Experts in Networks

National Grid Company plc
Annual Report and Accounts 2004/05

National Grid

Contents

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 France and Scotland.

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.

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.

Business overview

Background information

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

It owns and operates electricity assets, which include 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 real-time matching of generation output with demand, ensuring the stability and security of the power system and the maintenance of satisfactory voltage and frequency.

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. We have a duty under the Electricity Act 1989 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, we are responsible for setting charges and maintaining the charging statements, which describe the charges and methodologies used to calculate them. We receive income through charges to generators, distributors, suppliers and directly connected customers for use of, and connection to, the transmission system. Transmission Network Use of System charges are levied in respect of the provision of transmission assets and infrastructure (the electricity Transmission Owner activity) and Balancing Services Use of System charges are levied for operating the system (the electricity System Operator activity).

Transmission business

In its role as Transmission Owner, NGC owns and maintains the physical assets, develops the network to accommodate new connections and disconnections and 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 Ofgem's estimates of operating expenditure, capital expenditure, replacement expenditure and allowed rate of return (which is currently set at a real pre tax rate of 6.25%) on our regulatory asset value. 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 period commenced on 1 April 2001 and was intended to continue until 31 March 2006. However, in order to align the NGC and Transco Network Transportation System price controls, we are currently undergoing a mini review, which will effectively extend the period to 31 March 2007. It is anticipated that this review will address the issue of the increased levels of capital investment that have already been committed in the current price control. We expect these negotiations to conclude by the end of calendar year 2005. We are also preparing for discussions with Ofgem regarding the next five-year price control commencing on 1 April 2007.

An amended connection charging methodology for our electricity Transmission Owner, known as 'Plugs', was introduced from 1 April 2004. The changes for Plugs modified the charging boundary between connection assets that were attributable to specific users and the main interconnected transmission network shared by all users. This required us to make repayments to connected parties associated with relevant assets that had been subject to capital contributions or other accelerated payment terms. In total, these repayments were approximately £71 million, of which £61 million has been refunded in 2004/05. The majority of these repayments have been treated as capital expenditure for regulatory purposes.

As System Operator we are responsible for the operation of the high-voltage electricity transmission system across England and Wales. With the implementation of the British Electricity Trading and Transmission Arrangements (BETTA), we also took over responsibility for the operation of the transmission system in Scotland on 1 April 2005. Our activities as electricity System Operator include the procurement and use of balancing services to match supply and demand continuously. Balancing services include commercial agreements with market participants that enable the electricity System Operator to vary their electricity demand or generation output. Revenue from charges for the provision of balancing services is regulated under an incentive scheme where benefits of cost savings in system operation compared to a target are shared with customers.

The UK Government's Energy Bill was granted Royal Assent on 22 July 2004. The Act includes the legislative framework for BETTA. The Framework provides the transitional and enduring licence obligations in order to implement BETTA. NGC was formally announced as the Great Britain (GB) System Operator under BETTA on 1 September 2004.

As a result of licence modifications associated with BETTA, we are responsible for operating the GB transmission system, setting charges and maintaining the charging statements for all transmission users in Great Britain. In this role, we recover payments from all GB transmission users and make payments to the Scottish transmission operators in accordance with arrangements set out in the System Operator Transmission Operator Code. Scottish Power is currently seeking judicial review of the Gas and Electricity Markets Authority's decision to approve the GB electricity transmission use of system charging methodology developed and proposed by NGC. In addition, under the regulatory arrangements for BETTA the Scottish interconnector (previously outside of the regulated business) now forms part of the regulated businesses of Scottish Power and ourselves.

As GB electricity System Operator, we are also responsible for managing the operations of both the Scottish and the England and Wales networks, and also operating the GB energy balancing mechanism. For 2005/06 the electricity System Operator incentive scheme has been set with a target of £377.5 million, with sharing factors for the System Operator external costs of 40% upside and 20% downside. This compares to £415 million with sharing factors of 40% for both upside and downside for 2004/05 in relation to the operation of the England and Wales transmission system. The reduction in target of £37.5 million comparing 2004/05 with 2005/06 is due to the change in treatment of transmission losses, such that the gross value of losses is removed from the target. This is partly offset by the increase in scope of the incentive scheme, from operation of the England and Wales transmission system to the GB transmission system, following BETTA implementation. For comparison with the 2004/05 target, an equivalent target for 2005/06, including the gross value of losses would be £500 million.

BETTA has required significant information systems expenditure development during the past year. In particular, this has included a substantial increase in database capacity and the number displays on our new integrated energy management system. The tiled mosaic overview England and Wales diagrams in our two electricity control rooms have also been replaced with two video walls, the larger being 14 metres by 4.5 metres, which provide a powerful and flexible tool for the display of the GB system state.

We have recruited approximately 60 staff to support the BETTA activities, in both the commercial area and the control room environment, plus the functions that support it.

In 2004, the energy management system used for electricity system operations was replaced with a new integrated energy management system (IEMS). The new IEMS not only has the capability to handle the increasing complexity of the England and Wales systems, but also the 30% increase in network size, which was needed to incorporate the Scottish networks, which we now operate. Furthermore this system is designed to be upgraded on an ongoing basis and we believe it will be adequate for future growth of the electricity network.

Financial performance

Total operating profit, before exceptional items, for the year ended 31 March 2005 was £579 million, compared with £518 million in 2003/04 (restated).

Electricity transmission operating profit for the year ended 31 March 2005, before exceptional reorganisation costs, was £537 million, compared with £478 million in 2003/04 (restated). The £59 million increase in operating profit was mainly as a result of higher Transmission Use of System income of £32 million and lower operating costs of £22 million both resulting from the introduction of the new charging methodology 'Plugs'; timing and inflationary impacts associated with electricity transmission revenue collection of £29 million; partly offset by £21 million lower System Operator incentive profits.

Interconnectors operating profit for the year ended 31 March 2005 was £36 million compared with £29 million in 2003/04 and other businesses operating profit for the year ended 31 March 2005 was £5 million compared with £11 million in 2003/04.

Exceptional Items – No exceptional costs were charged to operating profit during the year ended 31 March 2005 (2004: £12 million).

Interest – The net interest payable by NGC for the year ended 31 March 2005 was £80 million (2004: £82 million).

Taxation – NGC's tax charge for the year ended 31 March 2005 was £140 million (2004: £81 million). The increase compared to the prior year is largely due to a release of £52 million of tax provision in the year ended 31 March 2004.

Employee numbers – The average number of employees during the year ended 31 March 2005 was 2,190 compared with 2,345 in the prior period, as a result of continuing restructuring of the business post merger.

Operating performance

The winter of 2004/05 saw demand from the electricity transmission network in England and Wales hit a peak of 53.29 GW. This slightly exceeded the previous year's peak of 52.97 GW.

Since 1 January 2005, NGC has operated under a new Transmission Network Reliability Incentive scheme. Scheme parameters have been set until 31 March 2007 and the incentive takes the form of a sliding scale. This scheme allows us to receive payments if we maintain or improve reliability of the England and Wales transmission system by delivering above average reliability of the network. The incentive target set is equivalent to a level of reliability of better than 99.9999%.

For the initial period from 1 January 2005 to 31 March 2006, there is the potential to earn additional revenue for performance better than the lower target level of 310 MWh, up to a maximum of 1.25% of revenue. For loss of supply in excess of 342 MWh there is the potential to lose revenue, up to a maximum of 1.875% of revenue capped at a level of loss of 816 MWh. For each incentive year, the revenue impact takes place in the following year, so that any change in revenue due to incentive performance for the initial period will be accounted for in our allowed revenue in 2006/07.

During 2004/05, excluding anomalous losses (defined as three or less customers), loss of supply totalled 55.3 MWh in 2004/05 spread across six incidents. This has only been bettered once in the last decade and represents successful delivery of 99.99998% of energy demanded during the year.

System performance is partly monitored through system availability, including winter peak and average annual availability. Availability is reduced whenever a circuit is taken out of operation, either for planned purposes e.g. construction work, or as a result of a fault. Planned work is required to provide new user connections as well as the maintenance necessary to retain a high level of system reliability to ensure that licence standards are met. Over the course of 2004/05, we have maintained our average annual availability of the electricity network at 95.3% compared with 95.2% in 2003/04 and 95.8% in 2002/03, and our five-year average was 95.5% in 2004/05. System availability at winter peak demand was 97.6% in 2004/05 compared with 98.0% in 2003/04 and 98.8% in 2002/03, and our five-year average was 98.3% in 2004/05. The 0.4% reduction in system availability at winter peak comparing 2004/05 with 2003/04 reflects the increased system outage commitment due to construction, connection and maintenance work.

Investment in the network
Capital investment in the replacement, reinforcement and extension of the UK electricity system in 2004/05 was £395 million, compared with £426 million in 2003/04.

The decrease in overall capital investment comparing 2004/05 with 2003/04 was largely due to completion of major projects on the electricity network, despite an underlying increase in electricity asset replacement investment in 2004/05.

We continue to work with the Government and Ofgem to make possible the necessary investments in the electricity transmission network to support the development of renewable energy projects. The final Transmission Investment for Renewable Generation proposals from Ofgem recognised the need to invest in networks to accommodate renewables. Financing costs for £108 million of investment will be allocated to our electricity Transmission Owner business allowable revenue for the upgrade of the Anglo-Scottish interconnector (conditional on the satisfactory outcome of key planning consent issues in Scotland). The proposals also include increased rates of return of 8.8% real pre-tax for the approved baseline projects, the funding to be recovered through our Transmission Network Use of System charges. At this time, access has been sought by 10.5 GW of wind generation (3.3 GW in England and Wales and 7.2 GW in Scotland), and as the Great Britain System Operator we have processed 65 applications. In addition to these, there is interest from another 3.4 GW (72 sites).

The bulk of the current electricity transmission network was installed during the 1960s and 1970s, with main plant asset lives typically of between 40 to 50 years. Over the next few years, we anticipate increasing investment substantially in replacing parts of our electricity network as these assets will be due for renewal. This, together with work required to support the development of renewable energy projects, means that we will be embarking on a significant increase in investment and network renewal on the electricity transmission system.

In order to meet the increasing programme of work, we will be recruiting staff, project and site engineers over the next two to three years. We will also be exploring ways to work more efficiently and collaboratively with major suppliers and contractors to manage the increase in workload effectively.

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 centres 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 2005 was £5,309 million, £1,146 million greater than the historic cost net assets value.

Safety
Safety performance in 2004/05 has been encouraging. During 2004/05, there was a 17% reduction in Lost Time Injuries (LTIs) from 6 in 2003/04 to 5 in 2004/05.

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. Our emphasis on contractor safety is also important to us, as we create a safety culture committed to achieving an injury-free workplace.

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 financial year.

In the last financial year there has been an encouraging drop in the number of significant environmental incidents related to substation sites. We continue to reduce our SF6 gas losses (this is used as an electrical insulant in high-voltage switchgear, and is a greenhouse gas which contributes to global warming). We have also seen a swifter response to leaks on our oil-filled cable system and a downturn of 41% in oil loss to the environment.

Electric and magnetic fields
Electric and magnetic fields (EMFs) are generated from a wide variety of sources, including our power lines and telecommunications infrastructure. While the balance of scientific evidence is against EMFs resulting in adverse health impacts, we recognise that there is some limited scientific evidence suggesting the possibility, and there are parts of society that are concerned about this issue.

In 2003, we took the initiative to improve the dialogue between the various parties with an interest in this issue, by creating a Stakeholder Advisory Group on EMFs (SAGE) with representation from Industry, Government, academia, professional bodies, and interest groups. As a result of the success of SAGE, the participants have now agreed to establish a more formal Stakeholder Advisory Group under the sponsorship of the Department of Health.

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 2006 are to continue to invest in network reliability and system security and to take out unnecessary cost from the business wherever it arises.

Directors' Report

The NGC ('the Company') Directors present their report and the audited accounts for the year ended 31 March 2005 on behalf of its Board ('the Board'). This report also contains references to the Company and its subsidiaries ('the Group'), the listed ultimate parent undertaking, National Grid Transco plc ('NGT'), the Board of NGT ('the NGT Board') and to NGT and its subsidiaries ('the NGT Group') as appropriate.

Principal activities

See Business Review on page 1.

Results and Developments

See Financial Performance section in the Business Review.

Capital Reduction

The capital reduction scheme which took place in March 2005 is described in note 20 to the accounts.

Dividends

The Directors do not recommend the payment of a final dividend (2004: £350 million). Following the capital reduction scheme an ordinary dividend of £1,100 million (2004: £240 million) was paid during the year. Preference dividends of £2.5 million (2004: £2.1 million) were paid or payable in relation to the year ended 31 March 2005.

International Financial Reporting Standards

This is the last annual report in which we will be presenting consolidated financial statements under UK GAAP, as we will apply International Financial Reporting Standards (IFRS) starting with our annual report for the year ending 31 March 2006.

Directors

The Directors of the Company, who served throughout the year unless otherwise stated, are:
A B Chapman (Appointed 24 November 2004)
S J Holliday
S Lucas
N Moore (Resigned 24 November 2004)
Dr R J Urwin
N P Winser

Directors' interests

The interests of Directors, other than Andy Chapman, who are also NGT Directors, in NGT's shares at 31 March 2005, are disclosed in the NGT Annual Report and Accounts.

The interests of Andy Chapman in NGT ordinary shares, are as follows:

	Employee Sharesave Scheme Options	Executive Share Options	Performance Share Plan Awards	Shares Beneficially Owned*
On appointment	–	86,413	40,797	20,203
Granted	4,314	–	–	–
Shares purchased under Share Incentive Plan	–	–	–	100
Exercised	–	–	–	–
31 March 2005	4,314	86,413	40,797	20,303

*Note: Includes shares acquired under the Share Matching scheme. Subject to retention of the shares acquired in accordance with the rules of the scheme, matching awards are exercisable by Andy Chapman (totalling 6,991 shares, on appointment and at 31 March 2005) in addition to the above.

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 the Company or its subsidiaries.

Biographies

Roger Urwin (59)
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 (44)
Nick Winser became the NGT Group Director responsible for UK and US Transmission operations, and Chief Executive of NGC, in April 2003. He was previously Chief Operating Officer of US Transmission for NGT. Nick joined the 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 (51)
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 is also a Non-executive Director of Compass Group PLC.

Steve Holliday (48)
Steve Holliday is also Executive Director of NGT responsible for the NGT'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 developed business opportunities in countries as diverse as China, Australia, Japan, Brazil and the former Soviet Union. Steve is also a Non-executive Director of Marks and Spencer Group plc.

Andy Chapman (48)
Andy Chapman is Finance Director, Transmission within NGT and Finance Director of the Company, appointed in November 2004. Prior to this, he was NGT Financial Controller following 5 years overseas in joint ventures where he spent 2 years as Chief Financial Officer, Intelig Telecomunicacoes, in Brazil and 3 years in Zambia working for the Copperbelt Energy Corporation occupying the position of Finance Director and, subsequently, Chief Executive Officer. He joined the Company in 1992 and is a qualified accountant.

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

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

The Company 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.

The Company 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 and a Share Incentive Plan.

Pension arrangements
NGT operates three major UK occupational pension schemes – the National Grid Company Group of the Electricity Supply Pension Scheme (the 'National Grid Scheme'); the Lattice Group Pension Scheme (the 'Lattice Scheme'); and the Crown Castle UK Pension Scheme (the 'Crown Castle Scheme'). There are no current plans to merge the schemes.

The National Grid 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 National Grid 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' contribution, 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 last actuarial valuation of the National Grid Scheme, at 31 March 2004, was completed during the year ended 31 March 2005 and revealed a pre-tax deficit of £271.5 million on the basis of the funding assumptions adopted by the actuary. Based on long term financial assumptions the contribution rate required to meet future benefit accrual was 19.1% of pensionable earnings (13.1% employers and 6% employees). This contribution rate will be reviewed when the next independent actuarial valuation is carried out, which will be no later than 31 March 2007.

Research and development
Expenditure charged in 2004/05 on research and development was £2.6 million (2004: £3.0 million).

Payment to suppliers
The Company 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 2005 for the Company was 18 days (2004: 15 days).

Charitable and other donations
During the year, charitable donations of £101,559 (2004: £23,760) were made to local UK charities, mainly in the area of the environment. In addition, the Company 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 (2004: 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 NGT Group. In turn, the Group seeks to ensure that all of its forecast cash needs for a period of at least twelve months ahead are covered and maintains a minimum level of committed facilities in support of that objective.

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 (US$0.6 billion unutilised), a joint Euro medium term note programme with NGT of €6.0 billion (€2.5 billion unissued), £485 million of committed bank facilities (undrawn) and the ability to demand repayment of an inter-company loan. The bank facilities are being held as a backup to commercial paper issuance.

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 NGT Board. The Finance Committee of the NGT 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 NGT Group has separate financing programmes for each of the rated companies, which includes the Company. All funding is approved by the NGT Finance Committee. In respect of its own activities, the Board has its own Finance Committee. The use of derivative financial instruments ('derivatives') is controlled by policy guidelines set by the NGT 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.

The 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 had borrowings outstanding at 31 March 2005 amounting to £3,088.9 million (2004: £2,829.5 million).

NGT 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 2005 are shown in note 17 to the financial statements, on page 21.

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 good access to the capital and money markets for future funding when necessary.

The main risks arising from the Group's financing activities are those risks associated with refinancing, interest rates, exchange rates and counterparty credit. The Board reviews and agrees policies for managing each risk and they are summarised below.

Risk Management

Refinancing risk management

The NGT 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 (i.e. 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 i.e. 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 £22.9 million (2004: £27.1 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 derivatives. 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 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 £75 million of new finance through the issue of one long term bond.

Going Concern

The Board has reviewed the Group's budget and cash flow forecasts for the year ending 31 March 2006 and the outline projections for the four 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 2005 will be issued separately to shareholders.

On behalf of the board

A B Kay
Company Secretary
19 May 2005
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 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: 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 and statement of total recognised gains and losses, 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 2005 and of the profit and cash flows 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
19 May 2005

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 which have been consistently applied except in relation to the adoption of FRS 20 'Share-based payment' as explained in note 1.

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 7.

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 12).

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 includes payroll 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

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. No liability is recognised when revenues exceed the maximum amount permitted by regulatory agreement and reductions will be made to future prices to reflect this over-recovery.

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 benefit trusts

Shares held by employee benefit trusts are carried at cost less provision for impairment. Impairment is measured by reference to the option price of those shares required to settle outstanding options, and by reference to market price, if applicable, for the remainder.

i) Share-based payments

The Company's ultimate parent company, National Grid Transco plc, issues equity-settled share-based payments to certain employees of the Company.

Equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the ultimate parent company management's estimate of shares that will eventually vest.

j) Research and development

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

k) 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 the 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.

l) Financial instruments

Derivative financial instruments ('derivatives') are used by the Group mainly for the management of its interest rate and foreign currency exposures. The principal 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	2005 £m	2004 (restated) £m
Turnover	2	**1,422.3**	1,368.8
Operating costs	3	**(843.6)**	(863.1)
Operating profit			
– Before exceptional reorganisation costs		**578.7**	517.7
– Exceptional reorganisation costs	3	**–**	(12.0)
Total operating profit	2	**578.7**	505.7
Profit on sale of fixed assets	4	**2.7**	–
Net interest payable	8	**(79.8)**	(82.0)
Profit on ordinary activities before taxation		**501.6**	423.7
Taxation			
– Excluding exceptional items		**(140.4)**	(84.5)
– Exceptional items		**–**	4.0
	9	**(140.4)**	(80.5)
Profit on ordinary activities after taxation		**361.2**	343.2
Equity dividends	10	**(1,100.0)**	(590.0)
Dividends in respect of non-equity shares	10	**(2.5)**	(2.1)
Loss transferred from reserves	20	**(741.3)**	(248.9)

All activities relate to continuing operations.

The restatement of the prior year numbers relates to the implementation of Financial Reporting Standard (FRS) 20 ‘Share-based Payment’. See note 1 to the accounts.

Group Statement of Total Recognised Gains and Losses for the years ended 31 March

	2005 £m	2004 (restated) £m
Profit for the year	**361.2**	343.2
Prior year adjustment (i)	**(36.0)**	–
Total recognised gains and losses since last annual report	**325.2**	343.2

(i) During the year ended 31 March 2005, the Group adopted FRS 20, see note 1.

Balance Sheets at 31 March

	Notes	Group 2005 £m	Group 2004 (restated) £m	Company 2005 £m	Company 2004 (restated) £m
Fixed assets					
Tangible assets	11	**4,334.3**	4,141.2	**4,328.9**	4,135.6
Investments	12	**28.0**	32.4	**28.1**	32.5
		4,362.3	4,173.6	**4,357.0**	4,168.1
Current assets					
Stocks		**13.8**	13.9	**13.8**	13.9
Debtors	13	**630.9**	1,712.3	**636.5**	1,720.8
Current asset investments		**0.8**	12.0	**0.7**	12.0
Cash at bank and in hand		**22.1**	15.1	**19.5**	15.1
		667.6	1,753.3	**670.5**	1,761.8
Creditors (amounts falling due within one year)					
Borrowings		**(476.4)**	(20.4)	**(476.4)**	(25.3)
Other creditors		**(841.3)**	(1,215.3)	**(840.3)**	(1,213.5)
	14	**(1,317.7)**	(1,235.7)	**(1,316.7)**	(1,238.8)
Net current (liabilities)/assets		**(650.1)**	517.6	**(646.2)**	523.0
Total assets less current liabilities		**3,712.2**	4,691.2	**3,710.8**	4,691.1
Creditors (amounts falling due after more than one year)					
Borrowings		**(2,612.5)**	(2,809.1)	**(2,612.5)**	(2,809.1)
Other creditors		**(89.2)**	(145.1)	**(89.2)**	(145.1)
	15	**(2,701.7)**	(2,954.2)	**(2,701.7)**	(2,954.2)
Provisions for liabilities and charges					
Deferred taxation		**(816.3)**	(820.1)	**(816.3)**	(820.1)
Other provisions		**(49.4)**	(31.8)	**(49.4)**	(31.8)
	18	**(865.7)**	(851.9)	**(865.7)**	(851.9)
Net assets employed		**144.8**	885.1	**143.4**	885.0
Capital and reserves					
Called up share capital	19	**43.7**	43.4	**43.7**	43.4
Share premium account	20	**–**	454.1	**–**	454.1
Capital redemption reserve	20	**0.1**	0.1	**0.1**	0.1
Special reserve	20	**–**	28.8	**–**	28.8
Profit and loss account	20	**101.0**	358.7	**99.6**	358.6
Equity shareholders' funds		**101.1**	841.7	**99.7**	841.6
Non-equity shareholders' funds		**43.7**	43.4	**43.7**	43.4
Total shareholders' funds	21	**144.8**	885.1	**143.4**	885.0

The restatement of the prior year numbers relates to the implementation of FRS 20 per note 1.

The accounts on pages 8 to 28 inclusive were approved by the Board of Directors on 19 May 2005 and were signed on its behalf by:

N Winser Director

A Chapman Director

Group Cash Flow Statement for the years ended 31 March

	Notes	2005 £m	2004 (restated) £m
Net cash inflow from operating activities before exceptional items	22(a)	**718.4**	789.6
Expenditure relating to exceptional items	3	**–**	(12.0)
Net cash inflow from operating activities		**718.4**	777.6
Returns on investments and servicing of finance			
Interest received and similar income		**113.5**	64.5
Interest paid and similar charges		**(170.2)**	(169.2)
Non-equity dividends paid to shareholders		**(1.1)**	(8.6)
Net cash outflow for returns on investments and servicing of finance		**(57.8)**	(113.3)
Taxation			
Corporate tax paid		**(179.9)**	–
Capital expenditure and financial investment			
Net payments to acquire tangible fixed assets		**(375.0)**	(412.2)
Receipts from disposals of tangible fixed assets		**4.4**	1.5
Net cash outflow for capital expenditure and financial investment		**(370.6)**	(410.7)
Acquisitions and disposals			
Payments to acquire Group undertakings	12	**(350.0)**	–
Net payments to acquire investments		**(0.4)**	–
Receipts from disposals of Group undertakings	12	**350.0**	–
Receipts from disposals of investments		**4.8**	4.9
Net cash inflow for acquisitions and disposals		**4.4**	4.9
Equity dividends paid to shareholders		**(1,450.0)**	(240.0)
Net cash (outflow)/inflow before the management of liquid resources and financing		**(1,335.5)**	18.5
Management of liquid resources			
Decrease/(increase) in short term deposits		**11.2**	(11.1)
Net cash inflow/(outflow) from the management of liquid resources	22(b)(c)	**11.2**	(11.1)
Financing			
Increase/(decrease) in borrowings	22(b)(c)	**240.5**	(120.7)
Increase in amounts due to Group undertakings		**1,093.2**	133.5
Net cash inflow from financing		**1,333.7**	12.8
Movement in cash and overdrafts	22(b)(c)	**9.4**	20.2

Liquid resources comprise money market deposits and gilts.

The restatement of the prior year numbers relates to the implementation of FRS 20 per note 1.

1. Adoption of Financial Reporting Standard (FRS) 20

During the year, the Group adopted FRS 20 'Share-based Payment'. The adoption of this standard constitutes a change in accounting policy. Therefore, the impact has been reflected as a prior year adjustment in accordance with Financial Reporting Standard 3.

The standard requires that where shares or rights to shares are granted to third parties, including employees, a charge should be recognised in the profit and loss account based on the fair value of the shares at the date the grant of shares or right to shares is made.

For the year ended 31 March 2005, the adoption of FRS 20 has reduced operating profit by £4.0m, reduced profit on ordinary activities after taxation for the year by £2.2m and increased net assets employed by £4.9m.

The effect of the adoption of FRS 20 on prior year comparatives is as follows:

	Year ended 31 March 2004		
	As previously reported £m	Impact of FRS 20 £m	As restated £m
Operating profit			
– Before exceptional items	525.8	(8.1)	517.7
– After exceptional items	513.8	(8.1)	505.7
Profit on ordinary activities after taxation			
– Before exceptional items	359.3	(8.1)	351.2
– After exceptional items	351.3	(8.1)	343.2
Net assets employed	883.0	2.1	885.1

The prior year adjustment recorded in the Group Statement of total recognised gains and losses reflects the cumulative profit and loss impact of FRS 20 at 31 March 2004 of £36.0m after deferred tax (£38.1m before deferred tax). The corresponding entry to the pre-tax FRS 20 charge is recorded through the profit and loss account reserve. Therefore, the impact of the restatements for FRS 20 on the profit and loss account reserve at 31 March 2004 represents only the deferred tax credit of £2.1m.

2. Segmental analysis

	Turnover					
	Total sales 2005 £m	**Sales between businesses 2005 £m**	**Sales to third parties 2005 £m**	Total sales 2004 £m	Sales between businesses 2004 £m	Sales to third parties 2004 £m
Continuing operations:						
Electricity transmission	1,366.0	28.9	1,337.1	1,306.7	27.4	1,279.3
Interconnectors	72.4	0.6	71.8	64.7	0.6	64.1
Other activities	29.1	15.7	13.4	44.2	18.8	25.4
Turnover	1,467.5	45.2	1,422.3	1,415.6	46.8	1,368.8

Group turnover is 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			
	2005 £m	2004 (restated) £m	**2005 £m**	2004 (restated) £m	**2005 £m**	2004 (restated) £m
Continuing operations:						
Electricity transmission	**537.1**	477.7	**537.1**	468.6	**4,440.8**	3,903.7
Interconnectors	**36.3**	28.8	**36.3**	28.8	**203.3**	167.0
Other activities	**5.3**	11.2	**5.3**	8.3	**13.4**	8.1
Operating profit	**578.7**	517.7	**578.7**	505.7		
Unallocated net liabilities					**(4,512.7)**	(3,193.7)
Net assets employed					**144.8**	885.1

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.

Following the implementation of BETTA from 1 April 2005, the Scottish Interconnector assets will be included within the Transmission network. The current year revenue and operating profit of the Scottish Interconnector were £38.4m and £13.4m respectively. Further details of BETTA arrangements are included in the Business Review.

3. Operating costs

	2005 £m	2004 (restated) £m
Total operating costs comprise:		
Depreciation	**210.7**	202.7
Net payroll costs (note 5)	**88.3**	84.2
Other operating charges:		
– Rates	**91.9**	92.0
– Balancing Services Incentive Scheme direct costs	**302.7**	279.0
– Exceptional reorganisation costs (see below)	**–**	12.0
– Other non-exceptional operating charges	**150.0**	193.2
	544.6	576.2
	843.6	863.1
Operating costs include:		
Research and development costs	**2.6**	3.0
Non-plant and machinery operating lease rentals	**2.7**	3.1
Auditors' remuneration:		
– Statutory audit fees (Company: £430,000 (2004: £265,000))	**0.4**	0.3
– Regulatory related services	**0.1**	0.1

No exceptional costs were charged to operating profit in the year ended 31 March 2005 (2004: £12.0m). The charges in the prior year arose as the Transmission business implemented its restructuring plans.

4. Exceptional items

The exceptional profit on sale of assets in the year ended 31 March 2005 was £2.7m (before and after taxation) in respect of the disposal, on 22 November 2004, of rights to income from the hydroelectric power station at Kielder. The exceptional profit represents the cash consideration received less the net book value of the assets.

5. Payroll costs and employees

	2005 £m	2004 (restated) £m
a) Payroll costs:		
Wages and salaries	**85.4**	80.7
Social security costs	**8.9**	8.5
Other pension costs	**20.7**	7.7
Employee share option costs	**2.3**	9.4
Gross payroll costs	**117.3**	106.3
Less: amounts capitalised	**(29.0)**	(22.1)
Net payroll costs	**88.3**	84.2

	2005 Number	2004 Number
b) Average number of employees	**2,190**	2,345

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 were restructuring costs including severance costs of £nil (2004: £5.4m), which have been included in other operating charges – exceptional reorganisation costs.

6. Directors' emoluments

Total emoluments of the Directors of the Company for the year ended 31 March 2005 were as follows:

	2005 £000	2004 £000
Salaries and benefits	**416**	460
Performance related bonus	**200**	215
	616	675

The emoluments of the highest paid Director were £213,800 (2004: £223,800). The amount of accrued pension at 31 March 2005 for the highest paid Director was £457,000 (2004: £81,000). 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 (2004: 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 (2004: one Director) exercised share options in National Grid Transco plc during the year.

Retirement benefits at 31 March 2005 are accruing in respect of five Directors (2004: five Directors) under a defined benefit scheme.

Where relevant, emoluments are based upon an allocation of Group Directors' costs from National Grid Transco plc.

7. 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 employer's 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 2004.

The actuarial valuation of the National Grid Scheme at 31 March 2004 was completed during the year ended 31 March 2005 and revealed a pre-tax deficit of £271.5m (£190.1m net of tax) on the basis of the funding assumptions adopted by the actuary.

It has been agreed that no funding of the deficit identified in the 2004 actuarial valuation will need to be provided to the scheme until the outcome of the actuarial valuation at 31 March 2007 is known. At this point, the Group will pay the gross amount of any deficit up to a maximum amount of £67.5m (£47.3m net of tax) into the scheme. Until the 31 March 2007 actuarial valuation has been completed, the Group has arranged for banks to provide the trustees of the National Grid Scheme with letters of credit. The main conditions under which these letters of credit could be drawn relate to events which would imperil the interests of the scheme, such as the Company becoming insolvent or the Group failing to make agreed payments into the fund. Employer cash contributions for the ongoing cost of the National Grid Scheme are currently being made at a rate of 13.1% of pensionable payroll.

The pension cost for the year ended 31 March 2005 charged to operating profit of £20.7m (2004: £7.7m) represents the regular pension cost of £8.3m (2004: £9.2m), a variation cost element of £13.9m (2004: nil) and a deduction from the regular pension cost of £1.5m (2004: £1.5m) which relates to the equalisation of the retirement age to 65. In addition, net interest includes a charge of £13.0m (2004: credit of £0.3m) in respect of the notional interest element of the variation from the regular pension cost.

Included within provisions for liabilities and charges at 31 March 2005 is a pension provision of £27.2m (2004: £7.7m) (note 18).

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:

	2005	2004	2003
Rate of increase in salaries*	**3.9%**	3.9%	3.5%
Rate of increase in pensions in payment	**3.0%**	3.0%	2.6%
Discount rate	**5.4%**	5.5%	5.4%
Rate of increase in RPI	**2.9%**	2.9%	2.5%

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

7. Pension (continued)

An analysis of the assets held in the scheme and the expected rates of return at 31 March 2005, 31 March 2004 and 31 March 2003 were as follows:

	Long term rate of return expected at 31 March 2005	**Value at 31 March 2005 £m**	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
Equities	**7.8%**	**697.0**	8.0%	665.0	8.5%	583.0
Bonds	**4.8%**	**357.0**	5.0%	336.0	4.6%	285.9
Property	**6.5%**	**98.0**	6.5%	90.0	6.5%	84.6
Other	**4.0%**	**12.0**	4.0%	15.0	4.0%	13.6
Total market value of assets		**1,164.0**		1,106.0		967.1
Present value of scheme liabilities		**(1,563.0)**		(1,537.0)		(1,399.7)
Deficit in the scheme		**(399.0)**		(431.0)		(432.6)
Related deferred tax asset		**120.0**		129.0		129.8
Net pension liability		**(279.0)**		(302.0)		(302.8)

The net pension liability comprises net pension liabilities relating to funded schemes in deficit of £271m (2004: £295m) and net pension liabilities relating to unfunded schemes in deficit of £8m (2004: £7m).

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:

	2005 £m	2004 (restated) £m	2003 (restated) £m
Net assets employed excluding net SSAP 24 pension provision	**172.0**	887.3	1,133.1
Net FRS 17 pension liability	**(279.0)**	(302.0)	(302.8)
Net (liabilities)/assets employed including net FRS 17 pension liability	**(107.0)**	585.3	830.3

The impact of the implementation of FRS 17 on net assets employed, as shown above, would be reflected within the profit and loss account reserve.

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

	2005 £m	2004 £m
At 1 April	**(431.0)**	(432.6)
Current service cost	**(16.0)**	(14.0)
Net loss on settlements or curtailments	**–**	(9.0)
Contributions	**15.0**	18.6
Other financial income	**(10.0)**	(7.0)
Actuarial losses	**43.0**	13.0
At 31 March	**(399.0)**	(431.0)

If FRS 17 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:

	2005 £m	2004 £m
Operating charge		
Current service cost	**16.0**	14.0
Net loss on settlements or curtailments	**–**	9.0
Total charge to operating profit	**16.0**	23.0
Other financial (income)/costs		
Expected return on scheme assets	**(73.1)**	(67.0)
Interest on scheme liabilities	**84.0**	74.0
Impact on financial income	**10.9**	7.0
Net profit and loss charge before taxation	**26.9**	30.0

Expected return on scheme assets for the year ended 31 March 2005 is reported after charging scheme administration expenses of £0.9m.

7. Pension (continued)

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

	2005 £m	2004 £m
Difference between actual and expected return on scheme assets	**38.0**	127.0
Experience gains arising in scheme liabilities	**(17.0)**	11.0
Changes in assumptions	**22.0**	(125.0)
Actuarial losses	**43.0**	13.0

History of experience gains and losses that would be recognised on an FRS 17 basis:

	2005	2004	2003
Difference between actual and expected return on scheme assets (£m)	**38.0**	127.0	(316.6)
– percentage of scheme assets	**3.3%**	11.5%	32.7%
Experience gains arising on scheme liabilities (£m)	**(17.0)**	11.0	7.3
– percentage of present value of scheme liabilities	**(1.1)%**	0.7%	0.5%
Actuarial losses (£m)	**43.0**	13.0	(369.0)
– percentage of present value of scheme liabilities	**2.8%**	0.8%	(26.4)%

8. Net interest payable

	2005 £m	2004 £m
Bank loans and overdrafts	**20.4**	26.5
Interest payable to group undertakings	**2.0**	0.5
Other interest payable	**173.5**	164.7
Interest payable and similar charges	**195.9**	191.7
Interest capitalised	**(37.7)**	(35.6)
Interest payable and similar charges (net of interest capitalised)	**158.2**	156.1
Interest receivable from group undertakings	**(63.9)**	(64.2)
Other interest receivable and similar income	**(14.5)**	(9.9)
	79.8	82.0

Interest on the funding attributable to assets in the course of construction was capitalised during the year at a rate of 5.8% (2004: 5.9%).

9. Taxation

	2005 £m	2004 £m
Adjustment to corporation tax in respect of prior years	**11.9**	(76.9)
Adjustments to amounts payable to group undertakings in respect of prior years	**(3.2)**	–
Payable to group undertakings for the surrender of tax losses	**134.5**	108.7
Total current tax	**143.2**	31.8
Deferred tax: timing differences	**15.9**	23.9
Adjustment to deferred tax in respect of prior years	**(18.7)**	24.8
Total deferred tax	**(2.8)**	48.7
Total tax	**140.4**	80.5

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

	2005	2004 (restated)
	% of profit before taxation	
UK corporation tax rate	**30.0**	30.0
Effect on tax charge of:		
Origination and reversal of timing differences	**(3.6)**	(5.4)
Permanent differences	**0.5**	1.2
Current tax charge	**26.9**	25.8
Origination and reversal of timing differences	**3.2**	5.4
Effective tax rate before prior year adjustments and exceptional items	**30.1**	31.2
Adjustment in respect of prior years	**(2.0)**	(11.8)
Effective tax rate before exceptional items	**28.1**	19.4
Exceptional items	**(0.1)**	(0.4)
Effective tax rate after exceptional items	**28.0**	19.0

10. Dividends and appropriations

	2005 per share £	2004 per share £	**2005 £m**	2004 £m
Dividends on ordinary shares:				
Paid dividend	**342**	7,531	**1,100.0**	240.0
Proposed dividend	**–**	10,982	**–**	350.0
	342	18,513	**1,100.0**	590.0
Dividends and appropriations in respect of non-equity shares	**0.0576**	0.0484	**2.5**	2.1
Total dividends			**1,102.5**	592.1

The 2005 dividend per share figure is based on 3,218,870 10p ordinary shares and the 2004 figure was based on 31,870 20p ordinary shares.

11. Tangible fixed assets

Group	Land and 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 2004	100.9	5,540.0	651.8	170.9	6,463.6
Capital expenditure	0.6	3.3	395.6	6.0	405.5
Disposals	(0.3)	(19.0)	–	(7.4)	(26.7)
Reclassifications	54.5	353.9	(424.1)	15.7	–
Cost at 31 March 2005	155.7	5,878.2	623.3	185.2	6,842.4
Depreciation at 1 April 2004	15.2	2,206.5	–	100.7	2,322.4
Charge for the year	3.1	182.6	–	25.0	210.7
Disposals	(0.2)	(19.0)	–	(5.8)	(25.0)
Reclassifications	19.5	(18.2)	–	(1.3)	–
Depreciation at 31 March 2005	37.6	2,351.9	–	118.6	2,508.1
Net book value at 31 March 2005	**118.1**	**3,526.3**	**623.3**	**66.6**	**4,334.3**
Net book value at 31 March 2004	85.7	3,333.5	651.8	70.2	4,141.2
Company					
Cost at 1 April 2004	100.9	5,539.9	651.8	162.0	6,454.6
Capital expenditure	0.6	3.3	395.6	3.6	403.1
Disposals	(0.3)	(18.9)	–	(5.2)	(24.4)
Reclassifications	54.5	353.9	(424.1)	15.7	–
Cost at 31 March 2005	155.7	5,878.2	623.3	176.1	6,833.3
Depreciation at 1 April 2004	15.2	2,206.4	–	97.4	2,319.0
Charge for the year	3.1	182.6	–	23.3	209.0
Disposals	(0.2)	(18.9)	–	(4.5)	(23.6)
Reclassifications	19.5	(18.2)	–	(1.3)	–
Depreciation at 31 March 2005	37.6	2,351.9	–	114.9	2,504.4
Net book value at 31 March 2005	**118.1**	**3,526.3**	**623.3**	**61.2**	**4,328.9**
Net book value at 31 March 2004	85.7	3,333.5	651.8	64.6	4,135.6

The cost of tangible fixed assets (net of disposals) of the Group and Company at 31 March 2005 includes £401.7m (2004: £366.8m) relating to interest capitalised.

The net book value of land and buildings comprises:

	Group		Company	
	2005 £m	2004 £m	**2005 £m**	2004 £m
Freehold	**93.9**	78.9	**93.9**	78.9
Long leasehold (over 50 years)	**2.7**	2.7	**2.7**	2.7
Short leasehold (under 50 years)	**21.5**	4.1	**21.5**	4.1
	118.1	85.7	**118.1**	85.7

12. Fixed asset investments

	Group	Company		
	Listed investments £m	Group undertakings £m	Listed investments £m	Total £m
Cost at 1 April 2004	34.6	0.1	34.6	34.7
Additions	0.4	350.0	0.4	350.4
Disposals	(6.8)	(350.0)	(6.8)	(356.8)
Cost at 31 March 2005	28.2	0.1	28.2	28.3
Impairment at 1 April 2004	2.2	–	2.2	2.2
Charge for the year	–	–	–	–
Disposals	(2.0)	–	(2.0)	(2.0)
Impairment at 31 March 2005	0.2	–	0.2	0.2
Net book value at 31 March 2005	**28.0**	**0.1**	**28.0**	**28.1**
Net book value at 31 March 2004	32.4	0.1	32.4	32.5

Listed investments relate to 6.5m 10p ordinary shares (2004: 7.9m 10p ordinary shares) in National Grid Transco plc held by employee share trusts for the purpose of satisfying certain obligations under the various share option schemes. The carrying value of £28.0m (market value £31.9m (2004: £34.0m)) represents the cost of these shares less provision for impairment. 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. On 21 May 2004 the Company purchased 100% of the share capital of Blackstone Limited, a company incorporated in Jersey and registered in the UK for taxation purposes. The total consideration paid was £350m. Following the re-naming of Blackstone Limited as National Grid Jersey Investments Limited it was disposed of for consideration of £350m on 20 August 2004. During the period of ownership of National Grid Jersey Investments Limited interest income of £3.6m was received by the Company.

Apart from NGC Leasing, the only other Group undertakings (both wholly-owned and incorporated in Great Britain) are NGC Employee Shares Trustee Limited (dormant sharesave trustee company) and Elexon Limited, which the Company holds in a purely nominal capacity and over which it exercises no control.

13. Debtors

	Group		Company	
	2005 £m	2004 £m	**2005 £m**	2004 £m
Amounts falling due within one year:				
Trade debtors	**29.0**	47.1	**29.0**	47.1
Amounts owed by other group undertakings	**392.1**	1,499.9	**397.7**	1,508.3
Other debtors	**28.0**	46.2	**28.0**	46.2
Corporation tax recoverable	**30.5**	–	**30.5**	–
Prepayments and accrued income	**107.7**	68.4	**107.7**	68.5
	587.3	1,661.6	**592.9**	1,670.1
Amounts falling due after more than one year:				
Other debtors	**39.4**	50.7	**39.4**	50.7
Corporation tax recoverable	**4.2**	–	**4.2**	–
	630.9	1,712.3	**636.5**	1,720.8

14. Creditors (amounts falling due within one year)

	Group		Company	
	2005 **£m**	2004 (restated) £m	**2005** **£m**	2004 (restated) £m
Borrowings (note 16)	**476.4**	20.4	**476.4**	25.3
Trade creditors and accruals	**253.2**	205.6	**252.9**	205.3
Deferred income	**63.7**	96.2	**63.7**	96.2
Amounts owed to ultimate parent company	**19.9**	10.5	**19.9**	10.5
Amounts owed to group undertakings	**387.1**	374.4	**386.6**	373.1
Amounts owed to related parties	**–**	1.3	**–**	1.3
Corporation tax	**0.2**	5.1	**–**	4.9
Social security and other taxes	**22.7**	17.5	**22.7**	17.5
Dividends	**1.9**	350.5	**1.9**	350.5
Other creditors	**92.6**	154.2	**92.6**	154.2
	1,317.7	1,235.7	**1,316.7**	1,238.8

In the prior year's Annual Report accruals were disclosed within 'Accruals and deferred income'. Accruals are now disclosed within 'Trade creditors and accruals' and the comparative figures have been restated to reflect this change.

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

	Group		Company	
	2005 **£m**	2004 £m	**2005** **£m**	2004 £m
Borrowings (note 16)	**2,612.5**	2,809.1	**2,612.5**	2,809.1
Deferred income	**87.7**	133.5	**87.7**	133.5
Other creditors	**1.5**	11.6	**1.5**	11.6
	2,701.7	2,954.2	**2,701.7**	2,954.2

16. Borrowings

	Group		Company	
	2005 **£m**	2004 £m	**2005** **£m**	2004 £m
Amounts falling due within one year:				
Bank loans and overdrafts	**18.0**	20.4	**18.0**	25.3
Commercial paper	**207.6**	–	**207.6**	–
Other bonds	**250.8**	–	**250.8**	–
	476.4	20.4	**476.4**	25.3
Amounts falling due after more than one year:				
Bank loans	**407.0**	407.0	**407.0**	407.0
Other bonds	**2,205.5**	2,402.1	**2,205.5**	2,402.1
	2,612.5	2,809.1	**2,612.5**	2,809.1
Total borrowings	**3,088.9**	2,829.5	**3,088.9**	2,834.4
Amounts falling due after more than one year:				
In more than one year, but not more than two years	**207.0**	250.6	**207.0**	250.6
In more than two years, but not more than five years	**414.0**	661.0	**414.0**	661.0
In more than five years – other than by instalments	**1,991.5**	1,897.5	**1,991.5**	1,897.5
	2,612.5	2,809.1	**2,612.5**	2,809.1

Included in other bonds is the following instrument that was issued during the year:

GBP 75 million 5.0% Fixed Rate Instrument due 2035

Included in borrowings falling due within one year are the following items that were reported in the prior year as borrowings falling due after more than one year:

GBP 240 million 8.0% Fixed Rate Instrument due 2006
GBP 11 million Floating Rate Note due 2006

During the year the GBP 40 million Floating Rate Instrument due 2007 was redeemed.

The notional amount at maturity of the Group's debt portfolio is £3,081.8m (2004: £2,804.1m).

17. Financial instruments

A description of the policies relating to financial instruments is set out in the Directors' report which forms part of these accounts. 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 2005	**Total £m**	**Variable rate £m**	**Fixed rate £m**	**Weighted average interest rate %**	**Weighted average period for which rate is fixed Years**
Borrowings (sterling)	**3,088.9**	**2,020.1**	**1,068.8**	**5.9**	**10.4**
Preference shares of £1 each	**43.4**	**43.4**	**–**	**–**	**–**
Other financial liabilities (sterling)	**4.9**	**4.9**	**–**	**–**	**–**
	3,137.2	**2,068.4**	**1,068.8**	**5.9**	**10.4**
At 31 March 2004					
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 2005, the weighted average interest rate on short term borrowings of £476.4m (2004: £20.4m) was 6.53% (2004: 5.0%).

Other financial liabilities relates to an onerous operating lease (see note 18).

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 assets		
At 31 March 2005	**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)	**22.9**	**22.9**	**–**	**–**	**–**
Net investment in finance lease (sterling)	**38.6**	**–**	**38.6**	**11.5**	**4.1**
	61.5	**22.9**	**38.6**	**11.5**	**4.1**
At 31 March 2004					
Cash and deposits (sterling)	27.1	27.1	–	–	–
Net investment in finance lease (sterling)	44.9	–	44.9	11.5	5.1
	72.0	27.1	44.9	11.5	5.1

In addition to the assets included in the above analysis the Group also holds investments in the shares of National Grid Transco plc as detailed in note 12 for the purpose of satisfying obligations under various share option schemes.

Cash and bank deposits earn interest at local prevailing rates for maturity periods not exceeding 12 months.

17. Financial instruments (continued)

Maturity of financial liabilities at 31 March	2005 £m	2004 £m
In one year or less	**476.9**	32.2
In more than one year, but not more than two years	**207.4**	250.6
In more than two years, but not more than five years	**415.4**	661.0
In more than five years	**2,037.5**	1,940.9
	3,137.2	2,884.7

Maturity of financial assets at 31 March	2005 £m	2004 £m
In one year or less	**30.1**	33.6
In more than one year, but not more than two years	**8.1**	7.4
In more than two years, but not more than five years	**23.3**	27.5
In more than five years	**–**	3.5
	61.5	72.0

Fair values of financial instruments at 31 March	2005		2004	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Short term debt	**(476.4)**	**(483.4)**	(20.4)	(20.4)
Other long term debt	**(2,605.4)**	**(2,751.0)**	(2,783.6)	(3,009.5)
Cash and deposits	**22.9**	**22.9**	27.1	27.1
Preference shares of £1 each	**(43.4)**	**(43.4)**	(43.4)	(43.4)
Other financial liabilities	**(4.9)**	**(4.9)**	(11.8)	(11.8)
Net investment in finance lease	**38.6**	**38.6**	44.9	44.9
Other financial assets	**28.0**	**31.9**	32.4	34.0
Financial instruments held to manage interest rate and currency profile:				
Interest rate swaps	**–**	**(12.4)**	–	(17.2)
Forward currency contracts and cross currency swaps	**(7.1)**	**5.5**	(25.5)	(13.5)

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 forward rate agreements; and foreign currency contracts and cross currency swaps amounted to £1,180m (2004: £621m); and £622m (2004: £2,977m) respectively.

Other financial assets relate to the Group's investments in the shares of National Grid Transco plc which also meet the definition of a financial asset under FRS 13. Details are included in note 12.

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 2004	15.4	(20.6)	(5.2)	–	(2.0)	(2.0)
(Gains)/losses arising in previous years recognised in the year	(1.3)	–	(1.3)	–	0.7	0.7
Gains/(losses) in previous years not recognised in the year	14.1	(20.6)	(6.5)	–	(1.3)	(1.3)
(Losses)/gains arising in the year	–	6.7	6.7	4.7	(2.7)	2.0
Unrecognised (losses)/gains on hedges at 31 March 2005	**14.1**	**(13.9)**	**0.2**	**4.7**	**(4.0)**	**0.7**
Of which:						
Gains/(losses) expected to be recognised in the next year	0.3	(1.0)	(0.7)	0.9	(1.3)	(0.4)
Gains/(losses) expected to be recognised in subsequent years	13.8	(12.9)	0.9	3.8	(2.7)	1.1

Borrowing facilities

At 31 March 2005, the Group had £485m committed, undrawn, credit facilities (2004: £460m) being held as a backup to commercial paper. The facilities mature within one year.

18. Provisions for liabilities and charges

Group and Company	Environmental £m	Pensions £m	Deferred taxation (restated) £m	Other £m	Total provisions (restated) £m
At 1 April 2004	10.3	7.7	820.1	13.8	851.9
Charged to profit and loss account	–	33.7	8.3	1.8	43.8
Released to profit and loss account	(0.5)	–	(11.1)	–	(11.6)
Utilised	(0.5)	(9.3)	–	(2.7)	(12.5)
Reclassification from other balance sheet accounts	–	(4.9)	(1.0)	–	(5.9)
At 31 March 2005	**9.3**	**27.2**	**816.3**	**12.9**	**865.7**

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 four years.

The pensions provision is £27.2m (2004: £7.7m). This relates to £21.0m arising from the recognition of pension deficit costs according to SSAP 24 with £6.2m relating to the equalisation of the pension retirement age to 65. Included within pension provision additions in the year is £1.7m which was payable to the Electricity Supply Pension Scheme as at 31 March 2005. The reclassification during the year relates to the transfer in of the net pension prepayment held within debtors as at 31 March 2004 (£6.5m). The remainder of the reclassification (£1.6m) represents an increase in the provision relating to the pensions deficit liability associated with non-NGC employees for which there is a matching intercompany debtor.

Other provisions include a severance provision of £1.5m (2004: £3.0m). It is currently estimated that this provision will be utilised within the next year. Other provisions also includes employer liability provisions of £4.8m (2004: £4.5m) which comprise 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.

Of the remaining balance within other provisions, £4.9m (2004: £6.3m) relates to other property commitments estimated to be utilised over the next nine years and £1.7m (2004: nil) relates to a provision created during the year to cover protected rights for employees where NGC has an obligation under several deeds of covenant.

Deferred taxation

Deferred taxation provided in the accounts comprises:

	Group		Company	
	2005 £m	2004 (restated) £m	**2005 £m**	2004 (restated) £m
Accelerated capital allowances	**832.0**	826.6	**832.0**	826.9
Other timing differences	**(15.7)**	(6.5)	**(15.7)**	(6.8)
	816.3	820.1	**816.3**	820.1

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 £2.2m (2004: £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 £1.7m (2004: £1.5m).

19. Share capital

	2005 £m	2004 £m
Authorised:		
1,000,000,000 ordinary shares of £0.20 each	**–**	200.0
2,003,155,130 ordinary shares of £0.10 each	**200.3**	–
74,803,600 preference shares of £1 each	**74.8**	74.8
	275.1	274.8
Allotted, called up and fully paid:		
3,218,870 ordinary shares of £0.10 each	**0.3**	–
43,406,000 preference shares of £1 each	**43.4**	43.4
	43.7	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.

The movement in share capital during the period is explained in note 20.

19. Share capital (continued)

Share Option and Award Schemes

The National Grid Transco Group (NGT Group) operates two principal forms of share option scheme in which the employees and Directors of the Company are entitled to participate. They are an employee sharesave scheme and an Executive Share Option Scheme (the Executive Scheme). The details given below relate to the schemes operated by the NGT Group for the benefit of the Company's employees and Directors.

The sharesave scheme is savings related where, under normal circumstances, share options are exercisable on completion of a three or five year save-as-you-earn contract. The exercise price of options granted represents 80% of the market price at the date the option was granted.

The Executive Scheme applies to senior executives, including Executive Directors. Options granted for the 1999/2000 financial year are subject to the achievement of performance targets related to earnings per share growth over a three year period and have now vested. Options granted for the 2000/01 financial year and thereafter are subject to the achievement of performance targets related to total shareholder returns over a three year period and these have not yet vested. The share options are generally exercisable between the third and tenth anniversaries of the date of grant if the relevant performance target is achieved.

The Company also operates a number of share award schemes including a Performance Share Plan (PSP) and a Share Matching Plan.

Under the PSP awards have been made to Executive Directors and a number of senior staff below the level of the Executive Management Team who have significant influence over the Group's ability to meet its strategic objectives. Under the PSP awards are conditional on present earnings per share targets over a three year period. Awards are delivered in National Grid Transco plc ordinary shares. At 31 March 2005 the number of conditional awards of ordinary share equivalents outstanding under the PSP was 2,288,973 (2004: 1,125,611) of which nil (2004: nil) were exercisable. The number of conditional awards during the year ended 31 March 2005 was 1,208,541 (2004: 1,468,166) with lapses/forfeits during the year of 45,179 (2004: nil) and exercises of nil (2004: nil).

The Share Matching Plan applies to Executive Directors whereby a predetermined part of each Director's bonus entitlement is automatically deferred into National Grid Transco plc shares and a matching award may be made under the Plan after a three year period provided the Director is still employed by the Group. At 31 March 2005 the number of conditional awards on ordinary share equivalents outstanding under the Share Matching Plan was 262,576 (2004: 195,079) of which 21,088 (2004: nil) were exercisable. The number of conditional awards during the year ended 31 March 2005 was 107,614 (2004: 55,517) with exercises during the year of 40,117 (2004: 10,699).

Movements in options to subscribe for ordinary shares under the NGT Group's various option schemes for the year ended 31 March 2005 are shown below and include those options related to shares issued to employee share benefit trusts:

	Sharesave scheme options		Executive share scheme options		Total Options
	Weighted average price £	millions	Weighted average price £	millions	millions
At 31 March 2004	3.46	6.1	4.70	4.8	10.9
Granted	3.83	1.2	–	–	1.2
Lapsed – expired	3.76	(0.3)	5.20	(0.2)	(0.5)
Exercised	3.42	(1.3)	3.67	(0.4)	(1.7)
At 31 March 2005	**3.54**	**5.7**	**4.77**	**4.2**	**9.9**

The weighted average share price at the exercise dates were as follows:

	2005 £	2004 £
Sharesave scheme options	**4.28**	3.97
Executive share scheme options	**4.65**	3.99

Included within options outstanding at 31 March 2005 and 31 March 2004 were the following options which were exercisable:

	Sharesave scheme options		Executive share scheme options		Total Options
	Weighted average price £	millions	Weighted average price £	millions	millions
At 31 March 2005	**4.52**	**0.1**	**4.82**	**2.7**	**2.8**
At 31 March 2004	–	–	4.43	2.1	2.1

The weighted average remaining contractual life of options in the employee sharesave scheme at 31 March 2005 was 2 years and 11 months. These options have exercise prices of between £3.12 and £4.57.

19. Share capital (continued)

Options outstanding and exercisable and their weighted average exercise prices for the respective ranges of exercise prices and years at 31 March 2005 are as follows:

	Weighted average exercise price of exercisable options £	Number exercisable millions	Weighted average exercise price of outstanding options £	Number outstanding millions	Exercise price per share Pence	Normal dates of exercise Years
Executive scheme	2.81	0.2	2.81	0.2	280.5	2001 – 2008
	3.82	0.3	3.82	0.3	375.8 – 490.0	2002 – 2009
	4.44	0.3	4.44	0.3	424.0 – 566.5	2003 – 2010
	5.33	0.8	5.33	0.8	526.0 – 623.0	2004 – 2011
	5.34	0.9	5.34	0.9	479.5 – 563.0	2005 – 2012
	4.73	–	4.69	1.6	434.3 – 481.5	2006 – 2013
	4.05	0.1	4.05	0.1	405.0	2007 – 2014
	4.82	**2.6**	**4.77**	**4.2**		

Under UK GAAP, a charge is made to the profit and loss account based on the fair value of grants in accordance with FRS20 'Share-based Payment'. All share awards are equity settled.

The charge to the profit and loss account for the year ended 31 March 2005 was £4.0m (2004: £8.1m).

The average share price at grant date of options granted during each of the two financial years ended 31 March are as follows:

	2005	2004
Where the exercise price is less than the market price at the date of the grant	**496.0p**	400.0p

The average exercise price of the options granted during each of the following financial years ended 31 March are as follows:

	2005	2004
Where the exercise price is less than the market price at the date of the grant	**182.9p**	254.7p

The average fair value of the options granted during each of the following financial years ended 31 March are as follows:

	2005	2004
Where the exercise price is less than the market price at the date of the grant	**145.6p**	159.8p

The fair value of the options granted are estimated using the following principal assumptions:

	2005	2004
Dividend Yield (%)	**5.3 – 5.8**	7.0
Volatility (%)	**15.4**	20.4
Risk-free Investment rate (%)	**4.5**	4.6
Average life (years)	**4.1**	3.7

Fair values of awards under the Sharesave Scheme have been calculated using the Black Scholes model. This is considered appropriate given the short exercise window of sharesave options.

Volatility has been derived based on the following:

(i) implied volatility in traded options over the NGT Group's traded shares;

(ii) historical volatility of the NGT Group's shares from October 2002 (the date of the merger of National Grid and Lattice); and

(iii) implied volatility of comparator companies where options in their shares are traded.

Volatility is assumed to revert from its current implied level to its long run mean, based on historical volatility under (ii) above.

19. Share capital (continued)

The average share price and fair value at grant of share awards granted during each of the two financial years ended 31 March are as follows:

	2005	2004
Average share price	**423.9p**	407.8p
Average fair value	**198.9p**	390.3p

The fair value of the options granted are estimated using the following principal assumptions:

	2005	2004
Dividend Yield (%)	**5.3 – 5.7**	7.0
Volatility (%)	**15.4**	20.4
Risk-free Investment rate (%)	**4.5 – 5.2**	4.6

In 2004 the fair value of awards were estimated by using the share price at date of grant less an adjustment for dividends in the vesting period. In 2005 fair values have been calculated using a Monte Carlo simulation model, which better reflects the total shareholder return performance conditions of the plan.

For other share scheme awards, where the primary vesting condition is that employees complete a specified number of years service, the fair value has been calculated as the share price at date of grant, adjusted to recognise the extent to which participants do not receive dividends over the vesting period.

Volatility for share awards has been calculated on the same basis as used for share options, as described above.

20. Reserves

Group

	Share premium account £m	Capital redemption reserve £m	Special reserve £m	Profit and loss account (restated) £m
At 1 April 2004	454.1	0.1	28.8	358.7
Bonus issue of shares	–	–	(28.8)	(306.1)
Capital reduction	(454.1)	–	–	788.7
Loss for the year	–	–	–	(741.3)
Other movements	–	–	–	1.0
At 31 March 2005	**–**	**0.1**	**–**	**101.0**

Company

	Share premium account £m	Capital redemption reserve £m	Special reserve £m	Profit and loss account (restated) £m
At 1 April 2004	454.1	0.1	28.8	358.6
Bonus issue of shares	–	–	(28.8)	(306.1)
Capital reduction	(454.1)	–	–	788.7
Loss for the year	–	–	–	(741.7)
Other movements	–	–	–	0.1
At 31 March 2005	**–**	**0.1**	**–**	**99.6**

The Company has no non-distributable reserves (2004: £334.9m).

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, £360.8m (2004: £336.5m) is attributable to the Company.

On 24 March 2005, the Company issued 3,187,000 ordinary shares of £105.08 each at nominal value by way of a bonus issue through the capitalisation of non-distributable reserves, being the special reserve and the non-distributable element of the profit and loss account amounting to £334.9m which was credited to share capital. The Company then underwent a Court approved capital reduction scheme, reducing the nominal value of these shares to 10 pence each, thereby reducing share capital by £334.6m, and also reducing the share premium account to zero. The net result of these transactions was to increase distributable reserves by £788.7m and share capital by £0.3m (see note 19) as compared with the position immediately prior to the issue of shares on 24 March 2005.

21. Reconciliation of movement in shareholders' funds

	Group		Company	
	2005 £m	2004 (restated) £m	**2005 £m**	2004 (restated) £m
Profit on ordinary activities after taxation	**361.2**	343.2	**360.8**	336.5
Equity dividends	**(1,100.0)**	(590.0)	**(1,100.0)**	(590.0)
Non-equity dividends	**(2.5)**	(2.1)	**(2.5)**	(2.1)
Share-based payments (note 1)	**–**	8.1	**–**	8.1
Other movements	**1.0**	–	**0.1**	–
Net reduction in shareholders' funds	**(740.3)**	(240.8)	**(741.6)**	(247.5)
Shareholders' funds at start of the year	**885.1**	1,125.9	**885.0**	1,132.5
Shareholders' funds at end of period	**144.8**	885.1	**143.4**	885.0

As disclosed in note 1, the adoption of FRS 20 during the year has led to a restatement of net assets in the prior year. This restatement comprised an increase in shareholders' funds at the start of the prior period by £2.1m due to the recognition of a deferred tax asset and is included in the analysis above.

22. Group cash flow statement

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

	Note	**2005 £m**	2004 (restated) £m
Total operating profit		**578.7**	505.7
Exceptional operating items	3	**–**	12.0
Depreciation		**210.7**	202.7
Decrease in stock		**0.1**	5.3
Increase in debtors		**(19.7)**	(34.8)
(Decrease)/increase in creditors		**(60.8)**	100.3
Increase/(decrease) in provisions		**9.4**	(9.7)
Share-based payments		**–**	8.1
Net cash inflow from operating activities before exceptional items		**718.4**	789.6

Amortisation previously included in depreciation has been reclassified as a movement in debtors (£1.0m) and a movement in creditors (£3.9m).

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

	2005 £m	2004 £m
Movement in cash and overdrafts	**9.4**	20.2
Net cash (inflow)/outflow from the management of liquid resources	**(11.2)**	11.1
(Increase)/decrease in borrowings	**(240.5)**	120.7
Change in net debt resulting from cash flows	**(242.3)**	152.0
Other non-cash movements	**(21.3)**	(23.6)
Movement in net debt in the year	**(263.6)**	128.4
Net debt at the start of the year	**(2,802.4)**	(2,930.8)
Net debt at the end of the year	**(3,066.0)**	(2,802.4)

c) Analysis of changes in net debt

	At 1 April 2004 £m	Cash flow £m	Interest accretion £m	At 31 March 2005 £m
Cash at bank and in hand	15.1	7.0	–	22.1
Bank overdrafts	(20.4)	2.4	–	(18.0)
	(5.3)	9.4	–	4.1
Current asset investments	12.0	(11.2)	–	0.8
Borrowings due after one year	(2,809.1)	217.9	(21.3)	(2,612.5)
Borrowings due within one year	–	(458.4)	–	(458.4)
	(2,809.1)	(240.5)	(21.3)	(3,070.9)
	(2,802.4)	**(242.3)**	**(21.3)**	**(3,066.0)**

23. Commitments and contingencies

a) Future capital expenditure

	Group and Company	
	2005 £m	2004 £m
Contracted for but not provided	**220.7**	177.7

b) Lease commitments

At 31 March 2005, the Group and Company's annual operating lease commitments, which relate to land and buildings, for the financial year ending 31 March 2006 amounted to £4.2m (2004: £4.3m) with lease expiry dates falling due after five years.

c) Guarantees and performance bonds

The Company has issued performance bonds in the ordinary course of business amounting to £6.9m (2004: £8.2m) and guarantees in respect of the performance of a third party up to £14.0m (2004: £14.0m).

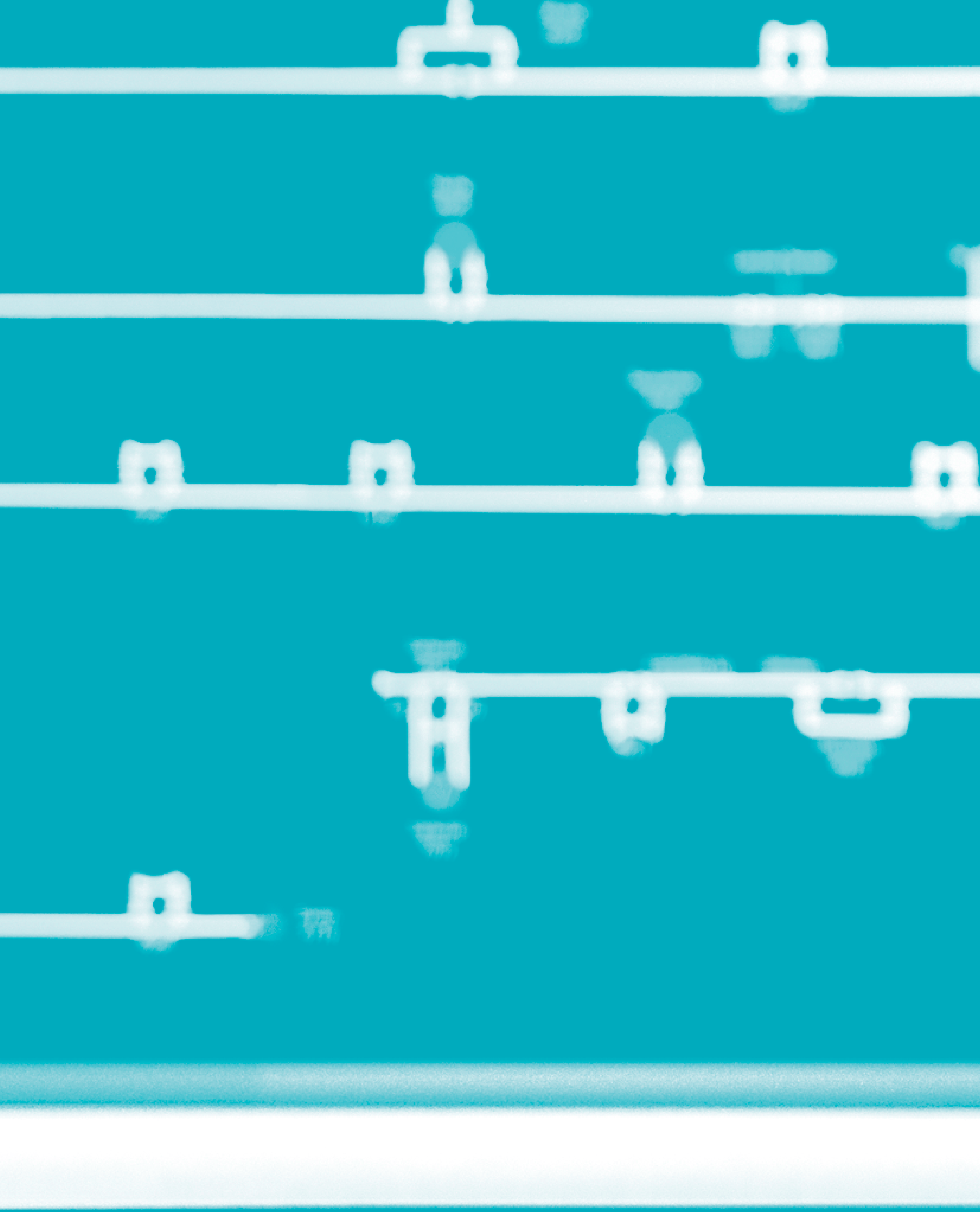
24. Related party transactions

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 FRS 8 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.

25. Holding company

The Company's ultimate controlling and parent company is National Grid Transco plc, and the immediate holding company for which consolidated 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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