

Regulatory Accounts 2006/07

National Grid Electricity Transmission plc

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Cautionary Statements

Relationship of regulatory accounting statements with statutory accounts

The financial information contained in these regulatory accounts statements does not constitute statutory accounts within the meaning of section 240 of the Companies Act 1985. Statutory accounts for National Grid Electricity Transmission plc for the year ended 31 March 2007, to which the financial information relates, have been delivered to the registrar of Companies.

The Auditors have made a report under Section 235 of the Companies Act 1985 on those statutory accounts which was unqualified and did not contain a statement under Section 237(2) or (3) of the addressed to, and for the benefit of, the members of National Grid Electricity Transmission plc and not for any other person or purpose. The auditors have clarified, in giving their opinion on those statutory accounts, that it 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. In giving their opinion, they do not accept or assume responsibility for any other purposes or to any other person to whom their audit report on the statutory accounts is shown or into whose hands it may come save where expressly agreed by their prior consent in writing.

The statutory accounts of National Grid Electricity Transmission plc can be obtained from the Company Secretary's Office, National Grid plc, 1-3 The Strand, London WC2N 5EH.

Scope of regulatory accounting statements

These regulatory accounting statements are only in respect of certain businesses of National Grid Electricity Transmission plc, as described in the Operating and Finance Review on page 3.

Basis of preparation of regulatory accounting statements

These regulatory accounting statements contain arbitrary apportionments of certain revenues, costs, assets, liabilities and shareholder's equity which are not specifically attributable to the businesses and activities reported in these regulatory accounting statements but which, nevertheless, are required by the electricity licence under which these regulatory accounting statements are prepared, to be reported against those businesses and activities. Further details of these items are provided in the Basis of preparations on page 36.

The bases used to allocate revenues, costs, assets, liabilities and shareholder's equity of National Grid Electricity

Transmission plc to the businesses reported on in these regulatory accounting statements have been determined in accordance with the requirements of the electricity licence under which these regulatory accounting statements have been prepared. These bases may differ from those used to determine the segmental analysis provided in the annual report and accounts of National Grid Electricity Transmission plc.

Definition of regulatory businesses

The regulatory businesses reported on in these regulatory accounting statements are defined in accordance with the electricity licence under which they are prepared.

The Obligation to Produce Regulatory Accounting Statements

Under Condition B1 of the Electricity Transmission Licence, National Grid Electricity Transmission plc is required to prepare and publish annual regulatory accounting statements setting out the financial position and performance of each of the regulatory businesses covered by that licence.

On August 14 2006, the Interconnectors business, previously a regulated activity of National Grid Electricity Transmission plc was transferred out of the licensee. These regulatory accounting statements have been prepared in respect of the Transmission and Interconnectors businesses, the latter up to the point of sale.

Restructuring of the regulatory accounts

National Grid Electricity Transmission plc is now required to allocate taxation, borrowings, and shareholders' equity across all its businesses for the purposes of preparing regulatory accounting statements. Previously these items were not so allocated and were outside of the results reported in those accounting statements.

As a result of these significant changes in presentation, audited prior year comparative information is not available for the Transmission and Interconnectors businesses. However, prior year information for these businesses has been restated on the same basis as the information for the year ended 31 March 2007, in so far as reasonably practicable, and is presented on an unaudited basis.

Operating and Financial Review

This Operating and Financial Review describes the main trends and factors underlying our development, performance and position during the year ended 31 March 2007 as well as those likely to affect our future development, performance and position. It has been prepared in line with the guidance provided in the Reporting Statement on the Operating and Financial Review issued by the UK Accounting Standards Board in January 2006.

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About National Grid Electricity Transmission

Principal operations

We are a part of the National Grid group of businesses. Our principal operations are the ownership and operation of regulated electricity transmission networks in the UK.

History

National Grid Electricity Transmission originated from the restructuring of the UK electricity industry in 1990. In 2005, we adopted National Grid as a single name for all our principal businesses.

Key milestones

1990	Electricity transmission network in England and Wales transferred to National Grid Company on electricity privatisation
1995	National Grid listed on the London Stock Exchange
2002	Merger of National Grid Group and Lattice Group to form National Grid Transco
2005	National Grid adopted as the group brand name, with National Grid Company renamed National Grid Electricity Transmission
2006	Disposal of interconnector business

Businesses and segments

The business activities of National Grid Electricity Transmission reported on in these regulatory accounting statements comprise:

Business	Segment	Description of principal activities
Electricity Transmission	Electricity Transmission	Owner and operator of the high-voltage electricity transmission network in England and Wales. Operator of the electricity transmission networks in Scotland.
Interconnectors	interconnectors	Owner and operator of electricity interconnector between France and England as part of joint arrangement with the French transmission operator, RTE.

All of our businesses and activities are undertaken within Great Britain.

External market environment

The principal market in which we operate is the electricity market in the UK.

The generation and supply of electricity in the UK is competitive in that consumers can contract with different suppliers to obtain the electricity they need. Those suppliers are then responsible for sourcing that electricity from electricity generators or importers as appropriate, as well as arranging for that electricity to be delivered through physical delivery networks.

These networks, including the ones we operate, are monopolies in their local areas as, for the majority of consumers, there are no alternative methods of receiving electricity.

Electricity delivery

Electricity is transported through electricity transmission networks to regional electricity networks that then deliver that electricity to consumers on behalf of suppliers. Certain end customers, primarily large industrial users, receive electricity direct from the transmission network.

We are the owner and operator of the electricity transmission network in England and Wales and operator (but not owner) of the two electricity transmission networks in Scotland.

The other principal infrastructure owners and operators in the UK are Scottish & Southern, Scottish Power, E.on, EDF, and MidAmerican Energy, each of which own two electricity distribution networks, and United Utilities and Western Power Distribution, both of which own one electricity distribution network. Scottish & Southern and Scottish Power also each own an electricity transmission network in Scotland, which we operate in each case. Viridian is responsible for the transmission and distribution of electricity in Northern Ireland.

Other markets in which we operate

Our other businesses primarily operate in energy related markets in the UK or are directly connected to our regulated businesses described above.

Regulation

As a result of our position in, and importance to, the UK economy, our electricity transmission business is subject to UK and European Union laws and regulations.

Our businesses are regulated by the Office of Gas and Electricity Markets (Ofgem). Ofgem operates under the direction and governance of the Gas and Electricity Markets Authority and has established price control mechanisms that restrict the amount of revenue that can be earned by regulated businesses, typically covering five-year price control periods.

We have two price controls for our electricity transmission operations, one in our role as transmission owner and the other as system operator.

These price controls are based around incentives. We have a financial incentive to invest, receiving a return on efficiently incurred capital expenditure through it increasing our regulatory asset base, and we can gain or lose through incentive arrangements for our performance in managing system operation, internal costs, pass-through costs and service quality.

The last price control period for our electricity transmission operations ended on 31 March 2007 and had been in place for one year, the previous five year control having ended on 31 March 2006. A new price control period commenced on 1 April 2007 and is planned to last until 31 March 2012.

Our businesses are covered by safety legislation which is enforced by the Health and Safety Executive (HSE).

National Grid Electricity Transmission has securities which are listed on the London Stock Exchange. As a consequence, we are regulated by the Financial Services Authority in the UK.

More information about the regulatory environment in which we operate, and on the nature of our price controls, is provided in the business discussions on page 19.

Business drivers

Our principal activities include the operation of highly complex electricity networks. As a consequence, there are many factors that influence the financial returns we obtain. We consider the following to be our main business drivers:

Price controls	<p>The prices we charge for use of our electricity transmission networks are determined in accordance with regulator-approved price controls.</p> <p>The negotiation of these arrangements has a significant impact on the revenues we obtain from our operations.</p> <p>In addition, these arrangements include incentives that permit us to earn additional revenues based on our performance or penalise us if we do not meet agreed performance targets.</p> <p>The period of these arrangements is significant to us in that they provide stability to our operations and allow us to plan ahead and invest in the confidence that we will obtain financial returns. Our price controls typically cover periods of five years.</p>
Safety and reliability	<p>Our ability to operate safely and reliably is very important to us, our employees, our contractors, our customers, the public and our regulators. Our financial performance is affected by our performance in these areas.</p>
Efficiency	<p>Our objective, and that of our regulator, Ofgem, is for us to deliver services as efficiently as possible. This allows us to limit price increases or to reduce prices to our customers and improve our own financial performance to the benefit of National Grid's shareholders.</p>
Capital investment	<p>Capital investment is a significant driver for organic growth.</p> <p>In our regulated energy networks, the prices we charge include an allowed return for capital investment determined in accordance with our price controls. These provide incentives for us to enhance the quality and reach of our networks through capital improvements.</p>
Relationships and responsibility	<p>Our reputation is vitally important to us. Delivering sustainable value depends on the trust and confidence of our stakeholders and this can only be earned by conducting our business in a responsible manner.</p>

A number of other factors also affect our financial performance, but are less significant than the principal business drivers above, or are mitigated by the way our operations are structured:

Volumes	<p>Changes in the quantities of electricity delivered through our transmission networks may result in an increase or decrease in our revenues. Volumes are affected by weather, consumer demand and network availability as well as other factors.</p> <p>The impact of changing volumes may sometimes be offset by changes in costs or may sometimes result in an under- or over-recovery against our allowable revenues, with a corresponding increase or decrease in revenues in future periods.</p>
Pass-through costs	<p>We are allowed to recover certain costs through charges to customers. The timing of recovery of these costs can vary between financial periods leading to an under- or over-recovery within any particular financial period.</p>
Inflation	<p>Without action to improve efficiency, our operating costs increase each year as a result of wage increases and inflation in external costs. In general, our revenues also increase each year, although not necessarily at the same rate, depending on our regulatory or contractual arrangements. As a consequence, our ability to control costs and improve efficiency is important to our ability to increase operating profits.</p> <p>Our price controls are linked to retail price inflation, as is a proportion of our borrowings.</p>
Seasonality	<p>Seasonality does not have a significant impact on our revenues. With the exception of volume related costs passed through to our customers operating costs are generally not seasonal.</p>
Interest rates	<p>The costs of financing our operations are affected by changes in prevailing interest rates, as some of our debt is at floating rates. We hedge some of our exposure to interest rates with fixed rate debt and derivative financial instruments to maintain a proportion of our debt at fixed interest rates.</p>

Current and future developments

External market developments

Market structure and ownership

There have been no significant changes in the structure of the UK electricity infrastructure market within the last two years. The most significant change in ownership is the takeover of Scottish Power (owner of one of the Scottish transmission networks that we operate) by Iberdrola, a Spanish utility, which completed on 23 April 2007.

Energy market developments

The UK is in a period of changing energy supply patterns, as the Government's emphasis on combating climate change means more reliance is placed on new sources of electricity generation, including renewables. We also continue to see a trend toward greater use of imported gas for power generation.

These changes are expected to impact on our electricity transmission networks. In particular, significant investment is planned in our electricity transmission networks to link new power plants with domestic, business and industrial consumers.

Regulatory developments

During the year ended 31 March 2007, there were no significant changes in the legislative and regulatory framework in the UK.

In January 2007, the European Commission published its final report on its energy sector competition inquiry, concluding that further action is required to improve energy markets in the European Union. It focused on problems from high levels of market concentration as well as vertical integration of supply, generation and infrastructure leading to a lack of equal access to, and sufficient investment in, infrastructure. The report also called for improvement in the regulatory framework to remove gaps in regulation, address concerns with market concentration and increase transparency in market operations.

Price controls

The previous price control arrangements for our electricity transmission business ceased on 31 March 2007 and have been replaced by new price controls which cover the period from 1 April 2007 to 31 March 2012.

We have accepted Ofgem's final proposals in respect of the price control covering our role as owner of electricity transmission networks. The key elements of these proposals are a 4.4% post-tax real rate of return on our regulatory asset value, a £3.5 billion baseline capital expenditure allowance over five years and a £0.9 billion controllable operating expenditure allowance over five years. Since our acceptance in principle of the final proposals, we have been working closely with Ofgem to agree the necessary licence amendments. This process should be completed during the first half of 2007. We have accepted Ofgem's final proposals for the system operator schemes that include annual negotiation on specific incentives.

Objectives and strategy

Strategic review

National Grid has undertaken a thorough and disciplined strategic review of its business which will set our direction for the next 5 to 10 years. In conducting this review, National Grid considered market trends and opportunities that exist in the utility sector, our market position, how we derive value from our businesses and the views of the capital markets. National Grid announced its conclusions in November 2006 and we have updated our objectives accordingly.

Focus

National Grid's future is about becoming more focused – a clear business model based on the ownership and operation of large scale asset intensive businesses, focusing on its principle growth markets, including electricity infrastructure in the UK.

Integration

We aim to run our businesses in a more integrated way – organising our activities along lines of business, supported by effective and efficient shared services and information systems. This involves deploying proven processes, common systems and best practices within each business, supported by common operating principles, and safety and environmental standards. In this way, we will maximise the competitive advantages that come from being part of an international organisation. However, it is critical that we balance this with the need to provide excellent service to customers and to maintain and build local relationships with other key stakeholders.

Discipline

We plan to be more disciplined in the application of best practice. Increasingly, we will standardise our approach, applying even greater rigour to financial discipline, ensuring that we have the capital to grow, but maintain the investor confidence that comes from a disciplined approach to our balance sheet.

Objectives

Our primary objective is to grow our business in order to create value for National Grid's shareholders. We can only create value if we achieve operational excellence and continue to improve our financial performance, we invest for the future and are financially disciplined, and we develop, recruit and retain skilled, talented and motivated people. In each area, we aim to increase our focus, benefit from improved integration and be disciplined in our approach.

As a consequence we have identified specific objectives in the following areas:

Performance	We aim for operational excellence by operating to the highest standards of safety, reliability and efficiency. We aim to continue to improve our financial performance.
Investment	We will invest in our existing businesses to generate future growth. We will be financially disciplined in the way we invest and in the way we manage our balance sheet.
Talent	We aim to maximise the contribution made by our employees by motivating our people to strive for continued improvement, developing their skills and talents, and by promoting a culture that recognises and respects inclusion and diversity.

Our strategy is underpinned by our commitments to developing strong and valued relationships with our customers, regulators, suppliers and the communities in which we operate and to acting responsibly, including specific commitments to reducing our environmental impact and to corporate governance and business ethics.

Relationships	We aim to improve our relationships with customers, regulators, suppliers and the communities in which we operate by focusing on the areas that are important to them, such as the quality of service we provide to customers, the quality of information we provide to regulators, by investing in local communities and by the way we address the concerns of, and interact with, all our stakeholders.
Responsibility	We believe operating responsibly is essential to the way we conduct our operations, invest, develop our people and manage our relationships and so responsibility underpins everything we do. We are committed to taking positive action to reduce our contribution to climate change and our other impacts on the environment. We want to operate to the highest standards of corporate governance and we believe in strong business ethics, based around our core values of respect, integrity and ownership.

Risk

Our principal risks relate to the achievement of our objectives and strategy, as we believe that by delivering on these objectives we will achieve our principal objective of delivering growth to drive shareholder value. We set out how we intend to achieve our objectives below and we describe our performance during the year against those objectives on pages 15 to 18.

In considering the opportunities we have to grow and develop our business, we have identified a number of risks and uncertainties in achieving our objectives. The most significant risk factors we have identified relate to:

- changes in laws or regulations;
- breaches in environmental or health and safety law or regulations;
- network failure or inability to carry out critical non-network operations;
- achievement of business performance objectives, including regulatory targets and delivering anticipated cost and efficiency savings;
- regulatory treatment of commodity costs passed through to consumers;
- reputation damage from disruptions to supply, even if outside our control;
- fluctuations in exchange rates and interest rates and their impact on borrowings and derivatives;
- increases in interest rates;
- restrictions in borrowings and changes in credit ratings or in tax rates;
- future funding requirements of pension schemes; and
- changes in accounting standards.

These are described in more detail on pages 10 to 12.

Shareholder Value

By achieving our objectives around performance, growth, talent, relationships and responsibility we aim to deliver sustainable growth to create value for National Grid's shareholders.

The following pages set out some of the specific objectives we have set ourselves in these areas in order to support our overall goals. Our objectives are set in the context of our strategy of increasing our focus, seeking to benefit from improved integration and being disciplined in our approach.

Performance

Our aim is for operational excellence, performing to the highest standards of safety, reliability and efficiency and continuing to improve our financial performance:

Safety

Safety is paramount.

Our most important goals are: to ensure that members of the public are not injured as a direct result of our operations; to deliver a working environment where there are zero work-related injuries or illnesses; and to improve the health of our employees so they are fit for work every day.

Measures we use to monitor our performance against our safety objectives include: members of the public injured as a direct result of our operations; employee lost time injury frequency rate; and employee sickness absence rate.

Reliability

Our principal operations are critical to the functioning of the UK economy. The reliability of our electricity transmission networks, and the delivery of electricity to our customers, are therefore our next highest priorities after safety.

Our approach to maintaining and improving reliability involves: investing in infrastructure and systems to provide the operational tools and techniques necessary to manage our assets and operations to high standards and investing in the renewal of assets; investing in the skills and capabilities of our people to give them the ability to operate our networks to a high degree of service excellence; and maintaining a constant focus on reliability as one of our principal objectives, ensuring we are proactive about planning to ensure reliability and that we react quickly to factors that could compromise reliability.

We use business-specific reliability performance indicators to measure our reliability performance.

Efficiency

By improving efficiency we can constrain the cost of our operations borne by customers and improve returns to shareholders. We review our operations continually to identify opportunities to improve the operational productivity of our assets and our people, and to identify areas in which we can reduce costs or restrict cost increases. Planning ahead is essential in our approach to maintaining and improving efficiency.

Our primary method of measuring improvements in efficiency is through our financial performance as described below.

Financial performance

If we achieve our objectives, we should be able to deliver continued improvements in financial performance. This will contribute to National Grid delivering on its commitment to growing its dividend by 7% per annum until 31 March 2008.

The principal measures we use to monitor financial performance are adjusted operating profit* and operating cash flows.

* Adjusted operating profit is operating profit before exceptional items and remeasurements.

Growth

Investment and financial discipline are critical to our plans to grow our businesses.

Investment

We invest in our existing businesses in order to grow those businesses.

Measures we use to monitor investment include capital expenditure.

Generate value from our investment

We aim to generate value from our investment by improving the operating performance of our networks and by selecting investments that will provide the best return.

Measures we use to monitor the value we generate from our investments include our return on investment.

Financial discipline In order to deliver sustainable growth we must be disciplined in the way we manage our balance sheet.

This means that cash will be returned to National Grid's shareholders to the extent that it is not required for our investment objective.

Talent

National Grid Electricity Transmission depends on the talents, skills and motivation of our employees. We aim to maximise the contribution made by our employees by developing their skills and talents, by motivating and driving continued improvement and by promoting a culture that recognises and respects inclusion and diversity and where all our employees share our core values of respect, integrity and ownership. In addition to obtaining the views of employees on an ongoing basis, we periodically carry out employee surveys to identify areas where we can improve the way we develop and interact with them.

Motivation and performance We plan to improve our operational performance and the service we provide to our customers by motivating our employees to strive for continued improvement.

Our aim is for a world-class performance management system, involving integrated common performance processes, a single set of performance criteria, pay linked to leadership qualities as well as operational and financial performance and greater differentiation between levels of performance.

Development of talent and skills Critical to our success is identifying, recruiting and developing talented people and helping our management and employees to operate to the best of their abilities.

Inclusion and diversity In order to develop, recruit and retain talented people we aim to achieve a more inclusive and diverse culture. A number of priority action areas have been identified to help achieve our vision of developing and operating our business in a way that results in a more inclusive and diverse culture, reflecting the composition of the communities in which we operate, and to be seen as an employer of choice across diverse communities.

Performance measures we use to monitor our objective of promoting inclusion and diversity include the percentage of female employees and the percentage of black and minority ethnic employees.

Values Our aim is for all of our people to be proud to work for National Grid Electricity Transmission, to share our core values of respect, integrity and ownership.

Relationships

We have a diverse range of external stakeholders including employees, customers, regulators, government and local communities. We strive to be open and constructive in our dealings with external audiences.

Our relationships with stakeholders are critical to our future success. Our strategy involves improving these relationships by focusing on the areas that are important to them, such as the quality of service we provide to customers, the quality of information we provide to regulators and the way we address the concerns of, and interact with, all our stakeholders.

Customer service Our objective is to impress our customers with the quality of the services we provide, with our responsiveness when things go wrong and with our dedication to continued improvement.

We plan to improve the way we interact with our customers by enhancing or replacing the systems we use, through providing our employees with the training, empowerment and support they need to deliver and by improving the quality of our communications with customers and internally.

We use business-specific service quality performance indicators to measure our performance in this area.

Regulatory relationships Our regulator's primary responsibilities are to electricity consumers. Hence the foundation of our relationship with regulators is based on the safety, reliability and efficiency of our operations and the quality of our customer service. Our strategic focus on operational excellence and on customer relationships plays a critical part in improving relationships with our regulator.

The other critical element in our regulatory relationships is in building trust. This involves being responsive to the need of our regulator for high quality information, complying with rules and regulations, operating in an ethical way and, most importantly, delivering on our promises.

Suppliers We aim to work in partnership with our suppliers, developing constructive relationships and working together effectively. Our objective is to develop contractual arrangements with our suppliers that align their interests with our own, as far as possible, and share financial risks appropriately.

We expect our suppliers to be as equally committed as ourselves to safety, reliability and efficiency and to acting responsibly. In turn, we aim to respect the capabilities and views of our suppliers and to treat them fairly in all our dealings with them.

Community involvement National Grid Electricity Transmission's role as a good corporate citizen supports our strategic ambitions and is delivered through a sustained and consistent approach.

In all our community investment, we aim to develop our business, support our employees, support communities and enhance our reputation. Our approach is based on two principles: 'Investment in our Communities, Investment in our People', and continues to be centred on three key themes: energy and environment; education and skills; and community development.

Sharing of best practice across our business and working collaboratively with key partners and stakeholders enables us to maximise how communities benefit from our activities.

Responsibility

We are committed to operating in a responsible way and this underpins our commitments to performance, growth, talent and relationships as discussed above.

As an asset intensive business, our operations have an impact on the environment. The most significant of these are climate change and historically contaminated land. We also take actions to minimise other environmental impacts of our operations, we are committed to strong governance and high ethical standards. We take the issues surrounding electric and magnetic fields seriously and we are committed to protecting human rights.

Climate change Climate change is possibly one of the greatest challenges facing society in the 21st Century. National Grid's public position statement on energy delivery and climate change sets out our approach to delivering energy while playing our role in minimising any impact our operations may have on the climate.

National Grid's overall target is to reduce carbon emissions by 60% compared with a verified baseline, ahead of the Government's target of 2050.

We plan to reduce emissions relating to our own energy use, saving at least 5% in energy consumption, and use the resultant cost savings to enable us to procure all of the electricity we use from renewable sources by the end of 2010.

With our skills in balancing supply and demand, we believe there are no insurmountable technical problems to accommodating the quantities of intermittent renewable generation that the market will bring forward. We are therefore investing in our networks to connect renewable generators and to reinforce them, ensuring large-scale renewably generated power can get from where it is generated to where it is used.

The key performance indicator we use to monitor our performance in this area is the percentage reduction in our greenhouse gas emissions.

Historically contaminated land National Grid Electricity Transmission has an inherited portfolio of historically contaminated land including older substations on our transmission networks.

The main focus of our remediation programme is on managing the environmental risk and returning any land no longer required for our operations to beneficial use.

Protecting the environment We are committed to continuous improvement in our environmental performance.

Our objective is to help protect the environment for future generations. In addition to aiming to actively reduce our contribution to climate change, we are committed to:

- being efficient in our use of natural resources;
- keeping our waste to a minimum and increasing the economic value of any waste we produce;
- acting to prevent environmental incidents; and
- improving, where we can, the environmental status of the land on which we operate.

We have implemented environmental management systems certified to the international standard ISO 14001 in all our businesses to help us deliver improvements in these areas.

Key performance indicators that we monitor in this area comprise the number of significant direct environmental incidents and the total value of fines from prosecutions.

Corporate governance We believe strong corporate governance is essential to operating responsibly and achieving our goals. National Grid's approach to corporate governance is described on pages 77 to 87 of its Annual Report and Accounts 2006/07.

Business ethics Not only are we committed to ensuring that all our behaviours are lawful and that we comply with our policies and licences, we expect all of our employees to live up to our core values of respect, integrity and ownership.

Electric and magnetic fields We take the issues that surround electric and magnetic fields seriously and in all our operations, as a minimum, we aim to comply with the regulations, guidelines or practices relating to electric and magnetic fields in force in the UK.

Human rights National Grid's public position statement sets out our commitment to protect human rights within our sphere of influence and ensure our own operations are a force for good, wherever we operate.

Principal risks and uncertainties

Risk management

Understanding and managing risks is integral to the way we run our business. We have a well established enterprise-wide risk management process that ensures risks are consistently assessed, recorded and reported in a visible, structured and continuous manner, the outputs of which are primarily used as a management tool. A secondary and natural output from this process is information that provides assurance to management at all levels and thus helps safeguard our assets and reputation. It is designed to manage rather than eliminate material risks to the achievement of our strategic and business objectives while also recognising that any such process can provide only reasonable, and not absolute, assurance against material misstatement or loss. This process complies with the Turnbull working party guidance (revised October 2005) and, in addition, contributes toward our compliance with our obligations under the Sarbanes-Oxley Act as well as other internal assurance activities.

Risk management in National Grid Electricity Transmission has become further embedded over time and our experience of this has enabled us to identify a number of key success criteria linked to both the risk management framework and process that, if in place, will help ensure the process continues to remain embedded.

The risk management process continues to be based on both bottom-up and top-down assessments of operational, financial and other business or project risks. From the bottom-up, our business units prepare and maintain risk registers that capture their key risks and the actions being taken to manage them. These risk registers are regularly reviewed and discussed by the executive committees for those business units. The key element in the top-down assessments of the enterprise-wide risk profile is the involvement of Directors and other senior management at critical stages in the review process. Their review and debate of bottom-up assessments produces the overall evaluations of the risks that are faced by National Grid Electricity Transmission. In addition, the Executive, the Risk & Responsibility and the Audit Committees of National Grid plc review National Grid's overall risk profile twice a year. The Audit Committee of National Grid plc also reviews the risk management process at least once during each year and reports on this to the Board of National Grid plc.

During the year we have continued to derive benefits from this process through ongoing interaction with National Grid plc's Internal Audit function and Sarbanes-Oxley teams. The external benchmarking exercise of National Grid as a whole has continued with other FTSE 100 companies and public sector organisations to measure the effectiveness of our own approach and exchange ideas on best practice. With the move to a line of business operating model, the opportunity is being taken to restructure risk and compliance management services to ensure approaches are consistent across businesses and continue to provide value to business operations, including major projects.

Risk factors

Our risk management process has identified the following risk factors which could have a material adverse effect on our business, financial condition, results of operations and reputation, as well as the value and liquidity of our securities. Not all of these factors are within our control. In addition, other factors besides those listed below may have an adverse effect on National Grid Electricity Transmission. Any investment decision regarding our securities and any forward-looking statements made by us should be considered in the light of these risk factors.

Change in law or regulation could have an adverse effect on our results of operations.

Our principal businesses are utilities or networks that are subject to regulation by the Government and other authorities. Consequently, changes in law or regulation could adversely affect us. Regulatory decisions concerning, for example, whether licences or approvals to operate are granted or are renewed, whether market developments have been satisfactorily implemented and whether there has been any breach of the terms of a licence or approval, the level of permitted revenues for our businesses and proposed business development activities could have an adverse impact on our results of operations, cash flows, the financial condition of our businesses and the ability to develop those businesses in the future. For further information, see the 'External market environment' and 'Regulation' sections of this Operating and Financial Review.

Breaches of, or changes in, environmental or health and safety laws or regulations could expose us to claims for financial compensation and adverse regulatory consequences, as well as damaging our reputation.

Aspects of our activities are potentially dangerous, such as the operation and maintenance of electricity lines. Electricity utilities also typically use and generate in their operations hazardous and potentially hazardous products and by-products. In addition, there may be other aspects of our operations which are not currently regarded or proved to have adverse effects but could become so; for example the effects of electric and magnetic fields. We are subject to laws and regulations relating to pollution, the protection of the environment, and how we use and dispose of hazardous substances and waste materials. We are also subject to laws and regulations governing health and safety matters protecting the public and our employees. Any breach of these obligations, or even incidents that do not amount to a breach, could adversely affect our results of operations and our reputation. For further information about environmental and health and safety matters relating to our businesses, see the 'Our Responsibility' section of National Grid's website at www.nationalgrid.com.

Network failure or the inability to carry out critical non-network operations may have significant adverse impacts on both our financial position and our reputation.

We may suffer a major network failure or may not be able to carry out critical non-network operations. Operational performance could be adversely affected by a failure to maintain the health of the system or network, inadequate forecasting of demand or inadequate record keeping. This could cause us to fail to meet agreed standards of service or be in breach of a licence or approval, and even incidents that do not amount to a breach could result in adverse regulatory and financial consequences, as well as harming our reputation. In addition to these risks, we may be affected by other potential events that are largely outside of our control such as the impact of weather or unlawful acts of third parties. Weather conditions can affect financial performance and severe weather that causes outages or damages infrastructure will adversely affect operational and potentially business performance. Terrorist attack, sabotage or other intentional acts may also physically damage our businesses or otherwise significantly affect corporate activities and as a consequence adversely impact the results of operations.

Our results of operations depend on a number of factors relating to business performance including performance against regulatory targets and the delivery of anticipated cost and efficiency savings.

Earnings maintenance and growth from our regulated electricity business will be affected by our ability to meet or better efficiency targets set by or agreed with Ofgem and other regulators. Earnings from our regulated business will be affected by our ability to recover incurred expenditure. Levels of earnings also depend on meeting service quality standards set by regulators. In addition, from time to time, we also publish cost and efficiency savings targets for our regulated business. We are also reorganising our operations along lines of business. To meet these targets and standards, we must continue to improve operational performance, service reliability and customer service. If we do not meet these targets and standards, we are not able to recover incurred expenditure or we do not implement this reorganisation as envisaged, we may not achieve the expected benefits, our business may be adversely affected and our performance, results of operations and our reputation may be harmed.

Changes to the regulatory treatment of commodity costs may have an adverse effect on the results of operations.

Changes in commodity prices could potentially impact our electricity transmission business. Current regulatory arrangements in the UK provide the ability to pass through virtually all of the increased costs related to commodity prices to consumers. However, if Ofgem were to restrict this ability, it could have an adverse effect on our operating results.

Our reputation may be harmed if consumers of energy suffer a disruption to their supply even if this disruption is outside our control.

Our electricity transmission business is responsible for transporting available electricity. We consult with and provide information to regulators, governments and industry participants about future demand and the availability of supply. However, where there is insufficient supply, our role is to manage the

relevant network safely, which in extreme circumstances may require us to disconnect consumers.

Fluctuations in exchange rates and interest rates could have a significant impact on our results of operations because of the significant proportion of our borrowings, and derivative financial instruments that may potentially be affected by such fluctuations.

Our results of operations may be impacted because a significant proportion of our borrowings and derivative financial instruments are affected by changes in exchange rates and interest rates. For further information about this and how we mitigate this risk, see the 'Financial position and financial management' section of this Operating and Financial Review.

The nature and extent of our borrowings means that an increase in interest rates could have an adverse impact on our financial position and business results.

A significant proportion of our borrowings are subject to variable interest rates which may fluctuate with changes to prevailing interest rates. Increases in these interest rates could therefore increase our costs and diminish our profits. For further information about this, see the 'Financial position and financial management' section of this Operating and Financial Review.

Our financial position may be adversely affected by a number of factors including restrictions in borrowing and debt arrangements, changes to credit ratings and effective tax rates.

We are subject to certain covenants and restrictions in relation to our listed debt securities and our bank lending facilities. We are also subject to restrictions on financing which have been imposed by regulators. These restrictions may hinder us in servicing the financial requirements of our businesses. Our debt is rated by credit rating agencies and changes to these ratings may affect both our borrowing capacity and the cost of those borrowings. The effective rate of tax we pay may be influenced by a number of factors including changes in law and accounting standards and our overall approach to tax planning, the results of which could increase that rate.

Future funding requirements of pension schemes could adversely affect our results of operations.

We participate in the Electricity Supply Pension Scheme which covers substantially all of our employees. The scheme is principally a defined benefit scheme with the scheme assets held independently of our own financial resources. Estimates of the amount and timing of future funding for the scheme are based on various actuarial assumptions and other factors including, among other things, the actual and projected market performance of the scheme assets, future long-term bond yields, average life expectancies and relevant legal requirements. The impact of these assumptions and other factors may require us to make additional contributions to the pension scheme which, to the extent they are not recoverable under our price controls, could adversely affect our results of operations.

New or revised accounting standards, rules and interpretations by the UK, or international accounting standard setting boards and other relevant bodies could have an adverse effect on our reported financial results.

The accounting treatment under International Financial Reporting Standards (IFRS), as adopted by the European Union, of replacement expenditure, pension and post retirement benefits, derivative financial instruments and commodity

contracts significantly affect the way we report our financial position and results of operations. As a body of practice develops for IFRS, the application and interpretation of accounting principles to our circumstances, and to those areas in particular, could result in changes in the financial results and financial position that we report. In addition, new standards, rules or interpretations may be issued which could also have significant effects.

Key performance indicators

We measure the achievement of our objectives through the use of qualitative assessments and through the monitoring of quantitative indicators, termed key performance indicators (KPIs).

In line with our operating objectives, we use both financial and non-financial KPIs. Where relevant, KPIs are used as our primary measures of whether we are achieving our objectives. However, the scale and size of our operations mean we use many other detailed performance measures in addition to KPIs. We also use KPIs to measure performance against our primary objective of growing our businesses to create value for National Grid's shareholders. We use qualitative assessments to judge progress against our objectives in areas where numerical measures are less relevant.

The majority of our KPIs are unchanged from last year; however, we have increased the number of KPIs presented in the table below by including business-specific reliability and KPIs.

Value	KPI	Description	Target	Results
Performance – safety	Injuries to the public	Members of the public injured as a direct result of our operations ¹	Zero	2006/07: 1 2005/06: 1
	Employee lost time injury frequency rate	Injuries resulting in employees taking time off work (per 100,000 hours worked)	Zero	2006/07: 0.20 2005/06: 0.17
	Sickness absence rate	Proportion of available work days which are lost due to sickness	Zero work-related sickness ²	2006/07: 1.39% 2005/06: 1.87%
Performance – reliability	Electricity Transmission system reliability	Electricity delivered by the electricity transmission system as a proportion of electricity demanded	99.9999%	2006/07: 99.9999% 2005/06: 99.9999%
Performance – efficiency and financial performance	Adjusted operating profit ³	Operating profit excluding exceptional items and remeasurements	To increase sufficiently to support 7% growth in National Grid's dividend through to March 2008	2006/07: £566 million 2005/06: £486 million
	Operating cash flows	Cash generated from continuing operations		2006/07: £789 million 2005/06: £869 million
Growth – Investment	Capital expenditure	Additions to plant and equipment and to intangible assets	There is no numerical target for capital expenditure, as each investment is different and is considered on its merits.	2006/07: £607 million 2005/06: £532 million
Growth – value from our investments	Return on investment	Adjusted regulatory profit ⁴ for electricity transmission as a percentage of regulatory asset value	To achieve a minimum return of 5.05% from 1 April 2007 consistent with the return projected by Ofgem for the 5-year price control period commencing 1 April 2007.	2006/07: 4.7% 2005/06: 4.5%
People – inclusion and diversity	Percentage of female employees	Proportion of employees who are female	We do not have specific targets – our aim is to ensure that we recruit the best candidates regardless of sex, race, disability, sexual orientation, age, religion or belief	2006/07: 13.7% 2005/06: 14.3%
	Percentage of black and minority ethnic employees	Proportion of employees who are black and minority ethnic		2006/07: 5.7% 2005/06: 4.7%
Responsibility – climate change	Percentage reduction in direct greenhouse gas Emissions ⁵	CO ₂ equivalent emissions estimated to be directly caused by our operations	Year on year reduction	2006/07: 16.5%
Responsibility – environmental impact	Significant direct environmental incidents	Own fault and contractor related environmental incidents	Zero	2006/07: 6, zero 2005/06: 10, zero
	Total amount of fines from environmental prosecutions	Financial amount of fines imposed	Zero	2006/07: zero 2005/06: zero

¹ Injuries comprise fatalities, injuries that require the person to receive hospital treatment and other injuries reported under the Reporting of Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR).

2 The sickness absence rate includes absences resulting from both work-related and non-work related illnesses. Our target relates to work-related illnesses, however, we do not have a measure that excludes non work-related illnesses sufficiently accurately.

3 Operating profit from continuing operations including exceptional items and remeasurements increased from £486 million in 2005/06 to £559 million in 2006/07.

4 The calculation of adjusted regulatory profit is explained on page 14.

5 The KPI we use for measuring reduction in greenhouse gas emissions has been changed from last year's measure of greenhouse gas emissions per £m revenue to a measure that aligns with our target of a 60% reduction in emissions.

Performance during the year

Our performance against our objectives in the areas of performance, investment, talent, relationship and responsibility is described below and on the following pages. Our financial results are described on page 18 and more information on the performance and financial results of each business are included in the business sections on pages 20 to 22.

Performance

Safety

Some aspects of our safety performance deteriorated in 2006/07 compared with 2005/06, which is disappointing after the significant improvement we recorded last year. Our aim in 2007/08 is to improve our safety performance in line with our goal of zero injuries.

In September 2006, managers from National Grid Electricity Transmission participated in National Grid's first combined UK and US safety, health and environment conference involving participants from across National Grid. The conference provided the opportunity to review our Safety and Occupational Health Policy and Vision for Safety and develop strategies to meet the challenges facing the business over the next few years.

Public safety

A member of the public died after illegally climbing and subsequently falling from an electricity tower. One member of the public died in similar circumstances in 2005/06. There were no other members of the public injured as a result of our operations in either year.

Employee safety

During 2006/07, 8 of our employees received injuries that resulted in them taking time off work, compared with 5 in 2005/06. As a consequence, employee lost time injuries per 100,000 hours worked rose to 0.20 in 2006/07 compared with 0.17 in the previous year.

In National Grid's 2006 employee opinion survey, 89% of respondents considered that National Grid has a clear commitment to operating safely and 89% considered that employees take safety seriously and do their best to prevent injuries and accidents compared with 86% on both these questions in the 2004 survey. 79% of respondents in 2006 felt confident safety concerns or issues raised would be addressed, up from 75% in the 2004 survey.

Contractor safety

It is with sadness we record the death of a contractor while working for our electricity transmission business during 2006/07. This was a tragic event and our thoughts and deepest sympathies are with all those affected.

There was a reduction in contractor lost time injuries from 29 in 2005/06 to 25 in 2006/07.

Employee health

We continue to focus on our employees' health and well being. Resulting from an action coming out of the September 2006 safety, health and environment conference, later in 2007/08 we will launch a new 'Vision for Wellness', setting out how we aim to help and support our employees in the maintenance of good physical and mental health through proper diet, exercise and habits. We also participate in the UK's Business in the Community Business Action on Health programme, at both a leadership team and practitioner level. The objectives of this programme are to raise the profile of health issues in companies and to quantify and track best practice workplace health activities.

Around 1.4% of available work days were lost due to sickness absence in 2006/07, an improvement on 1.9% in 2005/06. This equates to 3.6 days of sickness per employee per year. The UK Confederation of British Industry's 2007 sickness absence survey reported that average annual sickness for UK company employees was 7.0 days.

Reliability

Overall, our reliability performance was the best in recent years. In particular, the amount of electricity demanded, but not delivered was the second lowest in the past 5 years, and there were only 5 loss of supply incidents compared to an average of 11 over the preceding 4 years. As we enter a large programme of investment in our electricity transmission networks, there is an increased risk of loss of supply incidents and so we are increasing our focus on maintaining reliability over the next few years, by assessing the condition of circuits that remain in service during the periods that we replace or overhaul parts of the transmission network.

Further detail on the reliability of our operations is discussed in the business sections on page 20.

Efficiency

We continued to institute measures during the year to improve efficiency, with the implementation of a shared services function to support our businesses and our transmission business process review.

Financial performance

Information on our financial performance is contained under financial results on page 18 and in the business sections on pages 20 to 22.

Growth

Capital investment

Our capital investment continues to increase as changing energy requirements and the renewal of our networks require increased investment in infrastructure and we invested £592 million in the form of capital investment during 2006/07, compared with £528 million in 2005/06. In the UK, there are plans for significant expansion of renewable energy sources, as well as the need to increase the rate of asset replacement, as assets built in the 1960s and 1970s approach the end of their useful lives. The UK transmission price controls for the next five years include an allowance of £3.5 billion for investment in our electricity networks over that period. This investment is to

respond to changing sources of energy and to replace our ageing assets.

Acquisitions and disposals

Legislative changes which became effective on 14 August 2006, meant that as a holder of an electricity transmission licence, we were no longer allowed to own or operate the French Interconnector. Therefore, on 14 August 2006, we transferred our French Interconnector assets and related operating activities to National Grid Interconnectors Limited, a fellow subsidiary company of National Grid for a price of £128 million.

There were no other significant acquisitions or disposals completed during the year ended 31 March 2007.

Generating value from our investments

This year we are reporting for the first time a return on investment measure, the purposes of which is to allow us to monitor how we are performing in generating value from our businesses and from the investments we make. Return on investment has been calculated using the measure developed by Ofgem when setting our transmission price controls for the 5-year period commencing 1 April 2007. If we perform in accordance with Ofgem's projections, then we would earn an average annual return of 5.05% using Ofgem's measure. For 2006/7, our return on investment using this measure is 4.7%, compared with 4.5% in 2005/6. The returns in 2005/6 and 2006/7 were mainly suppressed by an increased investment programme prior to the price control outcome but for which higher revenue will be allowed in future years.

Talent

Motivation and performance

In July 2006, National Grid conducted a company-wide employee opinion survey. 58% of employees took part in the process – a 9% increase on the response rate compared with the 2004 survey. For over 90% of the questions asked, a more favourable response rate was received than in 2004. The survey demonstrated that the workforce better understand our strategy and the need for change. Our employees believe that the business is heading in the right direction and are willing to do their jobs differently to help National Grid improve. Respect and integrity, two of our three core values, are also becoming embedded in the culture of the organisation and safety continues to be recognised as one of National Grid's key strengths.

Areas which the survey results highlighted as needing improvement included general management behaviours around communication with employees and performance management. Action plans have been developed by each of the businesses to address their key priorities for improvement.

Greater use is being made of electronic communication channels with the new Chief Executive of National Grid outlining the new strategy for all employees via video and issuing a New Year video message to all employees.

Development of talent

Development and recruitment of employees is undertaken on an integrated basis for all National Grid's UK businesses.

Our focus on developing the talent of our current and future business leaders has intensified, with participants in our leadership and management development programmes more than doubled over last year. Specific areas of focus include leadership, communication, end user computing, project management and problem solving.

We continue to invest in the recruitment and development of skilled employees for the future and, in the past year, National Grid recruited 160 trainees onto the apprentice, foundation engineer, graduate and student programmes in which we participate. National Grid's UK Foundation Engineering Programme, launched in early 2006, is designed to facilitate the entrance, training and progression of talented people into key engineering roles. In conjunction with Aston University and Energy Utility Skills, our industry sector skills council in the UK, National Grid has also designed an industry specific foundation degree.

Through its 'e-futures' strategy, National Grid actively organises and sponsors a number of educational initiatives in the UK. These initiatives are designed to increase the number and diversity of young people interested in engineering careers and, ultimately, to create and sustain a greater pool of skilled talent from which we can recruit. Over the last four years, well over 15,000 young people have participated in these initiatives. Key to this success has been the dedicated involvement of our employees.

In the UK, National Grid was externally recognised as Graduate Employer of the Year at the Target National Graduate Recruitment awards and was highly commended by the National Council for Work Experience. The quality of National Grid's apprentice programmes has also been recognised by the Adult Learning Inspectorate, placing us in the top 10% of training providers in the UK.

Inclusion and diversity

Several employee interest networks have been established focusing on gender, ethnicity & faith and disability. The networks provide a mutually beneficial relationship for our employees by providing opportunities for employees to network with each other and senior management, to attain career building skills and to provide a better understanding of National Grid.

Working groups have been established with senior executive sponsors focusing on recruitment and employee development, employee engagement, communications and measuring the impact of our inclusion and diversity policies. We have also initiated a field force pilot programme in the UK to explore the development of inclusion and diversity best practices examples that can be replicated across our operational sites.

At 31 March 2007 13.7% of our employees were female and 5.7% were from black and ethnic minority groups compared with 14.3% and 4.7% respectively at 31 March 2006.

Our progress has already received external recognition. National Grid achieved The Times Top 50 UK 'where women want to work' status.

In the 2006 employee opinion survey, 83% (2004: 81%) of respondents considered they are treated fairly by National Grid without regard for race, age, ethnic background, gender, religion, disabilities or sexual orientation, while 66% (2004: not measured) considered that National Grid does a good job of treating them with fairness and respect.

Relationships

Customer service

We continue to aim for improvements in the service we provide to our customers and customer service is high on the agenda for the management teams in each of our businesses. In addition, we are supporting our businesses through the establishment of a shared services function in the UK.

Regulatory relationships

We continue to work very closely with Ofgem on the renewal of our electricity transmission networks and in expanding those networks to meet new and changing demand. In addition, we seek to maintain a professional approach with Ofgem in areas where we disagree.

Suppliers

We continue to make progress in improving the quality of our relationships with suppliers. A particular focus has been on the investment programmes in our electricity transmission operations, where we have worked with a number of suppliers to create alliances where we work in combined teams to deliver construction projects, and where we and suppliers share in the financial risk associated with these projects.

Community investment

Our policy on community investment provides a framework for ensuring that investment delivers benefits for our business and the communities we serve. During the year we reviewed our social policy to ensure our approach to community investment remains relevant to, and supports, society's wider social and environmental priorities. This review has included analysis of existing activities and best practice, both across National Grid Electricity Transmission and externally. We continue to use the model developed by the London Benchmarking Group to provide a framework for measuring and reporting our community investment contributions, by capturing, in accordance with the model, spend against our key themes. On this basis we invested some £0.3 million in support of community initiatives and relationships across our operations in 2006/07.

In the 2006 employee opinion survey, 68% (2004: 63%) of respondents considered National Grid makes a positive contribution to the communities in which we operate.

Responsibility

We continue to enjoy external endorsement of our responsible business approach. National Grid is 'sector leader' of the multi-utilities sector of the Dow Jones Sustainability World Index and one of only two companies listed. National Grid also continues

to feature in the FTSE4Good Index and is one of 29 companies regarded as a 'Platinum' company in the Business in the Community 2006 Corporate Responsibility Index, confirming that our approach to responsible business is indeed world class.

Climate change

National Grid as a whole has committed to reducing its greenhouse gas emissions by 60% against a verified baseline, in advance of the target date of 2050 set by the UK Government.

Last year we reported on our website for the first time our greenhouse gas emissions in line with the World Resources Institute' greenhouse gas protocol initiative. This provides a breakdown of our direct emissions (Scope 1), for example sulphur hexafluoride leaking from our electricity transformers, indirect emissions resulting from purchased electricity (Scope 2) and other indirect emissions (Scope 3). We believe this provides greater transparency and focuses attention on those emissions over which we have the greatest control.

Almost 100% of our reported Scope 3 emissions are due to losses on our electricity transmission networks. These losses are dependent on the distance between the location of electricity generators and centres of demand, a factor that is outside of our control. Emissions associated with these losses should be reported as Scope 1 emissions by electricity generators using the protocol.

During 2006/07, our Scope 1 and Scope 2 emissions amounted to some 259,000 tonnes CO₂ equivalent, a 16.5% reduction compared with emissions of 310,000 tonnes in 2005/06.

Protecting the environment

All of our employees work to certified ISO 14001 environmental management systems.

The number of significant environmental incidents in 2006/07 arising directly from our operations was 6, compared with 10 in 2005/06. None of these incidents were contractor-related and there were no prosecutions by enforcing bodies resulting from these incidents.

In National Grid's 2006 employee opinion survey, 73% (2004: 72%) of respondents considered National Grid acts responsibly in all its business dealings, including environmental management.

Electric and magnetic fields

We recognise there is some scientific evidence suggesting certain adverse health effects may be linked to electric and magnetic fields. There is also evidence linking an increased risk of certain diseases to proximity to power lines, though the cause of this is not clear. As a consequence, there is public concern and we take these issues very seriously. The balance of evidence remains against both power-frequency and radio-frequency electric and magnetic fields causing ill health. The World Health Organization has classified power-frequency magnetic fields as 'possibly' carcinogenic. National Grid's public position statement on electric and magnetic fields, which we review annually, helps set the framework within which we

continually assess the scientific evidence in this area, determine any implications for the way in which we conduct our business and explain to society what the science is telling us. We actively support high-quality research and open communication and in the UK we initiated and supported the Stakeholder Advisory Group on electric and magnetic fields, which reported its assessment of the issues in April 2007. This group represents a more constructive and less confrontational way of handling issues such as electric and magnetic fields, and its assessment brings greater clarity on the issues involved for society as a whole. This assessment is available at www.emfs.info/sage.

Business ethics

In March 2007, National Grid published its Standards of Ethical Business Conduct, replacing its UK Code of Business Conduct. The new Standard provides a common set of practical guidelines to ensure our behaviours are lawful, we comply with our policies and licences and we follow the values set out in our Framework for Responsible Business and our core values of respect, integrity and ownership.

In the 2006 employee opinion survey, 65% (2004: 56%) of respondents considered something would be done if they reported an inappropriate business practice or an ethical issue while 65% (2004: 61%) believe National Grid is a good company for customers to do business with.

Human rights

A review in 2004 of potential human rights risks highlighted the need to better understand our increasingly international supply chain. To improve control in this area, we have worked with other UK utilities to develop the UK's utilities vendor database supplier pre-qualification programme to include labour rights-related questions – this was introduced in 2006. To further strengthen controls, we have also carried out an assessment of the full range of materials and services purchased by our operations and identified those most likely to pose human rights risks to our operations. In 2007/08, we will further develop our purchasing strategies and processes to manage these potential risks.

Financial results

We report our financial results and position in accordance with International Financial Reporting Standards (IFRS) as adopted in the European Union.

Discontinued operations

The results of the French Interconnector operations transferred to a fellow subsidiary of National Grid on 14 August 2006 are presented as discontinued operations.

Measurement of financial performance and use of adjusted profit measures

In considering the financial performance of our businesses and segments, we analyse each of our primary financial measures of operating profit, profit before tax and profit for the year into two components, comprising firstly 'business performance' which excludes exceptional items and remeasurements and secondly 'exceptional items and remeasurements'. Exceptional items and remeasurements are excluded from the measures of

business performance used by management to monitor financial performance as they are considered to distort the comparability of our reported financial performance from year to year.

Measures of business performance are referred to in this Annual Report as adjusted profit measures in order to clearly distinguish them from the comparable total profit measures of which they are a component. Adjusted operating profit, adjusted profit before tax and adjusted earnings differ from total operating profit, profit before tax and profit for the year respectively by the exclusion of exceptional items and remeasurements.

Exceptional items and remeasurements are items of income and expenditure that, in the judgment of management, should be disclosed separately on the basis that they are material, either by their nature or their size, and are relevant to an understanding of our financial performance. Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, material changes in environmental provisions and gains or losses on disposals of businesses or investments. Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments. These fair values increase or decrease as a consequence of changes in financial indices and prices over which we have no control.

Adjusted profit measures are limited in their usefulness compared with the comparable total profit measures, as they exclude important elements of our underlying financial performance, namely exceptional items and remeasurements. We believe that in separately presenting financial performance in two components it is easier to read and interpret financial performance between periods, as adjusted profit measures are more comparable by excluding the distorting effect of exceptional items and remeasurements, and exceptional items and remeasurements are more clearly understood if separately identified and analysed. The presentation of these two components of financial performance is additional to, and not a substitute for, the comparable total profit measures presented.

Management uses adjusted profit measures as the basis for monitoring financial performance and in communicating financial performance to investors in external presentations and announcements of financial results. Internal financial reports, budgets and forecasts are primarily prepared on the basis of adjusted profit measures, although planned exceptional items, such as significant restructurings, are also reflected in budgets and forecasts. Management compensates for the limitations inherent in the use of adjusted profit measures through the separate monitoring and disclosure of exceptional items and remeasurements as a component of our overall financial performance.

Electricity Transmission

About the business

Our Electricity Transmission business comprises the following principal activities:

Electricity transmission owner	<p>We own the electricity transmission system in England and Wales.</p> <p>This comprises approximately 4,479 miles of overhead line, about 420 miles of underground cable and 337 substations at 244 sites.</p>
Electricity system operator	<p>We are the Great Britain System Operator, responsible for managing the operations of both the England and Wales transmission system that we own and the two high-voltage electricity transmission networks in Scotland.</p> <p>Day-to-day operation of the Great Britain electricity transmission system involves the continuous real-time matching of demand and generation output, ensuring the stability and security of the power system and the maintenance of satisfactory voltage and frequency.</p>

As electricity transmission owner, we own and maintain the physical assets, develop the networks to accommodate new connections and disconnections, and manage a programme of asset replacement and investment to ensure the long-term reliability of the networks.

As electricity system operator, we undertake a range of activities necessary for the successful, efficient delivery in real-time, of secure and reliable energy. This involves the continuous real-time balancing of supply and demand, and balancing services that include commercial arrangements with market participants that enable electricity demand or generation output to be varied.

The Company is the sole holder of an electricity transmission licence for England and Wales. This licence also covers our role as the Great Britain System Operator, in accordance with the British Electricity Trading and Transmission Arrangements (BETTA). 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. Charges to users of the transmission networks comprise two principal elements: transmission network use of system charges in respect of the electricity transmission owner activity and balancing services use of system charges in respect of the electricity system operator activity. We collect these charges from all Great Britain transmission network users and make payments to the owners of the Scottish transmission networks for the element of the transmission network use of system charges that relate to their networks.

Ofgem sets price controls in respect of the amounts that can be charged by the owners and operators of electricity infrastructure in the UK. The last price controls for our electricity transmission activities ended on 31 March 2007, having commenced as five year price controls on 1 April 2001, that were then extended by

one year. The new five-year price control periods for electricity transmission activities commenced on 1 April 2007.

Price controls

The charges that we can make for access to our electricity transmission system are determined by a formula linked to the retail price index (RPI). Up until 31 March 2007, this was set at RPI -1.5%. This formula is based upon Ofgem's estimates of operating expenditure, capital expenditure and asset replacement, together with an allowed rate of return. The rate of return up until 31 March 2007 was set at a real pre-tax rate of 6.25% on our regulatory asset value for our electricity network.

Our regulatory asset value as of 31 March 2007 is estimated as £6.0 billion (£5.6 billion at March 2006).

Where Ofgem determines that our capital investment is efficiently invested, we obtain a rate of return on that investment. The new price control allows a return of 4.4% post tax real rate of return on our regulatory asset value.

We are subject to an incentive scheme based on the reliability of the electricity transmission network in England and Wales. This is based on achieving reliability in excess of 99.9999%. For 2006/07, there was the potential to earn additional revenue up to 1% if loss of supply is less than 248 MWh. For loss of supply in excess of 274 MWh, up to a collar of 653 MWh, we could potentially lose up to 1.5% of revenue. For 2007/08 an identical incentive scheme is in place.

Our electricity system operation has incentive schemes where, if we operate our network more efficiently than Ofgem's forecasts, we can increase our revenues. We have an external cost scheme that covers the costs incurred in balancing the system. We also have an internal cost incentive scheme that covers the internal costs of the system operator function. Our electricity system operator external incentive, the Balancing Services Incentive Scheme (BSIS), has historically been agreed on an annual basis. For the 2006/07 scheme, we decided not to accept Ofgem's proposals for the BSIS target. We considered that neither of Ofgem's external proposals offered an appropriate balance of risk and reward. Normal arrangements for the operation of the system and management of payments continued, but without a financial incentive on National Grid Electricity Transmission. We are at all times obligated under our transmission licence to operate the system in an economic and efficient manner. For 2007/08, we have accepted a cost target of £430 million to £445 million. We retain 20% of any cost performance under this target deadband, up to a cap of £10 million and we incur 20% of any cost outturn above the deadband, up to a collar of £10 million.

Current and future developments

In addition to the current and future developments described on page 5, the following developments are relevant to the Electricity Transmission business.

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 proposals from Ofgem for

transmission investment for renewable generation recognised the need to invest in our networks to accommodate renewables and together with the transmission price control, funding costs for £350 million of investment will be allocated to our electricity transmission owner activity allowable revenue for the upgrade of the Anglo-Scottish interconnector and associated works (conditional on the satisfactory outcome of key planning consents). At this time, access is being sought by approximately 12 GW of renewable generation consisting of 165 projects, each with connection agreements in Scotland. For England and Wales connection offers have been made to an additional 5 GW of renewable generation.

Performance during the year

The winter of 2006/07 saw demand from the electricity transmission network in England and Wales hit a peak of 52.1 GW. This compares with 53.7 GW for 2005/06. The total amount of electricity transmitted for 2006/07 was 303,721 GWh compared with 312,339 GWh for 2005/06.

Descriptions of our progress against our overall objectives in the areas of performance, growth, talent, relationships (including customer service) and responsibility are set out on pages 7 to 9. We include below further information specific to Electricity Transmission with respect to our performance, growth and customer service objectives.

Performance

Our progress against our operating objectives during the year, in addition to those described on page 7, includes the following:

Objective	Performance
Reliability	Average annual availability of our electricity transmission network in 2006/07 was 95.02%, compared with 95.09% in 2005/06. Reduced availability reflects the increased amount of asset replacement activity to ensure the reliability of the network for years to come. System availability at winter peak demand was 98.2% in 2006/07 and 97.9% in 2005/06.
Efficiency	We have been undertaking a number of internal business process reviews to seek out further savings without compromising our other objectives. Efficiency is reflected in our financial performance, which is discussed below.
Financial performance	Adjusted operating profit of £564 million is 17% higher than 2005/06. This is discussed in further detail in the financial results sections following.

Growth

Investment

Investment in electricity transmission systems is, by its nature, variable and is largely driven by changing sources of supply and asset replacement requirements. Our electricity transmission licence also obliges us to provide connections and capacity upon request.

The bulk of the current UK electricity transmission network was installed during the 1960s and 1970s, with main plant asset lives typically of between 40 and 50 years. We have increased our level of investment as, over the next few years, we replace

parts of our electricity network as these assets become due for renewal. This, together with work required to meet changing supply sources, means that the Electricity Transmission business has embarked on a significant increase in investment and network renewal.

Capital investment in the replacement, reinforcement and extension of the UK electricity transmission systems in 2006/07 was £604 million compared with £530 million in 2005/06.

In addition, in 2006/07, 48% or £290 million (2005/06: 50% or £265 million) of electricity transmission capital expenditure was related to asset replacement, reflecting the increasing need to replace transmission network assets, many of which were commissioned in the 1960s.

	2007 £m	2006 £m
Property, plant & equipment	592	528
Intangible	12	2
Capital investment	604	530

Financial results

The results for the electricity transmission for the years ended 31 March 2007 and 2006 were as follows:

	Years ended 31 March	
	2007 £m	2006 £m
Revenue	1,991	1,869
Operating costs excluding exceptional items and remeasurements	(1,427)	(1,386)
Adjusted operating profit	564	483
Exceptional items	(6)	-
Total operating profit	558	483

The principal movements between 2005/06 and 2006/07 can be summarised as follows:

	Revenue £m	Operating costs £m	Operating Profit £m
2005/06 results	1,869	(1,386)	483
Add back 2005/06 exceptional items	-	-	-
2005/06 adjusted results	1,869	(1,386)	483
Allowed revenues	106	(3)	103
Timing on recoveries	(36)	-	(36)
Depreciation and amortisation	-	19	19
Other	52	(57)	(5)
2006/07 adjusted results	1,991	(1,427)	564
2006/07 exceptional items	-	(6)	(6)
2006/07 results	1,991	(1,433)	558

Revenue, increased by £122 million in 2006/07 compared to 2005/06 driven by an £85 million increase in electricity transmission owner revenue, from the regulatory settlement with Ofgem for the extension of the previous price control for 2006/07, a 6% increase in real terms. The balance of the increase arose from higher incentivised costs associated with balancing the electricity system, which flow through to revenue, partly offset by unfavourable relative timing impacts on revenue

recoveries, with repayment in 2006/07 of amounts over-recovered in 2005/06.

Operating costs, excluding exceptional items and remeasurements, increased by £41 million in 2006/07 compared to 2005/06. This reflected higher incentivised BSIS costs, resulting from higher response and constraint costs, partly offset by lower margin costs, and higher expenditure relating to tower foundations and steelwork (in future periods this expenditure will be remunerated as part of the regulatory asset base). These increases were partly offset by an £19 million reduction in transmission owner depreciation and amortisation due to the absence of accelerated depreciation charges and early asset write-offs which arose in 2005/06.

The £81 million increase in electricity transmission adjusted operating profit comparing 2006/07 with 2005/06 reflects the movements in revenue and operating costs, excluding exceptional items, as described above.

The £6 million exceptional charge in 2006/07 relates to the establishment of a shared services function and the implementation of a review of our business processes.

Adjusted earnings

	Years ended 31 March	
	2007	2006
Transmission	£m	£m
Adjusted operating profit	564	483
Allocated net finance costs excluding exceptional items and remeasurements	(136)	(139)
Adjusted profit before taxation	428	344
Allocated taxation excluding taxation on exceptional items and remeasurements	(128)	(101)
Adjusted profit from continuing operations	300	243

Earnings

	Years ended 31 March	
	2007	2006
Continuing operations	£m	£m
Operating profit	558	483
Allocated net finance costs	(145)	(138)
Profit before taxation	413	345
Allocated taxation	(126)	(101)
Profit from continuing operations	287	244

Allocated net finance costs

Allocated net interest excluding exceptional finance costs and remeasurements decreased by £3 million from 2005/06 to 2006/07.

Allocated exceptional finance costs and remeasurements

Allocated exceptional finance costs of £8 million in 2006/07 and £2 million in 2005/06 relate to the early repayment of debt.

Financial remeasurements relate to net losses on derivative financial instruments of £1 million, compared with net gains of £3 million in 2005/06.

Allocated taxation

A net allocated charge of £126 million arose in 2006/07, compared with £101 million in 2005/06. This includes net tax

credits in respect of exceptional items and remeasurements amounting to £2 million in 2006/07. The effective tax rate was 31% for 2006/07 and 29% for 2005/06.

Excluding the effect of net tax credits on exceptional items and remeasurements, the effective tax rate for 2006/07 and 2005/06 was 30% and 29% respectively, compared with a standard UK corporation tax rate of 30% for both years.

Profit for the year

Profit for the year rose from £244 million in 2005/06 to £287 million in 2006/07 as a consequence of the above changes.

Adjusted profit measures

The following tables reconcile the adjusted profit measure to the corresponding total profit measure in accordance with IFRS.

a) Reconciliation of adjusted operating profit to total operating profit

	Years ended 31 March	
	2007	2006
Transmission	£m	£m
Adjusted operating profit	564	483
Exceptional operating items	(6)	-
Total operating profit	558	483

Adjusted operating profit is presented on the face of the Income Statement, under the heading 'Operating profit – Before exceptional items and remeasurements'.

b) Reconciliation of adjusted profit before taxation to profit before taxation

	Years ended 31 March	
	2007	2006
Transmission	£m	£m
Adjusted profit before taxation	428	344
Exceptional operating items	(6)	-
Allocated exceptional finance costs	(8)	(2)
Allocated financial remeasurements	(1)	3
Total profit before taxation	413	345

Adjusted profit before taxation is presented on the face of the Income Statement, under the heading 'Profit before taxation – Before exceptional items and remeasurements'.

c) Reconciliation of adjusted earnings to earnings (profit for the year)

	Years ended 31 March	
	2007	2006
Transmission	£m	£m
Adjusted earnings	300	243
Exceptional operating items	(6)	-
Allocated exceptional finance costs	(8)	(2)
Allocated financial remeasurements	(1)	3
Allocated tax on exceptional items and remeasurements	2	-
Earnings	287	244

Adjusted earnings is presented on the face of the Income Statement, under the heading 'Profit for the year after taxation – Before exceptional items and remeasurements'.

Cash flows**Cash flows from operating activities**

Cash generated operating operations was £783 million in 2006/07 compared with £741 million in 2005/06.

After reflecting net allocated corporate tax payments, net cash inflow from operating activities was £637 million, compared with £504 million in 2005/06.

Cash outflows from investing activities

Cash outflows from investing activities increased from £472 million in 2005/06 to £504 million in 2006/07.

Cash flows from financing activities

Net cash flows relating to financing activities changed from a net outflow of £199 million in 2005/06 to a £239 million inflow in 2006/07. This movement was due to new net allocated borrowings. Payments to providers of finance, in the form of net allocated interest, totalled £120 million in 2006/07 compared with £132 million in 2005/06.

Cash inflows from investing activities

Cash flows in 2006/07 relating to discontinued operations comprised £128 million of disposal proceeds.

Cash flows from financing activities

Net cash flows from discontinued operations relating to finance activities changed from a net inflow of £38 million in 2005/6 to a nil movement in 2006/7.

Discontinued operations

About discontinued operations

Discontinued businesses comprise the results of our French Interconnector operations, which were transferred to a fellow subsidiary of National Grid plc on 14 August 2006.

Performance during the year**Financial performance**

	Years ended 31 March	
	2007	2006
	£m	£m
Revenue	27	77
Operating costs before exceptional items	(4)	(14)
Adjusted operating profit	23	63
Exceptional items	-	-
Operating profit	23	63
Net allocated finance costs	(1)	(3)
Taxation	(7)	(19)
Profit from discontinued operations	15	41
Gain on disposal of discontinued operations	33	-
Profit for the year	48	41

The lower operating profit in 2006/07 compared to 2005/06 reflects that 2006/07 only includes operating results for the period to 14 August 2006.

The gain on disposal of £33 million arises from the excess of the transfer value over the carrying value of the assets concerned.

Cash flows**Cash flows from operating activities**

Cash generated from operating operations was £14 million in 2006/07 compared with £41 million in 2005/06. This reflects the business being transferred at 14 August 2006.

Financial position and financial management

Going concern

Having made enquiries, the Directors consider that National Grid Electricity Transmission has adequate resources to continue in business for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing these regulatory accounting statements.

Financial position

Balance sheet

Our balance sheet for the regulated Transmission business at 31 March 2007 can be summarised as follows:

	Assets £m	Liabilities £m	Net assets £m
Property, plant and equipment and non-current intangible assets	4,837	-	4,837
Other non-current assets and liabilities	-	(136)	(136)
Current assets and liabilities	534	(847)	(313)
Allocated post retirement obligations	-	(482)	(482)
Allocated deferred tax	-	(644)	(644)
Held for sale	-	-	-
Total before net debt	5,371	(2,109)	3,262
Allocated net debt	842	(3,778)	(2,936)
Total as at 31 March 2007	6,213	(5,887)	326
Total as at 31 March 2006	4,995	(4,896)	99

The increase in net assets from £99 million at 31 March 2006 to £326 million at 31 March 2007 resulted mainly from the profit for the year of £287 million.

Allocated net debt and gearing

Net debt increased by £44 million from £2,892 million at 31 March 2006 to £2,936 million at 31 March 2007. This was due to an increase in the amount allocated to the Transmission business.

The composition of net debt at 31 March 2007 is shown in note 25(b) to the accounts.

Gearing at 31 March 2007 and 31 March 2006, calculated as net debt at that date expressed as a percentage of net debt plus net assets shown in the balance sheet, amounted to 47% and 50% respectively. By comparison, the gearing ratio, adjusted for the inclusion of regulated businesses at their estimated regulatory asset values (adjusted gearing ratio), amounted to 41% at 31 March 2007 compared with 43% 31 March 2006.

We believe this adjusted ratio is a more relevant measure of gearing than one based on book values alone, because the book values do not reflect the economic value of the regulated business assets. A reconciliation of the adjustments necessary to calculate adjusted net assets is shown in the table below:

	2007 £m	2006 £m
Net assets per balance sheet	326	99
Adjustments for regulatory asset values	1,265	1,243
Deferred tax	(380)	(373)
Adjusted net assets	1,211	969

Equity shareholders' funds

Equity shareholders' funds rose from £99 million at 31 March 2006 to £326 million at 31 March 2007 for the same reasons that net assets increased.

Liquidity and treasury management

Cash flow

Cash flows from our operations are largely stable over a period of years, but they do depend on the timing of customer payments. Our electricity transmission operations are subject to multi-year price control agreements with the regulator, Ofgem. Significant changes in volumes, for example as a consequence of weather conditions, can affect cash inflows in particular, with abnormally mild or extreme weather driving volumes down or up respectively. Subject to this, we have essentially stable cash flows.

Cash flow forecasting

Both short- and long-term cash flow forecasts are produced frequently to assist in identifying our liquidity requirements.

These forecasts are supplemented by a financial headroom position, details of which are supplied to the Finance Committee of the Board of National Grid plc regularly to demonstrate funding adequacy for at least a 12 month period. We also maintain a minimum level of committed facilities in support of that objective.

Credit facilities and unutilised Commercial Paper and Medium Term Note Programmes

We have both committed and uncommitted facilities that are available for general corporate purposes. At 31 March 2007, National Grid Electricity Transmission plc had a US\$1.0 billion US Commercial Paper Programme (unutilised) and a US\$1.0 billion Euro Commercial Paper Programme (unutilised); and National Grid Electricity Transmission plc and National Grid plc had a joint Euro Medium Term Note Programme of €12 billion (€3.2 billion unissued).

At 31 March 2007, the Company had £450 million of long term committed facilities (undrawn) and around £500 million of uncommitted borrowing facilities (undrawn).

Regulatory restrictions

As part of our regulatory arrangements, our operations are subject to a number of restrictions on the way we can operate. These include a regulatory 'ring-fence' that require us to maintain adequate financial resources and restricts our ability to transfer funds or levy charges between the Company and other companies in the National Grid group of companies.

Treasury policy

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

There is a separate financing programme for National Grid Electricity Transmission plc. The Finance Committees of both National Grid and of National Grid Electricity Transmission approve all funding programmes.

The Treasury function is not operated as a profit centre. Debt and treasury positions are managed in a non-speculative manner, such that all transactions in financial instruments or products are matched to an underlying current or anticipated business requirement.

The use of derivative financial instruments is controlled by policy guidelines set by the Board of National Grid plc. Derivatives entered into in respect of gas commodities are used in support of the business' operational requirements and the policy regarding their use is explained below.

For the regulated Transmission business, we had borrowings outstanding at 31 March 2007 amounting to £3,712 million (31 March 2006: £2,912 million). The table in note 19 shows the expected maturity of these borrowings.

Appropriate committed facilities are in place, such that we believe that the maturing amounts in respect of our contractual obligations, as shown in 'Commitments and Contingencies', can be met from these facilities, operating cash flows and other refinancings that we reasonably expect to be able to secure in the future. Our financial position and expected future operating cash flows are such that we can borrow on the wholesale capital and money markets and most of our borrowings are through public bonds and commercial paper.

We place surplus funds on the money markets, usually in the form of short-term fixed deposits that are invested with approved banks and counterparties. Details relating to cash, short-term investments and other financial assets at 31 March 2007 are shown in notes 17 and 18 to the accounts.

As of 31 March 2007, the long-term senior unsecured debt and short-term debt credit ratings respectively provided by Moody's, Standard & Poor's (S&P) and Fitch were as follows:

Moody's	A2/P1
Standard & Poor's (S&P)	A/A1
Fitch	A/F2

In connection with the proposed acquisition of KeySpan Corporation by National Grid, our ratings have been moved to 'creditwatch with negative implications' by S&P. Moody's have placed our ratings on 'review for downgrade' and Fitch have maintained our ratings as 'stable'.

It is a condition of the regulatory ring-fence around the Company that it uses reasonable endeavours to maintain an investment grade credit rating. At these ratings, we should have good access to the capital and money markets for future funding when necessary.

The main risks arising from our financial activities are set out below, as are the policies for managing these risks, which are agreed and reviewed by the Board of National Grid and the Finance Committee of that Board.

Refinancing risk management

The Board of National Grid plc controls refinancing risk mainly by limiting the amount of financing obligations (both principal and interest) arising on borrowings in any financial year. This policy is intended to prevent National Grid and its subsidiaries from having an excessively large amount of debt to refinance in a given time-frame.

Interest rate risk management

Our interest rate exposure arising from borrowings and deposits is managed by the use of fixed and floating rate debt, interest rate swaps, swaptions and forward rate agreements. Our interest rate risk management policy is to seek to minimise total financing costs (being 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 our bonds in issue are index-linked, that is their cost is linked to changes in the UK Retail Price Index (RPI). We believe that these bonds provide a good hedge for revenues and our regulatory asset values that are also RPI-linked under our price control formulae.

The performance of the Treasury function in interest rate risk management is measured by comparing the actual total financing costs of our debt with those of a passively-managed benchmark portfolio. More information on the interest rate profile of our debt is included in note 19 to the National Grid Electricity Transmission plc annual report and accounts 2006/7.

Foreign exchange risk management

We have a policy of hedging certain contractually committed foreign exchange transactions over a prescribed minimum size. This covers a minimum of 75% of such transactions expected to occur up to six months in advance and a minimum of 50% of transactions six to twelve months in advance. Cover generally

takes the form of forward sale or purchase of foreign currencies and must always relate to underlying operational cash flows.

Counterparty risk management

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. The Finance Committee of National Grid plc has agreed a policy for managing such risk, which is controlled through credit limits, approvals and monitoring procedures. Where multiple transactions are entered into with a single counterparty, a master netting arrangement can be put in place to reduce our exposure to credit risk of that counterparty. At the present time, we use standard International Swap Dealers Association (ISDA) documentation, which provides for netting in respect of all transactions governed by a specific ISDA agreement with a counterparty, when transacting interest rate and exchange rate derivatives.

Derivative financial instruments held for purposes other than trading

As part of our business operations, we are exposed to risks arising from fluctuations in interest rates and exchange rates. We use financial instruments, including derivatives, to manage exposures of this type and they are a useful tool in reducing risk. Our policy is not to use derivatives for trading purposes. Derivative transactions can, to varying degrees, carry both counterparty and market risk.

We enter 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, we enter into bought and written option contracts on interest rate swaps. These contracts are known as swaptions. We also enter 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.

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

More details on derivative financial instruments are provided in note 18 to the National Grid Electricity Transmission plc Annual Report and Accounts 2006/7.

Valuation and sensitivity analysis

We calculate the fair value of debt and derivative instruments by discounting all future cash flows by the market yield curve at the balance sheet date. The market yield curve for each currency is obtained from external sources for interest and foreign exchange rates. In the case of instruments that include options, the Black's variation of the Black-Scholes model is used to calculate fair value.

The valuation techniques described above for interest rate swaps and currency swaps are a standard market methodology. These techniques do not take account of the credit quality of either party, but this is not considered to be a

significant factor, unless there is a material deterioration in the credit quality of either party.

In relation to swaptions, we only use swaptions for hedging purposes with a European style exercise. As a consequence, the Black's variation of the Black-Scholes model is considered to be sufficiently accurate for the purpose of providing fair value information in relation to these types of swaptions. More sophisticated valuation models exist but we do not believe it is necessary to employ these models, given the extent of our activities in this area.

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

Details of the sensitivity of our income statement and equity to changes in the UK Retail Prices Index and UK interest rates are set out in note 19(d) of the National Grid Electricity plc Annual Report and Accounts 2006/7. Under the assumptions set out in note 19(d) a 0.5% change in the UK Retail Prices Index would affect the income statement by £8 million, but would have no effect on equity, while a 0.5% change in UK interest rates would affect the income statement by £2 million and equity by £3 million.

Commodity contracts

Commodity trading

We have entered into electricity options, pursuant to the requirement to stabilise the electricity market in Great Britain through the operation of the British Electricity Trading and Transmission Arrangements (BETTA). The options are for varying terms and have been entered into so that we have the ability to deliver electricity as required to meet our obligations under our electricity transmission licence. We have not and do not expect to enter into any significant derivatives in connection with our BETTA role.

Commitments and contingencies

Commitments and contingencies relating to the regulated Transmission business outstanding at 31 March 2007 and 2006 are summarised in the table below:

	2007 £m	2006 £m
Future capital expenditure		
contracted but not provided for	497	336
Total operating lease commitments	-	-
Other commitments and contingencies	1	1

Information regarding obligations under pension and other post-retirement benefits is given below under the heading 'Retirement arrangements'.

We propose to meet all of our commitments from operating cash flows, existing credit facilities, future facilities and other financing that we reasonably expect to be able to secure in the future.

Details of material litigation as at 31 March 2007

We were not party to litigation that we considered to be material at 31 March 2007.

Retirement arrangements

The substantial majority of our employees are members of the National Grid Electricity Group of the Electricity Supply Pension Scheme, (the Scheme).

The Scheme is a defined benefit scheme and is closed to new entrants. New employees are offered membership of the defined contribution section of the National Grid UK Pension Scheme, which is operated by Lattice Group plc, a fellow subsidiary of National Grid.

Net pension and other post-retirement obligations

Net allocated pension obligations at 31 March 2007 included in the balance sheet were £482 million compared with £385 million at 31 March 2006.

Further details of total movements in pension obligations may be found on p27 of National Grid Electricity Transmission plc's Annual Report and Accounts 2006/7.

Related party transactions

National Grid Electricity Transmission plc provide services to and receive services from related parties. In the year ended 31 March 2007, the statutory entity charged £5 million and received charges of £14 million from related parties (other than Directors and key managers), compared with £1 million and £15 million respectively in 2005/06.

Further information relating to related party transactions is contained within note 26 to the accounts. Details of key management compensation are included within note 5(c) to the accounts.

Accounting policies**Basis of accounting**

The regulatory accounting statements present our results for the years ended 31 March 2007 and 2006 and our financial position as at 31 March 2007 and 2006. They have been prepared using the accounting policies shown, in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union.

Choices permitted under IFRS

Since 1 April 2005 we have presented our regulatory accounting statements in accordance with IFRS. We were required to make a number of choices on the adoption of IFRS and in addition we continue to choose certain options that are available within accounting standards.

The principal choices made on the adoption of IFRS, which cannot be changed, were as follows:

Option	Choice adopted
Transition date	Our opening IFRS balance sheet was established as at 1 April 2004. We used certain balances in our previous UK GAAP financial statements as the basis for our opening IFRS balance sheet.
Business combinations	Business combinations prior to 1 April 2004 were not changed retrospectively.
Financial instruments	We adopted IAS 39 on 1 April 2005. As a consequence the closing balances at 31 March 2005 are presented using different accounting policies for financial instruments from those used for 2005/06 and 2006/07.
Carrying value of assets at transition	In most cases we used brought forward depreciated cost, as adjusted for changes in accounting policies to conform with IFRS, to be the opening carrying value under IFRS.
Share-based payments	We recognised all active grants retrospectively.
Cumulative translation differences	We chose to present cumulative translation differences arising since 1 April 2004 only.

Significant choices that we continue to make on an ongoing basis include the following:

Option	Choice adopted
Presentation formats	We use the nature of expense method for our income statement and total our balance sheet to net assets and total equity. In the income statement, we present subtotals of total operating profit, profit before tax and profit from continuing operations together with additional subtotals excluding exceptional items and remeasurements. Exceptional items and remeasurements are presented on the face of the income statement.
Pensions	We recognise actuarial gains and losses each year in the statement of recognised income and expense.
Capitalised interest	We capitalise interest into the cost of assets that we construct.
Capital contributions	Contributions received towards capital expenditure are recorded as deferred income and amortised in line with the depreciation on the associated asset.
Financial instruments	We normally opt to apply hedge accounting in most circumstances where this is permitted.

Critical accounting policies

The application of accounting principles requires us to make estimates, judgments and assumptions that may affect the reported amounts of assets, liabilities, revenue and expenses and the disclosure of contingent assets and liabilities in the accounts. On an ongoing basis, we evaluate our estimates using historical experience, consultation with experts and other methods that we consider reasonable in the particular circumstances to ensure compliance with IFRS. Actual results may differ significantly from our estimates, the effect of which is recognised in the period in which the facts that give rise to the revision become known.

Certain accounting policies have been identified as critical accounting policies, as these policies involve particularly

complex or subjective decisions or assessments. The discussion of critical accounting policies below should be read in conjunction with the description of our accounting policies set out in our regulatory accounting statements.

Our critical accounting policies and accounting treatments are considered to be:

Estimated asset economic lives	<p>The reported amounts for amortisation of intangible fixed assets and depreciation of property, plant and equipment can be materially affected by the judgments exercised in determining their estimated economic lives.</p> <p>Intangible asset amortisation and depreciation of property, plant and equipment relating to the regulated businesses amounted to £23 million and £223 million respectively in 2006/07 and £22 million and £242 million respectively in 2005/06.</p>
Carrying value of assets and potential for impairments	<p>The carrying value of assets recorded in the balance sheet could be materially reduced if an impairment were to be assessed as being required. Our total assets at 31 March 2007 were £6,213 million, including £4,772 million of property, plant and equipment and £65 million of other intangible assets.</p> <p>Impairment reviews are carried out when a change in circumstance is identified that indicates an asset might be impaired. An impairment review involves calculating either or both of the fair value or the value-in-use of an asset or group of assets and comparing with the carrying value in the balance sheet. These calculations involve the use of assumptions as to the price that could be obtained for, or the future cash flows that will be generated by, an asset or group of assets, together with an appropriate discount rate to apply to those cash flows.</p>
Revenue accruals	<p>Revenue includes an assessment of transmission services supplied to customers between the date of the last meter reading and the year end. Changes to the estimate of the transmission services supplied during this period would have an impact on our reported results.</p> <p>Our estimates of unbilled revenues relating to the regulated businesses amounted to £99 million at 31 March 2007 compared with £135 million at 31 March 2006.</p>
Assets and liabilities carried at fair value	<p>Certain assets and liabilities, principally financial investments and derivative financial instruments, are carried in the balance sheet at their fair value rather than historical cost.</p> <p>The fair value of financial investments is based on market prices, as are those of derivative financial instruments where market prices exist. Other derivative financial instruments are valued using financial models, which include judgments on, in particular, future movements in exchange and interest rates as well as equity prices.</p>
Hedge accounting	<p>We use derivative financial instruments to hedge certain economic exposures arising from movements in exchange and interest rates or other factors that could affect either the value of our</p>

assets or liabilities or affect our future cash flows.

Movements in the fair values of derivative financial instruments may be accounted for using hedge accounting where we meet the relevant eligibility, documentation and effectiveness testing requirements. If a hedge does not meet the strict criteria for hedge accounting, or where there is ineffectiveness or partial ineffectiveness, then the movements will be recorded in the income statement immediately instead of being recognised in the Statement of Recognised Income and Expense or by being offset by adjustments to the carrying value of debt.

Pensions	<p>Pensions obligations, prior to their allocation across the businesses of National Grid Electricity Transmission, are recorded in the balance sheet are calculated actuarially using a number of assumptions about the future, including inflation, salary increases, length of service and pension and investment returns, together with the use of a discount rate based on corporate bond yields to calculate the present value of the obligation.</p> <p>The selection of these assumptions can have a significant impact on both the pension obligation recorded in the balance sheet and on the net charge recorded in the income statement.</p>
Assets held for sale and discontinued operations	<p>At 31 March 2006, the transfer of French Interconnector assets did not meet the criteria to be classified as assets held for sale. On 14 August 2006, these criteria were met and the assets and liabilities of the business were immediately transferred on that date.</p> <p>The results of these operations are classified as discontinued operations.</p> <p>The determination of the date that the transfer met the criteria to be classified as assets held for sale is a matter of judgment by management, with consequential impact on balance sheet presentation and the amount recorded for depreciation in the results of the discontinued operation.</p>
Exceptional items and remeasurements	<p>Exceptional items and remeasurements are items of income and expenditure that, in the judgment of management, should be disclosed separately on the basis that they are material, either by their nature or their size, to an understanding of our financial performance between periods.</p> <p>Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, material changes in environmental provisions, gains or losses on disposals of businesses or investments. Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments. These fair values increase or decrease as a consequence of changes in financial indices and prices over which we have no control.</p>
Provisions	<p>Provision is made for liabilities that are uncertain in estimates. These include provisions for the cost of environmental restoration and remediation.</p>

Calculations of these provisions are based on estimated cash flows relating to these costs, discounted at an appropriate rate where the impact of discounting is material. The total costs and timing of cash flows relating to environmental liabilities are based on management estimates supported by the use of external consultants.

At 31 March 2007, we have recorded provisions totalling £8 million (2006: £12 million), including £4 million (2006: £8 million) in respect of environmental liabilities.

Tax estimates	Our tax charge is based on the profit for the year for each regulated business and tax rates in effect. The determination of appropriate provisions for taxation requires us to take into account anticipated decisions of tax authorities and estimate our ability to utilise tax benefits through future earnings and tax planning. Our estimates and assumptions may differ from future events.
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In order to illustrate the impact that changes in assumptions could have on our results and financial position, the following sensitivities are presented:

Asset useful economic lives	An increase in the useful economic lives of assets of one year on average would reduce our annual depreciation charge on property, plant and equipment by £7 million and our annual amortisation charge on intangible assets by £3 million.
Revenue accruals	A 10% change in our estimate of unbilled revenues at 31 March 2007 would result in an increase or decrease in our recorded net assets and profit for the year by approximately £7 million net of tax.
Assets carried at fair value	A 10% change in assets and liabilities carried at fair value would result in an increase or decrease in the carrying value of derivative financial instruments of £1 million.
Hedge accounting	If the gains and losses arising on derivative financial instruments during the year ended 31 March 2007 had not achieved hedge accounting then the profit for the year for the Transmission business would have been approximately £33 million lower than that reported net of tax and net assets would have been £37 million lower.
Provisions	A 10% change in the estimates of future cash flows estimated in respect of provisions for liabilities would result in an increase or decrease in net assets of approximately £1 million.

Accounting developments

IFRS accounting standards and interpretations adopted in 2006/07

In preparing our regulatory accounting statements for 2006/07, we have complied with International Financial Reporting Standards, International Accounting Standards and interpretations applicable for periods beginning on or after 1 April 2006. The following amendments to standards and interpretations were adopted during 2006/07, none of which resulted in a material change to results, assets or liabilities in 2006/07 or in those of previous periods.

Leases	International Financial Reporting Interpretations Committee (IFRIC) 4 on leases provides guidance on determining when other forms of contractual arrangements should also be accounted for as leases.
Financial instruments disclosures	IFRS 7 on financial instruments disclosures replaces the disclosure requirements of IAS 32 and provides additional qualitative and quantitative disclosures on the risks arising from financial instruments.
Financial instruments	Amendments to IAS 39, IFRS 4, and IAS 21 allow for financial liabilities to be designated as fair value through profit and loss in certain circumstances, for certain financial guarantees to be recorded in the balance sheet at their fair value and permitted inter-company exchange gains and losses to be taken to equity reserves on consolidation in certain circumstances.
Other interpretations	IFRIC 5, IFRIC 6 and IFRIC 7 contain guidance on accounting for decommissioning, restoration and environmental funds, for waste electrical and electronic equipment and for subsidiaries in hyperinflationary economies.

Forthcoming changes in IFRS

The following accounting standards and interpretations have not yet been adopted, but are expected to be adopted in future periods.

Segment reporting	IFRS 8 on segment reporting changes the requirements for segmental reporting. Assuming that it is adopted by European Union, it will apply with effect from 1 April 2009. If IFRS 8 had been adopted in 2006/07, there would have been no change in business segments reported.
Service concessions	IFRIC 12 on service concessions, effective from 1 April 2008, requires assets operated on behalf of a public authority as a concession, where the asset reverts back to the public authority at the conclusion of the arrangement, to be recognised as a financial or intangible asset, depending on whether income is recovered from the public authority or from users. This is not expected to affect the majority of our assets and liabilities. However, we have not yet completed our assessment of this interpretation, so it is possible that there may be an impact on our assets and liabilities as a consequence of the adoption of this interpretation.
Borrowing costs	An amendment of IAS 23 on borrowing costs will require interest to be capitalised into the cost of assets we construct. We already adopt this policy and so this will have no impact.
Other interpretations	IFRIC 8, IFRIC 9, IFRIC 10 and IFRIC 11 contain guidance on accounting for share-based exchange transactions, embedded derivatives, impairments in half yearly reports and share-based payments. These interpretations are not expected to have a material impact on our results, assets or liabilities.

Corporate Governance Statement

National Grid group corporate governance

As a part of National Grid Group of companies, National Grid Electricity Transmission is subject to corporate governance as detailed in the annual report and accounts of National Grid plc. National Grid's corporate governance policies comply with best practice for a company quoted on the London and New York Stock exchanges.

These corporate governance policies include:

- Published governance policies;
- Independent Non-executive Directors;
- A rigorous succession process for Executive Directors;
- Appropriate training for Directors;
- Monitoring of the performance of the Board;
- Separation of the roles and Chairman and Group Chief Executive;
- Appointment of a Senior Independent Director;
- Clear definition of the roles and responsibilities of the Board, including the establishment of an Executive Committee and a Finance Committee;
- Independent Audit, Nominations, Remuneration, and Risk and Responsibility Committees comprised of Non-executive Directors; and
- A group-wide risk management process.

Directors' Report

Board of Directors

The following information relates to National Grid Electricity Transmission plc as a whole and not just the businesses reported on within these regulatory accounting statements.

Nick Winser (46)

Appointed to the Board of the Company in 2003, as Chief Executive, he is also Executive Director of National Grid plc responsible for transmission. He was previously Chief Operating Officer of the US transmission business of National Grid Transco plc. He 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.

Andy Chapman (50)

Appointed to the Board of the Company in November 2004, as Finance Director, he is also Director of Finance, Transmission, within National Grid plc. Prior to this, he was Financial Controller of National Grid plc, 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 with the Copperbelt Energy Corporation as Finance Director and, subsequently, Chief Executive Officer. He joined the Company in 1992 and is a qualified accountant.

Malcolm Cooper (48)

Appointed to the Board of National Grid Electricity Transmission plc in July 2007, he is also Tax and Treasury Director of National Grid plc. He joined British Gas plc in 1991, having previously worked for Andersen Consulting and was appointed Director of Corporate Finance in October 1998. He is President and a Fellow of the Association of Corporate Treasurers. He is also a Fellow of the Chartered Association of Certified Accountants.

Mark Fairbairn (48)

Appointed to the Board of National Grid Electricity Transmission plc in July 2007, he is also Executive Director of National Grid plc with responsibility for gas distribution. He joined National Grid in 1989 from BNFL. He was awarded an OBE in 2001 for his services to the electrical industry in respect of his leadership of the fundamental changes implemented for the introduction of the New Electricity Trading Arrangements.

Paul Whittaker (47)

Appointed to the Board of National Grid Electricity Transmission plc in July 2007, he is also UK Director of Regulation for National Grid and is responsible for National Grid Electricity Transmission's relationship with Ofgem. He was previously Head of Strategy for National Grid. He joined British Gas in 1981 and has held a number of commercial and regulatory roles since then.

During the year the following directors resigned: Roger Urwin, (December 2006), Steve Holliday (July 2007), Steve Lucas (July 2007)

Alison Kay

Company Secretary

Alison Kay was appointed Company Secretary in October 2002. She is also Company Secretary of National Grid Gas plc.

Other information

The following information relates to National Grid Electricity Transmission plc as a whole and not just the businesses reported on within these regulatory accounting statements.

Principal activities and business review

The principal activities of the company and its subsidiaries during the year were the transmission of electricity and the provision of related services.

The Directors consider that the requirement to produce a business review is fulfilled by the inclusion in these Regulatory Accounts of an Operating and Financial Review (on pages 3 to 29).

Substantial shareholders

National Grid Electricity Transmission plc is a wholly owned subsidiary undertaking of National Grid Holdings Ltd. The ultimate parent company of National Grid Electricity Transmission is National Grid plc.

Directors' remuneration

Details of Directors' remuneration are shown in note 7 National Grid Electricity Transmission plc Annual Report and Accounts 2006/7.

National Grid Electricity Transmission plc does not have a Remuneration Committee, National Grid Electricity Transmission's Directors being remunerated in line with the policy developed by the National Grid plc Remuneration Committee, details of which may be found in that company's annual report and accounts.

Directors' interests

None of the Directors (nor any person connected with them) has a beneficial interest or non-beneficial interest in the share capital of the Company. None of the Directors (nor any person connected with them) holds any interest in any other securities, including options over the Company's shares, of the Company.

Steve Holliday, Steve Lucas and Nick Winser are also Directors of the ultimate parent company, National Grid plc, and details of their interests in the shares of National Grid plc appear in that company's annual report and accounts. The interests of Andy Chapman in the shares of National Grid plc are set out in the Annual Report and Accounts of National Grid Electricity Transmission plc 2006/7.

Share capital

On 22 December 2006, the Company's 43,406,000 preference shares of £1 each were converted into 434,060,000 preference shares of 10p each, which were then converted into 434,060,000 ordinary shares of 10p each.

Dividends

During the year an interim dividend of £120 million in respect of the year to 31 March 2007 was paid. (2006: no dividends were paid).

Donations

Charitable donations of £300,000 were made during the year in support of community initiatives and relationships in the UK (2006: £300,000).

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

Research and development

Expenditure on research and development was £2.6 million during the year (2006: £2.5 million).

Financial Instruments

Details on the use of financial instruments and financial risk management are included on pages 25 and 26.

Disabled persons

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.

Employee involvement

The Company, as part of National Grid plc, has well established and effective arrangements through electronic mail, intranet and in-house publications (including videos and briefing meetings), at each business location, for communication and consultation with both employees and trade union representatives and for communication of the Company's and National Grid's results and significant business issues.

The Company, as part of National Grid plc, recognises the importance of aligning employee and shareholder interests. We are committed to employee share ownership through participation in the National Grid plc All Employee Share Ownership Plan and Sharesave scheme.

Policy and practice on payment of creditors

It is the Company's policy to include in contracts or other agreements, terms of payment with suppliers. Once agreed, the Company aims to abide by these terms of payment.

The average creditor payment period 31 March 2007 was 14 days (15 days at 31 March 2006).

Auditors

PricewaterhouseCoopers LLP have indicated their willingness to be re-appointed auditors of the Group.

Audit information

Having made the requisite enquiries, so far as the Directors in office at the date of the signing of this report are aware, taking into account their periods of office, there is no relevant audit information (as defined by Section 234ZA of the Companies Act 1985) of which the Company's auditors are unaware, and the Directors have taken all the steps they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

On behalf of the Board

Alison Kay
Company Secretary
25 July 2007

National Grid Electricity Transmission plc
Registered Office:
1-3 Strand London WC2N 5EH
Registered in England and Wales No. 2366977

Statement of Directors' Responsibilities for Preparing Regulatory Accounting Statements

The Directors of National Grid Electricity Transmission plc are required by Condition B1 of the Transmission Licence granted under section 6 (1) (b) of the Electricity Act 1989 ("the Transmission Licence") to prepare regulatory accounts for each financial year which give a true and fair view of the assets, liabilities, reserves and provision of, or reasonably attributable to, the transmission business, and of revenues, costs and cash flows of, or reasonably attributable to, the transmission business for the financial year.

The Directors consider that, in preparing the regulatory accounting statements, National Grid Electricity Transmission plc has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgments and estimates and all applicable accounting standards have been followed.

The Directors have responsibility for preparing the regulatory accounting statements on the going concern basis, unless it is inappropriate to presume that National Grid Electricity Transmission plc will continue in business. Therefore, these regulatory accounting statements have been prepared on the going concern basis.

The directors have responsibility for ensuring that National Grid Electricity Transmission plc and its related undertakings keep accounting records in such form that revenues, costs, assets, liabilities, reserves and provisions of, or reasonably attributable to, each of the businesses are separately identifiable in the books of National Grid Electricity Transmission plc and its related undertakings from those of any other business.

The Directors have responsibility for ensuring that the regulatory accounting statements fairly present the financial position, financial performance and cash flow of, or reasonably attributable to, each business.

The Directors have responsibility to ensure that, in so far as is reasonably practicable, the regulatory accounting statements have the same content and format in respect of the business to which they relate as the annual accounts of National Grid Electricity Transmission plc; that they conform to best commercial accounting practices including all relevant accounting standards issued or adopted by the Accounting Standards Board or by the International Accounting Standards Board as the case may be, currently in force that the accounting policies used are stated.

The Directors have responsibility to ensure that the regulatory accounting statements show separately and in appropriate detail the amounts of any revenues, costs, assets, liabilities, reserves or provisions that have been charged from or to any non-National Grid Electricity Transmission business of National Grid, or that have been determined by apportionment, where

they relate to goods or services received or supplied for the purposes of the regulated businesses.

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

The Directors, having prepared the regulatory accounting statements, have required the Auditors to take whatever steps and to undertake whatever inspections they consider to be appropriate for the purpose of enabling them to give their audit report.

The Directors confirm that the Audit Committee of National Grid Electricity Transmission plc continues to review the adequacy of the system of internal financial controls adopted by National Grid Electricity Transmission plc.

The Directors are responsible for ensuring that the regulatory accounting statements are published and where they are published in the Internet, for the maintenance and integrity of the website. Uncertainty regarding legal requirements is compounded, as information published in the Internet is accessible in many countries with different legal requirements relating to the preparation and dissemination of financial statements.

Independent Auditors' Report to the Members of National Grid Electricity Transmission plc

We have audited the Regulatory Accounts of National Grid Electricity Transmission plc ("the Company") on pages 41 to 60 which comprise the profit and loss account, the statement of total recognised income and expense, the balance sheet, the cash flow statement and the related notes to the Regulatory Accounts.

This report is solely made to the Company, on terms that have been agreed, and the Regulator in order to meet the requirements of the Transmission Licence. Our audit work has been undertaken so that we might state to the Company and the Regulator those matters that we have agreed to state to them in our report, in order (a) to assist the Company to meet its obligation under the Transmission Licence to procure such a report and (b) to facilitate the carrying out by the Regulator of its regulatory functions, and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Regulator, for our audit work, for this report or for the opinions we have formed.

Basis of preparation

The Regulatory Accounts have been prepared under the historical cost convention and in accordance with condition B1 of the Company's Transmission Licence and the accounting policies set out in the statement of accounting policies on pages 26 and 36.

The Regulatory Accounts present details only in respect of the Separate Businesses of the Licensee and do not show information in respect of the other business operations of the Licensee.

The Regulatory Accounts are separate from the statutory financial statements of the Company and have not been prepared in accordance with International Financial reporting Standards ("IFRS") and IFRIC interpretations endorsed by the European Union (EU). Financial information other than that prepared in accordance with IFRS does not necessarily represent a true and fair view of the financial performance or financial position of a company as shown in financial statements prepared in accordance with the Companies Act 1985.

Respective responsibilities of the Regulator, the Directors and Auditors

The nature, form and content of Regulatory Accounts are determined by the Regulator. It is not appropriate for us to assess whether the nature of the information being reported upon is suitable or appropriate for the Regulator's purposes. Accordingly we make no such assessment.

The directors' responsibilities for preparing the Regulatory Accounts in accordance with condition B1 of the Transmission Licence are set out in the statement of directors' responsibilities on page 33.

Our responsibility is to audit the Regulatory Accounts in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board, except as stated in the 'Basis of audit opinion' below, and having regard to the guidance

contained in Audit 05/03 'Reporting to Regulators of Regulated Entities'.

We report our opinion as to whether the Regulatory Accounts present fairly, in accordance with condition B1 of the Company's Transmission Licence and the accounting policies set out on pages 26 and 36, the results and financial position of the company. We also report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read the other information contained within the Regulatory Accounts, including any supplementary schedules on which we do not express an audit opinion, and consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the Regulatory Accounts.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board, except as noted below. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Regulatory Accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Regulatory Accounts, and of whether the accounting policies are 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 Regulatory Accounts are free from material mis-statement, whether caused by fraud or other irregularity or error. However, as the nature, form and content of Regulatory Accounts are determined by the Regulator, we did not evaluate the overall adequacy of the presentation of the information, which would have been required if we were to express an audit opinion under Auditing Standards.

Our opinion on the Regulatory Accounts is separate from our opinion on the statutory accounts of the Company on which we reported on [date] which are prepared for a different purpose. Our audit report in relation to the statutory accounts of the Company (our "Statutory" audit) was made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our Statutory audit work was undertaken so that we might state to the Company's members those matters we are required to state to them in a Statutory auditor's report and for no other purpose. In these circumstances, to the fullest extent permitted by law, we do not accept or assume any responsibility to anyone other than the Company and the Company's members as a body, for our Statutory audit work, for our Statutory audit report, or for the opinions we have formed in respect of that Statutory audit.

The Condition requires the Regulatory Accounts to be drawn up on the basis set out therein, including the separate disclosure of amounts charged to or from other businesses of National Grid plc or determined by apportionment. The Directors of National Grid Electricity Transmission plc are responsible for determining the bases of charges and apportionments, which requires a number of judgements and assumptions to be made. We do not give an opinion on the appropriateness of the bases of charges and apportionments.

Unaudited comparatives

We draw your attention to the fact that all 2006 comparatives included in these regulatory accounting statements are unaudited. Our opinion is not qualified in this respect. Further detail is provided in Accounting Policies (a) "Basis of preparation of regulatory accounts" to these Regulatory Accounts.

Opinion

In our opinion the Regulatory Accounts fairly present in accordance with condition B1 of the Company's Transmission Licence, and the accounting policies set out on page 26 and 36, the state of the Separate Businesses' affairs at 31 March 2007 and of their profit and cash flows for the year then ended, and have been properly prepared in accordance with this condition and accounting policies.

PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
Birmingham
27 July 2007

Accounting Policies

for the year ended 31 March 2007

(a) Basis of preparation of regulatory accounts

These regulatory accounting statements have been prepared in accordance with International Financial Reporting Standards (IFRS) adopted by the European Union. They are prepared on the basis of all IFRSs and Interpretations that are mandatory for periods ending 31 March 2007 and in accordance with applicable United Kingdom law and Article 4 of the IAS regulation. The 2006 comparative financial information has also been prepared on this basis, with the exception of certain standards, details of which are given below, for which comparative information has not been restated.

The regulatory accounting statements have been prepared on an historical cost basis, except for the revaluation of certain financial instruments from 1 April 2005 onwards, the date of adoption of IAS 32 'Financial Instruments: Presentation and Disclosure' and IAS 39 'Financial Instruments: Recognition and Measurement'.

These regulatory accounting statements are presented in pounds sterling.

The licence under which these regulatory accounting statements are prepared was issued in April 2007 and these are the first regulatory accounting statements that fully reflect the requirements of the condition contained in that licence in addition to further requirements requested by the Regulator. The presentation of financial information in these regulatory accounting statements is significantly different to that in the regulatory accounting statements for the year ended 31 March 2006. Comparative information included within these regulatory accounting statements has been restated and presented in accordance with the requirements of the current condition and the Regulator, but has not been audited.

The preparation of financial statements 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.

Attribution of revenue, costs, asset, liabilities and equity

Not specified in the licence, but however requested by the Regulator, is the requirement to apportion previously centrally held balances across the identifiable businesses of National Grid Electricity Transmission plc. These regulatory accounting statements reflect that request. Comparative information for 2006 has been restated using these new principles, but has not been audited. Those centrally held balances and the method of apportionment is as follows:

Balance	Method of apportionment
Net debt (borrowings, derivatives, bank overdrafts net of cash, cash equivalents and financial investments).	Fixed asset net book value at balance sheet date.
Interest payable and receivable relating to net debt.	Fixed asset net book value at balance sheet date.
Intercompany balances.	Fixed asset net book value at balance sheet date.
Interest payable and receivable relating to intercompany balances	Fixed asset net book value at balance sheet date.
Deferred tax liabilities.	Fixed asset net book value at balance sheet date.
Retirement benefit obligations	According to the Licencee's final proposals.
Taxation charge and corporate tax payable	Calculation to be specific to each business
Total equity (called up share capital, share premium account, retained profits and other reserves).	Balancing item.

(b) Foreign currencies

Transactions in currencies other than the functional currency of the Company or subsidiary concerned are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at closing exchange rates. Other non-monetary assets are not retranslated unless they are carried at fair value.

As set out in note (m) below, as permitted by IFRS 1, prior to 1 April 2005 the Company adopted the prevailing UK GAAP for hedge accounting in its regulatory accounting statements and, consequently, monetary assets and liabilities denominated in foreign currencies were translated at hedged rates instead of closing exchange rates.

Gains and losses arising on retranslation of monetary assets and liabilities are included in the income statement.

(c) Intangible assets other than goodwill

Identifiable intangible assets other than goodwill are recorded at cost less accumulated amortisation and any provision for impairment.

Internally generated intangible fixed assets, such as software, are recognised only if an asset is created that can be identified; it is probable that the asset created will generate future economic benefits; and that the development cost of the asset can be measured reliably. Where no internally generated

intangible asset can be recognised, development expenditure is recorded as an expense in the period in which it is incurred.

Intangible assets other than goodwill are amortised on a straight-line basis over their estimated useful economic lives. The principal amortisation periods for categories of intangible assets are:

Amortisation periods	Years
Software	3 to 5

(d) Property, plant and equipment

Property, plant and equipment is recorded at cost or deemed cost at the date of transition to IFRS, less accumulated depreciation and any impairment losses.

Cost includes payroll and finance costs incurred which are directly attributable to the construction of property, plant and equipment.

Property, plant and equipment includes assets in which National Grid Electricity Transmission's interest comprises legally protected statutory or contractual rights of use.

Additions represent the purchase or construction of new assets, including capital expenditure for safety and environmental assets, and extensions to, enhancements to, or replacement of existing assets.

Contributions received towards the cost of property, plant and equipment are included in payables as deferred income and credited on a straight-line basis to the income statement over the estimated economic useful lives of the assets to which they relate.

Depreciation is not provided on freehold land or assets in the course of construction.

Other property, plant and equipment are depreciated 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 relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of property, plant and equipment are, in general, as shown below:

Depreciation periods	Years
Freehold and leasehold buildings	up to 40
Plant and machinery	
– towers	40 to 60
– Substation plant, overhead lines and cables	40 to 50
– Protection, control and communications equipment	15 to 25
Motor vehicles and office equipment	up to 5

(e) Impairment of assets

Impairments of assets are calculated as the difference between the carrying value of the asset and its recoverable amount, if lower. Where such an asset does not generate cash flows that

are independent from other assets, the recoverable amount of the cash-generating unit to which that asset belongs is estimated.

Recoverable amount is defined as the higher of fair value less costs to sell and estimated value in use at the date the impairment review is undertaken.

Value in use represents the present value of expected future cash flows, discounted using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

Tests for impairment are carried out only if there is some indication that the carrying value of the assets may have been impaired.

Impairments are recognised in the income statement and, where material, are disclosed separately.

(f) Taxation

Current tax

Current tax asset and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the balance sheet date.

Deferred tax and investment tax credits

Deferred tax is provided using the balance sheet liability method and is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit.

Deferred tax liabilities are generally recognised on all taxable temporary differences and deferred tax assets are recognised to the extent that is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition (other than a business combination) of assets and liabilities in a transaction that affects neither the accounting profits nor the taxable profits.

Deferred tax liabilities are recognised on taxable temporary differences arising on investments in subsidiaries except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on the tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date. Deferred tax is charged or credited to the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the deferred income tax asset to be recovered. Unrecognised deferred tax assets are reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable profit will allow the deferred tax assets to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right exists to set off current tax assets against current tax liabilities, when they relate to income taxes levied by the same taxation authority and it is intended to settle current tax asset and liabilities on a net basis.

Investment tax credits are amortised over the economic life of the asset which gives rise to the credits.

(g) Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs, as well as those overheads that have been incurred in bringing the inventories to their present location and condition.

(h) Environmental costs

Provision is made for environmental costs, based on future estimated expenditures, on an undiscounted basis.

(i) Revenue

Revenues primarily represent the sales value derived from the transmission of electricity and the provision of related services to customers during the year and excludes value added tax and intra-group sales.

Revenue includes an assessment of transmission services supplied to customers between the date of the last meter reading and the year end.

Where revenues received or receivable exceed the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, no liability is recognised. Similarly, no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

(j) Pensions

For defined benefit retirement schemes, the cost of providing benefits is determined using the projected unit method, with actuarial valuations being carried out at each balance sheet date.

Current service cost is recognised in operating costs in the period in which the defined benefit obligation increases as a result of employee services.

Actuarial gains and losses are recognised in full in the period in which they occur in the Statement of Recognised Income and Expense.

Past service costs are recognised immediately to the extent that benefits are already vested. Otherwise such costs are

amortised on a straight-line basis over the period until the benefits vest.

Settlements are recognised when a transaction is entered into that eliminates all further legal or constructive obligations for benefits under a scheme.

Curtailements are recognised when a commitment is made to material reduction in the number of employees covered by a scheme.

The retirement benefit obligations recognised in the balance sheet represent the present value of the defined benefit obligations, as reduced by the fair value of scheme assets and any unrecognised past service cost.

The expected return on scheme assets and the unwinding of the discount on defined benefit obligations are recognised within interest income and expense respectively.

(k) Leases

Rentals under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

(l) Financial instruments

Financial assets, liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into.

An equity instrument is any contract that evidences a residual interest in the consolidated assets of the Company after deducting all of its liabilities and is recorded at the proceeds received, net of direct issue costs.

Trade receivables are initially recognised at fair value and subsequently measured at amortised cost, less any appropriate allowances for estimated irrecoverable amounts. A provision is established for irrecoverable amounts when there is objective evidence that amounts due under the original payment terms will not be collected. Indications that the trade receivable may become irrecoverable would include financial difficulties of the debtor, likelihood of the debtor's insolvency, and default or significant failure of payment.

Loans receivable and other receivables are carried at amortised cost using the effective interest rate method. Interest income, together with gains and losses when the loans and receivables are derecognised or impaired, are recognised in the income statement.

Other financial investments are initially measured at cost including transaction costs, but with effect from 1 April 2005, are subsequently carried at fair value. Changes in the fair value of investments classified at fair value through profit and loss are included in the income statement, while changes in the fair value of investments classified as available-for-sale are recognised directly in equity, until the investment is disposed of or is determined to be impaired. At this time, the cumulative gain or loss previously recognised in equity is included in the net profit or loss for the period. Investment income on investments classified at fair value through profit and loss and

on available-for-sale investments is recognised in the income statement as it accrues.

Interest-bearing loans and overdrafts are recorded at their initial fair value which normally reflects the proceeds received, net of direct issue costs, and subsequently stated at amortised cost, inclusive of accrued interest. Any difference between the proceeds after direct issue costs and the redemption value is recognised in the income statement over the life of the borrowing.

Finance charges, including premiums payable on settlement or redemption and direct issue costs, are accounted for on an accruals basis using the effective interest rate method.

With effect from 1 April 2005, derivative financial instruments are recognised initially at fair value, and are subsequently also measured at fair value. Changes in the fair value of derivative financial instruments are included in the income statement to the extent hedge accounting is not applied.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value and which are quoted in active markets, are based on bid prices for assets held and offer prices for issued liabilities. When independent prices are not available, fair values are determined by using valuation techniques which refer to observable market data. These include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets (being assets that necessarily take a substantial period of time to get ready for their intended use) are added to their cost. Such additions cease when the assets are substantially ready for their intended use. All other borrowing costs are recognised in the income statement in the period in which they are incurred.

Purchases and sales of financial assets are usually recognised on the trade date, being the date of commitment to purchase or sell the assets.

(m) Hedge accounting and derivative financial instruments

Both derivative financial instruments ('derivatives') and non-derivative financial instruments are entered into in order to manage interest rate and foreign currency exposures. The principal derivatives used include interest rate swaps, forward rate agreements, currency swaps, forward foreign currency contracts and interest rate swaptions.

All derivative transactions are undertaken, or maintained, with a view to managing the interest and currency risks associated with underlying business activities and the financing of those activities.

From 1 April 2005, the accounting policy for hedge accounting is as described below.

Changes in the carrying value of financial instruments that are designated and effective as hedges of future cash flows (cash

flow hedges) are recognised directly in equity and any ineffective portion is recognised immediately in the income statement. Amounts deferred in equity in respect of cash flow hedges are subsequently recognised in the income statement in the same period in which the hedged item affects net profit or loss. Where a non-financial asset or a non-financial liability results from a forecasted transaction or firm commitment being hedged, the amounts deferred in equity are included in the initial measurement of that non-monetary asset or liability.

Changes in the carrying value of financial instruments that are designated as hedges of the changes in the fair value of assets or liabilities (fair value hedges) are recognised in the income statement. An offsetting amount is recorded as an adjustment to the carrying value of the hedged items, with a corresponding entry in the income statement, to the extent that the adjustment to the carrying value is attributable to the risk being hedged and that the fair value hedge is effective.

Changes in the fair value of derivatives that do not qualify for hedge accounting are recognised in the income statement as they arise, within finance costs.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gains or losses relating to cash flow hedges recognised in equity are initially retained in equity and subsequently recognised in the income statement, in the same periods in which the previously hedged item affects net profit or loss. For fair value hedges, the cumulative adjustment recorded to the carrying value of the hedged item at the date hedge accounting is discontinued, is amortised to the income statement using the effective interest method.

If a hedged forecast transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement immediately.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of their host contracts.

Prior to 1 April 2005 and the adoption of IAS 32 and IAS 39, derivatives used for hedging purposes were not recorded on the balance sheet as assets or liabilities. Monetary assets and liabilities in foreign currencies were retranslated at hedged rates instead of closing rates. Exchange gains and losses relating to the hedge of the net investment in overseas subsidiaries were recorded directly in equity.

(n) Share-based payments

National Grid issues equity-settled share-based payments to certain employees of the Company and its subsidiaries. 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, based on an estimate of shares that will eventually vest, is recognised on a straight-line basis over the vesting period, as an operating cost and an increase in equity. Payments made by the Company to National

Grid in respect of share-based payments are recognised as a reduction in equity.

(o) Business performance, exceptional items and remeasurements

Our financial performance is analysed into two components: business performance, which excludes exceptional items and remeasurements; and exceptional items and remeasurements. Exceptional items and remeasurements are excluded from the measures of business performance used by management to monitor financial performance, as they are considered to distort the comparability of our reported financial performance from year to year. Business performance measures presented on the face of the income statement or in the notes to the accounts include operating profit before exceptional items and remeasurements, profit before tax before exceptional items and remeasurements and profit for the year before exceptional items and remeasurements.

Exceptional items and remeasurements are items of income and expenditure that, in the judgment of management, should be disclosed separately on the basis that they are material, either by their nature or their size, to an understanding of our financial performance between periods. Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, material changes in environmental provisions and gains or losses on disposals of businesses or investments.

Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments to the extent that hedge accounting is not achieved or is not effective.

(p) Restructuring costs

Costs arising from restructuring programmes primarily relate to redundancy costs. Redundancy costs are charged to the income statement in the year in which an irrevocable commitment is made to incur the costs and the main features of the restructuring plan have been announced to affected employees.

(q) Cash and cash equivalents

Cash and cash equivalents include cash held at bank and in hand, together with short-term highly liquid investments with an original maturity of less than three months that are readily

convertible to known amounts of cash and subject to an insignificant change in value.

(r) Key sources of estimation uncertainty

The preparation of financial statements 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. Information about such judgements and estimation is contained in the accounting policies and/or the notes to the accounts, and the key areas are summarised below.

Areas of judgement that have the most significant effect on the amounts recognised in the financial statements:

- The categorisation of certain items as exceptional and the definition of adjusted earnings – note 4.
- The exemptions adopted under IFRS including, in particular, those relating to business combinations – Accounting policies (a) Basis of preparation of regulatory accounting statements.

Key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

- Review of residual lives, carrying values and impairment charges for other intangible assets and property, plant and equipment – Accounting policies (c) Intangible assets other than goodwill, (d) Property, plant and equipment and (e) Impairment of assets.
- Estimation of liabilities for pensions – note 7.
- Valuation of financial instruments and derivatives – note 14.
- Revenue recognition and assessment of unbilled revenue – Accounting policies (i) Revenue.
- Recoverability of deferred tax assets – Accounting policies (f) Taxation and note 12.
- Environmental liabilities – note 21.
- Hedge accounting and derivative financial instruments – Accounting Policies (m) Hedge accounting and derivative financial instruments.

Income Statements

for the years ended 31 March

	Notes	Transmission		Discontinued operations (i) Interconnectors	
		2007	2006 unaudited	2007	2006 unaudited (ii)
		£m	£m	£m	£m
Revenue		1,991	1,869	27	77
Operating costs	2	(1,433)	(1,386)	(4)	(14)
Operating profit					
- Before exceptional items and remeasurements		564	483	23	63
- Exceptional items and remeasurements	4	(6)	-	-	-
Total operating profit		558	483	23	63
Interest income and similar income	8	120	102	-	1
Interest expense and other finance costs					
- Before exceptional items and remeasurements	8	(256)	(241)	(1)	(4)
- Exceptional items and remeasurements		(9)	1	-	-
Interest expense and other finance costs		(265)	(240)	(1)	(4)
Profit before taxation					
- Before exceptional items and remeasurements		428	344	22	60
- Exceptional items and remeasurements	4	(15)	1	-	-
Total profit before taxation		413	345	22	60
Taxation					
- Before exceptional items and remeasurements		(128)	(101)	(7)	(19)
- Exceptional items and remeasurements	4	2	-	-	-
Total taxation	9	(126)	(101)	(7)	(19)
Gain on disposal of discontinued operations		-	-	33	-
Profit for the year after taxation					
- Before exceptional items and remeasurements		300	243	15	41
- Exceptional items and remeasurements	4	(13)	1	33	-
Profit after taxation for the year		287	244	48	41

Statements of Recognised Income and Expense

for the years ended 31 March

		Transmission		Discontinued operations Interconnectors	
		2007	2006 unaudited	2007	2006 unaudited
		£m	£m	£m	£m
Actuarial (losses)/gains		(92)	42	-	-
Net gains taken to equity in respect of cash flow hedges		1	-	-	-
Tax on items taken directly to or transferred from equity	9	28	(12)	2	(1)
Net (expense)/income recognised directly in equity	24	(63)	30	2	(1)
Profit for the year	24	287	244	48	41
Total income and expense for the year		224	274	50	40
Effect of change in accounting policy - IAS 39		-	(3)	-	-

(i) On 14 August 2006, the company disposed of its interconnectors business.

(ii) Prior year balances have been restated, consistent with the 2006/7 approach of allocating corporate balances.

The notes on pages 44 to 60 form part of the financial statements

Balance Sheets

at 31 March

	Notes	Transmission		Discontinued operations Interconnectors	
		2007	2006	2007	2006
		£m	unaudited £m	£m	unaudited (i) £m
Non-current assets					
Intangible assets	10	65	76	-	-
Property, plant and equipment	11	4,772	4,401	-	96
Other receivables	13	-	-	-	1
Derivative financial assets	14	3	23	-	-
Total non-current assets		4,840	4,500	-	97
Current assets					
Inventories	15	16	14	-	-
Trade and other receivables	16	518	451	-	14
Financial investments	17	376	-	-	-
Derivative financial assets	14	2	15	-	-
Cash and cash equivalents	18	461	15	-	6
Total current assets		1,373	495	-	20
Total assets		6,213	4,995	-	117
Current liabilities					
Bank overdrafts	18	(26)	(15)	-	-
Borrowings	19	(236)	(237)	-	(5)
Derivative financial liabilities	14	(4)	(8)	-	-
Trade and other payables	20	(845)	(727)	-	(24)
Provisions	21	(2)	(2)	-	-
Total current liabilities		(1,113)	(989)	-	(29)
Non-current liabilities					
Borrowings	19	(3,476)	(2,675)	-	(58)
Derivative financial liabilities	12	(36)	(10)	-	-
Other non-current liabilities	22	(130)	(145)	-	-
Deferred tax liabilities	12	(644)	(682)	-	(15)
Retirement benefit obligations	7	(482)	(385)	-	-
Provisions	21	(6)	(10)	-	-
Total non-current liabilities		(4,774)	(3,907)	-	(73)
Total liabilities		(5,887)	(4,896)	-	(102)
Net assets		326	99	-	15
Total shareholders' equity	24	326	99	-	15

(i) Prior year balances have been restated, consistent with the 2006/7 approach of allocating corporate balances.

These financial statements comprising the Income Statement, Statement of Recognised Income and Expense, Balance Sheet, Cash Flow Statement and the related notes 1 to 27, were approved by the Board of Directors on 25 July 2007 and were signed on its behalf by:

N Winsor Director

M Cooper Director

Cash Flow Statement

for the years ended 31 March

	Notes	Transmission		Discontinued operations Interconnectors	
		2007 £m	2006 unaudited £m	2007 £m	2006 unaudited £m
Cash flows from operating activities					
Total operating profit		558	483	-	-
Adjustments for:					
Depreciation and amortisation	2	245	259	-	-
Share-based payment charge		4	-	-	-
Changes in working capital		(25)	-	-	-
Changes in provisions		(4)	(4)	-	-
Changes in post-retirement benefit obligations		5	3	-	-
Cash flows generated from continuing operations		783	741	-	-
Cash flows generated from discontinued operations		-	-	14	81
Cash generated from operations		783	741	14	81
Tax paid - continuing operations		(146)	(237)	-	-
Tax paid - discontinued operations		-	-	-	(40)
Net cash from operating activities		637	504	14	41
Cash flows from investing activities					
Purchases of intangible assets		(12)	(2)	-	-
Purchases of property, plant and equipment		(492)	(470)	-	-
Cash flows used in continuing operations investing activities		(504)	(472)	-	-
Cash flows generated from discontinued operations - disposal proceeds		-	-	128	-
Net cash inflow (used in)/from investing activities		(504)	(472)	128	-
Cash flows from financing activities					
New borrowings from Group undertakings		194	-	-	-
New financial investments in Group undertakings		(376)	-	-	-
(Decrease)/Increase in amounts due to Group undertakings		(13)	77	-	-
Increase/(decrease) in borrowings		554	(144)	-	-
Interest received		40	30	-	-
Interest paid		(160)	(162)	-	-
Cash flows used in continuing operations financing activities		239	(199)	-	-
Cash flows relating to discontinued operations		-	-	-	38
Net cash used in financing activities		239	(199)	-	38
Net increase/(decrease) in cash and cash equivalents		372	(167)	142	79
Transfers		55	166	(148)	(74)
Net increase/(decrease) in cash and cash equivalents		427	(1)	(6)	5
Cash and cash equivalents at start of year (i)		-	1	6	1
Transfers		8	-	-	-
Cash and cash equivalents at start of year (i)		8	1	6	1
Cash and cash equivalents at end of year (i)	18	435	-	-	6

(i) Net of bank overdrafts

Notes to the Accounts

1. Adoption of new accounting standards

In preparing these consolidated financial statements, the Company has complied with all IFRSs applicable for periods beginning on or after 1 January 2006.

New IFRS accounting standards and interpretations adopted in 2006/07

International Financial Reporting Interpretations Committee (IFRIC) 4 'Determining whether an arrangement contains a lease' provides guidance on determining whether arrangements which convey the right to use an asset in return for a series of payments should be accounted for in accordance with IAS17 'Leases'

IFRIC 5 'Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds' addresses the issues of how a contributor to such a fund should account for its interest in the fund and how obligations to make additional contributions should be accounted for.

IFRIC 6 'Liabilities arising from participating in a specific market – Waste electrical and electronic equipment' relates to the European Union's Directive on waste electrical and electronic equipment, which deals with the responsibility of producers for the backlog of waste for goods sold to private households.

IFRIC 7 'Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies' deals with what is meant by the phrase 'measuring unit current at the balance sheet date' and also with how an entity accounts for opening deferred tax items in its restated financial statements.

Amendment to IAS 39 'Financial Instruments: Recognition and Measurement: The Fair Value Option' restricts the ability of entities to designate financial assets and liabilities as at fair value through profit or loss to those financial instruments that meet certain specified conditions.

Amendment to IAS 39 'Financial Instruments: Recognition and Measurement', and IFRS 4 'Insurance Contracts: Financial Guarantee Contracts' define a financial guarantee contract and specify which accounting standard will apply to such contracts. Generally, financial guarantee contracts are within the scope of IAS39. However, where the issuer of a financial guarantee contracts previously asserted that it regards such contracts as insurance contracts, then they may elect to apply either IAS39 or IFRS4 to those contracts. The Company accounts for such contracts as insurance contracts.

Amendment to IAS 21 'The Effects of Changes in Foreign Exchange Rates' clarifies the requirements of IAS 21 regarding an entity's investment in foreign operations and, in particular, the treatment of monetary items entered into as net investment hedges.

New IFRS accounting standards and interpretations not yet adopted

IFRIC 8 'Scope of IFRS 2' addresses the issue of whether IFRS 2 'Share Based Payment' applies to transactions in which the entity cannot identify specifically some or all of the goods or services received. Implementation of this Interpretation is not expected to have a material impact on consolidated results or assets and liabilities.

IFRIC 9 'Reassessment of Embedded Derivatives' prohibits reassessment of the treatment of embedded derivatives subsequent to initial recognition unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contracts, in which case reassessment is required.

IFRIC 19 'Interim financial reporting and impairment' states that any impairment losses on goodwill and certain financial assets recognised in an interim financial statement may not be reversed in subsequent interim or annual financial statements.

IFRIC 11, 'IFRS 2 – Group and treasury share transactions' provides guidance on whether share-based transactions involving treasury shares or involving subsidiary undertakings (for instance, options over a parent's shares) should be accounted for as equity-settled or cash-settled share-based payment transactions.

New IFRS accounting standards and interpretations not yet endorsed by the EU

IFRS 8 'Operating segments' sets out the requirements for the disclosure of information about an entity's operating segments and about the entity's products and services, the geographical areas in which it operates and its major customers. IFRS 8 achieves convergence with the US accounting standard, FAS131 'Disclosures about Segments of an Enterprise and Related Information' with minor differences. It has not yet been determined whether if this standard had been implemented in the year ended 31 March 2007, it would have had a material impact on results or the presentation of those results.

Amendment to IAS 23 'Borrowing costs' removes the option of immediately recognising as an expense borrowing costs that relate to assets that take a substantial period of time to get ready for use or sale. Implementation of this amendment is not expected to have any impact on results or assets and liabilities as the Group's accounting policy is to capitalise borrowing costs.

IFRIC 12, 'Service concession arrangements' applies to contractual arrangements whereby a private sector operator participates in the development, financing, operation and maintenance of infrastructure for public sector services, for example, under private finance initiative contracts (PFI) contracts. The impact of this interpretation on results or assets and liabilities has not yet been assessed.

Notes to the Accounts

2. Operating costs

	Transmission		Discontinued operations	
	2006	2006 unaudited	Interconnectors	
			2007	2006 unaudited
	£m	£m	£m	£m
Depreciation of property, plant and equipment	222	237	1	5
Amortisation of intangible assets	23	22	-	-
Payroll costs (note 5)	89	78	-	-
Other operating charges:				
- Rates	95	93	-	-
- Balancing Services Incentive Scheme direct costs	551	537	-	-
- Payments to Scottish network owners under BETTA	280	259	-	-
- Other non-exceptional operating charges	173	160	3	9
	1,433	1,386	4	14
Operating costs include:				
Consumption of inventories	4	4	-	-
Research expenditure	3	2	-	-

3. Auditor's remuneration

Auditor's remuneration for the regulatory accounting statements of National Grid Electricity Transmission plc was as follows:

	2007	2006
	£'m	£'m
	0.1	0.1

4. Exceptional items and remeasurements

Exceptional items and remeasurements are items of income and expenditure that, in the judgment of management, should be disclosed separately on the basis that they are material, either by their nature or their size, to an understanding of our financial performance and significantly distort the comparability of financial performance between periods. Items of income or expense that are considered by management for designation as exceptional items include such items as significant restructurings, write-downs or impairments of non-current assets, material changes in environmental provisions, and gains or losses on disposals of businesses or investments. Remeasurements comprise gains or losses recorded in the income statement arising from changes in the fair value of derivative financial instruments to the extent that hedge accounting is not achieved or is not effective.

	Transmission		Discontinued operations	
	2007	2006 unaudited	Interconnectors	
			2007	2006 unaudited
	£m	£m	£m	£m
Exceptional items included within operating profit (i)	(6)	-	-	-
Exceptional items included within finance costs	(8)	(2)	-	-
Remeasurements - net gains on financial instruments included within finance costs (ii)	(1)	3	-	-
Total exceptionals items and remeasurements before taxation	(15)	1	-	-
Tax credit on loss on repurchase of debt	2	1	-	-
Tax on financial instrument remeasurements (iii)	-	(1)	-	-
Tax on exceptional items and remeasurements	2	-	-	-
Gain on disposal of discontinued operations	-	-	33	-
Total exceptionals items and remeasurements	(13)	1	33	-

(i) Restructuring costs to planned cost reduction programmes.

(ii) Exceptional finance costs for the year ended 31 March 2007 represent debt redemption costs related to the restructuring of our debt portfolio.

(iii) Remeasurements - net gains on derivative financial instruments comprise non-cash gains and losses arising from derivative financial instruments reported in the income statements. These exclude gains and losses for which hedge accounting has been effective, which have been recognised directly in equity or offset by adjustments to the carrying value of debt.

Notes to the Accounts

5. Payroll costs

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Wages and salaries	86	82	-	-
Social security costs	9	9	-	-
Other pension costs	17	13	-	-
Share based payments	4	2	-	-
Severance costs	4	-	-	-
Gross payroll costs	120	106	-	-
Less: amounts capitalised	(31)	(28)	-	-
Net payroll costs	89	78	-	-

b) Average number of employees

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	United Kingdom	2,073	2,098	4

Information is not available on the actual number of employees by regulatory business, as many of National Grid Electricity Transmission's activities are undertaken on a centralised or shared services basis. Therefore, employee numbers relating to Transmission have been apportioned between the different businesses relative to wages and salaries.

c) Key management compensation

Key management compensation has been apportioned between the different businesses relative to wages and salaries.

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Salaries and short-term employee benefits	2	1	-	-
Post-employment benefits	1	1	-	-
Share-based payments	1	-	-	-
	4	2	-	-

The key management is defined as the Board of Directors of National Grid Electricity Transmission plc. Amounts attributable to the regulated businesses have been apportioned based on reported profits.

6. Directors' emoluments

The businesses reported in these regulatory accounting statements are not entities with statutory Directors. Accordingly, there are no relevant Directors' emoluments. Details of the emoluments of the Directors of National Grid Electricity Transmission plc are provided in the Annual Report and Accounts 2006/7.

Notes to the Accounts

7. Retirement benefit obligations

Substantially all of the businesses employees are members of the Electricity Supply Pension Scheme which is a defined benefit 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. The Group's section of the scheme was closed to new entrants on 1 April 2006. It is subject to independent valuations at least every three years, on the basis of which the qualified actuary certifies the rate of employers' contributions, which, together with the specified contributions payable by the employees and proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme.

The latest actuarial valuation was carried out by Hewitt Bacon and Woodrow at 31 March 2004. The projected unit method was used and the principal actuarial assumptions adopted were that the annual rate of inflation would be 2.9% and that future real increases in pensionable earnings would be 1.0%. Investments held in respect of pensions before they became payable would average 3.8% real annual rate of return and investments held in respect of pensions after they became payable would average 2.8% real annual rate of return and that pensions would increase at a real annual rate of 0.1%. The aggregate market value of the scheme's assets was £1,110m and the value of the assets represented approximately 80.4% of the actuarial value of benefits due to members calculated on the basis of pensionable earnings and service at 31 March 2004 on an ongoing basis and allowing for projected increases in pensionable earnings. The results of the actuarial valuation carried out at 31 March 2004 showed that, 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. The actuarial valuation 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 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 National Grid Electricity Transmission plc, a Group undertaking, becoming insolvent or the Group failing to make payments into the fund.

For disclosures relating to the scheme refer to the National Grid Electricity Transmission plc Annual Report and Accounts 2006/7.

Notes to the Accounts

8. Finance income and costs

	Transmission		Discontinued operations	
	2007	2006	Interconnectors	
	£m	2006 unaudited £m	2007	2006 unaudited £m
Pensions - expected return on scheme assets	83	75	-	-
Interest income on financial instruments	37	27	-	1
Interest income and similar income	120	102	-	1
Pensions - interest on scheme liabilities	(82)	(83)	-	-
Interest expense on financial liabilities held at amortised cost	(190)	(191)	(1)	(4)
Exceptional debt redemption costs	(8)	(2)	-	-
Interest on derivatives	(16)	-	-	-
Less: interest capitalised	32	33	-	-
Interest expense	(264)	(243)	(1)	(4)
Net (losses)/gains:				
On derivatives designated as fair value hedges	(1)	6	-	-
On derivatives not designated as hedges or ineligible for hedge accounting	-	(3)	-	-
Net (losses)/gains on derivative financial instruments	(1)	3	-	-
Interest expense and other finance costs	(265)	(240)	(1)	(4)
Net finance costs	(145)	(138)	(1)	(3)
Comprising:				
Interest income and similar income	120	102	-	1
Interest expense and other finance costs				
Before exceptional items and remeasurements	(256)	(241)	(1)	(4)
Exceptional items and remeasurements	(9)	1	-	-
	(145)	(138)	(1)	(3)

Interest on the funding attributable to assets in the course of construction was capitalised during the year at a rate of 5.5% (2006: 5.8%).

Derivative net losses on fair value hedges includes a net loss on the hedging instruments of £36m (2006: £17m), offset by a net loss of £37m (2006: £11m) from the fair value adjustments to the carrying value of debt.

Notes to the Accounts

9. Taxation

Taxation on items charged / (credited) to the income statement

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
United Kingdom				
Corporation tax at 30%	132	149	8	24
Adjustments in respect of prior years (i)	(14)	(25)	(1)	(4)
Deferred tax (ii)	8	(23)	-	(1)
Taxation	126	101	7	19
Comprising:				
Taxation - excluding exceptional items and remeasurements	128	101	7	19
Taxation - exceptional items and remeasurements (note 4)	(2)	-	-	-
	126	101	7	19

(i) The corporate tax adjustment in respect of prior years does not include any adjustments relating to exceptional items.

(ii) Deferred tax includes an exceptional tax credit of £2m (2006: £nil).

Taxation on items charged / (credited) to the equity

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Deferred tax credit on revaluation of cash flow hedges	(2)	-	-	-
Deferred tax (credit)/charge on actuarial gains/losses	(26)	12	(2)	1
Tax on items recognised in statement of recognised income and expense	(28)	12	(2)	1
Deferred tax credit on employee share schemes recognised directly in equity (note 24)	(5)	(3)	-	-
Deferred tax (credit)/charge to equity for the year	(33)	9	(2)	1

Notes to the Accounts

10. Intangible assets

	Transmission	Discontinued operations Interconnectors
Software	£m	£m
Cost at 1 April 2005	131	-
Additions	2	-
Cost at 31 March 2006	133	-
Additions	12	-
Cost at 31 March 2007	145	-
Amortisation at 1 April 2005	35	-
Charge for the year	22	-
Amortisation at 31 March 2006	57	-
Charge for the year	23	-
Amortisation at 31 March 2007	80	-
Net book value at 31 March 2007	65	-
Net book value at 31 March 2006	76	-

Notes to the Accounts

11. Property, plant and equipment

	Transmission		Discontinued operations	
	£m		Interconnectors	
			£m	
Cost at 1 April 2005	6,279		392	
Additions	528		-	
Disposals	(34)		(1)	
Transfers	29		(29)	
Cost at 31 March 2006	6,802		362	
Additions	592		-	
Disposals	(29)		(362)	
Cost at 31 March 2007	7,365		-	
Depreciation at 1 April 2005	2,189		270	
Charge for the year	237		5	
Disposals	(33)		(1)	
Transfers	8		(8)	
Depreciation at 31 March 2006	2,401		266	
Charge for the year	222		1	
Disposals	(30)		(267)	
Depreciation at 31 March 2007	2,593		-	
Net book value at 31 March 2007	4,772		-	
Net book value at 31 March 2006	4,401		96	

	Transmission		Discontinued operations	
	2007	2006	2007	2006
	£m	£m	£m	£m
The net book value of land and buildings comprised:				
Freehold	96	80	-	7
Long leasehold (over 50 years)	3	3	-	-
Short leasehold (under 50 years)	6	6	-	-
	105	89	-	7

Transmission's cost of property, plant and equipment (net of disposals) at 31 March 2007 included £466m (2006:£434m) relating to interest capitalised. No amounts are capitalised within Interconnectors.

Included within Transmission's trade and other payables and other non-current liabilities at 31 March 2007 are contributions to the cost of property, plant and equipment amounting to £2m (2006: £4m) and £124m (2006: £111m respectively). There are no amounts relating to contributions within Interconnectors.

Notes to the Accounts

12. Deferred tax assets and liabilities by business

The following are the major deferred tax liabilities and assets recognised, and the movements thereon, during the current and prior reporting periods:

	Transmission £m	Discontinued Operations Interconnectors £m
At 1 April 2005	-	-
Credited to income statements	(23)	(1)
Charged to equity	9	1
Other transfers	696	15
At 31 March 2006 (unaudited)	682	15
Charged to income statements	8	-
Credited to equity	(33)	(2)
Transfer to group undertakings	-	(27)
Other transfers	(13)	14
At 31 March 2007	644	-

Deferred tax assets and liabilities by source

	Accelerated tax depreciation £'m	Employee share options £'m	Pensions £'m	Cashflow hedge reserve £'m	Other temporary net differences £'m	Total £'m
At 1 April 2005	-	-	-	-	-	-
Charged/(credited) to income statements	(48)	(2)	72	-	(46)	(24)
Charged / (credited) to equity	-	(3)	13	-	-	10
Other transfers	878	(5)	(201)	(3)	42	711
At 31 March 2006 (unaudited)	830	(10)	(116)	(3)	(4)	697
Charged/(credited) to income statements	4	2	(1)	-	3	8
Credited to equity	-	(5)	(28)	(2)	-	(35)
Transfers to group undertakings	(27)	-	-	-	-	(27)
Transfers	1	-	-	-	-	1
At 31 March 2007	808	(13)	(145)	(5)	(1)	644

All of the deferred tax assets were available for offset against deferred tax liabilities and hence the net deferred tax provision at 31 March 2007 was £644m (2006: £697m). At the balance sheet date there were no material short term deferred tax assets or liabilities.

Deferred tax assets in respect of capital losses of £1m (2006:£2m) have not been recognised as their future recovery is uncertain or not currently anticipated. The capital losses are available to carry forward indefinitely and can be offset against specific types of future capital gains.

There are no other unrecognised deferred tax assets or liabilities.

Notes to the Accounts

13. Other non-current receivables

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Amounts falling due after more than one year:				
Other receivables	-	-	-	1

The fair value of other non-current receivables is approximately equal to their carrying value. All other non-current receivables are denominated in sterling.

14. Derivative financial instruments

The allocation of financial instruments to the regulated businesses is carried out by a simple apportionment of National Grid Electricity Transmission plc's balances. This has resulted in all of the balances being allocated to Transmission. All disclosures relating to National Grid Electricity Transmission plc's instruments can be found in the Annual Report and Accounts 2006/7.

15. Inventories

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Raw materials and consumables	12	13	-	-
Work in progress	4	1	-	-
	16	14	-	-

16. Trade and other receivables

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Trade receivables	26	4	-	6
Amounts owed by other fellow subsidiaries	372	296	-	6
Other receivables	6	3	-	1
Corporation tax recoverable	10	10	-	1
Prepayments and accrued income	104	138	-	-
	518	451	-	14
Provision for impairment of receivables				
At 1 April 2005, 31 March 2006 and 31 March 2007	(1)	-	-	-

Notes to the Accounts

16. Trade and other receivables (continued)

Trade receivables are non-interest bearing and generally have a 30-90 day term. Due to their short maturities, the fair value of trade and other receivables approximates to the book value.

The carrying amounts of trade and other receivables are denominated primarily in sterling.

There was no movement in the provision for impairment of receivables during either year.

As at 31 March 2007, trade receivables of £10m (2006: £1m) were past due but not impaired. The ageing analysis of these trade receivables is as follows:

	2007	2006
	£m	unaudited £m
Up to 3 months past due	5	-
3 to 6 months past due	1	1
Over 6 months past due	4	-
	10	1

17. Financial investments

	Transmission		Discontinued operations Interconnectors	
	2007	2006	2007	2006
	£m	unaudited £m	£m	unaudited £m
Current assets				
Amounts due from fellow subsidiaries	376	-	-	-

Due to their short maturities, the fair values of loans and receivables approximates to their book value.

All loans and receivables are denominated in sterling.

18. Cash and cash equivalents

	Transmission		Discontinued operations Interconnectors	
	2007	2006	2007	2006
	£m	unaudited £m	£m	unaudited £m
Cash at bank and in hand	26	15	-	6
Short term deposits	435	-	-	-
Cash and cash equivalents	461	15	-	6
Bank overdrafts	(26)	(15)	-	-
Net cash and cash equivalents	435	-	-	6

The fair value of cash and cash equivalents and bank overdrafts approximates to their book values.

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on immediate cash requirements, and earn interest at the respective short-term deposit rates.

Net cash and cash equivalents are denominated primarily in sterling.

Notes to the Accounts

19. Borrowings

The following table analyses the separate business' total borrowings (excluding bank overdrafts)

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Current:				
Bank loans	1	197	-	4
Bonds	41	40	-	1
Borrowings from fellow subsidiaries	194	-	-	-
	236	237	-	5
Non current:				
Bank loans	398	195	-	4
Bonds	3,078	2,480	-	54
	3,476	2,675	-	58
Total borrowings	3,712	2,912	-	63
Total borrowings are approximately repayable as follows:				
In one year or less	236	237	-	5
In more than one year, but not more than two years	405	-	-	-
In more than two years, but not more than three years	-	410	-	9
In more than three years, but not more than four years	244	-	-	-
In more than four years, but not more than five years	-	241	-	5
In more than five years				
- other than by instalments	2,827	2,024	-	44
	3,712	2,912	-	63

Applying the apportionment rules, the carrying amounts of the separate business' borrowings are denominated in the following currencies:

	Transmission		Discontinued operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Sterling	3,213	2,208	-	48
Euro	414	419	-	9
Other	85	285	-	6
	3,712	2,912	-	63
Fair value of borrowings	3,810	3,142	-	68
Notional amount of outstanding debt portfolio	3,711	2,802	-	61

Further information on borrowings can be found in the National Grid Electricity Transmission plc Annual Report and Accounts 2006/7.

Notes to the Accounts

20. Trade and other payables

	Transmission		Discontinued Operations Interconnectors	
	2007	2006	2007	2006
	£m	unaudited £m	£m	unaudited £m
Trade payables	332	317	-	-
Amounts owed to ultimate parent company	2	17	-	-
Amounts owed to fellow subsidiaries	381	302	-	7
Social security and other taxes	16	20	-	5
Other payables	55	21	-	2
Deferred income	59	50	-	10
	845	727	-	24

Due to their short maturities, the fair value of trade and other payables approximates to their book value.

The carrying amounts of trade and other payables are denominated primarily in sterling

21. Provisions

	Transmission	Discontinued Operations Interconnectors
	£m	£m
Environmental		
At 1 April 2005	-	-
Transfers	9	-
Utilised	(1)	-
At 31 March 2006 (unaudited)	8	-
Utilised	(4)	-
At 31 March 2007	4	-
Other		
At 1 April 2005	5	-
Utilised	(1)	-
At 31 March 2006 (unaudited)	4	-
At 31 March 2007	4	-

The environmental provision is calculated on an undiscounted basis and represents the estimated environmental restoration and remediation costs relating to a number of sites owned and managed by the Group. It is currently estimated that substantially all of this provision will be utilised within the next five years. Other provisions relates to other property commitments estimated to be utilised over the next nine years

Notes to the Accounts

21. Provisions (continued)

Provisions have been analysed between current and non-current as follows:

	Transmission		Discontinued Operations Interconnectors	
	2007	2006	2007	2006
	£m	unaudited £m	£m	unaudited £m
Current	2	2	-	-
Non-current	6	10	-	-
	8	12	-	-

22. Other non-current liabilities

	Transmission		Discontinued Operations Interconnectors	
	2007	2006	2007	2006
	£m	unaudited £m	£m	unaudited £m
Other payables	6	34	-	-
Deferred income	124	111	-	-
	130	145	-	-

The fair value of other payables at 31 March 2007 approximates to their book value.

The carrying amounts of other payables are denominated primarily in sterling.

23. Share option and award plans

Share option and award plans are operated at a National Grid plc level. Details of those plans can be found in the National Grid Electricity Transmission plc Annual Report and Accounts 2006/7.

Notes to the Accounts

24. Reconciliation of movements in total equity

	Transmission	Discontinued Operations Interconnectors
	£m	£m
At 1 April 2005	9,252	712
Adoption of IAS39 transfer	(3)	-
Restated 1 April 2005	9,249	712
Net income recognised directly in equity	30	(1)
Profit for the year	244	41
Share-based payments	(1)	-
Tax on share based payments	3	-
Transfers	(9,426)	(737)
At 31 March 2006 (unaudited)	99	15
Net income recognised directly in equity	(63)	2
Profit for the year	287	48
Share-based payments	3	-
Tax on share based payments	5	-
Transfers	(5)	(65)
At 31 March 2007	326	-

25. Cash flow statement

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

	Transmission		Discontinued Operations Interconnectors	
	2007	2006 unaudited	2007	2006 unaudited
	£m	£m	£m	£m
Movement in cash and cash equivalents	427	(1)	(6)	5
Increase in financial investments	376	-	-	-
(Increase)/decrease in borrowings and derivatives	(735)	67	-	-
Net interest paid	120	132	-	-
Change in net debt resulting from cash flows	188	198	(6)	5
Net interest charge	(177)	(166)	(1)	(3)
Changes in fair value of financial assets and liabilities	(4)	-	-	-
Other non-cash movements	(51)	(2,900)	7	(2)
Movements in net debt (net of related derivative financial instruments)	(44)	(2,868)	-	-
Net debt at the start of the year	(2,892)	-	-	-
Impact of adoption of IAS32 and IAS39 (i)	-	(24)	-	-
Net debt (net of related derivative financial instruments) at the end of the year	(2,936)	(2,892)	-	-

(i) There are no comparatives for net debt related derivative assets and liabilities as the Group adopted IAS 39 with effect from 1 April 2005 consistent with the requirements of IFRS 1. The adoption of IAS 39 also resulted in changes to the carrying value of borrowings as at 1 April 2005.

Notes to the Accounts

25. Cash flow statement (continued)

b) Analysis of changes in Transmission net debt

	At 1 April 2005	Impact of adoption of IAS32 and IAS39 (i)	Cash flow	Other non-cash movements	At 31 March 2006 unaudited
	£m	£m	£m	£m	£m
Cash and cash equivalents	-		(4)	19	15
Bank overdrafts	-		3	(18)	(15)
Borrowings due within one year (excluding bank overdrafts)	-	(37)	151	(351)	(237)
Borrowings due after one year	-	11	(105)	(2,581)	(2,675)
Derivative financial assets	-	2	-	36	38
Derivative financial liabilities	-	0	-	(18)	(18)
	-	(24)	45	(2,913)	(2,892)

	At 1 April 2006	Cash flow	Fair value gains and losses	Other non-cash movements	At 31 March 2007
	£m	£m	£m	£m	£m
Cash and cash equivalents	15	446	-	-	461
Bank overdrafts	(15)	(11)	-	-	(26)
Financial investments	-	376	-	-	376
Borrowings due within one year (excluding bank overdrafts)	(237)	20	-	(19)	(236)
Borrowings due after one year	(2,675)	(755)	50	(96)	(3,476)
Derivative financial assets	38	-	(33)	(0)	5
Derivative financial liabilities	(18)	-	(21)	(1)	(40)
	(2,892)	76	(4)	(116)	(2,936)

Notes to the Accounts

26. Related party transactions

The following information is provided in accordance with IAS24, Related Party Disclosures, as being material transactions with related parties during the year. These transactions relate to the statutory entity National Grid Electricity Transmission plc and are with joint ventures and a pension plan. The transactions were in the normal course of business and are summarised below.

Transactions with related parties were in the normal course of business and are summarised below:

	2007 £m	2006 £m
Sales:		
Services supplied	5	1
Purchases:		
Services received	14	15

It is not practical to identify the intercompany trading transactions for all related parties because the intercompany balances are transferred to an intercompany loan with National Grid Holdings One plc, the parent of the Company's immediate parent company, on a monthly basis. This is as a result of transfer pricing rules which require that intercompany transactions must be accounted for on an arms length financing basis.

With respect to the regulated businesses, amounts receivable from and payable to fellow subsidiaries at 31 March 2007, amounted to £748m (2006: £302m) and £383m (2006: £326m) respectively and had amounts payable to pension funds amounting to £2m (2006: £2m).

Details of key management compensation are provided in note 5(c).

27. Commitments and contingencies

Future capital expenditure

	Transmission		Discontinued operations Interconnectors	
	2007 £m	2006 unaudited £m	2007 £m	2006 unaudited £m
Contracted for but not provided	497	337	-	-