average number of years for which interest rates are fixed, swaps which are cancellable at the option of the swap provider are taken to have a life based on the earliest date at which they can be cancelled.

Currency and interest rate composition of financial assets

				Fixed rate liabilities	
At 31 March 2004	Total £m	Variable rate £m	Fixed rate £m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Cash and deposits (sterling)	**27.1**	**27.1**	**–**	**–**	**–**
Other financial assets (sterling)	**44.9**	**–**	**44.9**	**11.5**	**5.1**
	72.0	**27.1**	**44.9**	**11.5**	**5.1**
At 31 March 2003					
Cash and deposits (sterling)	13.8	13.8	–	–	–
Other financial assets (sterling)	50.4	–	50.4	11.5	4.5
	64.2	13.8	50.4	11.5	4.5

Other financial assets comprise a net investment in a finance lease of £44.9m (2003: £50.4m). Cash and bank deposits earn interest at local prevailing rates for maturity periods generally not exceeding 12 months.

16. Financial instruments (continued)

Maturity of financial liabilities at 31 March	2004 £m	2003 £m
In one year or less	**32.2**	292.2
In more than one year, but not more than two years	**250.6**	7.9
In more than two years, but not more than five years	**661.0**	761.1
In more than five years	**1,940.9**	1,942.9
	2,884.7	3,004.1

Maturity of financial assets at 31 March	2004 £m	2003 £m
In one year or less	**33.6**	19.7
In more than one year, but not more than two years	**7.4**	6.5
In more than two years, but not more than five years	**27.5**	24.5
In more than five years	**3.5**	13.5
	72.0	64.2

	2004		2003	
Fair values of financial instruments at 31 March	Book value £m	Fair value £m	Book value £m	Fair value £m
Short term debt	**(20.4)**	**(20.4)**	(252.4)	(252.4)
4.25% exchangeable bonds 2008	**–**	**–**	(502.5)	(509.6)
Other long term debt	**(2,783.6)**	**(3,009.5)**	(2,149.9)	(2,246.0)
Cash and deposits	**27.1**	**27.1**	13.8	13.8
Preference shares of £1 each	**(43.4)**	**(43.4)**	(43.4)	(43.4)
Other financial liabilities	**(11.8)**	**(11.8)**	(16.1)	(14.0)
Net investment in finance lease	**44.9**	**44.9**	50.4	50.4
Financial instruments held to manage interest rate and currency profile:				
Interest rate swaps	**–**	**(17.2)**	–	(15.9)
Forward currency contracts and cross currency swaps	**(25.5)**	**(13.5)**	(39.8)	(49.3)

Market values, where available, have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting cash flows at prevailing interest rates.

The notional principal amounts relating to financial instruments held to manage interest rate and currency profile for interest rate swaps; and foreign currency contracts and cross currency swaps amounted to £621.0m (2003: £100.0m); and £2,977.2m (2003: £204.7m) respectively.

Gains and losses on hedges	Unrecognised Gains £m	Unrecognised Losses £m	Unrecognised Net gain/(loss) £m	Deferred Gains £m	Deferred Losses £m	Deferred Net gain/(loss) £m
Gains/(losses) on hedges at 1 April 2003	–	(25.4)	(25.4)	5.1	–	5.1
(Gains)/losses arising in previous years recognised in the year	–	9.5	9.5	(5.1)	–	(5.1)
Losses in previous years not recognised in the year	–	(15.9)	(15.9)	–	–	–
(Losses)/gains arising in the year	15.4	(4.7)	10.7	–	(2.0)	(2.0)
Unrecognised (losses)/gains on hedges at 31 March 2004	**15.4**	**(20.6)**	**(5.2)**	**–**	**(2.0)**	**(2.0)**
Of which:						
Losses/gains expected to be recognised in the next year	1.3	–	1.3	–	(0.7)	(0.7)
(Losses)/gains expected to be recognised in subsequent years	14.1	(20.6)	(6.5)	–	(1.3)	(1.3)

Borrowing facilities

At 31 March 2004, the Group had £460m committed, undrawn, credit facilities (2003: nil) being held as a backup to commercial paper. The facilites mature within one year.

17. Provisions for liabilities and charges

Group and Company	Environmental £m	Pensions £m	Deferred taxation £m	Other £m	Total provisions £m
At 1 April 2003	12.5	9.2	773.5	19.9	815.1
Additions	–	–	48.7	–	48.7
Released	(0.4)	–	–	(0.1)	(0.5)
Utilised	(1.8)	(1.5)	–	(6.0)	(9.3)
At 31 March 2004	**10.3**	**7.7**	**822.2**	**13.8**	**854.0**

The environmental provision relates to estimated liabilities relating to uninsured events, principally of an environmental nature. The assessment of this liability is subject to periodic reviews, which may result in the amount being revised. It is currently estimated that substantially all of this provision will be utilised within the next five years.

The pensions provision, which relates to the equalisation of the pension retirement age to 65, will be eliminated once FRS17 is adopted.
Other provisions include a severance provision of £3.0m (2003: £3.0m). It is currently estimated that this provision will be utilised within the next year. Other provisions also includes employer liability provisions of £4.5m (2003: £5.4m) which comprises estimates of liabilities in respect of past events for which no payment date can be identified although it is expected that the liability will be substantially settled over 30 years. The remaining £6.3m balance within other provisions relates to other property commitments estimated to be utilised over the next ten years

Deferred taxation
Deferred taxation provided in the accounts comprises:

	Group 2004 £m	Group 2003 £m	**Company 2004 £m**	Company 2003 £m
Accelerated capital allowances	**826.6**	785.4	**826.9**	785.4
Other timing differences	**(4.4)**	(11.9)	**(4.7)**	(11.9)
	822.2	773.5	**822.2**	773.5

No provision has been made for capital gains rolled over into the base cost of other assets. Such tax would only become payable if the other assets were sold. The amount unprovided is £1.5m. No asset has been recognised for capital losses carried forward. These losses are available to reduce future capital gains. The benefit will only arise if assets giving rise to a capital gain are sold in future periods. The unrecognised deferred tax asset is £1.5m.

18. Share capital

	2004 £m	2003 £m
Authorised:		
1,000,000,000 ordinary shares of £0.20 each	**200.0**	200.0
74,803,600 preference shares of £1 each	**74.8**	74.8
	274.8	274.8

	2004 £m	2003 £m
Allotted, called up and fully paid:		
43,406,000 preference shares of £1 each	**43.4**	43.4
	43.4	43.4

The preference shares, which are non-voting except in matters that directly affect their rights or in the event their dividends are in arrears, are entitled to a dividend of 1% above LIBOR and have a preferential right to return of capital on a winding up.

19. Reserves

	Group				Company			
	Share premium account £m	Capital redemption reserve £m	Special reserve £m	Profit and loss account £m	Share premium account £m	Capital redemption reserve £m	Special reserve £m	Profit and loss account £m
At 1 April 2003	454.1	0.1	28.8	597.4	454.1	0.1	28.8	604.0
Loss for the year	–	–	–	(240.8)	–	–	–	(247.5)
At 31 March 2004	**454.1**	**0.1**	**28.8**	**356.6**	**454.1**	**0.1**	**28.8**	**356.5**

The Company has £334.9m (2003: £334.9m) of non-distributable reserves.

The special reserve is a non-distributable reserve set up for creditor protection purposes as part of the prior year capital reduction exercise.

The Company has not presented its own profit and loss account as permitted by Section 230 of the Companies Act 1985. Of the Group profit after taxation, £344.6m (2003: £304.9m) is attributable to the Company.

20. Reconciliation of movement in shareholders' funds

	2004 £m	2003 £m
Profit on ordinary activities after taxation	**351.3**	305.6
New shares issued	**–**	334.9
Share reduction	**–**	(334.9)
Equity dividends	**(590.0)**	–
Non-equity dividends	**(2.1)**	(2.2)
Appropriations on non-equity shares credited to reserves	**–**	(4.8)
Shares repurchased and cancelled	**–**	–
Net (reduction)/increase in shareholders' funds	**(240.8)**	298.6
Shareholders' funds at start of year	**1,123.8**	825.2
Shareholders' funds at end of year	**883.0**	1,123.8

21. Group cash flow statement

a) Reconciliation of operating profit to net cash inflow from operating activities before exceptional items

	Notes	**2004 £m**	2003 £m
Total operating profit		**513.8**	539.0
Exceptional operating items	2	**12.0**	32.3
Depreciation and amortisation		**199.8**	190.7
Decrease/(increase) in Stock		**5.3**	(2.1)
(Increase)/Decrease in Debtors		**(35.8)**	34.1
Increase/(Decrease) in Creditors		**104.2**	(20.1)
Decrease in Provisions		**(9.7)**	(2.4)
Net cash inflow from operating activities before operating exceptional items		**789.6**	771.5

b) Reconciliation of net cash flow to movement in net debt

	2004 £m	2003 £m
Movement in cash and overdrafts	**20.2**	(29.6)
Net cash outflow/(inflow) from the management of liquid resources	**11.1**	(0.1)
Decrease/(increase) in borrowings	**120.7**	(806.3)
Change in net debt resulting from cash flows	**152.0**	(836.0)
Other non-cash movements	**(23.6)**	(24.9)
Movement in net debt in the year	**128.4**	(860.9)
Net debt at the start of the year	**(2,930.8)**	(2,069.9)
Net debt at the end of the year	**(2,802.4)**	(2,930.8)

c) Analysis of changes in net debt

	At 1 April 2003 £m	Cash flow £m	Interest accretion £m	At 31 March 2004 £m
Cash at bank and in hand	12.9	2.2	–	15.1
Bank overdrafts	(38.4)	18.0	–	(20.4)
		20.2		
Current asset investments	0.9	11.1	–	12.0
Borrowings due after one year	(2,652.4)	(133.1)	(23.6)	(2,809.1)
Borrowings due within one year	(253.8)	253.8	–	–
		120.7		
	(2,930.8)	**152.0**	**(23.6)**	**(2,802.4)**

22. Commitments and contingencies

a) Future capital expenditure

	Group		Company	
	2004 £m	2003 £m	**2004 £m**	2003 £m
Contracted for but not provided	**177.7**	218.5	**177.7**	218.5

b) Lease commitments

At 31 March 2004, the Group and Company's annual operating lease commitments for the financial year ending 31 March 2005 amounted to £4.3m (2003: £3.0m) and are analysed by lease expiry date as follows:

	Land and buildings	
Group and Company	**2004 £m**	2003 £m
After five years	**4.3**	3.0
	4.3	3.0

Where provision already exists for vacant property lease costs, these have been excluded from the analysis above.

c) Guarantees and performance bonds

The Company has issued performance bonds in the ordinary course of business amounting to £8.2m (2003: £5.6m) and guarantees in respect of the performance of a third party up to £14.0m (2003: £14.1m).

23. Related party transactions

The Company is exempt from disclosing transactions with National Grid Transco plc and other subsidiaries of that company by virtue of the fact that the voting rights of all these companies are held within the National Grid Transco Group.

Under FRS8 paragraph 3(c), the Company is exempt from disclosing transactions with entities that are part of the Group qualifying as related parties by virtue of the fact that the transactions are disclosed in the ultimate parent company's consolidated accounts. The entity which might otherwise have been disclosed is EnMO.

24. Holding company

The Company's ultimate controlling and parent company is National Grid Transco plc, and the immediate holding company for which onsolidated financial statements are prepared is National Grid Holdings Limited. Both companies are incorporated in Great Britain.

Copies of their consolidated financial statements can be obtained from their Company Secretary at National Grid Transco plc, 1-3 Strand, London, WC2N 5EH.

National Grid Company plc

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