Annual Report and Accounts 2008/09
National Grid Gas plc

Company number 2006000

nationalgrid

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Note on use of terms and abbreviations

Within these accounts, National Grid Gas plc is referred to by the abbreviation 'NGG', and National Grid plc, its ultimate parent company, by the abbreviation 'National Grid'. References to NGG, 'the Company', 'we', 'our' and 'us' refer to National Grid Gas plc itself, or to National Grid Gas plc and its subsidiaries collectively, as the context requires. A full glossary of terms used is included on page 91.

Operating and Financial Review

Operating and Financial Review contents

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This Operating and Financial Review describes the main trends and factors underlying the development, performance and position of National Grid Gas plc (NGG) during the year ended 31 March 2009 as well as those likely to affect the Company in the future. 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.

Principal operations

NGG's principal operations are the ownership and operation of regulated gas infrastructure networks and the provision of gas metering services in Great Britain. NGG also has an interest in liquefied natural gas (LNG) storage facilities in Great Britain.

The performance of the principal businesses is reported by segment, reflecting the management responsibilities and economic characteristics of each activity. The principal businesses and segments, together with other activities, are as follows:

Businesses and segments	Description of principal activities
Gas Transmission	The transmission of gas in the UK as owner and operator of the gas national transmission system in Great Britain and storage facilities for LNG.
Gas Distribution	The distribution of gas in England as the owner and operator of four of the UK's eight gas distribution networks.
Gas Metering	The provision of regulated gas metering and meter reading services in Great Britain.
Other activities	Other activities do not constitute a segment in their own right, but comprise the provision of transportation transaction services on behalf of all the major gas network transportation companies, including those of NGG, together with corporate activities.

History

NGG originated from the restructuring of the UK gas industry in 1986.

Key milestones	
1986	British Gas incorporated as a public limited company
1997	British Gas demerged Centrica
1999	Financial and restructuring programme completed leading to creation of a new parent company, BG Group, separation of the regulated Transco business from the other businesses of BG Group and the establishment of a financial ring-fence around Transco
2000	Lattice Group, including Transco, demerged from BG Group
2002	Merger of Lattice Group and National Grid Group to form National Grid Transco
2005	Sale of four UK regional gas distribution networks
2005	National Grid adopted as the group brand name; Transco plc renamed National Grid Gas plc

Organisation and structure

NGG is a subsidiary of National Grid plc (National Grid).

The continuing operations of National Grid are organised and managed by global lines of business, which include Transmission and Gas Distribution. The day-to-day management of National Grid's operations, and the execution of strategy as approved by the Board of National Grid, is carried out by the National Grid Executive Committee which is composed of the Executive Directors of National Grid and its Company Secretary and General Counsel.

The Gas Transmission and Gas Distribution businesses of NGG form part of the global Transmission and Gas Distribution businesses of National Grid respectively.

The overall management and governance of NGG is the responsibility of its Board of Directors. The Board of Directors has established committees and sub-committees of the Board that assist it in its activities. These include the Transmission Executive Committee and the Distribution Executive Committee.

The day-to-day management of NGG's Gas Transmission business is carried on by the Transmission Executive Committee. This committee is chaired by Nick Winser, who is a Director of NGG, and who also sits on the Board and Executive Committee of National Grid and is the National Grid Executive Director responsible for the global Transmission business.

The day-to-day management of NGG's Gas Distribution business is carried on by the Distribution Executive Committee, chaired by Mark Fairbairn who is a Director of NGG, and also sits on the Board and Executive Committee of National Grid and is the National Grid Executive Director responsible for the global Gas Distribution business.

Certain activities, including safety, employee engagement and climate change, are reported on a line of business level rather than at company level. As a result, KPIs and objectives may be measured and monitored for the Transmission and Gas Distribution businesses rather than for NGG. This is discussed further under 'Vision, strategy and objectives' on page 6 and 'Performance against objectives' on page 8.

In addition to its own governance processes, NGG participates in the governance process of National Grid which is subject to the Combined Code on Corporate Governance.

More information on the business activities, organisation, structure, management and governance of National Grid can be found in the National Grid Annual Report and Accounts 2008/09 and on the website at www.nationalgrid.com. See note 32 on page 78 for further details of where these reports can be obtained.

External market and regulatory environment

Markets in which NGG operates

The principal market in which NGG operates is the natural gas market in the UK.

The supply of natural gas in the UK is competitive in that consumers can contract with different suppliers to obtain the gas they need. Those suppliers are then responsible for sourcing the gas from gas extractors or importers as appropriate, as well as arranging for the gas to be delivered through physical delivery networks. These networks, including the ones operated by NGG, are monopolies in their local areas as, for the majority of consumers, there are no alternative methods of receiving natural gas.

Natural gas delivery in the UK

Domestic and commercial consumers contract directly with gas suppliers who obtain the gas from shippers. Gas is transported through the national transmission system to regional gas distribution networks which deliver the gas to consumers on behalf of suppliers. Certain end customers, primarily large industrial users, receive gas direct from the national transmission system.

NGG is the owner and operator of the gas national transmission system and of four of the eight regional gas distribution networks in Great Britain. We charge gas shippers for our services, which they then incorporate into the prices charged to end consumers.

The other principal gas infrastructure owners in the UK are the owners of the other four distribution networks, Scotia Gas Networks, which owns the networks in Scotland and southern England, Northern Gas Networks, which owns the network in the north of England, and Wales & West Utilities which owns the network in Wales and the west of England.

Other markets in which we operate
We also operate in gas related markets in the UK which are directly connected to our regulated businesses described above. Our legacy regulated metering business currently owns approximately 80% of the domestic gas meters in the UK. We also participate in the competitive market for the provision of LNG storage services in Great Britain.

Regulation

Due to our position in, and importance to, the UK economy, our gas transmission and distribution businesses are subject to UK and European Union laws and regulations.

Our businesses are also subject to safety legislation which is enforced by the Health and Safety Executive (HSE). Our gas operations work under a permissioning regime, whereby our organisation, processes and procedures are documented in safety cases that are subject to acceptance by the HSE.

Our gas transmission, distribution and metering 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.

We have six price controls, comprising two for our gas transmission operations and one for each of our four regional gas distribution networks. These price controls provide a financial incentive to invest, as we receive a return on efficiently incurred capital expenditure increasing our regulatory asset base, and also provide incentives by which we can gain or lose for our performance in managing system operation, and controlling internal costs, pass-through costs and service quality.

The current price control period for gas transmission operations commenced on 1 April 2007 and is planned to last until 31 March 2012. The current price control period for gas distribution operations commenced on 1 April 2008, and is planned to last until 31 March 2013.

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 pages 20 to 23.

In addition, as a public company with securities listed on the London Stock Exchange and on the New York Stock Exchange, we are subject to regulation by the UK Financial Services Authority and by the US Securities and Exchange Commission and the exchanges themselves.

Current and future developments

External market developments

Market structure and ownership
There have been no significant changes in the structure of the UK gas infrastructure market or in ownership during 2008/09.

Energy market developments
Despite significant declines in wholesale energy prices since mid 2008, high consumer energy prices have been experienced in UK markets during the current year. This has led to significant increases in bills to consumers for their energy supplies. The combination of higher energy prices and the current economic climate has lead to a reduction in demand for gas.

The UK energy market continues to undergo developments driven by the projected increased reliance on imported gas, on new sources of electricity generation, including renewables, and increased focus on security of supply. The energy sector faces significant challenges relating to the declining UK continental shelf gas reserves in the North Sea, meeting the UK Government's targets on renewable generation, and significant levels of retirement of the current power generation fleet.

As a consequence of the decline in gas production from the North Sea, our latest forecast is that the UK will import around 50% of its gas requirements by the end of the decade.

These changes are expected to impact our gas transmission and distribution networks and in particular will require significant investment to link new generation plants and gas import facilities with domestic, business and industrial consumers.

We continue to develop a strategic plan for our networks up to 2050, recognising the unique role they play in meeting the UK's climate change objectives.

Regulatory developments

During the year ended 31 March 2009, there were a number of legislative changes in the UK including the introduction of new consumer arrangements. These arrangements incorporate an energy ombudsman scheme to deal with consumer complaints and a new Energy Act facilitating a roll out of smart meters in the UK by 2020.

In addition, this year Ofgem announced a review of the current RPI-X based regulatory framework. This is a two year assessment of the current regulatory regime and its ability to address the challenges facing energy networks in the future. The outcome of this review is unlikely to impact our current regulatory settlements, but could influence future price controls from 2012.

In December 2008 the European Union approved a number of environmental proposals. Legally binding national targets have been established that dictate the proportion of energy production to be provided from renewable sources by 2020. For the UK the target is 15%. In order to achieve this it is believed the proportion of electricity generated by renewable sources will need to rise to around 35%. At present it is unclear specifically how these targets will impact NGG; however, they will significantly influence the regulatory framework and price control reviews in the future.

The European Commission's third package of legislative proposals for European gas and electricity markets has been submitted for final adoption by the EU Council of Ministers, following approval by the European Parliament in April 2009. The new legislation consists of two directives on rules for the internal gas and electricity markets, two regulations on conditions for access to those markets, and one regulation establishing an Agency for the Cooperation of Energy Regulators. The original legislation, published in September 2007, contained measures to force energy companies to unbundle their transmission businesses from supply and generation activities. The revised draft proposals include alternatives to full unbundling. Adoption is expected in summer 2009.

Changes in price controls

New price controls with respect to our role as owner and operator of four of the eight gas distribution networks in the UK, covering the period from 1 April 2008 to 31 March 2013, came into effect and have been implemented successfully. The key elements are a 4.3% post-tax real rate of return (equivalent to a 4.94% vanilla return) on our regulatory asset value, a £2.5 billion baseline five year capital expenditure allowance and a £1.6 billion five year operating expenditure allowance. We were subject to one year system operator price controls for our gas transmission operations for 2008/09. One year system operator price controls for gas transmission operations for 2009/10 have been agreed with Ofgem.

Further details of these price controls are provided in the business discussion section under Gas Transmission on page 20 and Gas Distribution on page 21.

Other agreements

Alliance contracts with various contractors have been entered into by the Gas Distribution and Gas Transmission businesses. These contracts establish a framework for contractors to carry out capital investment projects. Under the terms of the agreements our supply chain partners share in the risks and rewards, and are jointly responsible with us for work delivery.

Legal and related matters

An update on the ongoing metering competition investigation that was reported in last year's Annual Report and Accounts is provided on page 27.

In October 2008 we informed and launched a joint investigation with Ofgem into the misreporting of gas distribution mains replacement activity; further details of this are also provided on page 27.

External relationships

We aim to enhance our relationships with all of our external stakeholders including investors, customers, regulators, governments, suppliers and the communities in which we operate.

Investor relations

As a subsidiary company of National Grid, NGG participates in communications to both National Grid's equity shareholders and to holders of debt in NGG, supporting National Grid's programme of active communication.

Customers, regulators and governments

For customers, it is important that we treat them with respect, that we communicate clearly and that we make interaction with them as straightforward as possible. Our focus on customer service and operational excellence is also a critical component of our relationship with our regulators and governments, underpinning the building of trust with both. This involves being responsive to the needs of our regulators for high quality information, complying with rules and regulations, operating in an ethical way and, most importantly, delivering on our promises.

We continue to work very closely with Ofgem on the renewal of our gas transmission and gas distribution 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, in particular with respect to their investigation into metering services in the UK as discussed on page 27.

Suppliers

Our objective is to use the scale and breadth of our activities to get the best value for money from our suppliers. We continue to work in partnership with our suppliers, developing constructive relationships and working together effectively. Our focus in these areas has increased, in response to the greater uncertainties from credit market volatility and the global economic downturn. Collectively, all of the areas we have developed or are working towards make NGG an attractive company to do business with. They also enhance our ability to drive value from our supply chain and provide an excellent opportunity for suppliers who are aligned to our approach and ambition.

Community involvement

We continue to participate in National Grid's community involvement programmes, details of which can be found in the National Grid Annual Report and Accounts 2008/09.

Working closely with Ofgem, we have developed the framework for connecting fuel poor communities to the gas distribution network under the Affordable Warmth Solutions Community Interest Company. This will result in the connection of a number of communities to the gas distribution network in the future.

Business drivers

Business drivers

The Company's principal activities include the operation of complex gas transmission and distribution networks. There are many factors that influence the financial returns we obtain. The business is highly developed with numerous drivers. We consider the following to be our principal business drivers:

Price controls
The prices we charge for use of our gas transmission and distribution networks are determined in accordance with regulator approved price controls. The negotiation of these arrangements has a significant impact on our revenues.
Their duration is significant in providing stability, allowing us to plan ahead and invest with confidence that we will obtain financial returns.
Our price controls contain incentive and/or penalty arrangements that can affect us financially based on performance targets.

Multi-year contracts
Revenues from metering services are largely determined by contractual arrangements, which are long-term and with 'blue chip' customers.

Safety, efficiency and reliability
Our ability to operate safely and reliably is of paramount importance to us, our employees, our contractors, our customers, our regulators and the communities we serve. Our financial performance is affected by our performance in these areas.
Operating efficiently allows us to minimise prices to our customers and improve our own financial performance.

Customer service
The quality of the service we deliver to customers, and the experiences that they have in dealing with us, is important as it feeds through to the attitudes of regulators and is also linked to our financial performance.

Capital investment
Capital investment is a significant driver for organic growth. In our regulated transmission and distribution 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.

Inflation and deflation
During periods of inflation, 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. Correspondingly, during periods of deflation our revenues can decrease, the timing and extent of which may not be offset by equivalent reductions in our operating costs. Consequently, our ability to control costs and improve efficiency is important in order to maintain and increase operating profits.
Our price controls and a proportion of our borrowings are linked to retail price inflation.

Relationships and responsibility
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.

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

Commodity and pass-through costs
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. We are affected by commodity prices to the extent that they affect our own energy requirements, most significantly gas purchases for the operation of our gas transmission and gas distribution networks.

Interest rates
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.

Vision, strategy and objectives

As described under 'Organisation and structure' on page 2, National Grid's businesses are managed on the basis of global lines of business. As a subsidiary company of National Grid, therefore, NGG participates in the National Grid vision and strategy. The following section describes National Grid's vision and strategy to the extent that it relates to NGG. Further details and discussion of the strategy and objectives of National Grid can be found in the National Grid Annual Report and Accounts 2008/09.

Vision

The vision is the long term aspiration for National Grid – what we want to be in the future.

We, at National Grid, will be the foremost international electricity and gas company, delivering unparalleled safety, reliability and efficiency, vital to the well-being of our customers and communities.
We are committed to being an innovative leader in energy management and to safeguarding our global environment for future generations.

Strategy and objectives

Our strategy and objectives are a medium term step in the journey towards the vision – what we are doing over the next few years. We will build on our core regulated business base and financial discipline to deliver sustainable growth and superior financial performance.

Driving improvements in our safety, customer and operational performance

Delivering strong, sustainable regulatory and long-term contracts with good returns

Modernising and extending our transmission and distribution networks

Becoming more efficient through transforming our operating model and increasingly aligning our processes

Building trust, transparency and an inclusive and engaged workforce

Developing our talent, leadership skills and capabilities

Positively shaping the energy and climate change agenda with our external stakeholders

Responsibility

Our strategy and objectives are underpinned by our commitment to corporate responsibility. We will operate to the highest standards of corporate governance and conduct our business in a lawful and ethical manner.

Line of sight

The vision, strategy and objectives flow down into every employee's annual performance objectives – what we are doing now and how we ensure we achieve our strategy and vision.

Our strategy and objectives provide the basis for the annual priorities for each line of business and global function.

These annual priorities form the basis of the objectives for the Executive Directors and flow down the organisation into the individual objectives for every manager and employee. Therefore the actions required to deliver the strategy are allocated and aligned with employee responsibilities.

The aim is that every employee is able to trace their objectives through to the strategy and vision.

Performance indicators

We use a variety of performance measures to monitor progress against our objectives. Some of these indicators are considered to be key performance indicators and are set out below. Details of our performance indicators are provided in the Performance summary section on page 7.

Objective	KPI
Delivering superior financial performance	Adjusted operating profit
Driving improvements in safety, customer and operational performance	Employee lost time injury frequency rate
Delivering strong sustainable regulatory and long-term contracts with good returns	Operational return
Modernising and extending our transmission and distribution networks	Network reliability measures
Building trust, transparency and an inclusive and engaged workforce	Employee engagement index

Performance summary and key performance indicators

Objective	KPI/performance measure	Description and performance	Target
Delivering superior financial performance	**Adjusted operating profit**	**Operating profit excluding exceptional items and remeasurements 2008/09: £1,091 million 2007/08: £994 million**	**Year on year profit increase**
	Cash generated by continuing operations	Cash generated by continuing operations 2008/09: £1,005 million 2007/08: £1,555 million	
	Regulatory gearing	Net debt divided by RAV 2009: 60% 2008: 55%	
Driving improvements in safety, customer and operational performance	**Employee lost time injury frequency rate**	**Injuries resulting in employees taking time off work per 100,000 hours worked** **Gas Transmission 2008/09: 0.33 2007/08: 0.36** **Gas Distribution 2008/09: 0.23 2007/08: 0.17**	**Zero**
	Injuries to the public	2008/09: 25 2007/08: 26	Zero
	Employee sickness absence rate	2008/09: 2.52% 2007/08: 2.18%	Zero work-related absences
Delivering strong sustainable regulatory contracts with good returns	**Operational return**	**Operational return** **Gas Transmission 2008/09: 6.9% 2007/08: 6.9%** **Gas Distribution 2008/09: 5.7% 2007/08: 5.1%**	**Achieve or exceed regulatory allowed return over 5 year price control period of: Gas Transmission 5.05% Gas Distribution 4.94%**
Modernising and extending our transmission and distribution networks	**Network reliability**	**Network reliability scores** **Gas Transmission 2008/09: 100% 2007/08: 100%** **Gas Distribution 2008/09: 99.999% 2007/08: 99.999%**	**Gas Transmission 100% Gas Distribution 99.999%**
	Total capital investment	2008/09: £1,080 million 2007/08: £1,393 million	
	Gas Distribution mains replacement	km of iron mains decommissioned and replaced 2008/09: 1,900 km 2007/08: 1,850 km	2008/09 1,852 km 2007/08 1,835 km
Building transparency, trust and an inclusive and engaged workforce	**Employee engagement index**	**Engagement score calculated from responses to employee survey** **Transmission business: 2008/09: 82% 2007/08:71%** **Gas Distribution business: 2008/09: 70% 2007/08: 64%**	**Year-on-year increase**
Positively shaping the energy and climate change agenda	Significant direct environmental incidents	2008/09: 0 2007/08: 26	Zero
	Greenhouse gas emissions	Year-on-year reduction % Reported one year in arrears 2007/08: 3% 2006/07: 9%	Year-on-year reduction

Performance against objectives

NGG's performance and the progress made against objectives are described below and on the following pages. This includes commentary on the financial results on pages 17 to 20. More information on the performance and financial results of each business is included in the business review sections on pages 20 to 23.

We measure the achievement of objectives through the use of qualitative assessments and through the monitoring of quantitative indicators, called 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. The scale and size of our operations mean we use many other detailed performance measures in addition to KPIs. We use qualitative assessments to judge progress against our objectives in areas where numerical measures are less relevant.

During 2008/09, an assessment of NGG's performance measures has been undertaken, which has resulted in a rationalisation of performance indicators, more directly aligning them with objectives.

We have introduced a new KPI this year for employee engagement. This is measured using an employee engagement score derived from the National Grid annual employee survey administered by Sirota, an independent consultancy firm.

Delivering superior financial performance

We aim to increase adjusted operating profit each year.
The key performance measure used is adjusted operating profit.

Adjusted operating profit for 2008/09 was £1,091 million compared to £994 million in 2007/08, an increase of £97 million. Adjusted operating profit excludes exceptional items and remeasurements.

A more detailed analysis of financial performance is provided on page 20.

Driving improvements in safety, customer and operational performance

We aim for operational excellence by performing to the highest standards of safety and by improving customer service.

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 and illness; to reduce gas leaks on our distribution networks; and to improve the health of our employees so they are fit for work every day.
We use a range of indicators to measure our performance against our safety objectives, including: members of the public injured as a direct result of our operations; employee lost time injury frequency rate; kilometres of distribution gas mains replaced in the UK, and employee sickness absence rate. The key performance indicator is employee lost time injury frequency rate.

Operating major hazard sites and pipelines means we remain vigilant to process safety risks as well as personal safety risks. During the year, there was one serious explosion in a flat in the UK as a result of escapes from our gas distribution networks. We continue to replace our iron gas mains in line with a programme agreed with the Health and Safety Executive (HSE) to reduce the risks of this type of incident. In the last year, we have implemented revised processes to manage gas escapes in the UK satisfying the requirements of an enforcement notice served by the HSE.

Employee safety

We report the lost time injury frequency rate (LTIFR), expressed as lost time injuries per 100,000 hours worked, as a key measure that can be compared with other companies. This rate takes into account the number of employees and the workload. As well as reporting the LTIFR, we report the number of lost time injuries.

Overall during 2008/09, 29 employees sustained injuries that resulted in them taking time off work, compared with 21 in 2007/08 and a target of zero.

In the Gas Transmission business, the lost time injury frequency rate was 0.33 in 2008/09 compared with 0.36 in 2007/08. There were 4 lost time injuries in 2008/09 compared with 5 in 2007/08.

In the Gas Distribution business the lost time injury frequency rate was 0.23 in 2008/09 compared with 0.17 in 2007/08. There were 24 lost time injuries during 2008/09 compared with 16 in 2007/08.

In the Gas Metering business there was one employee lost time injury in 2008/09 compared with none in 2007/08.

The principal causes of lost time injuries to employees are road traffic collisions, impact injuries, musculoskeletal injuries and slips trips and falls. Behavioural change initiatives have been targeted in these areas to try to improve performance.

Employee health
Improving the health and well-being of employees continues to be a major focus for National Grid, which for several years has had a comprehensive Occupational Health Service to deal with work related health issues. National Grid is now extending its approach to look at the health and well-being of employees in a more holistic way. As well as the obvious benefits to individuals, there are significant business and societal benefits to having a fit and healthy workforce. In January a new Health and Wellbeing Strategy was launched to provide a series of innovative initiatives that engage staff and encourage the restoration and maintenance of an individual's health, function and fitness. An early focus has been cardiovascular risk with screening being offered to all employees over 45.

The sickness absence rate in 2008/09 was 2.52% compared to 2.18% in 2007/08.

Public safety
During 2008/09, 25 members of the public were injured as a result of our operations compared with 26 during 2007/08 and a target of zero.

Contractor safety
We are committed to the safety of our workforce, not only direct employees. There were 20 contractor lost time injuries in 2008/09 compared to 36 in 2007/08 and a target of zero.

Gas safety
We again exceeded all our regulatory agreed targets on safety related standards.

During 2008/09, we have decommissioned more than 1,900 kilometres of iron gas mains under our long-term mains replacement programme, exceeding the target agreed with the Health and Safety Executive (HSE) for the third consecutive year. The HSE target this year was 1,852 kilometres. We decommissioned over 1,850 kilometres in 2007/08.

As detailed on page 27, we identified that some of our mains replacement activity may have been misreported. We have notified both Ofgem and the HSE, and a full investigation is currently being conducted.

We are investing around £25 million in a wider roll out of active control systems, which change the pressure in the gas mains automatically as customer demand conditions require. This investment reduces average system pressure on our gas mains, thereby reducing natural gas escapes and is a direct consequence of the new environmental emissions incentive laid out by Ofgem in this current price control period. The combined effect of the above mains replacement activity and pressure management investments ultimately reduces the number of gas escapes that impact climate change.

Customer service
We aim 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 use business-specific service quality measures to measure our performance in this area.

We will achieve this by enhancing or replacing the systems we use, providing our employees with the training, empowerment and support they need to deliver, and by improving the quality of our internal and customer communications.

Gas Transmission
Our aim is to support generators and distribution network customers, including our own networks operated by Gas Distribution in the UK, in delivering energy efficiently and effectively to consumers.

Our transmission customer service activities principally relate to facilitating new connections and maintaining existing connections and relationships with the customers who are already connected.

Gas Distribution
In addition to meeting all service standards defined by Ofgem, we aim to deliver high quality customer experience, with satisfaction levels measurable through industry surveys.

In the UK, quality of service standards apply to three principal areas of activity: new connections; the telephone service; and attendance at gas emergencies. All standards have been met in 2008/09. In the individual cases where compensation is due, we have processes to ensure that customers receive the statutory compensation which they are entitled to. Customer satisfaction with the levels of service provided in respect of our main types of work (emergency response and repair, planned work and connections work) is measured and reported on a quarterly basis.

Results of these surveys are directly comparable with the other independent distribution network operators and can be found at www.nationalgrid.com/uk/Gas and www.ofgem.gov.uk. In summary, out of a maximum score of 10, we achieved the following year-to-date network average scores: 7.86 for emergency response and repair; 7.29 for planned work; and 6.74 for connections work. All scores are calculated within the Ofgem template and represent the mean scores of individual quarters. There is a programme of activities to improve these scores in future surveys.

Gas Metering
Gas Metering has met 17 out of 18 standards of service in 2008/09.

Delivering strong, sustainable regulatory contracts with good regulatory returns

We will work with Ofgem and the UK government to develop the changes that are required to address climate change and security of supply in a way that is affordable for consumers and ensures timely delivery. Significant levels of investment over the next few years means that it is vital that we optimise our regulatory returns and ensure we are appropriately compensated for our investments.

Operational return

Our aim is to deliver good financial returns compared to the regulatory allowances within our price controls.
We measure performance through an operational return metric comparable to the vanilla return defined in the price controls.

Details of these returns are summarised below.

Years ended 31 March	2009	2008
Gas Transmission operational return	6.9%	6.9%
Gas Distribution operational return	5.7%	5.1%

The return on investment of the Gas Transmission business significantly outperformed regulatory assumptions, mainly as a result of performance under incentive schemes. The regulatory allowance for Gas Transmission is 5.05% over the 5 year price control. The Gas Distribution return also exceeded the regulatory allowance of 4.94% over the 5 year price control.

Modernising and extending our networks

Significant capital investment is needed over the next few years to ensure we meet the challenges around security of supply and maintaining and improving the reliability of our networks.

In addition, we have committed to developing new processes to enable investment in new physical network capacity, which provides customers with easier access to our network.

Reliability

Our principal operations are critical to the functioning of the UK economy. The reliability of our networks is one of our highest priorities after safety. Our objective is to meet regulatory targets and to have zero loss of supply incidents.
We use business specific reliability performance indicators to measure our reliability performance.

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; 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.

Network reliability information for Gas Transmission and Gas Distribution is summarised below.

Years ended 31 March	2009	2008
Gas Transmission network reliability target 100%	100%	100%
Gas Distribution network reliability target 99.999%	99.999%	99.999%

In the Gas Transmission system, total gas transmitted amounted to 1,158 TWh compared to 1,134 TWh in 2007/08. The winter of 2008/09 saw a maximum gas demand of 443 million standard cubic metres on 6 January 2009. This compares to the previous years' peak of 419 standard cubic metres on 17 and 20 December 2007.

Gas compressor fleet performance improved in 2008/09, with the mean time between compressor failures of 405 hours compared to 259 hours in 2007/08.

In the Gas Distribution networks, actual gas consumption in 2008/09 was 317 TWh compared with 315 TWh. We continue to focus on improving reliability, in particular in the area of gas escapes, meeting our targets in this area.

Our asset management policies promote continual improvement in how our physical assets (plant, pipes, meters and regulators) are managed throughout their life cycle from conception through construction, operation, maintenance and decommissioning.

Capital investment

Capital investment is one of the principal drivers of future growth, as the majority of capital investment we make enables us to earn an increased financial return.

The principal measure we use to monitor organic investment is capital expenditure, which includes investment in property, plant and equipment as well as in internally generated intangible assets such as software.

Our capital investment plans reflect changing energy infrastructure requirements. The capital investment programme takes place within defined regulatory frameworks that permit us to earn a return on allowed investments.

Total capital expenditure during 2008/09 was £1,080 million compared to £1,393 million in 2007/08. More detail on capital expenditure by business is provided in the following sections.

Gas Transmission

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

Within the gas transmission system, assets ancillary to the high pressure pipelines, including compressors and control systems, are reaching the end of their technical lives and are becoming due for replacement. As a result of this network renewal, together with work required to meet changing supply sources, the Gas Transmission business will continue to see a significant level of investment.

Capital investment in the replacement, reinforcement and extension of the Gas Transmission system in 2008/09 was £389 million, compared with £800 million in 2007/08. 2008/09 has seen a substantial decrease in the level of investment in gas pipeline projects as the south Wales project is now substantially complete. Capital investment included £18 million with respect to intangible assets, principally software applications (2007/08: £22 million).

Gas Distribution

Capital investment including reinforcement, extension and replacement of the UK gas distribution network was £598 million in 2008/09 compared with £514 million in 2007/08. Of these amounts, £425 million in 2008/09 related to replacement expenditure that is capitalised (2007/08: £353 million) and £173 million to other capital investment including new connections, new pipelines and minor capital expenditure (2007/08: £161 million). Expenditure on software applications included within the above amounts was £22 million (2007/08: £18 million).

Replacement expenditure increased by £72 million (20%) compared with 2007/08 reflecting an increase in workload and a higher proportion of complex large diameter mains. Performance under the mains replacement incentive scheme is expected to be broadly neutral in 2008/09.

In collaboration with our alliance partnerships, we have replaced more than 1,900 kilometres of iron gas mains this year and approximately 8,800 kilometres since 2004/05, the vast majority of which relates to the long-term mains replacement programme agreed with the HSE.

The increase in other capital expenditure in 2008/09 compared with 2007/08 is driven by the commencement of the construction of a major new pipeline in west London, which is due for completion in 2009/10, together with information technology expenditure to replace obsolete equipment in system control and operational activities.

Gas Metering

Capital expenditure invested in new and replacement meters in 2008/09 amounted to £90 million compared with £73 million in 2007/08.

Becoming more efficient by transforming our operating model and increasingly aligning our processes

Our operating model is focused on the delivery of services to customers, developing the sharing of best practice and positioning ourselves to deliver improvements in operating and financial performance.

Our focus during the current year and in the short term is on maximising efficiencies in the operating model within each line of business. Through targeted reductions in the number of processes and through standardisation and simplification we aim to maximise efficiencies and reduce cost.

National Grid continues to develop its procurement operating model which is now structured on a strategic spend category basis. This structure drives greater focus in delivering value from the supply chain. The management team has been strengthened as we seek to improve the performance of this part of the business.

During the year we have implemented new technology tools that better enable our capacity to plan, monitor, report spend and undertake e-commerce events. We have also introduced a system that provides robust financial monitoring services, focusing on our critical suppliers.

Within Gas Distribution, we will start the progressive replacement of our ageing front office IT suite of systems in 2009/10. The lessons learnt from the pilots, and the advances in technology since the original front office was installed, will help us drive further improvements in the efficiency and customer performance of the gas business.

Efficiency

By improving efficiency we can constrain the cost of our operations borne by customers and improve returns. We review our operations continually to identify opportunities to improve the operational productivity of our assets and employees and to identify areas in which we can reduce costs or restrict cost increases.

Our aim is to maintain the proper level of investment in our infrastructure to enable related operating cost reductions, and to focus on incremental efficiencies. In Gas Distribution, the transformation of the front office programme is an example of how we are looking to execute information systems priorities to facilitate savings.

Building trust, transparency and an inclusive and engaged workforce

In order to maximise the potential of our workforce and achieve our objectives it is important to develop their belief and engagement in National Grid's vision.

Engagement and performance

To succeed we need to engage our employees to strive for continuous improvement. For that purpose our aim is to implement a world-class performance management process.
The key performance indicator is the employee engagement index based on the independent annual employee survey

Our approach involves adopting National Grid integrated common performance processes and a single set of performance criteria with pay linked to leadership qualities (how we deliver) as well as operational and financial performance (what we deliver), providing for clearer differentiation between levels of performance.

Employee engagement

In February 2009, National Grid conducted its second annual employee engagement survey. A total of 24,727 employees, representing 91.8% of the total workforce, took part, a 5.5% increase in the response rate compared to 2008. During 2008, intensive action planning was undertaken at National Grid, line of business and individual level to address the key themes of improving communications, providing greater clarity on vision and direction and providing stronger links between performance and reward.

The 2009 survey reported a 10% increase in employee engagement within National Grid as a whole. Improvements were reported across all survey dimensions, with significant improvements in the areas of vision, direction and communications which were key action items from the 2008 survey.

Within NGG we monitor the engagement scores for the principal lines of business, Transmission and Gas Distribution. In 2008/09, Transmission employee engagement was 82% (2007/08: 71%) and Gas Distribution employee engagement was 70% (2007/08: 64%).

Performance management

National Grid continues the task of building a high performance culture and, further to our work with senior managers, we have now completed training for the majority of middle and first line managers on 'Performance for Growth', National Grid's global performance management system. The process continues to focus on raising the performance bar and supporting high quality conversations. We have established 'support and challenge' groups which continue to review best practice, share knowledge and enable managers to have a peer support network.

Our performance programmes are driving stronger personal accountability and the leadership within National Grid is now actively involved in creating a culture where everyone across the business understands that business results are of primary importance and that they can directly influence this.

Inclusion and diversity

In order to develop, recruit and retain talented people, we aim to achieve a more inclusive and diverse workforce, 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 the objective of promoting inclusion and diversity include the percentage of female employees and the percentage of ethnic minority employees.

Following a thorough review of policies throughout National Grid, we have reaffirmed our commitment to inclusion and diversity by highlighting its importance to employee engagement and productivity, the recruitment and retention of talent, and our external reputation within our inclusion business case.

During the year National Grid launched its global Inclusion Charter. The charter explains what employees can expect from the Company, as well as what National Grid expects from employees and builds on work in progress throughout the business.

In addition, an inclusion and diversity transition group has been established to develop the necessary communications, governance and human resource processes to support our efforts. Training has continued to offer greater awareness of inclusive behaviours and we have recently launched a new inclusive leadership learning programme.

At 31 March 2009, 22.5% of our employees were female and 6.3% were from ethnic minority groups, compared to 24.5% and 5.8% at 31 March 2008.

Across all of National Grid's operations in the UK, as at 31 March 2009 22.1% of employees were female and 7.5% from ethnic minority groups, compared to 22.5% and 6.5% at 31 March 2008. Of all new hires in National Grid's UK operations in 2008/09, 36.7% were female and 13.1% were from ethnic minority groups.

We aim to maximise the contribution of our employees by motivating them to strive for continued improvement, developing their skills and talents and promoting a culture that recognises and respects inclusion and diversity.

Developing talent, leadership skills and capabilities

Identifying, recruiting and developing talented people is critical to our future success.

We aim to support all our employees so that they can operate to the best of their abilities by creating an environment that allows them to realise their full potential.

National Grid has strengthened its talent management processes in 2008/09, creating talent management plans for senior management and for business critical roles. We are now

conducting regular cross-business talent planning sessions using consistent processes to support senior management in developing employees within each business area and to address succession issues.

National Grid's focus on developing the talent of current and future business leaders has moved forward with the launch of the developing future leaders programme for senior managers. National Grid has also launched a foundation of leadership programme for first line leaders and supervisors and a future leaders programme with a focus on enhancing business acumen and the demonstration of leadership qualities.

We continue to invest in the recruitment and development of skilled employees for the future, jointly with National Grid's other UK businesses, recruiting 184 advanced apprentices, 58 foundation engineers and 30 graduates across the UK. These programmes are designed to facilitate the entrance, training and progression of talented people into National Grid, with special emphasis on key engineering roles.

Positively shaping the energy and climate change agenda with our external stakeholders

National Grid's aim is to embrace, address and lead on the current and future issues affecting the energy market. It is committed to safeguarding the global environment for future generations, taking positive action to reduce its contribution to climate change and other impacts on the environment. National Grid strives to be an environmental leader and will work with regulators to develop the regulatory framework required to address the changes in future energy supplies.

This year has seen significant changes to UK government policy with the introduction of the Climate Change and Energy Acts, which will implement a wide range of measures including setting carbon budgets on a national scale and enshrining climate change targets in law.

Positively shaping the agenda

National Grid aims to take the lead on the energy and climate change issues facing society, not simply reacting to the initiatives of other relevant bodies but instead, being proactive in leading the agenda to help safeguard the environment.

National Grid's performance measure in this area is the qualitative monitoring of its contribution to various projects, committees, task forces and other initiatives aimed at addressing these issues.

Climate change

National Grid continues with its climate change initiatives and energy efficiency programmes, focusing on initiatives that are cost effective and regulated.

The National Grid key performance indicator to monitor performance in this area is the percentage reduction in greenhouse gas emissions against baseline.

As reported last year, National Grid has adopted a long-term target of reducing Scope 1 and 2 greenhouse gas emissions by 80% against baseline by 2050. An intermediate objective has now been set of a 45% reduction in emissions by 2020. These targets remain at the centre of efforts to identify and implement measures to meet National Grid's commitment to safeguard the global environment for future generations. In 2009/10, the inclusion of Scope 3 emissions into these targets will be evaluated.

This year, efforts have been focused on educating the workforce on the targets and the means by which they will be achieved. An inventory of greenhouse gas emissions has been conducted across National Grid to ensure that there is up-to-date information on the magnitude of the reductions necessary, and the areas of operations where reductions can take place. Internal working teams have been established, tasked with developing opportunities to achieve the 80% target.

This climate change initiative is being embedded in all areas and operations of National Grid through the establishment of teams working in such areas as introducing low emission vehicles, developing low carbon design features for asset replacement programmes and incorporating a 'cost of carbon' methodology in investment decision making processes.

During 2009/10, carbon budgets will be implemented within National Grid. For each financial year, each business within National Grid will be set a maximum level of greenhouse gas emissions which can be emitted. Subsequent years will see a reduction in these budgets that is needed to achieve the 2020 and 2050 targets.

Performance on greenhouse gas emissions against target are reported for National Grid as a whole in the National Grid plc Annual Report and Accounts 2008/09. For NGG, we currently report year on year reductions. The 2008/09 data is not currently available. It is expected to become available in July 2009 at which point the data for National Grid as a whole will be presented on the National Grid website. Data for NGG will be presented in next years' Annual Report and Accounts, and in future periods, the year-on-year performance will continue to lag by one year.

Protecting the environment

National Grid is committed to helping to protect the environment for future generations and continuously improving environmental performance.

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

The performance indicators that we monitor in this area include the number of significant direct environmental incidents.

In 2008/09 there were no significant environmental incidents arising directly from our operations. In 2007/08, there were 26 incidents including 24 contractor-related incidents. There were no prosecutions by enforcing bodies resulting from these incidents.

NGG has an inherited portfolio of historically contaminated land including former manufactured gas plants and former and current gas holders. Sites can sometimes have a complex mix of contamination dating back over 100 years.

National Grid Property Limited, a fellow subsidiary company of National Grid, manages land contamination issues on NGG's behalf.

Responsibility
We believe operating responsibly is essential to the way we conduct our operations, invest in our business, develop our people and manage our relationships. It underpins everything we do and is a prerequisite to our contribution to delivering National Grid's vision.

We always strive to operate to the highest standards of corporate governance and we believe in strong business ethics, based around National Grid's Framework for Responsible Business and our core values of respecting others and valuing diversity, demonstrating integrity and openness in all relationships, taking ownership for driving performance and operating as one team.

The Framework defines the principles by which we manage our business and our day-to-day dealings with our customers, employees, shareholders, suppliers and local communities. It is underpinned by National Grid wide policies and position statements that are available on the National Grid website.

More information on National Grid's approach to corporate responsibility and business ethics is included in the Corporate Governance section of the National Grid plc Annual Report and Accounts 2008/09.

Risks and opportunities

Risks and opportunities
We believe that the principal opportunities we have to contribute to the achievement of National Grid's vision and to the delivery of growth in value for its shareholders have been identified in National Grid's strategy and our objectives.

Conversely, we risk a shortfall in this contribution if we do not fulfil National Grid's strategy or if we fail to achieve our objectives.

Financial performance
Financial performance and operating cash flows are the basis for funding our future capital investment programmes, for servicing our borrowings and paying dividends.

Responsibility
Strong corporate governance is essential to operating responsibly and the achievement of all our objectives. Our reputation as a responsible business depends on all our behaviours being lawful and ethical, on complying with our policies and licences and on living up to our core values.
If we do not live up to these high standards we could be exposed to adverse financial or other consequences.

Driving improvements in safety, customer and operational performance
The operating profits and cash flows we generate are dependent on our operating performance – operating safely, reliably, and providing a quality service to customers.

Delivering strong, sustainable regulatory contracts with good returns
Our relationships with our stakeholders are critical to our future success. Maintaining these good relationships is dependent on 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.

Modernising and extending our transmission and distribution networks
Our future organic growth is dependent on the delivery of our capital investment plans. In order to deliver sustainable growth with a superior financial performance we will need to finance our investment plans. Instability in the financial markets may restrict our ability to raise finance.

Becoming more efficient through transforming our operating model and increasingly aligning our processes
Transforming the way we operate through the simplification and standardisation of our systems and process will drive efficiency and reduce costs. Conversely, if we do not achieve this transformation, or associated benefits in efficiency, reductions of costs will not be achieved.

Building trust, transparency and an inclusive and engaged workforce
Our workforce is a vital part of our business and is critical to our future success. Failure to maintain a trusting, engaged, and motivated workforce, who can see how their actions directly contribute to achieving our strategy and objectives, will restrict our ability to meet those objectives.

Developing talent, leadership skills and capabilities
The skills and talents of our employees, and their motivation and dedication, are critical to the achievement of our objectives. Failure to develop our existing employees or to attract and recruit talented new employees could hamper our ability to deliver in the future.

Positively shaping the energy and climate change agenda
Safeguarding our global environment for future generations is dependent on integrating sustainability and climate change considerations into our business decisions, influencing legislators and regulators to reshape energy markets to meet the climate change challenge, and helping and supporting our employees, customers and suppliers in changing their behaviour to be more environmentally aware.

We set out how we intend to achieve our objectives and the progress we have made during the year against our objectives on pages 7 to 14.

Risk management
The approach of NGG to risk management is described in the principal risks and uncertainties section of this Operating and Financial Review on the following page. In addition, information on how we have addressed certain of our financial risks is included in the financial position and financial management section of this Operating and Financial Review on pages 24 to 27.

Risk factors
The following significant risks and uncertainties in achieving our objectives have been identified:

- changes in laws or regulation
- breaches of 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
- reputation damage from disruptions to supply, even if outside our control
- fluctuations in interest rates and their impact on borrowings and derivatives

- restrictions in borrowings, changes in credit ratings, volatility and disruption of global financial markets and reduced liquidity and access to funding opportunities
- periods of deflation
- future funding requirements of our pension schemes
- changes in accounting standards or in tax rates
- consumers, suppliers or other counterparties failing to perform their obligations

Not all of these factors are within our control and, in addition, there may be other factors besides those listed that may have an adverse effect on NGG.

These risk factors are described in more detail in the Principal risks and uncertainties section below.

Principal risks and uncertainties

Risk management

Identifying, evaluating and managing risks is integral to the way we run our business. National Grid continues to 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. An output from this process is information that provides assurance to management and thus helps safeguard our assets and reputation. NGG participates in this enterprise wide process.

More information on National Grid's risk management process can be found in the National Grid plc Annual Report and Accounts 2008/09.

Risk factors

The risk management process has identified the following risk factors that could have a material adverse effect on our business, financial condition, results of operations and reputation. Not all of these factors are within our control. In addition, other factors besides those listed below may have an adverse effect on NGG.

Changes in law or regulation could have an adverse effect on our results of operations.
Our businesses are subject to regulation by governments 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 there has been any breach of the terms of a licence or approval, recovery of incurred expenditure, and other decisions relating to the implications of energy change, the level of permitted revenues and dividend distributions for our businesses and in relation to 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 Operating and Financial Review and, in particular, the 'External market and regulatory environment' and 'Current and future development' sections and the business review sections for each of our lines of business.

Breaches of, or changes in, environmental or health and safety laws or regulations could expose us to increased costs, claims for financial compensation and adverse regulatory consequences, as well as damaging our reputation.
Aspects of our activities are potentially dangerous, including the transmission and distribution of gas. Gas 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 that are not currently regarded or proved to have adverse effects but could become so. 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. These expose us to costs and liabilities relating to our operations and our properties whether current, including those inherited from predecessor bodies, or formerly owned by us.

We are also subject to laws and regulations governing health and safety matters protecting the public and our employees. We are increasingly subject to regulation in relation to climate change. We commit significant expenditure toward complying with these laws and regulations and to meeting our obligations under negotiated settlements. If additional requirements are imposed or our ability to recover these costs changes, this could have a material impact on our businesses and our results of operations and financial position. 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 the National Grid website at www.nationalgrid.com.

Network failure, the inability to carry out critical non-network operations and damage to infrastructure may have significant adverse impacts on both our financial position and 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 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 and our reputation. Terrorist attack, sabotage or other intentional acts may also damage our assets or otherwise significantly affect

corporate activities and as a consequence have an adverse impact on 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 regulated businesses will be affected by our ability to meet or exceed efficiency and integration targets and service quality standards set by, or agreed with, our regulators. In addition, from time to time, we publish cost and efficiency savings targets for our businesses. 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 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 energy delivery businesses. Current regulatory arrangements provide the ability to pass through virtually all of the increased costs related to commodity prices to consumers. However, if regulators 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.
Our gas transmission and distribution businesses are responsible for transporting available gas. 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, which may damage our reputation.

Our financial position may be adversely affected by a number of factors including restrictions in borrowing and debt arrangements, changes to credit ratings and adverse changes and volatility in the global credit markets.
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 that have been imposed by regulators. These restrictions may hinder us in servicing the financial requirements of our businesses. Some of 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.

Our business is partly financed through debt and the maturity and repayment profile of debt used to finance investments often does not correlate to cash flows from our assets. Accordingly, we rely on access to short-term commercial paper and money markets and longer-term bank and capital markets as sources of finance. The global financial markets are currently experiencing extreme volatility and disruption. A shortage of liquidity, lack of funding, pressure on capital and extreme price volatility across a wide range of asset classes are putting financial institutions under considerable pressure and, in certain cases, placing downward pressure on stock prices and credit availability for companies. If we are not able to access capital at competitive rates, our ability to finance our operations and implement our strategy will be adversely affected.

Our results of operations could be affected by deflation
Our income under our price controls is linked to the retail price index. Therefore if the UK economy suffers from a prolonged period of deflation, our revenues may decrease, which may not be offset by reductions in operating costs.

Future funding requirements of our pension schemes could adversely affect our results of operations.
Substantially all of our employees are members of a defined benefit pension scheme where the scheme assets are held independently of our own financial resources. Estimates of the amount and timing of future funding for this 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 these pension schemes 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 could have an adverse effect on our reported financial results. Changes in law and accounting standards could increase our effective rate of tax.
The accounting treatment under International Financial Reporting Standards (IFRS), as adopted by the European Union, of, among other things, replacement expenditure, rate regulated entities, pension and post-retirement benefits, derivative financial instruments and commodity contracts, significantly affect the way we report our financial position and results of operations. New or revised standards and interpretations may be issued which could have a significant impact on the financial results and financial position that we report. The effective rate of tax we pay may be influenced by a number of factors including changes in law and accounting standards, the results of which could increase that rate.

Customers and counterparties to our transactions may fail to perform their obligations, or arrangements we have may be terminated, which could harm our results of operations.
Our operations are exposed to the risk that customers and counterparties to our transactions that owe us money or commodities will not perform their obligations, which could cause us to incur additional costs.

Financial performance

Performance against KPIs is described on page 7. In the following section we provide a more detailed analysis of the financial results.

We report our financial results and position in accordance with International Financial Reporting Standards (IFRS).

Continuing and discontinued operations
The financial results of our business segments and of our other activities (as described on page 1) are presented within continuing operations. Discontinued operations in 2007/08 comprise residual amounts in respect of the four gas distribution networks sold on 1 June 2005.

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 judgement of management, should be disclosed separately on the basis that they are material, either by virtue of their nature or 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 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.

Profit for the year

Adjusted earnings

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Adjusted operating profit	**1,091**	994
Net finance costs excluding exceptional items and remeasurements	**(401)**	(341)
Adjusted profit before taxation	**690**	653
Taxation excluding taxation on exceptional items and remeasurements	**(393)**	(278)
Adjusted profit for the year from continuing operations	**297**	375

Earnings

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Total operating profit	**767**	971
Net finance costs	**(407)**	(317)
Profit before taxation	**360**	654
Taxation	**(312)**	(161)
Profit for the year from continuing operations	**48**	493

Net finance costs
Net interest excluding exceptional finance costs and remeasurements increased by £60 million from 2007/08 to 2008/09. This was primarily explained by an increase in average debt balances.

Financial remeasurements relate to net losses on derivative financial instruments of £6 million in 2008/09, compared with net gains of £24 million in 2007/08.

Taxation
The net tax charge of £312 million in 2008/09 comprised a £393 million charge on adjusted profit before tax and a £81 million credit on exceptional items and remeasurements. This

compares with a net charge of £161 million in 2007/08, comprising a £278 million charge on adjusted profit before tax and a £117 million credit on exceptional items and remeasurements, relating to the release of deferred tax provisions following the change in the UK corporation tax rate from 30% to 28% which was enacted in the year and takes effect from 1 April 2008.

The effective tax rate before and after exceptional items and remeasurements was 57% and 87% respectively (2007/08: 43% and 25%), compared with a standard UK corporation tax rate of 28% in 2008/09 and 30% in 2007/08.

The effective tax rate before exceptional items for 2008/09 reflects charges relating to additional tax arising under UK transfer pricing arrangements, which is offset by equivalent tax credits in other UK subsidiary companies of National Grid. In 2008/09, these comprised a prior year tax charge equivalent to an effective tax rate of 15%, and amounts included in the current year charge equivalent to an effective rate of 13%. This reflects a change to the basis of calculation under which we include the tax relating to transfer pricing adjustments in the current year, rather than on submission of the relevant tax returns. The effective tax rate before exceptional items for 2007/08 reflected a prior year charge only, equivalent to an effective rate of 17%.

Profit for the year from continuing operations

Profit for the year from continuing operations decreased from £493 million in 2007/08 to £48 million in 2008/09 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.

Reconciliation of adjusted operating profit to total operating profit

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Adjusted operating profit	**1,091**	994
Exceptional items	**(324)**	(23)
Total operating profit	**767**	971

Adjusted operating profit is presented on the face of the consolidated income statement, under the heading 'Operating profit – before exceptional items'.

Reconciliation of adjusted profit before taxation to profit before taxation

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Adjusted profit before taxation	**690**	653
Exceptional items	**(324)**	(23)
Derivative financial remeasurements	**(6)**	24
Total profit before taxation	**360**	654

Adjusted profit before taxation is presented on the face of the consolidated income statement, under the heading 'Profit before taxation – before exceptional items and remeasurements'.

Reconciliation of adjusted earnings to earnings (profit for the year from continuing operations)

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Adjusted earnings	**297**	375
Exceptional items	**(243)**	101
Derivative financial remeasurements	**(6)**	17
Earnings	**48**	493

Adjusted earnings is presented on the face of the consolidated income statement, under the heading 'Profit for the year from continuing operations after taxation – before exceptional items and remeasurements'.

Discontinued operations

	Years ended 31 March	
	2009	2008
	£m	£m
Gain on disposal of discontinued operations	**-**	3
Profit for the year	**-**	3

Discontinued operations in 2007/08 comprised amounts in respect of the four regional gas distribution networks we sold on 1 June 2005.

Net profit for the year

Net profit from both continuing and discontinued operations was £48 million in 2008/09 compared with £496 million in 2007/08.

Operating profit

Operating profit for 2008/09 and 2007/08 was as follows:

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Revenue	**2,574**	2,440
Other operating income	**27**	8
Operating costs	**(1,834)**	(1,477)
Total operating profit	**767**	971
Comprising:		
Adjusted operating profit	**1,091**	994
Exceptional items	**(324)**	(23)
Total operating profit	**767**	971

The following tables set out the consolidated revenue, adjusted operating profit and operating profit by business segment.

Details of the financial results of business segments, including information on exceptional items and remeasurements, are included in the business reviews on pages 20 to 23.

Revenue by business segment

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Gas Transmission	**813**	770
Gas Distribution	**1,466**	1,383
Gas Metering	**340**	349
Other activities	**43**	38
Total segmental revenues	**2,662**	2,540
Less: sales between business segments	**(88)**	(100)
Revenue	**2,574**	2,440

Segmental operating profit before exceptional items and remeasurements

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Gas Transmission	**321**	318
Gas Distribution	**668**	595
Gas Metering	**125**	101
Other activities	**(23)**	(20)
Adjusted operating profit	**1,091**	994

Segmental total operating profit

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Gas Transmission	**56**	315
Gas Distribution	**610**	575
Gas Metering	**124**	101
Other activities	**(23)**	(20)
Total operating profit	**767**	971

2008/09 compared with 2007/08

Changes in revenue and other operating income, operating costs and operating profit for 2008/09 compared with 2007/08 can be summarised as follows:

Continuing operations	Revenue and other operating income £m	Operating costs £m	Operating profit £m
2007/08 results	2,448	(1,477)	971
Add back 2007/08 exceptional items	-	23	23
2007/08 adjusted results	2,448	(1,454)	994
Gas Transmission	43	(40)	3
Gas Distribution	83	(10)	73
Gas Metering	(9)	33	24
Other activities	24	(27)	(3)
Sales between businesses	12	(12)	-
2008/09 adjusted results	2,601	(1,510)	1,091
2008/09 exceptional items	-	(324)	(324)
2008/09 results	2,601	(1,834)	767

Revenue and other operating income in 2008/09 was £153 million higher than in 2007/08, primarily as a result of higher Gas Transmission and Gas Distribution revenues. Operating costs excluding exceptional items increased by £56 million as a result of higher operating costs in Gas Transmission and Gas Distribution, partly offset by a reduction in the costs of Gas Metering. As a consequence, adjusted operating profit was £97 million higher than 2007/08.

Net operating exceptional charges of £324 million in 2008/09 were £301 million higher than 2007/08. These relate to restructuring costs of £83 million, an increase in environmental provisions of £13 million due to significant movements in discount rates during the year, and pension deficit charges of £228 million arising from contributions to the National Grid UK Pension Scheme under the recovery plan agreed with the trustees.

Total operating profit reduced by £204 million compared to 2007/08 as a result of the £97 million increase in adjusted operating profit and the £301 million increase in operating exceptional charges.

Cash flows

Cash flows from operating activities

Cash generated from continuing operations was £1,005 million in 2008/09 compared with £1,555 million in 2007/08. This included cash outflows relating to exceptional items of £261 million and £23 million respectively.

There was a net corporate tax payment in 2008/09 of £71 million compared with £228 million in 2007/08.

The net cash inflow from operating activities after taxation was £934 million in 2008/09, compared with £1,327 million in 2007/08.

Cash flows from investing activities

Cash outflows from investing activities were £1,447 million in 2008/09 compared to £1,592 million in 2007/08. Cash outflows to purchase property, plant and equipment and intangible fixed assets, net of disposal proceeds, were £975 million in 2008/09 compared to £1,470 million in 2007/08. Interest received was £19 million in 2008/09 compared to £14 million in 2007/08. Net cash outflows to acquire financial investments were £491 million in 2008/09 compared to £136 million in 2007/08.

Cash flows from financing activities

The net cash inflow from financing activities was £504 million in 2008/09 compared to £97 million in 2007/08. This reflected net inflows from loans of £1,122 million (2007/08: £852 million inflow) and net payments to providers of finance, in the form of interest and dividends, of £618 million (2007/08: £755 million).

Net interest cash outflows, excluding exceptional debt redemption costs, increased from £241 million in 2007/08 to £299 million in 2008/09.

Dividends in respect of the financial year

	2009	2008
	£m	£m
Interim	**300**	500

The table above shows the ordinary dividends paid or payable by NGG in respect of the last two financial years. These dividends do not include any associated UK tax credit in respect of such dividends.

Business reviews by segment

These business reviews should be read in conjunction with the rest of this Operating and Financial Review, in particular external market and regulatory environment, current and future developments, business drivers, vision, strategy and objectives and risks and opportunities as set out on pages 2 to 6 and 14 to 15.

Gas Transmission

Principal operations

The Gas Transmission business comprises the following principal activities:

Gas Transmission owner NGG owns the gas national transmission system in Great Britain. This comprises approximately 7,600 kilometres of high pressure pipe and 26 compressor stations, connecting to 8 distribution networks and to third party independent systems for onward transportation of gas to end consumers.	
Gas system operator NGG operates the gas national transmission system. Day-to-day operation includes balancing supply and demand, maintaining satisfactory system pressures and ensuring gas quality standards are met.	
LNG storage NGG currently owns and operates four LNG storage facilities in Great Britain. With the scheduled closure of one of these, Dynevor Arms, during 2009, the number of facilities will decrease to three.	

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

As gas system operator, we undertake a range of activities necessary for the successful, efficient delivery, in real time, of secure and reliable energy. We ensure the system is balanced with supply and demand at the end of each day. We are also required to maintain levels of short-term gas reserves to ensure that domestic and other non-interruptible gas supplies can be maintained during prolonged cold conditions.

Regulation

NGG holds a gas transporter licence in respect of the national transmission system in Great Britain. Under the Gas Act 1986 we have a duty to develop and maintain an efficient and economical pipeline system for the conveyance of gas. The LNG storage business is managed as a separate business from the gas transmission business. However, some elements of its operations are regulated under the gas transporter licence.

Ofgem sets price controls in respect of the amounts that can be charged by the owners and operators of gas infrastructure in the UK. These controls are reviewed every five years and the current price control for gas transmission activities covers the period 1 April 2007 to 31 March 2012.

We accepted Ofgem's final proposals for the system operator schemes that applied to the year ended 31 March 2009 and we

have also accepted their proposals for the one year period from 1 April 2009.

The key elements of the current price control are that we earn a 4.4% post-tax real rate of return on our regulatory asset value (equivalent to a 5.05% vanilla return), a £0.9 billion baseline five year capital expenditure allowance and a £0.3 billion five year operating expenditure allowance.

The charges that we can make for access to our gas transmission system are determined by a formula linked to the Retail Prices Index (RPI). This formula is based upon Ofgem's estimates of our operating expenditure, capital expenditure and asset replacement, together with an allowed rate of return.

In addition, our gas system operation activities are subject to financial incentive schemes to promote efficiency. If we operate our network more efficiently than Ofgem's forecasts, we can increase our revenues, with penalties for reductions in performance.

We have a number of incentive schemes covering activities such as cost of investment for additional capacity to facilitate new connections to the system, managing constraints, the provision of market information, the cost of purchasing shrinkage gas (gas used in operating the system) and other gas system operation costs.

Financial performance

The results for the Gas Transmission segment for the years ended 31 March 2009 and 2008 were as follows:

	Years ended 31 March	
	2009	2008
	£m	£m
Revenue	**813**	770
Operating costs excluding exceptional items	**(492)**	(452)
Adjusted operating profit	**321**	318
Exceptional items	**(265)**	(3)
Operating profit	**56**	315

The principal movements between 2007/08 and 2008/09 can be summarised as follows:

	Revenue	Operating costs	Operating profit
	£m	£m	£m
2007/08 operating profit	770	(455)	315
Add back 2007/08 exceptional items	-	3	3
2007/08 adjusted operating profit	770	(452)	318
Allowed revenues	81		81
Timing of recoveries	(38)		(38)
Depreciation and amortisation	-	(13)	(13)
Other	-	(27)	(27)
2008/09 adjusted operating profit	813	(492)	321
2008/09 exceptional items	-	(265)	(265)
2008/09 operating profit	813	(757)	56

Revenue and other operating income increased by £43 million driven by an increase in allowed revenues offset by lower LNG storage auction income and a £38 million timing impact on recoveries.

Operating costs excluding exceptional items increased by £37 million in 2008/09 compared to 2007/08. Depreciation and amortisation increased by £13 million as a result of increasing capital investment. Other cost increases of £27 million arose from higher pass-through costs, which are recovered through revenue, and higher gas shrinkage costs due to higher prices.

Exceptional charges of £265 million in 2008/09 are made up of pension deficit payments of £212 million, and restructuring costs, primarily a £50 million charge relating to the restructuring of our LNG storage facilities. Exceptional charges of £3 million in 2007/08 related to cost reduction programmes.

As a consequence of these items, adjusted operating profit, excluding exceptional items, increased by £3 million in 2008/09 compared with 2007/08, while operating profit after exceptional items decreased by £259 million.

Gas Distribution

Principal operations

NGG's Gas Distribution business comprises four of the eight regional gas distribution networks in Great Britain. These networks consist of approximately 132,000 kilometres of gas distribution pipelines. Gas is transported on behalf of approximately 25 active gas shippers from the gas national transmission system to around 10.8 million consumers.

We also manage the national emergency number (0800 111 999) for all of the gas distribution networks and for other gas transporters in the UK. During 2008/09 we handled approximately 2 million calls to the national emergency number and a further 1.4 million calls to the enquiries line, appliance repair helpline and meter number enquiry service.

Regulation

We hold a single gas distribution transporter licence, which authorises us to operate the four gas distribution networks we own. Detailed arrangements for transporting gas are provided

through the Uniform Network Code which defines the obligations, responsibilities and roles of industry participants and is approved by Ofgem.

Our four regional gas distribution networks each have a separate price control, which determines the maximum prices we can charge to gas shippers for our gas delivery service. These maximum prices are based on Ofgem’s allowances for operating, capital and replacement expenditure, together with depreciation of and a return on Ofgem’s allowances for our regulatory asset value.

The current price control period came into force on 1 April 2008 and covers the period up to 31 March 2013. This provides for an allowed average revenue increase of 2% per annum above the Retail Prices Index. Key elements of the price control are a 4.3% post-tax real rate of return (equivalent to 4.94% vanilla return) on regulatory asset value. Ofgem’s final proposals (at 2005/06 prices) allow a £1.6 billion five year operating expenditure allowance and a £2.5 billion baseline five year capital expenditure allowance split £1.8 billion for replacement expenditure and £0.7 billion for capital expenditure.

The allowed formula revenue was decoupled from delivery volumes from 1 April 2007. This eliminated the sensitivity to warm weather and lower underlying volumes. In addition, from 1 October 2008 only a minimal proportion of income is recovered through the volume element of charges.

The price control formulas specify a maximum allowed revenue assigned to each network. Each formula consists of a fixed core revenue, cost pass-through items and an opportunity to earn additional revenue through new incentive schemes including a mains and services replacement adjustment mechanism, shrinkage and environmental emissions incentives, an exit capacity scheme and innovative environmental and community incentives.

Replacement expenditure maintains the safety and reliability of the network, by replacing older gas pipes with modern polyethylene equivalents. Ofgem treats 50% of projected replacement expenditure as recoverable during the price control period and 50% as recoverable over future years. Each network is subject to its own mains replacement incentive mechanism and retains 36% of any outperformance against Ofgem’s annual cost targets as additional return or, alternatively, bears 36% of any overspend if it underperforms.

In specific instances Ofgem has agreed the price control can be re-opened in response to changes in legislation that may increase the cost of carrying out work in the public highway.

Transportation charges are set broadly to recover allowed revenue, but in any year, collected revenue can be more or less than allowed. Any difference is carried forward and our charges are adjusted accordingly in future periods.

Ofgem has established standards of service we are required to meet. These include standards of service incorporated within our gas transporter licence, for example, answering 90% of all calls to the national gas emergency number, enquiries line and meter number enquiry service within 30 seconds of the call being connected, and attending 97% of reports of a gas escape or other gas emergency within the required timescale; and guaranteed standards of service for our other transportation services, such as restoration of supply after an unplanned interruption and complaint handling. Compensation is payable for any failures to meet guaranteed standards of service.

Financial performance

The results for the Gas Distribution segment for the years ended 31 March 2009 and 2008 were as follows:

	Years ended 31 March	
	2009	2008
Continuing operations	**£m**	£m
Revenue	**1,466**	1,383
Other operating income	**2**	8
Operating costs excluding exceptional items	**(800)**	(796)
Adjusted operating profit	**668**	595
Exceptional items	**(58)**	(20)
Total operating profit	**610**	575

The principal movements between 2007/08 and 2008/09 can be summarised as follows:

	Revenue and other operating income	Operating costs	Operating profit
Continuing operations	£m	£m	£m
2007/08 operating profit	1,391	(816)	575
Add back 2007/08 exceptional items	-	20	20
2007/08 adjusted operating profit	1,391	(796)	595
Allowed revenues	90	-	90
Timing of recoveries	(15)		(15)
Pass-through costs	-	(9)	(9)
Non-formula costs	-	(12)	(12)
Other revenues and costs	2	17	19
2008/09 adjusted operating profit	1,468	(800)	668
2008/09 exceptional items	-	(58)	(58)
2008/09 operating profit	1,468	(858)	610

Revenue and other operating income in increased by £77 million in 2008/09 compared with 2007/08. Allowed revenue was up £90 million, driven by the five year price control that came into effect on 1 April 2008 and incentive gains through the efficient management of capacity requirements and improved pressure management. This was partially offset by £15 million timing impact on recoveries.

Operating costs for 2008/09, excluding exceptional items, were in line with 2007/08. Efficiency savings through strong operating cost performance were combined with one-off benefits in the year. As expected, this was offset by £9 million higher pass-through costs due to an increase in business rates following the changes in rateable values introduced from 1 April 2005 and shrinkage costs due to higher gas prices. Non-formula costs were £12 million higher because of increased meter work and other activities.

Exceptional charges of £58 million in 2008/09 include pension deficit payments of £16 million and an increase in the environmental provision of £13 million due to significant movements in discount rates during the year. The remaining £29 million arose from restructuring and transformation costs. This compared with a charge of £20 million in 2007/08 which related to restructuring costs

As a consequence of these items, adjusted operating profit, excluding exceptional items, increased by £73 million in 2008/09 compared with 2007/08, while operating profit after exceptional items increased by £35 million.

Gas Metering

The Gas Metering business, which is undertaken through NGG's subsidiary company National Grid Metering Limited, provides installation and maintenance services to gas suppliers in the regulated gas market. Services are provided for domestic, industrial and commercial gas meters situated throughout Great Britain.

National Grid Metering is regulated by Ofgem and retains a large share of the legacy installed base of gas meters in the UK. It is subject to a tariff cap price control.

Current and future developments

Metering competition investigation

An update on the ongoing metering competition investigation that was reported in last year's Annual Report and Accounts is provided on page 27.

Financial performance

The results for the Gas Metering segment for the years ended 31 March 2009 and 2008 were as follows:

	Years ended 31 March	
	2009	2008
	£m	£m
Revenue	**340**	349
Operating costs excluding exceptional items	**(215)**	(248)
Adjusted operating profit	**125**	101
Exceptional items	**(1)**	-
Total operating profit	**124**	101

The increase in adjusted operating profit is largely due to a reduction in operating costs.

Other activities

Other activities comprises xoserve, which delivers transportation transactional services on behalf of all the major gas network transportation companies in Great Britain, including our Gas Transmission and Gas Distribution businesses, and corporate overheads that are not borne by individual businesses.

Financial results

The results for other activities for the years ended 31 March 2009 and 2008 were as follows:

	Years ended 31 March	
	2009	2008
	£m	£m
Revenue	**43**	38
Operating costs excluding exceptional items	**(66)**	(58)
Operating loss	**(23)**	(20)

Financial position and financial management

Going concern

Having made enquiries, the Directors consider that NGG and its subsidiaries have adequate resources to continue in business for the foreseeable future and that it is therefore appropriate to adopt the going concern basis in preparing the consolidated and individual financial statements of NGG. More details on NGG's liquidity position are provided under the heading Liquidity and treasury management below and in note 30 to the consolidated financial statements.

Financial position

Balance sheet

The balance sheet at 31 March 2009 can be summarised as follows:

	Assets £m	Liabilities £m	Net assets £m
Property, plant and equipment and non-current intangible assets	10,436	-	10,436
Current assets and liabilities	484	(899)	(415)
Other non-current assets and liabilities	5,611	(1,205)	4,406
Deferred tax	-	(1,777)	(1,777)
Total before net debt	16,531	(3,881)	12,650
Net debt	1,901	(8,781)	(6,880)
Total as at 31 March 2009	18,432	(12,662)	5,770
Total as at 31 March 2008	16,572	(10,592)	5,980

The £210 million decrease in net assets from £5,980 million at 31 March 2008 to £5,770 million at 31 March 2009 resulted from the profit for the year from continuing operations of £48 million, net income recognised directly in equity of £39 million and other changes in equity of £3 million and dividends paid of £300 million.

Net debt

Net debt increased by £706 million from £6,174 million at 31 March 2008 to £6,880 million at 31 March 2009. Cash flows from operations net of tax of £934 million were offset by capital expenditure, net of disposals, of £975 million, dividends paid of £300 million and interest paid of £299 million, together with fair value and other movements of £66 million.

At 31 March 2009, net debt comprised borrowings of £8,672 million including bank overdrafts of £10 million, less derivative financial instruments with a net carrying value of £783 million, and financial investments of £1,009 million (31 March 2008: borrowings of £6,816 million including bank overdrafts of £6 million less derivative financial instruments with a net carrying value of £119 million, cash and cash equivalents of £5 million and financial investments of £518 million).

The maturity of borrowings is shown in note 18 to the consolidated financial statements.

Capital structure

We monitor the regulatory asset value (RAV) gearing within the Gas Transmission and Gas Distribution businesses. This is calculated as net debt expressed as a percentage of RAV, and indicates the level of debt employed to fund the regulated businesses. It is compared with the level of RAV gearing indicated by Ofgem as being appropriate for these businesses, at around 60%.

We consider this to be a more appropriate measure than the standard gearing ratio using the accounting value of net assets as it better reflects the economic value of our assets.

To calculate RAV gearing for the regulated Gas Transmission and Gas Distribution businesses we exclude an element of the debt that is associated with the Gas Metering business. RAV gearing as at 31 March 2009 was 60% (estimated) compared to 55% as at 31 March 2008 (actual).

Liquidity and treasury management

Treasury policy

Funding and treasury risk management for NGG is carried out by the Treasury function of National Grid under policies and guidelines approved by the Finance Committees of the Boards of National Grid plc and National Grid Gas plc. The Finance Committees have authority delegated from the relevant Boards and are responsible for regular review and monitoring of treasury activity and for approval of specific transactions, the authority for which may be delegated.

The primary objective of the Treasury function is to manage the funding and liquidity requirements of National Grid. A secondary objective is to manage the associated financial risks (in the form of interest rate risk and foreign exchange risk) to within acceptable boundaries. Further details of the management of funding and liquidity and the main risks arising from our financing activities are set out below, as are the policies for managing these risks including the use of financial derivatives, which are agreed and reviewed by the Boards and the Finance Committees.

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.

Commodity derivatives entered into in respect of gas commodities are used in support of the business's operational requirements and their use is explained on page 26.

Current condition of the financial markets

During 2008/09 there has been a deterioration in the world economic situation. In particular, we have seen a crisis in the banking system, the failure or near failure of individual banks and increased restrictions on lending across capital and money markets. This has been accompanied by a significant widening in credit spreads. However, with our low risk business model and cash flows that are largely stable over a period of years, we have been able to continue to access the markets and during

2008/09 have issued £1,515 billion of external long-term debt. We remain confident of our ability to access the public debt markets going forward.

Cash flow and cash flow forecasting

Cash flows from operations are largely stable annually and over a period of years, although they do depend on the timing of customer payments. Our gas transmission and distribution operations are subject to multi-year price control agreements with our regulator, Ofgem.

NGG's capital investment programme is financed through a combination of internal cash flows and borrowings. Both short and long-term cash flow forecasts are produced regularly to assist in identifying short-term liquidity and long-term funding requirements and we are undertaking a project to enhance our cash flow forecasting processes. Cash flow forecasts, supplemented by a financial headroom position, are supplied to the Finance Committee to assess funding adequacy for at least a 12 month period.

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 requires us to maintain adequate financial resources and restricts our ability to make dividend payments, lend cash or levy charges between NGG and fellow subsidiary companies of National Grid.

Funding and liquidity management

We maintain medium term note and commercial paper programmes to facilitate long and short-term debt issuance into capital and money markets.

At 31 March 2009, NGG had a $2.5 billion US commercial paper programme (unutilised), a $1.25 billion Euro commercial paper programme (unutilised) and a €10 billion Euro medium term note programme (€6.1 billion issued).

In addition we have both committed and uncommitted bank borrowing facilities that are available for general corporate purposes. At 31 March 2008, the Company had £755 million of long-term committed facilities (undrawn).

We invest surplus funds on the money markets, usually in the form of short-term fixed deposits and placements with money market funds that are invested in highly liquid instruments of high credit quality. Investment of surplus funds is subject to our counterparty risk management policy, and we continue to believe that our cash management and counterparty risk management policies provide appropriate liquidity and credit risk management in light of the current crisis in the financial markets. Details relating to cash, short-term investments and other financial assets at 31 March 2009 are shown in notes 16 and 17 to the consolidated financial statements.

We believe that maturing amounts in respect of contractual obligations as shown in Commitments and contingencies in note 26 to the consolidated financial statements can be met from existing cash and investments, operating cash flows and other financings that we reasonably expect to be able to secure in the future, together with the use of committed facilities if required.

Credit ratings

It is a condition of the regulatory ring-fence around the Company that it uses reasonable endeavours to maintain an investment grade credit rating. As of 31 March 2009, the long-term senior unsecured debt and short-term debt credit ratings respectively provided by Moody's, Standard & Poor's and Fitch were as follows:

Moody's	A3/P2
Standard & Poor's	A-/A2
Fitch	A/F2

Standard & Poor's and Fitch have current outlooks of stable while Moody's has a current outlook of negative which we expect to be resolved during the summer of 2009.

Use of financial derivatives

As part of our business operations, including our treasury activities, we are exposed to risks arising from fluctuations in interest rates and exchange rates. We use financial instruments, including financial derivatives, to manage exposures of this type. Our policy is not to use financial derivatives for trading purposes. Derivative positions are managed in a non speculative manner, such that all transactions in financial derivatives are matched to an underlying current or anticipated business requirement. More details on derivative financial instruments are provided in note 13 to the consolidated financial statements.

Refinancing risk management

Refinancing risk within National Grid is controlled mainly by limiting the amount of debt maturities (both principal and interest) arising on borrowings in any financial year.

Note 18 to the consolidated financial statements sets out the contractual maturities of our borrowings over the next five years, with total contracted borrowings maturing over 43 years. We expect to be able to refinance this debt through the capital and money markets as we have done during 2008/09.

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. The interest rate risk management policy followed by National Grid 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 an extreme movement in interest rates, neither the interest cost nor the total financing cost is expected to exceed pre-set limits with a high degree of certainty.

Within these constraints, the interest rate risk of National Grid is actively managed, with over 50% of our debt exposed to floating or index-linked interest rates in the longer term. In 2009/10 we expect the financing costs of National Grid to benefit from lower interest rates, some of which have already been locked in using short-term interest rate derivatives, and inflation.

Some of our bonds in issue are index-linked, that is their cost is linked to changes in the UK Retail Prices 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 formulas.

The performance of the Treasury function in interest rate risk management is measured by comparing the actual total financing costs of the National Grid debt with those of a passively-managed benchmark portfolio with a constant ratio of fixed rate to floating rate debt, to identify the impact of actively managing National Grid's interest rate risk. This is monitored regularly by the Finance Committee of National Grid.

More information on the interest rate profile of our debt is included in note 30(a) to the consolidated financial statements.

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 the future. In addition, where foreign currency cash flow forecasts are uncertain and a judgement has to be made, our policy is to hedge a proportion of such cash flows based on the likelihood of them occurring, with the aim of hedging substantially all the cash flows without overhedging. Cover generally takes the form of forward sale or purchase of foreign currencies and must always relate to underlying operational cash flows.

In addition, we are exposed to currency exposures on borrowings in currencies other than sterling, principally the US dollar and the euro. This currency exposure is managed through the use of cross-currency swaps, so that post derivatives the currency profile is almost entirely sterling.

The currency compositions of financial liabilities and assets are shown in note 30(a) to the consolidated financial statements.

Counterparty risk management
Counterparty risk arises within the National Grid Treasury function from the investment of surplus funds and from the use of derivative instruments, and outside the Treasury function from commercial contracts entered into by the businesses, including commodity contracts. The National Grid Finance Committee has agreed a policy for managing such risk. This policy sets limits as to the exposure that National Grid can have with any one counterparty, based on that counterparty's credit rating from independent rating agencies. National Grid's exposure to individual counterparties is monitored on a frequent basis and counterparty limits are regularly updated for changes in credit ratings. The Treasury function is responsible for managing the policy. Where contracts are entered into outside the Treasury function, part of the relevant counterparty limit can be allocated to the business area involved. This ensures that National Grid's overall exposure is managed within the appropriate limit.

Further information is provided in note 30(b) to the consolidated financial statements.

Where multiple transactions are entered into with a single counterparty, a master netting arrangement is usually 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.

Valuation and sensitivity analysis
We calculate the fair value of debt and financial derivatives by discounting all future cash flows by the market yield curve at the balance sheet date and in the case of financial derivatives taking into account the credit quality of both parties. 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.

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.

As described in note 30(d) to the consolidated financial statements, movements in financial indices would have the following estimated impact on the financial statements as a consequence of changes in the value of financial instruments.

Years ended 31 March	2009		2008	
	Income statement £m	Other equity reserves £m	Income statement £m	Other equity reserves £m
UK Retail Prices Index ± 0.50%	10	-	10	-
UK interest rates ± 0.50%	7	16	5	12

Commodity contracts
Gas purchased for our own use relates to the operation of our gas transmission and gas distribution networks

In our Gas Transmission operation we are obliged to offer for sale, through a series of auctions (both short and long term), a predetermined quantity of entry capacity for every day in the year at predefined locations. Where, on the day, the gas transmission system's capability is constrained, such that gas is prevented from entering the system for which entry capacity rights have been sold, then the Gas Transmission business is required to buy back those entry capacity rights sold in excess of system capability. Forward and option contracts are used to reduce the risk and exposure to on-the-day entry capacity prices.

In addition we buy back capacity rights already sold in accordance with our gas transporter licences and Uniform Network Code obligations as part of our management of the gas transmission and gas distribution networks.

Commitments and contingencies

Commitments and contingencies outstanding at 31 March 2009 and 2008 are summarised in the table below:

	2009 £m	2008 £m
Future capital expenditure contracted but not provided for	**480**	461
Total operating lease commitments	**75**	82
Other commitments and contingencies	**150**	84

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 existing cash and investments, 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 2009

We were not party to litigation that we considered to be material as at 31 March 2009.

Metering competition investigation

In February 2008 the Gas and Electricity Markets Authority (GEMA) issued a decision to fine National Grid £41.6 million for a breach of the UK Competition Act 1998 in respect of term contracts with gas suppliers entered into by the Gas Metering business in 2004. We subsequently appealed this decision to the Competition Appeal Tribunal (the Tribunal). On 29 April 2009, the Tribunal overturned the decision in part and reduced the fine to £30 million but also upheld the original decision in part. On 29 May 2009 we lodged our application at the Tribunal for leave to appeal on points of law and on the amount of the penalty.

Gas distribution mains replacement investigation

In October 2008, we informed Ofgem that our mains replacement activity carried out within the UK’s West Midlands Alliance partnership may have been misreported. National Grid and Ofgem have jointly appointed Ernst & Young to carry out a full investigation to determine the extent of the issue. At present it is too early to determine the likely outcome of the investigation and any potential consequences.

Related party transactions

We provide services to and receive services from related parties, principally fellow subsidiary companies of National Grid. In the year ended 31 March 2009, NGG charged £19 million and received charges of £358 million from related parties (other than Directors and key managers), compared with £25 million and £116 million respectively in 2007/08.

Further information relating to related party transactions is contained within note 27 to the consolidated financial statements. Details of key management compensation and amounts paid to Directors are included within notes 3(c) and 3(d) to the consolidated financial statements respectively.

Retirement arrangements

The substantial majority of our employees are members of the National Grid UK Pension Scheme, which is operated by Lattice Group plc, an intermediate holding company of NGG. We do not provide any other post-retirement benefits.

The scheme has both a defined benefit section, which is closed to new entrants, and a defined contribution section, which is offered to all new employees.

As there is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to NGG, we account for the scheme as if it were a defined contribution scheme and do not recognise any share of the assets and liabilities of the scheme.

Actuarial position

The last completed full actuarial valuation of the National Grid UK Pension Scheme was as at 31 March 2007. This concluded that the pre-tax funding deficit was £442 million in the defined benefit section on the basis of the funding assumptions. Employer cash contributions for the ongoing cost of this plan are currently being made at a rate of 32.6% of pensionable payroll.

Contributions

In addition to ongoing employer contributions NGG made additional deficit contributions to the scheme of £228 million during 2008/09 and £58 million in April 2009 to clear in full the deficit revealed by the 2007 valuation.

The next valuation of the scheme is due as at 31 March 2010.

Accounting policies

The consolidated financial statements present NGG's results for the years ended 31 March 2009 and 2008 and financial position as at 31 March 2009 and 2008. They have been prepared using the accounting policies shown, in accordance with International Financial Reporting Standards (IFRS).

In complying with IFRS, we are also complying with the version of IFRS that has been endorsed by the European Union for use by listed companies.

IFRS differ from UK Generally Accepted Accounting Principles (UK GAAP).

Choices permitted under IFRS

Since 1 April 2005, we have presented our consolidated financial 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 from certain options that are available within accounting standards.

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

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.

Carrying value of assets at transition
In most cases we used brought forward depreciated cost, as adjusted for changes in accounting policies to conform to IFRS, to be the opening carrying value under IFRS.

Share-based payments
We recognised all active share option grants retrospectively.

Cumulative translation differences
We chose to measure and present cumulative translation differences arising since 1 April 2004 only.

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

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 transactions with the defined benefits section of the National Grid UK Pension Scheme as if it were a defined contribution scheme, and do not recognise any of the Scheme assets and liabilities or actuarial gains and losses.

Capitalised interest
We capitalise interest into the cost of assets that we construct where the conditions of IAS 23 are met.

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.

Individual accounts
We have chosen to continue to use UK GAAP, rather than IFRS, in the individual financial statements of National Grid Gas plc and of its UK subsidiary companies.

Accounting standards and interpretations adopted in 2008/09

In preparing our consolidated financial statements we have complied with International Financial Reporting Standards, International Accounting Standards and interpretations applicable for 2008/09. The following amendments to standards and interpretations were adopted during 2008/09, none of which resulted in a material change to our consolidated results, assets or liabilities in 2008/09 or in those of previous periods:

Amendments to standards
An amendment to IAS 39 that permits reclassification of financial assets in certain circumstances.

New interpretations
IFRIC 12 and IFRIC 14 contain guidance on accounting for service concession arrangements and pension assets and minimum funding.

Segmental reporting

In addition to presenting the consolidated financial results and financial position in the financial statements, a breakdown of those results and balances into business segments is provided. The presentation of segment information is based on management responsibilities that existed at 31 March 2009 and the external and regulatory environments in which the Company operates. The business segments are Gas Transmission, Gas Distribution and Gas Metering, with other operations and corporate activities aggregated within other activities. Geographical segments are not reported, as all activities are within the UK. Discontinued operations comprise amounts in

respect of the four gas distribution networks sold on 1 June 2005.

Gas transportation transaction services undertaken by NGG's subsidiary xoserve are reported within other activities, in line with the current management structure.

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 will be 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 consolidated financial statements.

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

Estimated economic lives of property, plant and equipment
The reported amounts for depreciation of property, plant and equipment and amortisation of non-current intangible assets can be materially affected by the judgments exercised in determining their estimated economic lives.

Depreciation amounted to £400 million in 2008/09 and £418 million in 2007/08. Amortisation amounted to £15 million in 2008/09 and £13 million in 2007/08

Carrying value of assets and potential for impairments
The carrying value of assets recorded in the consolidated balance sheet could be materially reduced if an impairment were to be assessed as being required. Total assets at 31 March 2009 were £18,432 million, including £10,359 million of property, plant and equipment, £77 million of intangible assets and £5,611 million owed by NGG's immediate parent undertaking (31 March 2008: £16,572 million, £9,753 million, £60 million and £5,611 million respectively).

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.

Revenue
Revenue includes an assessment of transportation services supplied to customers between the date of the last invoice and the year end. Changes to the estimate of the transportation services supplied during this period would have an impact on the reported results.

Estimates of unbilled revenues amounted to £189m million at 31 March 2009 compared with £142 million at 31 March 2008.

Assets and liabilities carried at fair value
Certain financial investments and derivative financial instruments are carried in the balance sheet at their fair value rather than historical cost.

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 judgements on, in particular, future movements in exchange and interest rates.

Hedge accounting
Derivative financial instruments are used to hedge certain economic exposures arising from movements in exchange and interest rates or other factors that could affect either the value of the Company's assets or liabilities or affect future cash flows.

Movements in the fair values of derivative financial instruments may be accounted for using hedge accounting where the relevant eligibility, documentation and effectiveness testing requirements are met. 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
Defined benefit pension obligations are accounted for as if the National Grid UK Pension Scheme were a defined contribution scheme as there is neither a contractual arrangement, nor a stated policy under which the Company is charged for the costs of providing pensions.

A change in these arrangements may lead to the Company recognising the cost of providing pensions on a different basis, together with a proportion of the actuarial gains and losses and of the assets and liabilities of the pension scheme.

Exceptional items and remeasurements
Exceptional items and remeasurements are items of income and expenditure that, in the judgement of management, should be disclosed separately on the basis that they are material, either by their nature or their size, to an understanding of the Company's financial performance and 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, 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 the Company has no control.

Provisions
Provisions are made for liabilities that are uncertain in estimate. These include provisions for the cost of environmental restoration and remediation, restructuring and employer and public liability claims.

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 2009, there were recorded provisions totalling £149 million (2008: £116 million), including £56 million (2008: £44 million) in respect of environmental liabilities.

Tax estimates
The tax charge is based on the profit for the year and tax rates in effect. Current tax assets and liabilities arising from transfer pricing adjustments, which are expected to be fully recovered through group relief, are initially estimated and recognised in the current year where material. Further adjustments are recognised when tax returns are submitted to the tax authorities. In the prior year, current tax assets and liabilities arising from transfer pricing adjustments, which were expected to be fully recovered through group relief, were recognised when tax returns were submitted to the tax authorities.

The determination of appropriate provisions for taxation requires the Company to take into account anticipated decisions of tax authorities and estimate its ability to utilise tax benefits through future earnings and tax planning.

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 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 £10 million (before tax) and our annual amortisation charge on intangible assets by £1 million (before tax).

Revenue accruals
A 10% change in the estimate of unbilled revenues at 31 March 2009 would result in an increase or decrease in recorded net assets and profit for the year by approximately £14 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 £78 million.

Hedge accounting
If the gains and losses arising on derivative financial instruments during the year ended 31 March 2009 had not achieved hedge accounting then the profit for the year would have been £225 million higher than that reported net of tax and net assets would have been £176 million higher.

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 £15 million.

Accounting developments

New accounting standards and interpretations which have been issued but not yet adopted by NGG are discussed in the financial statements on pages 42 and 43.

Directors' Report

for the year ended 31 March 2009

In accordance with the requirements of the Companies Acts and UK Listing Authority's Listing, Disclosure and Transparency Rules, the following sections describe the matters that are required for inclusion in the Directors' Report and were approved by the Board. Further details of matters required to be included in the Directors' Report are incorporated by reference into this report, as detailed below.

Directors

The Directors serving as at the date of this report were:

Malcolm Cooper	Appointed June 2007
Mark Fairbairn	Appointed June 2003
Stuart Humphreys	Appointed 7 July 2008
Paul Whittaker	Appointed June 2007
Adam Wiltshire	Appointed July 2006
Nick Winser	Appointed July 2003

Andy Chapman also served as Director during the period, resigning on 7 July 2008.

Directors' and Officers' liability insurance cover is arranged and qualifying third party indemnities are in place for each Director.

Principal activities and business review

A full description of the Company's principal activities, businesses and principal risks and uncertainties is contained in the Operating and Financial Review on pages 1 to 30, which are incorporated by reference into this report.

Material interests in shares

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

Dividends

During the year, interim dividends totalling £300 million were paid (2008: £500 million interim dividend). The Directors have not proposed a final dividend.

Donations

During 2008/09, some £2.7 million (2007/08: £3.0 million) was invested in support of community initiatives and relationships in the UK, including direct charitable donations of £0.5 million (2008: £0.4 million).

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

Research and development

Expenditure on research and development was £3.9 million during the year (2008: £2.1 million).

Financial instruments

Details on the use of financial instruments and financial risk management are included on pages 24 to 26 in the Operating and Financial Review.

Future developments

Details of future developments are contained in the Operating and Financial Review.

Post balance sheet events

On 29 April 2009, the Competition Appeal Tribunal announced its decision not to uphold in full Ofgem's 2008 decision in relation to metering contracts. Further information is provided in the Operating and Financial Review on page 27.

Disability

Through National Grid's inclusion and diversity programme, NGG 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

NGG, as a part of National Grid, has well established and effective arrangements through electronic mail, intranet and in-house publications and briefing meetings, at each business location and company wide, for communication and consultation with both employees and trade union representatives, and for communication of performance, strategy and operating model, together with significant business issues. NGG recognises the importance of aligning employee and shareholder interests, and is committed to employee share ownership through the National Grid plc Share Incentive Plan and Sharesave scheme, which are open to all employees.

Policy and practice on payment of creditors

It is NGG's policy to include in contracts or other agreements, terms of payment with suppliers. Once agreed, NGG aims to abide by these terms of payment. The average creditor payment period at 31 March 2009 was 16 days (22 days at 31 March 2008).

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, there is no relevant audit information of which the auditors are unaware and each Director has taken all reasonable steps to make themselves aware of any relevant audit information and to establish that the auditors are aware of that information.

Annual General Meeting

Notice of the NGG's Annual General Meeting for 2009 will be issued separately to shareholders.

On behalf of the Board

Helen Mahy
Company Secretary
5 June 2009

National Grid Gas plc
1-3 Strand London WC2N 5EH
Registered in England and Wales Number 2006000

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Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and Accounts, including the consolidated financial statements and the Company financial statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have prepared the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union, and the Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice). In preparing the consolidated financial statements, the directors have also elected to comply with IFRS, issued by the International Accounting Standards Board (IASB).The consolidated financial statements and Company financial statements are required by law to give a true and fair view of the state of affairs of the Company on a consolidated and individual basis and of the consolidated profit of the Company for that period.

In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state that the consolidated financial statements comply with IFRS as adopted by the European Union, and with regard to the Company financial statements that applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the consolidated financial statements and Company financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company on a consolidated and individual basis and to enable them to ensure that the consolidated financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation and the Company financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and its subsidiaries and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Each of the Directors, whose names are listed in the Directors report on page 31, confirms that, to the best of their knowledge:

- The consolidated financial statements and the Company financial statements, which have been prepared in accordance with IFRSs as adopted by the European Union and UK GAAP respectively, give a true and fair view of the assets, liabilities, financial position and profit of the Company on a consolidated and individual basis; and
- The Annual Report includes a fair review of the development and performance of the business and the position of the Company on a consolidated and individual basis, together with a description of the principal risks and uncertainties that it faces.

By order of the Board

Helen Mahy
Company Secretary
5 June 2009

Independent Auditors' report to the Members of National Grid Gas plc

We have audited the consolidated and Company financial statements (the 'financial statements') of National Grid Gas plc for the year ended 31 March 2009 which comprise the consolidated income statement, the consolidated and Company balance sheets, the consolidated cash flow statement, the consolidated statement of recognised income and expense, the Accounting Policies and Company Accounting Policies, the Adoption of new accounting policies, the Notes to the consolidated financial statements and the Notes to the Company financial statements. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors
The directors' responsibilities for preparing the Annual Report and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and for preparing the Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985 and whether, in addition, the consolidated financial statements have been properly prepared in accordance with Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Business Review section of the Directors' Report.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the items listed in the contents section of the Annual Report, excluding the audited 2009 financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion
In our opinion:

- the consolidated financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 March 2009 and of its profit and cash flows for the year then ended;
- the consolidated financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 March 2009;
- the Company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham 5 June 2009

Accounting policies

for the year ended 31 March 2009

A. Basis of preparation of consolidated financial statements under IFRS

NGG's principal activities involve the transmission and distribution of gas and the provision of gas metering services within Great Britain. The Company is a public limited company incorporated and domiciled in England with its registered office at 1-3 Strand, London WC2 5EH.

These consolidated financial statements were approved for issue by the Board of Directors on 5 June 2009.

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board and as adopted by the European Union. They are prepared on the basis of all IFRS accounting standards and interpretations that are mandatory for periods ending 31 March 2009 and in accordance with the Companies Act 1985 applicable to companies reporting under IFRS and Article 4 of the European Union IAS regulation. The 2008 comparative financial information has also been prepared on this basis.

The November 2008 amendment to IAS 39 and IFRS 7 on the reclassification of financial assets, which is effective 1 July 2008, is still subject to endorsement by the European Union. The amendment relating to the reclassification of financial assets does not have an impact on consolidated results or asset or liabilities of the Company and therefore these consolidated financial statements comply with both IFRS as issued by the IASB and IFRS as adopted by the European Union.

The consolidated financial statements have been prepared on a historical cost basis, except for the revaluation of derivative financial instruments and investments classified as available for sale.

These consolidated financial statements are presented in pounds sterling, which is the functional currency of the Company.

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.

B. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries.

A subsidiary is defined as an entity controlled by the Company. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

Where necessary, adjustments are made to bring the accounting policies used under UK generally accepted accounting principles (UK GAAP) or other framework used in the individual financial statements of the Company and its subsidiaries into line with those used by the Company in its consolidated financial statements under IFRS. Inter-company transactions are eliminated.

C. 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.

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

On consolidation, the assets and liabilities of overseas financing operations that have a functional currency different from the Company's functional currency of sterling are translated at exchange rates prevailing at the balance sheet date. Income and expense items are translated at the weighted average exchange rates for the period. Exchange differences arising are classified as equity and transferred to the consolidated translation reserve.

D. Intangible assets

Identifiable intangible assets 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 under development are not amortised. Other non-current intangible assets 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

Intangible emission allowances are accounted for in accordance with accounting policy T.

E. Property, plant and equipment

Property, plant and equipment is recorded at cost 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 as well as the cost of any associated asset retirement obligations.

Property, plant and equipment include assets in which the Company'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, principally on a straight-line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements 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 in the table below:

Depreciation periods	Years
Freehold and leasehold buildings	up to 50
Plant and machinery	
– mains, services and regulating equipment	30 to 100
– meters and metering equipment	5 to 18
Motor vehicles and office equipment	3 to 10

Following a review of the useful economic lives of property, plant and equipment, the depreciation periods of certain assets within the Gas plant – mains, services and regulating equipment have been amended. This has resulted in a decrease in the depreciation charge and a corresponding increase in operating profit for the year ended 31 March 2009 of £43m.

F. 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.

Material impairments are recognised in the income statement and are disclosed separately.

G. Taxation

Current tax

Current tax assets 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. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation and establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Current tax assets and liabilities arising from transfer pricing adjustments, which are expected to be fully recovered through group relief, are initially estimated and recognised in the current year where material. Further adjustments are recognised when tax returns are submitted to the tax authorities. In the prior year, current tax asset and liabilities arising from transfer pricing adjustments, which were expected to be fully recovered through group relief, were recognised when tax returns were submitted to the tax authorities.

Deferred tax

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 is has become probable that future taxable profit will allow the deferred tax asset 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.

H. Discontinued operations

Cash flows and operations that relate to a major component of the business that has been sold are shown separately from continuing operations.

I. Inventories

Inventories, which comprise raw materials and consumables, are stated at cost less provision for damage and obsolescence. Cost comprises cost of direct materials and those costs that have been incurred in bringing the inventories to their present location and condition.

J. Environmental costs

Provision is made for environmental costs, based on future estimated expenditures, discounted to present values. Changes in the provision arising from revised estimates or discount rates or changes in the expected timing of expenditures are recognised in the income statement. The unwinding of the discount is included within the income statement as a financing charge.

K. Revenue

Revenue represents the sales value derived from the transmission and distribution of gas and the provision of gas metering services during the year. It excludes value added tax and intra-group sales.

The sales value for the transmission and distribution of gas is largely determined from the amount of system capacity sold for the year and the amount of gas transported in the year, evaluated at contractual prices on a monthly basis. Where revenue for the year exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, a liability for the over-recovery is not recognised as such an adjustment to future prices relates to the provision of future services. Similarly, an asset is not recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

The sales value for the provision of gas metering services is largely derived from monthly contractual charges for the provision of individual meters under long-term contractual arrangements.

L. Segmental information

Segmental information is presented in accordance with the management responsibilities and economic characteristics, including consideration of risks and returns, of business activities. The Company assesses the performance of its businesses principally on the basis of operating profit before exceptional items and remeasurements. The primary reporting format is by business. As all of our operations are within the same geographical area, Great Britain, no secondary reporting format is presented.

M. Pensions

The substantial majority of NGG's employees are members of the defined benefit section of the National Grid UK Pension Scheme. There is no contractual arrangement or stated policy for charging the net defined benefit cost of the Scheme to NGG. Accordingly, the Scheme is recognised as if it were a defined contribution scheme. The pension charge for the year represents the contributions payable to the Scheme for the period. A share of the assets and liabilities, or the actuarial gains and losses of the Scheme are not recognised in these financial statements.

N. Leases

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

O. Financial instruments

Financial assets, liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into, and recognised on trade date. Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any other categories.

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. Trade payables are initially recognised at fair value and subsequently measured at amortised cost.

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 recognised at fair value plus directly related incremental transaction costs and are subsequently carried at fair value on the balance sheet. 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 as available-for-sale is recognised on an effective interest rate basis and taken through interest income in the income statement.

Borrowings, which include interest-bearing loans, UK Retail Prices Index (RPI) linked debt and overdrafts, are recorded at their initial fair value which normally reflects the proceeds received, net of direct issue costs less any repayments. Subsequently they are stated at amortised cost, using the effective interest rate method. Any difference between the proceeds after direct issue costs and the redemption value is recognised over the term of the borrowing in the income statement using the effective interest rate method.

Borrowing costs directly attributable to the acquisition, construction or development 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.

Derivative financial instruments are recorded at fair value, and where fair value of a derivative is positive, it is carried as a derivative asset and where negative, it is carried as a derivative liability. Assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right to set-off exists and the cash flows are intended to be settled on a net basis. Gains and losses arising from changes in the fair value are included in the income statement in the period they arise.

Where we have derivatives embedded in financial instruments or other contracts that are closely related to those instruments or host contracts, no adjustment is made with respect to such derivative clauses. In particular, interest payments on UK RPI debt are linked to movements in the UK retail price index. The link to RPI is considered to be an embedded derivative, which is closely related to the underlying debt instrument based on the view that there is a strong relationship existing between interest rates and inflation in the UK economy. Consequently, these embedded derivatives are not accounted for separately from the debt instrument.

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 with an annual amount equal to the nominal amount of the shares issued included in the share capital account and the balance recorded in the share premium account.

Subsequent to initial recognition, the fair values of financial instruments measured at fair value that 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 are consistent with techniques commonly used by the relevant market. The techniques use observable market data.

P. Hedge accounting

The Company and its subsidiaries enter into both derivative financial instruments (derivatives) and non-derivative financial instruments in order to manage interest rate and foreign currency exposures, and commodity price risks associated with underlying business activities and the financing of those activities.

Hedge accounting allows derivatives to be designated as a hedge of another (non-derivative) financial instrument, to mitigate the impact of potential volatility in the income statement of changes in fair value of the derivative instruments. To qualify for hedge accounting documentation is prepared specifying the hedging strategy, the component transactions and methodology used for effectiveness measurement. The Company uses two hedge accounting methods.

Firstly, 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.

Secondly, fair value hedge accounting offsets the changes in the fair value of the hedging instrument against the change in the fair value of the hedged item in respect to the risk being hedged. These changes are recognised in the income statement to the extent the fair value hedge is effective. Adjustments made to the carrying amount of the hedged item

for fair value hedges will be amortised over the remaining life, in line with the hedged item.

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 rate 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.

Q. 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 based on an estimate of the number of shares that will eventually vest. This fair value 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.

R. Business performance and 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. Business performance is used by management to monitor financial performance, as it is considered to increase the comparability of our reported financial performance from year to year. Business performance subtotals, which exclude exceptional items and remeasurements, are presented on the face of the income statement or in the notes to the financial statements.

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, significant changes in environmental provisions, and gains or losses on disposals of businesses or investments.

Costs arising from restructuring programmes primarily relate to redundancy costs, impairment of assets, and site decommissioning 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.

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.

S. Other operating income

Other operating income primarily relates to profits or losses arising on the disposal of properties arranged by National Grid's property management business, which is considered to be part of normal recurring operating activities but which does not represent revenue, income from the sale of emission allowances, and pension deficit recovery.

T. Emission allowances

Emission allowances, which relate to the emissions of carbon dioxide, are recorded as an intangible asset within current assets and are initially recorded at cost, and subsequently at the lower of cost and net realisable value. For allocations of emission allowances granted by the UK Government, cost is deemed to be equal to fair value at the date of allocation. Receipts of such grants are treated as deferred income and are recognised in the income statement in the period in which carbon dioxide emissions are made. A provision is recorded in respect of the obligation to deliver emission allowances and charges are recognised in the income statement in the period in which carbon dioxide emissions are made.

Income from the sale of emission allowances is reported as part of other operating income.

U. 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 and bank overdrafts, which are reported in borrowings.

V. Other reserves

Other reserves comprise the capital redemption reserve arising from the refinancing and restructuring of the Lattice Group in 1999. It represents the amount of the reduction in the share capital of the Company as a consequence of that restructuring. As the amounts included in other reserves are not attributable to any of the other classes of equity presented, they have been disclosed as a separate classification of equity.

W. Dividends

Interim dividends are recognised when they become payable to the Company's shareholders. Final dividends are recognised in the financial year in which they are approved.

X. Areas of judgement and 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 or the notes to the financial statements, 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 items and remeasurements and the definition of adjusted earnings – note 4.
- The exemptions adopted on transition to IFRS on 1 April 2004.
- The non-recognition of certain net current tax liabilities expected to arise from transfer pricing adjustments – accounting policy G.
- The recognition of defined benefit pension costs as if the National Grid UK Pension Scheme was a defined contribution scheme – accounting policy M.
- Hedge accounting – accounting policy P.

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 intangible assets and property, plant and equipment – accounting policies D, E and F.
- Valuation of financial instruments and derivatives – notes 13, 16 and 29.
- Revenue recognition and assessment of unbilled revenue – accounting policy K.
- Environmental provisions – note 22.

Adoption of new accounting standards

New IFRS accounting standards and interpretations adopted in 2008/09

During the year ended 31 March 2009, NGG adopted the following amendments to International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and the International Financial Reporting Interpretation Committee pronouncements (IFRIC). None of these had a material impact on consolidated results or assets and liabilities.

IFRIC 12 on 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 (PFI) contracts.
IFRIC 14 on defined benefit assets and minimum funding requirements	Considers the limit on the measurement of a defined benefit asset to the present value of economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan plus unrecognised gains and losses, as set out in IAS 19 'Employee Benefits'. The interpretation considers when refunds or reductions in future contributions should be considered available, particularly when a minimum funding requirement exists.
Amendment to IAS 39 Financial Instruments: Recognition and measurement and IFRS 7 financial instruments: Disclosures on reclassification of financial assets.	Permits reclassification of financial assets in certain circumstances.

New IFRS accounting standards and interpretations not yet adopted

NGG has yet to adopt the following standards and interpretations. NGG has a number of transactions that fall within the scope of IFRIC 18 'Transfer of assets from customers' and the impact of this interpretation is being considered. The other standards and interpretations listed below are not expected to have a material impact on consolidated results or assets and liabilities.

IFRS 8 on 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, SFAS 131 'Disclosures about segments of an enterprise and related information' with minor differences. IFRS 8 has been adopted by the Company with effect from 1 April 2009.
IAS 23 revised on 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. IAS 23 revised has been adopted by the Company with effect from 1 April 2009.
IFRIC 13 on customer loyalty programmes	Clarifies that the sale of goods or services together with customer award credits (for example, loyalty points or the right to free products) is accounted for as a multiple-element transaction. The consideration received from the customer is allocated between the components of the arrangement based on their fair values, which will defer the recognition of some revenue. IFRIC 13 has been adopted by the Company with effect from 1 April 2009.
IAS 1 revised on the presentation of financial statements	Requires changes to the presentation of financial statements and adopts revised titles for the primary statements, although companies may continue to use the existing titles. IAS 1 revised has been adopted by the Company with effect from 1 April 2009.
IFRS 3R on business combinations	Makes a number of changes to the accounting for business combinations, including requirements that all payments to purchase a business are to be recorded at fair value at the acquisition date, with some contingent payments subsequently remeasured at fair value through income; an option to calculate goodwill based on the parent's share of net assets only or to include goodwill related to the minority interest; and a requirement that all transaction costs be expensed. IFRS 3R will be adopted by the Company on 1 April 2010, subject to endorsement by the European Union.
IAS 27R on consolidated and individual financial statements	Requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control. The revised standard also specifies the accounting when control is lost. IAS 27R will be adopted by the Company on 1 April 2010, subject to endorsement by the European Union.
Amendment to IFRS 2 on share-based payments	Clarifies the definition of vesting conditions and the accounting treatment of cancellations. Vesting conditions are defined as either service conditions or performance conditions. Cancellations by employees are accounted for in the same way as cancellations by the company. The amendment to IFRS 2 has been adopted by the Company with effect from 1 April 2009.
Amendments to IAS 32 and IAS 1 on puttable financial instruments and obligations arising on liquidation	Addresses the classification as a liability or as equity of certain puttable financial instruments and instruments, or components thereof, which impose upon an entity an obligation to deliver a pro rata share of net assets on liquidation. The amendment to IAS 32 and IAS 1 have been adopted by the company from 1 April 2009.

Amendments to IFRS 1 First-time Adoption of International Financial Reporting Standards and IAS 27 Consolidated and Separate Financial Statements of the cost of an investment in a subsidiary, Jointly Controlled Entity or Associate.	Permits investments to be recognised on first-time adoption of IFRS at cost or deemed cost (fair value of previous GAAP carrying amount) and removes the requirement to recognise dividends out of pre-acquisition profits as a reduction in the cost of investment. The amendments to IFRS 1 and IAS 27 have been adopted by the Company with effect from 1 April 2009.
Improvements to IFRS 2008	Contains amendments to various existing standards. The amendments are effective, in most cases, from 1 January 2009, or otherwise for annual periods beginning on or after 1 July 2009.
IFRIC 15 on agreements for the construction of real estate	Addresses the timing of revenue recognition for entities engaged in the construction of real estate for their customers. IFRIC 15 will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union.
IFRIC 16 on hedges of a net investment in a foreign operation.	Clarifies that a hedged risk may be designated at any level in a group and hedging instruments may be held by any company in a group (except the foreign entity being hedged), that net investment hedge accounting may not be adopted in respect of a presentational currency and that on disposal the amounts to be reclassified from equity to profit or loss are any cumulative gain or loss on the hedging instrument and the cumulative translation difference on the foreign operation disposed of. IFRIC 16 will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union.
Amendments to IAS 39 financial instruments: Recognition and measurement on eligible hedged items.	Prohibits designating inflation as a hedgeable component of an instrument, unless cash flows relating to the separate inflation component are contractual and also prohibits the designation of a purchased option in its entirety as the hedge of a one-sided risk in a forecast transaction. The amendment to IAS 39 will be adopted by the Company with effect from 1 April 2010, subject to endorsement by the European Union.
Amendment to IAS 39 Financial Instruments: Recognition and measurement: Reclassification of Financial Assets: Effective Date and Transition.	Clarifies the effective date of the reclassification of financial assets. The amendment is effective under IFRS but has not yet been endorsed by the European Union and has therefore not been adopted by the Company. Adoption of the amendment would not have any impact on results or assets and liabilities.
Revised IFRS 1 on first-time adoption of IFRS	Changes the structure while retaining the substance, of the previously issued version of IFRS 1. The revised version of IFRS 1 will be adopted by the Company with effect from 1 April 2010, subject to endorsement by the European Union.
IFRIC 17 on the distribution of non-cash assets to owners	Requires such a distribution to be measured at the fair value of the asset and any difference between the carrying amount of the asset and its fair value to be recognised in the profit or loss. IFRIC 17 will be adopted by the Company with effect from 1 April 2010.
IFRIC 18 on the transfer of asset from customers	Addresses arrangements whereby an entity receives items of property, plant or equipment or cash which the entity must use to connect customers to a network or provide access to a supply of goods or services, or both. IFRIC 18 will be adopted by the Company with effect from 1 July 2009, subject to endorsement by the European Union.
Amendment to IFRS 7 on improving disclosures about financial instruments	Enhances disclosures about fair value and liquidity risk. The amendment will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union.
Amendments to IAS 39 and IFRIC 9 on embedded derivatives	Requires reassessments of whether an embedded derivative should be separated out if a financial asset is reclassified out of the fair value through profit or loss category. The amendment will be adopted by the Company with effect from 1 April 2009, subject to endorsement by the European Union.
Improvements to IFRS 2009	Contains amendments to various existing standards. The amendments will be adopted by the Company with effect from 1 April 2010, subject to endorsement by the European Union.

Consolidated income statement

for the years ended 31 March

	Notes	2009 £m	2009 £m	2008 £m	2008 £m
Revenue	1(a)		**2,574**		2,440
Other operating income	2		**27**		8
Operating costs	3		**(1,834)**		(1,477)
Operating profit					
Before exceptional items	1(b)	**1,091**		994	
Exceptional items	4	**(324)**		(23)	
Total operating profit	1(b)		**767**		971
Interest income and similar income	6		**18**		16
Interest expense and other finance costs					
Before exceptional items and remeasurements	6	**(419)**		(357)	
Exceptional items and remeasurements	4, 6	**(6)**		24	
	6		**(425)**		(333)
Profit before taxation					
Before exceptional items and remeasurements		**690**		653	
Exceptional items and remeasurements		**(330)**		1	
Total profit before taxation			**360**		654
Taxation					
Before exceptional items and remeasurements	7	**(393)**		(278)	
Exceptional items and remeasurements	4, 7	**81**		117	
Total taxation	7		**(312)**		(161)
Profit from continuing operations after taxation					
Before exceptional items and remeasurements		**297**		375	
Exceptional items and remeasurements	4	**(249)**		118	
Profit for the year from continuing operations			**48**		493
Profit for the year from discontinued operations					
Exceptional items	8		**-**		3
Profit for the year			**48**		496
Attributable to:					
Equity shareholders of the parent			**47**		495
Minority interests			**1**		1
			48		496

The notes on pages 48 to 78 form part of the consolidated financial statements.

Consolidated balance sheet

at 31 March

	Notes	**2009 £m**	2008 £m
Non-current assets			
Intangible assets	10	**77**	60
Property, plant and equipment	11	**10,359**	9,753
Other non-current assets	12	**5,611**	5,611
Derivative financial assets	13	**688**	139
Total non-current assets		**16,735**	15,563
Current assets			
Inventories and current intangible assets	14	**34**	31
Trade and other receivables	15	**450**	365
Financial investments	16	**1,009**	518
Derivative financial assets	13	**204**	90
Cash and cash equivalents	17	**-**	5
Total current assets		**1,697**	1,009
Total assets	1(d)	**18,432**	16,572
Current liabilities			
Borrowings	18	**(1,421)**	(1,284)
Derivative financial liabilities	13	**(67)**	(27)
Trade and other payables	19	**(814)**	(851)
Current tax liabilities		**(34)**	(27)
Provisions	22	**(51)**	(51)
Total current liabilities		**(2,387)**	(2,240)
Non-current liabilities			
Borrowings	18	**(7,251)**	(5,532)
Derivative financial liabilities	13	**(42)**	(83)
Other non-current liabilities	20	**(1,107)**	(1,043)
Deferred tax liabilities	21	**(1,777)**	(1,629)
Provisions	22	**(98)**	(65)
Total non-current liabilities		**(10,275)**	(8,352)
Total liabilities	1(d)	**(12,662)**	(10,592)
Net assets		**5,770**	5,980
Equity			
Called up share capital	23	**45**	45
Share premium account	24	**204**	204
Retained earnings	24	**4,184**	4,434
Cash flow hedge reserve	24	**4**	(35)
Other reserves	24	**1,332**	1,332
Shareholder's equity		**5,769**	5,980
Minority interest	24	**1**	-
Total equity		**5,770**	5,980

These financial statements, comprising the consolidated income statement, consolidated balance sheet, consolidated statement of recognised income and expense, consolidated cash flow statement, accounting policies, adoption of new accounting standards and related notes 1 to 33 were approved by the Board of Directors on 5 June 2009 and were signed on its behalf by:

Paul Whittaker Director

Adam Wiltshire Director

Consolidated statement of recognised income and expense

for the years ended 31 March

		2009 £m	2008 £m
Net gains taken to equity in respect of cash flow hedges		**60**	14
Transferred to profit or loss on cash flow hedges		**(5)**	1
Tax on items taken directly to or transferred from equity	7	**(16)**	(1)
Net income recognised directly in equity		**39**	14
Profit for the year		**48**	496
Total recognised income and expense for the year		**87**	510
Attributable to:			
Equity shareholders of the parent		**86**	509
Minority interests		**1**	1
		87	510

Consolidated cash flow statement

for the years ended 31 March

	Notes	**2009 £m**	2008 £m
Cash flows from operating activities			
Total operating profit		**767**	971
Adjustments for:			
Exceptional items		**324**	23
Depreciation and amortisation		**415**	431
Profit on disposal of property, plant and equipment		**(2)**	-
Share based payment charge		**6**	5
Changes in working capital		**(245)**	138
Changes in provisions		**1**	10
Cash flows relating to exceptional items		**(261)**	(23)
Cash flows generated from operations		**1,005**	1,555
Tax paid		**(71)**	(228)
Net cash inflow from operating activities		**934**	1,327
Cash flows from investing activities			
Purchases of intangible assets		**(32)**	(29)
Purchases of property, plant and equipment		**(957)**	(1,451)
Disposals of property, plant and equipment		**14**	10
Interest received		**19**	14
Purchases of financial investments		**(500)**	(194)
Disposal of financial investments		**9**	58
Cash flows used in continuing operations - investing activities		**(1,447)**	(1,592)
Cash flows used in discontinued operations - investing activities		**-**	(1)
Net cash flow used in investing activities		**(1,447)**	(1,593)
Cash flows from financing activities			
Proceeds from loans received		**1,829**	2,120
Repayment of loans		**(1,389)**	(251)
Net movements in short-term borrowings and derivatives		**682**	(1,017)
Interest paid		**(318)**	(255)
Dividends paid to shareholders		**(300)**	(500)
Net cash flow from financing activities		**504**	97
Net decrease in cash and cash equivalents		**(9)**	(169)
Cash and cash equivalents at the start of the year (i)		**(1)**	168
Net cash and cash equivalents at the end of the year (i)	17	**(10)**	(1)

(i) Net of bank overdraft of £10m (2008: £6m, 2007: £6m).

Notes to the consolidated financial statements - analysis of items in the primary statements

1. Segmental analysis

The following table describes the main activities for each business segment:

Gas Transmission	The gas transmission network in the UK and the associated UK liquefied natural gas (LNG) storage activities
Gas Distribution	Four of the eight regional networks of Great Britain's gas distribution system
Gas Metering	Regulated gas metering activities in the UK

Other activities relate to the xoserve business which provides transportation transaction services on behalf of all the major gas network transportation companies, including ourselves, together with corporate activities.

Our segments are unchanged from those reported in the financial statements for the year ended 31 March 2008. All of the Company's sales and operations take place within the UK and therefore there is no secondary reporting format by geographical area.

Sales between businesses are priced having regard to the regulatory and legal requirements that the businesses are subject to, which include requirements to avoid cross-subsidies.

a) Revenue

	Total sales 2009 £m	**Sales between businesses 2009 £m**	**Sales to third parties 2009 £m**	Total sales 2008 £m	Sales between businesses 2008 £m	Sales to third parties 2008 £m
Business segments - continuing operations						
Gas Transmission	**813**	**1**	**812**	770	14	756
Gas Distribution	**1,466**	**65**	**1,401**	1,383	61	1,322
Gas Metering	**340**	**1**	**339**	349	2	347
Other activities	**43**	**21**	**22**	38	23	15
	2,662	**88**	**2,574**	2,540	100	2,440

The table above represents revenue from continuing operations only, as disclosed in the consolidated income statement. There was no revenue from discontinued operations.

b) Operating profit

	Before exceptional items		After exceptional items	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Business segments - continuing operations				
Gas Transmission	**321**	318	**56**	315
Gas Distribution	**668**	595	**610**	575
Gas Metering	**125**	101	**124**	101
Other activities	**(23)**	(20)	**(23)**	(20)
	1,091	994	**767**	971

The table above represents operating profit from continuing operations only, as disclosed in the consolidated income statement. Discontinued operations had no operating results during the year.

1. Segmental analysis continued

c) Capital expenditure and depreciation

	Capital expenditure		Depreciation and amortisation	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Business segments - continuing operations				
Gas Transmission	**389**	800	**123**	122
Gas Distribution	**598**	514	**177**	181
Gas Metering	**90**	73	**113**	127
Other activities	**3**	6	**2**	1
	1,080	1,393	**415**	431

Capital expenditure comprises additions to property, plant and equipment and intangible assets amounting to £1,048m (2008: £1,364m) and £32m (2008: £29m) respectively. There was no capital expenditure in respect of discontinued operations.

Depreciation and amortisation includes depreciation of property, plant and equipment and amortisation of intangible assets amounting to £400m (2008: £418m) and £15m (2008: £13m) respectively. There was no depreciation and amortisation in respect of discontinued operations.

d) Total assets and total liabilities

	Total assets		Total liabilities	
	2009 £m	2008 £m	**2009 £m**	2008 £m
Business segments - continuing operations				
Gas Transmission	**3,866**	3,569	**(414)**	(357)
Gas Distribution	**6,139**	5,758	**(1,261)**	(1,222)
Gas Metering	**729**	745	**(126)**	(144)
Other activities	**7**	37	**(43)**	(44)
	10,741	10,109	**(1,844)**	(1,767)
Unallocated	**7,691**	6,463	**(10,818)**	(8,825)
	18,432	16,572	**(12,662)**	(10,592)

The analysis of total assets and total liabilities excludes inter-business balances. Unallocated total assets include amounts owed by fellow subsidiaries, cash and cash equivalents, taxation, financial investments and derivative assets. Unallocated total liabilities include amounts owed to fellow subsidiaries, bank overdrafts, borrowings and derivative financial liabilities, taxation and interest.

2. Other operating income

Other operating income includes income on disposal of properties as a result of property management, emissions trading income, and pension deficit recovery.

3. Operating costs

	Before exceptional items		Exceptional items		Total	
	2009	2008	**2009**	2008	**2009**	2008
	£m	£m	**£m**	£m	**£m**	£m
Depreciation of property, plant and equipment	**400**	418	**-**	-	**400**	418
Amortisation of intangible assets	**15**	13	**-**	-	**15**	13
Payroll costs	**266**	254	**12**	17	**278**	271
Other operating charges:						
Purchases of gas	**172**	110	**-**	-	**172**	110
Rates	**236**	227	**-**	-	**236**	227
Other	**421**	432	**312**	6	**733**	438
	1,510	1,454	**324**	23	**1,834**	1,477

	2009	2008
Operating costs include:		
Consumption of inventories	**4**	5
Research expenditure	**4**	2
Operating lease rentals:		
Plant and machinery	**5**	5
Other	**11**	11

(a) Payroll costs

	2009	2008
	£m	£m
Wages and salaries	**258**	240
Social security costs	**23**	22
Other pension costs	**54**	66
Share-based payments	**6**	6
Severance costs (excluding pension costs)	**5**	9
	346	343
Less: payroll costs capitalised	**(68)**	(72)
	278	271

Payroll costs above represent continuing operations only.

(b) Number of employees, including Directors

	31 March	**Average**	Average
	2009	**2009**	2008
	Number	**Number**	Number
UK			
Continuing operations	6,558	6,650	6,410

The vast majority of employees are either directly or indirectly employed in the transmission and distribution of gas.

(c) Key management compensation

	2009	2008
	£m	£m
Salaries and short-term employee benefits	**3**	2
Post-employment benefits	**1**	1
Share-based payments	**1**	1
	5	4

Key management comprises the Board of Directors of the Company together with those Executive Directors of National Grid plc who have managerial responsibility for any of the businesses of NGG and who are not also Directors of the Company.

3. Operating costs continued

(d) Directors' emoluments

The aggregate amount of emoluments paid to Directors in respect of qualifying services for 2009 was £1,355,133 (2008: £1,530,063). There were no payments in respect of compensation for loss of office in either year.

The highest paid Director and two other Directors exercised share options during 2009 (2008: highest paid Director and four other Directors).

A number of the current Directors are also Directors and employees of National Grid plc or a subsidiary undertaking of that Company and are paid by these companies.

As at 31 March 2009, retirement benefits were accruing to six Directors under a defined benefit scheme (2008: six under a defined benefit scheme).

The aggregate emoluments for the highest paid Director were £500,716 for 2009 (2008: £464,286); and total accrued annual pension at 31 March 2009 for the highest paid Director was £85,676 (2008: £73,796).

(e) Auditors' remuneration

	2009 **£m**	2008 £m
Audit services		
Audit of parent Company and consolidated financial statements	**0.3**	0.5
Other services		
Other services supplied pursuant to legislation	**0.2**	0.7

Comparatives have been restated to present items on a basis consistent with the current year classification.

Other services supplied pursuant to legislation represents fees payable for services in relation to engagements which are required to be carried out by the auditor. In particular, this includes fees for audit reports on regulatory returns and fees for reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley).

4. Exceptional items and remeasurements

	2009 £m	2008 £m
Exceptional items - restructuring costs (i)	**(83)**	(23)
Exceptional items - environmental related provisions (ii)	**(13)**	-
Pension deficit charges (iii)	**(228)**	-
Total exceptional items included within operating profit	**(324)**	(23)
Remeasurements - gains on derivative financial instruments (iv)	**(6)**	24
Total exceptional items and remeasurements included within finance costs	**(6)**	24
Total exceptional items and remeasurements before taxation	**(330)**	1
Exceptional tax item - deferred tax credit arising from reduction in the UK tax rate (v)	**-**	117
Exceptional tax item - deferred tax charge arising from changes to the IBAs regime (vi)	**(23)**	-
Tax on exceptional items - restructuring costs	**23**	6
Tax on exceptional items - pension deficit charges (iii)	**81**	-
Tax on remeasurements - derivative financial instruments (iv)	**-**	(6)
Tax on exceptional items and remeasurements	**81**	117
Total exceptional items and remeasurements after taxation	**(249)**	118
Total exceptional items after taxation	**(243)**	100
Total derivative financial instrument remeasurements after taxation	**(6)**	18
Total exceptional items and remeasurements after taxation	**(249)**	118

(i) Restructuring costs relate to planned cost reduction programmes. For the year ended 31 March 2009, these included pension curtailment costs of £9m arising as a result of redundancies (2008: £10m), costs of £50m relating to the restructuring of our LNG storage facilities (2008: £nil), and other business reorganisation costs.

(ii) Environmental provision related charges include £5m due to movements in discount rates arising from reductions in market risk free rates due to the current economic conditions together with £8m arising from changes in landfill tax legislation in the UK.

(iii) Pension deficit charges arise from recovery plan contributions to the National Grid UK Pension Scheme.

(iv) Remeasurements - gains on derivative financial instruments comprise gains and losses arising on derivative financial instruments reported in the income statement. 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.

(v) The exceptional tax credit in the prior period arose from a reduction in the UK corporation tax rate from 30% to 28% included in the 2007 Finance Act. This resulted in a reduction in deferred tax liabilities.

(vi) The exceptional tax charge in the period arose from changes to the industrial buildings allowances (IBA) in the 2008 Finance Act. This resulted in an increase in deferred tax liabilities.

5. Pensions

Substantially all of NGG's employees are members of the defined benefit section of the National Grid UK Pension Scheme. There is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to NGG. Accordingly, the Company accounts for the scheme as if it were a defined contribution scheme. For further details regarding the nature and terms of the scheme and the actuarial assumptions used to value the associated assets and pension obligations, refer to note 28.

The following disclosures relate to the scheme as a whole and include amounts not recognised in these financial statements, but which are recognised in the consolidated financial statements of National Grid plc.

	2009	2008
	£m	£m
Amounts recognised in the consolidated balance sheet of National Grid plc		
Present value of fund obligations	**(10,771)**	(11,814)
Fair value of plan assets	**11,040**	12,660
	269	846
Present value of unfunded obligations	**(15)**	(17)
Asset in the balance sheet	**254**	829

	2009	2008
	£m	£m
Changes in the present value of the defined benefit obligation		
Opening defined benefit obligation (including unfunded obligations)	**11,831**	12,828
Current service cost	**47**	60
Interest cost	**762**	677
Actuarial gains	**(1,244)**	(1,134)
Curtailment gains on redundancies	**(3)**	(1)
Curtailment gain on sale of business	**-**	(12)
Special termination benefits	**11**	4
Curtailment cost - augmentations	**5**	11
Employee contributions	**7**	9
Benefits paid (including unfunded obligations)	**(630)**	(611)
Closing defined benefit obligation (including unfunded obligations)	**10,786**	11,831

	2009	2008
	£m	£m
Changes in the fair value of plan assets		
Opening fair value of plan assets	**12,660**	12,865
Expected return on plan assets	**(1,356)**	760
Actuarial losses	**-**	(550)
Employer contributions	**373**	200
Employee contributions	**7**	9
Benefits paid (including unfunded obligations)	**(630)**	(611)
Expenses paid	**(14)**	(13)
Closing fair value of plan assets	**11,040**	12,660
Expected contributions to defined benefit plans in the following year	**120**	311

6. Finance income and costs

	2009 £m	2008 £m
Interest income on financial instruments (i)	**18**	16
Interest income and similar income	**18**	16
Interest expense on financial liabilities held at amortised cost:		
Interest on bank loans and overdrafts	**(404)**	(33)
Interest on other borrowings	**(41)**	(343)
Interest on derivatives	**7**	(16)
Other interest	**(6)**	(9)
Unwinding of discount on provisions	**(3)**	(1)
Less: interest capitalised (ii)	**28**	45
Interest expense	**(419)**	(357)
Net gains on derivative financial instruments included in remeasurements:		
Ineffectiveness on derivatives designated as fair value hedges (iii)	**-**	6
Ineffectiveness on derivatives designated as cash flow hedges	**(7)**	3
On derivatives not designated as hedges or ineligible for hedge accounting	**1**	15
Net (losses)/gains on derivative financial instruments included in remeasurements (iv)	**(6)**	24
Interest expense and other finance costs	**(425)**	(333)
Net finance costs	**(407)**	(317)
Comprising:		
Interest income and similar income	**18**	16
Interest expense and other finance costs		
Before exceptional items and remeasurements	**(419)**	(357)
Exceptional items and remeasurements	**(6)**	24
	(407)	(317)

(i) Interest income on financial instruments comprises interest income from bank deposits and other financial assets.

(ii) Interest on funding attributable to assets in the course of construction was capitalised during the year at a rate of 6.2% (2008: 6.4%).

(iii) Includes a net gain on instruments designated as fair value hedges of £245m (2008: £46m) less a net loss of £245m arising from the fair value adjustments to the carrying value of debt (2008: £40m).

(iv) Includes a net foreign exchange loss on financing activities of £383m (2008: £80m). These amounts are offset by foreign exchange gains and losses on derivative financial instruments measured at fair value.

7. Taxation

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

The tax charge for the year can be analysed as follows:

	Before exceptional items and remeasurements		Exceptional items and remeasurements		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
United Kingdom						
Corporation tax at 28% (2008: 30%)	**180**	74	**(105)**	6	**75**	80
Corporation tax adjustment in respect of prior years	**105**	89	**-**	-	**105**	89
	285	163	**(105)**	6	**180**	169
Deferred tax	**110**	94	**24**	-	**134**	94
Deferred tax credit arising from reduction in UK tax rates	**-**	-	**-**	(117)	**-**	(117)
Deferred tax adjustment in respect of prior years	**(2)**	21	**-**	-	**(2)**	21
	108	115	**24**	(117)	**132**	(2)
Overseas						
Corporate tax	**-**	-	**-**	(6)	**-**	(6)
Corporate tax adjustment in respect of prior years	**-**	-	**-**	-	**-**	-
	-	-	**-**	(6)	**-**	(6)
Total tax charge/(credit)	**393**	278	**(81)**	(117)	**312**	161

Taxation on items charged/(credited) to equity

	2009 £m	2008 £m
Deferred tax charge on revaluation of cash flow hedges	**14**	1
Tax charge recognised in consolidated statement of recognised income and expense	**14**	1
Deferred tax charge/(credit) on share-based payments recognised directly in equity	**2**	5
Corporate tax credit on share-based payments recognised directly in equity	**-**	(4)
	16	2

The tax charge for the year after exceptional items and remeasurements is higher (2008: lower) than the standard rate of corporation tax in the UK of 28% (2008: 30%). The differences are explained below:

	Before exceptional items and remeasure-ments 2009 £m	**After exceptional items and remeasure-ments 2009 £m**	Before exceptional items and remeasure-ments 2008 £m	After exceptional items and remeasure-ments 2008 £m
Profit before taxation				
Before exceptional items and remeasurements	**690**	**690**	653	653
Exceptional items and remeasurements	**-**	**(330)**	-	1
Profit before taxation from continuing operations	**690**	**360**	653	654
Profit on continuing operations multiplied by the rate of corporation tax in the UK of 28% (2008: 30%)	**193**	**101**	196	196
Effects of:				
Adjustments in respect of prior years	**103**	**103**	110	110
Expenses not deductible for tax purposes	**7**	**7**	6	7
Non-taxable income	**(1)**	**(1)**	(4)	(4)
Adjustment in respect of foreign tax rates	**-**	**-**	-	(1)
Impact of employee share schemes	**2**	**2**	1	1
Remeasurement of deferred tax - change in UK tax rate	**-**	**-**	-	(117)
Other	**89**	**100**	(31)	(31)
Total taxation from continuing operations	**393**	**312**	278	161
	%	**%**	%	%
At the effective income tax rate	**57.0**	**86.7**	42.6	24.6

7. Taxation continued

Factors that may affect future tax charges

A number of changes to the UK Corporation Tax system were announced in the April 2009 Budget Statement which are expected to be enacted in the Finance Act 2009.

These changes include temporary changes to the capital allowances regime and the introduction of a system for taxing foreign profits, which is expected to bring in a dividend exemption and a worldwide debt cap.

The dividend exemption is likely to be available for both UK and foreign distributions, falling within an exempt classification, received on or after 1 July 2009. This is not expected to have a material effect on our future tax charge.

The worldwide debt cap is likely to restrict the amount of finance expense available for UK tax purposes, based on the consolidated finance expense, and is expected to apply for the accounting period ended 31 March 2011 onwards. We are in the process of evaluating the impact of the worldwide debt cap will have on our future tax charge.

These changes have not been substantively enacted at the balance sheet date and therefore have not been reflected in these financial statements.

8. Discontinued operations

Comprises amounts in respect of the four regional gas distribution networks that were disposed of in June 2005.

	2009 £m	2008 £m
Gain on disposal of discontinued operations before and after tax	**-**	3

9. Dividends

The following table shows the dividends paid to equity shareholders:

	2009 pence (per ordinary share)	**2009 £m**	2008 pence (per ordinary share)	2008 £m
Ordinary dividends				
Interim dividend for the year ended 31 March 2009	**7.61**	**300**	-	-
First interim dividend for the year ended 31 March 2008	**-**	**-**	7.61	300
Second interim dividend for the year ended 31 March 2008	**-**	**-**	5.07	200
	7.61	**300**	12.68	500

10. Intangible assets

	Software £m
Non-current	
Cost at 1 April 2007	96
Additions	29
Cost at 31 March 2008	125
Additions	32
Disposals	(8)
Cost at 31 March 2009	149
Amortisation at 1 April 2007	(52)
Amortisation charge for the year	(13)
Amortisation at 31 March 2008	(65)
Amortisation charge for the year	(15)
Disposals	8
Amortisation at 31 March 2009	(72)
Net book value at 31 March 2009	**77**
Net book value at 31 March 2008	60

Current other intangible assets are presented together with inventories in note 14 and consist of emissions allowances of £5m (2008: £nil).

11. Property, plant and equipment

	Land and buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2007	79	12,066	768	590	13,503
Additions	13	552	789	10	1,364
Disposals	(2)	(19)	-	(12)	(33)
Reclassifications	2	964	(1,007)	41	-
Cost at 31 March 2008	92	13,563	550	629	14,834
Additions	7	991	9	41	1,048
Disposals	-	(16)	-	(4)	(20)
Reclassifications	10	239	(235)	(14)	-
Cost at 31 March 2009	109	14,777	324	652	15,862
Depreciation at 1 April 2007	(24)	(4,225)	-	(437)	(4,686)
Depreciation charge for the year	(5)	(369)	-	(44)	(418)
Disposals	1	13	-	9	23
Depreciation at 31 March 2008	(28)	(4,581)	-	(472)	(5,081)
Depreciation charge for the year	(9)	(344)	-	(47)	(400)
Impairment	-	(30)	-	-	(30)
Disposals	-	4	-	4	8
Reclassifications	(6)	6	-	-	-
Depreciation at 31 March 2009	(43)	(4,945)	-	(515)	(5,503)
Net book value at 31 March 2009	**66**	**9,832**	**324**	**137**	**10,359**
Net book value at 31 March 2008	64	8,982	550	157	9,753

The net book value of land and buildings comprised:

	2009 £m	2008 £m
Freehold	**41**	41
Short leasehold (under 50 years)	**25**	23
	66	64

The cost of property, plant and equipment at 31 March 2009 included £124m (2008: £96m) relating to interest capitalised.

Included within trade and other payables and other non-current liabilities at 31 March 2009 are contributions to the cost of property, plant and equipment amounting to £24m (2008: £28m) and £1,027m (2008: £985m) respectively.

12. Other non-current assets

	2009 £m	2008 £m
Loans and receivables - amounts owed by parent	**5,611**	5,611

The amount owed by the parent is non-contractual and accordingly its fair value equals its book value.

13. Derivative financial instruments

For further information and a detailed description of our derivative financial instruments and hedge type designations, refer to note 29. The fair value by designated hedge type can be analysed as follows:

	2009			2008		
	Asset £m	**Liabilities £m**	**Total £m**	Asset £m	Liabilities £m	Total £m
Fair value hedges						
Interest rate swaps	**98**	**-**	**98**	8	(3)	5
Cross-currency interest rate swaps	**488**	**(11)**	**477**	98	(38)	60
	586	**(11)**	**575**	106	(41)	65
Cash flow hedges						
Interest rate swaps	**1**	**(31)**	**(30)**	29	(36)	(7)
Cross-currency interest rate swaps	**210**	**(4)**	**206**	67	(8)	59
Foreign exchange forward contracts	**-**	**-**	**-**	14	(5)	9
	211	**(35)**	**176**	110	(49)	61
Derivatives not in a formal hedge relationship						
Interest rate swaps	**53**	**(57)**	**(4)**	9	(20)	(11)
Cross-currency interest rate swaps	**39**	**-**	**39**	4	-	4
Forward exchange forward contracts	**3**	**-**	**3**	-	-	-
Forward rate agreements	**-**	**(6)**	**(6)**	-	-	-
	95	**(63)**	**32**	13	(20)	(7)
Total	**892**	**(109)**	**783**	229	(110)	119

The maturity of derivative financial instruments is as follows:

	2009			2008		
	Assets £m	**Liabilities £m**	**Total £m**	Assets £m	Liabilities £m	Total £m
In one year or less	**204**	**(67)**	**137**	90	(27)	63
Current	**204**	**(67)**	**137**	90	(27)	63
In more than one year, but not more than two years	**-**	**-**	**-**	40	(1)	39
In more than two years, but not more than three years	**-**	**-**	**-**	-	-	-
In more than three years, but not more than four years	**5**	**(6)**	**(1)**	-	-	-
In more than four years, but not more than five years	**160**	**(19)**	**141**	-	(5)	(5)
In more than five years	**523**	**(17)**	**506**	99	(77)	22
Non-current	**688**	**(42)**	**646**	139	(83)	56
	892	**(109)**	**783**	229	(110)	119

For each class of derivative the sterling equivalent notional value of the pay leg is as follows:

	2009 £m	2008 £m
Forward rate agreements	**(3,345)**	-
Interest rate swaps	**(2,924)**	(2,800)
Cross-currency interest rate swaps	**(1,707)**	(1,096)
Foreign exchange forward contracts	**(15)**	(176)
	(7,991)	(4,072)

14. Inventories and other intangible assets

	2009 **£m**	2008 £m
Raw materials and consumables	**29**	31
Other intangible assets	**5**	-
	34	31

Other intangible assets consists of emission allowances.

15. Trade and other receivables

	2009 **£m**	2008 £m
Trade receivables	**47**	40
Amounts owed by fellow subsidiaries	**179**	99
Other receivables	**7**	43
Prepayments and accrued income	**217**	183
	450	365

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 their book value.

Provision for impairment of receivables

	£m
At 1 April 2007	3
Release of provision	(1)
At 31 March 2008	2
Additions off net of recoveries	1
At 31 March 2009	**3**

As at 31 March 2009, trade receivables of £8m (2008: £2m) were past due but not impaired. The ageing analysis of these trade receivables is as follows:

	2009 **£m**	2008 £m
Up to 3 months past due	**3**	1
3 to 6 months past due	**2**	-
Over 6 months past due	**3**	1
	8	2

For further information about wholesale credit risk refer to note 30 (b).

16. Financial investments

	2009 £m	2008 £m
Current		
Available-for-sale investments - investments in short term money funds	**990**	490
Loans and receivables - amounts due from fellow subsidiaries	**19**	19
Other loans and receivables - restricted cash balances	**-**	9
	1,009	518

Available-for-sale investments are recorded at their fair value. The fair value of loans and receivables approximates to their book value.

The maximum exposure to credit risk at the reporting date is the fair value of the financial instruments - for further information on our treasury related credit risk refer to note 30. None of the financial investments are past due or impaired.

Restricted cash balances represent cash posted by the Company and its subsidiaries under collateral agreements.

17. Cash and cash equivalents

	2009 £m	2008 £m
Cash at bank	**-**	1
Short-term deposits	**-**	4
Cash and cash equivalents excluding bank overdrafts	**-**	5
Bank overdrafts	**(10)**	(6)
Net cash and cash equivalents	**(10)**	(1)

The fair values of cash and cash equivalents and bank overdrafts approximate to their book amounts.

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

18. Borrowings

The following table analyses borrowings, including bank overdrafts:

	2009 £m	2008 £m
Current		
Bank loans	**275**	41
Bonds	**895**	688
Other loans	**2**	2
Borrowings from fellow subsidiaries	**239**	547
Bank overdrafts	**10**	6
	1,421	1,284
Non-current		
Bank loans	**602**	584
Bonds	**6,229**	4,836
Other loans	**170**	112
Borrowings from fellow subsidiaries	**250**	-
	7,251	5,532
Total borrowings	**8,672**	6,816

Total borrowings are repayable as follows:	**2009 £m**	2008 £m
In one year or less	**1,421**	1,284
In more than one year, but not more than two years	**1**	710
In more than two years, but not more than three years	**250**	-
In more than three years, but not more than four years	**221**	-
In more than four years, but not more than five years	**752**	215
In more than five years other than by instalments	**6,027**	4,607
	8,672	6,816

The fair value of borrowings at 31 March 2009 was £7,760m (2008: £6,432m). Market values, where available, have been used to determine fair values. Where market values are not available, fair values have been calculated by discounting cash flows at prevailing interest rates.

The notional amount outstanding of the debt portfolio as at 31 March 2009 was £8,805m (2008: £7,076m).

Collateral is placed with or received from any counterparty where we have entered into a credit support annex to the ISDA Master Agreement once the current mark-to-market valuation of the trades between the parties exceeds an agreed threshold. Included in current bank loans is £273m (2008: £39m) in respect of cash received under collateral agreements. Cash placed under collateral agreements is shown in note 16.

As at 31 March 2009, the Company had committed credit facilities of £755m (2008: £810m) of which £755m was undrawn (2008: £810m undrawn). These undrawn facilties expire in more than one year but less than two years.

All of the unused facilities at 31 March 2009 and at 31 March 2008 were held as back-up to commercial paper and similar borrowings.

None of the Company's borrowings are secured by charges over assets of the Company.

19. Trade and other payables

	2009 £m	2008 £m
Trade payables	**382**	444
Amounts owed to fellow subsidiaries	**209**	243
Social security and other taxes	**62**	85
Other payables	**33**	25
Deferred income	**128**	54
	814	851

Due to their short maturities, the fair value of trade and other payables (excluding deferred income) approximates to their book value.

20. Other non-current liabilities

	2009 £m	2008 £m
Trade payables	**18**	-
Other payables	**-**	3
Deferred income	**1,089**	1,040
	1,107	1,043

The fair value of trade and other payables approximates to their book value.

21. Deferred tax assets and liabilities

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

	Accelerated tax depreciation £m	Employee share options £m	Financial instruments £m	Other net temporary differences £m	Total £m
Deferred tax assets at 31 March 2007	-	(10)	-	(14)	(24)
Deferred tax liabilities at 31 March 2007	1,599	-	17	34	1,650
At 1 April 2007	1,599	(10)	17	20	1,626
Charged/(credited) to income statement	3	-	(4)	(2)	(3)
Charged to equity	-	5	1	-	6
At 31 March 2008	1,602	(5)	14	18	1,629
Deferred tax assets at 31 March 2008	-	(5)	-	(14)	(19)
Deferred tax liabilities at 31 March 2008	1,602	-	14	32	1,648
At 1 April 2008	1,602	(5)	14	18	1,629
Charged/(credited) to income statement	134	-	(2)	-	132
Charged to equity	-	2	14	-	16
At 31 March 2009	**1,736**	**(3)**	**26**	**18**	**1,777**
Deferred tax assets at 31 March 2009	-	(3)	-	(14)	(17)
Deferred tax liabilities at 31 March 2009	1,736	-	26	32	1,794
At 31 March 2009	1,736	(3)	26	18	1,777

Deferred tax assets are all offset against deferred tax liabilities.

At the balance sheet date there were no material current deferred tax assets or liabilities (2008: £nil).

Deferred tax assets in respect of capital losses of £24m (2008: £18m) have not been recognised as their future recovery is uncertain or not currently anticipated. The capital losses are available to carry forward indefinitely. The capital losses can be offset against specific types of future capital gains.

22. Provisions

	Environmental £m	Emissions £m	Restructuring £m	Other £m	Total provisions £m
At 1 April 2007	44	1	20	41	106
Additions	-	5	23	12	40
Release of unused amounts	-	(1)	-	(5)	(6)
Unwinding of discount	1	-	-	-	1
Utilised	(1)	-	(22)	(2)	(25)
At 31 March 2008	44	5	21	46	116
Additions	13	6	34	16	69
Release of unused amounts	-	(9)	-	-	(9)
Unwinding of discount	2	-	-	1	3
Utilised	(3)	-	(12)	(15)	(30)
At 31 March 2009	**56**	**2**	**43**	**48**	**149**

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

	2009 £m	2008 £m
Current	**51**	51
Non-current	**98**	65
	149	116

Environmental provision

The environmental provision represents the net present value of the estimated statutory decontamination costs of old gas manufacturing sites owned by National Grid Gas plc (discounted using a nominal rate of 2.0%). The anticipated timing of the cash flows for statutory decontamination cannot be predicted with certainty, but they are expected to be incurred over the next 50 years.

There are a number of uncertainties that affect the calculation of the provision for gas site decontamination, including the impact of regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. We have made our best estimate of the financial effect of these uncertainties in the calculation of the provision, but future material changes in any of the assumptions could materially impact on the calculation of the provision and hence the income statement.

The undiscounted amount of the provision at 31 March 2009 relating to gas site decontamination was £85m (2008: £69m), being the best undiscounted estimate of the liability having regard to the uncertainties referred to above.

Emissions provision

The provision for emission costs is expected to be settled using emission allowances granted or purchased.

Restructuring provision

At 31 March 2009, £5m of the total restructuring provision (2008: £6m) consisted of provisions for the disposal of surplus leasehold interests and rates payable on surplus properties. The expected payment dates for property restructuring costs remain uncertain. The remainder of the restructuring provision related to business reorganisation costs, to be paid during 2009 and 2010.

Other provisions

Other provisions at 31 March 2009 include £12m (2008: £17m) in respect of property transfer costs related to the sales of four UK gas distribution networks and £21m (2008: £18m) in respect of employer liability claims. The payment dates for the property transfer costs are uncertain but should largely be over the next two years. In accordance with insurance industry practice, the estimates for employer liability claims are based on experience from previous years and, therefore, there is no identifiable payment date associated with these items.

23. Share capital

	Number of shares 2009 millions	Number of shares 2008 millions	2009 £m	2008 £m
At 31 March 2008 and 2009 - ordinary shares of 1 $^{2}/_{15}$p each				
Allotted, called up and fully paid	**3,944**	3,944	**45**	45
Authorised	**6,052**	6,052	**69**	69

24. Reconciliation of movements in total equity

	Called up share capital £m	Share premium account £m	Cash flow hedge reserve £m	Other reserves £m	Retained earnings £m	Total shareholders' equity £m	Minority interest £m	Total equity £m
At 1 April 2007	45	204	(49)	1,332	4,435	5,967	-	5,967
Total recognised income and expense for the year	-	-	14	-	495	509	1	510
Equity dividends	-	-	-	-	(500)	(500)	-	(500)
Other movements in minority interests	-	-	-	-	-	-	(1)	(1)
Share-based payments	-	-	-	-	5	5	-	5
Tax on share-based payments	-	-	-	-	(1)	(1)	-	(1)
At 31 March 2008	45	204	(35)	1,332	4,434	5,980	-	5,980
Total recognised income and expense for the year	-	-	39	-	47	86	1	87
Equity dividends	-	-	-	-	(300)	(300)	-	(300)
Share-based payments	-	-	-	-	6	6	-	6
Tax on share-based payments	-	-	-	-	(3)	(3)	-	(3)
At 31 March 2009	**45**	**204**	**4**	**1,332**	**4,184**	**5,769**	**1**	**5,770**

The Company is prohibited from declaring a dividend or other distribution unless it has certified that it is in compliance in all material respects with certain regulatory obligations, including a requirement to ensure it has sufficient financial resources and facilities to enable it to carry on its business and a requirement to use all reasonable endeavours to maintain an investment grade credit rating.

Gains and losses recognised in the cash flow hedge reserve on interest rate swap contracts as of 31 March 2009 will be continuously transferred to the income statement until the borrowings are repaid (note 18).

The amount of the cash flow hedge reserve due to be released from reserves to the income statement within the next year is £1m, with the remaining amount due to be released with the same maturity profile as borrowings in note 18.

25. Consolidated cash flow statement

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

	2009 **£m**	2008 £m
Movement in cash and cash equivalents	**(9)**	(169)
Increase in financial investments	**491**	136
Increase in borrowings and derivatives	**(1,122)**	(852)
Net interest paid	**310**	232
Change in net debt resulting from cash flows	**(330)**	(653)
Changes in fair value of financial assets and liabilities	**47**	39
Net interest charge	**(423)**	(376)
Movement in net debt (net of related derivative financial instruments) in the year	**(706)**	(990)
Net debt at the start of the year	**(6,174)**	(5,184)
Net debt (net of related derivative financial instruments) at the end of the year	**(6,880)**	(6,174)

b) Analysis of changes in net debt

	Cash and cash equivalents £m	Bank overdrafts £m	Net cash £m	Financial investments £m	Borrowings £m	Derivatives £m	Total debt £m
At 1 April 2007	174	(6)	168	380	(5,717)	(15)	(5,184)
Cash flow	(169)	-	(169)	122	(612)	6	(653)
Fair value gains and losses	-	-	-	-	(105)	144	39
Interest charges	-	-	-	16	(376)	(16)	(376)
At 31 March 2008	5	(6)	(1)	518	(6,810)	119	(6,174)
Cash flow	(5)	(4)	(9)	476	(1,401)	604	(330)
Fair value gains and losses	-	-	-	-	(6)	53	47
Interest charges	-	-	-	15	(445)	7	(423)
At 31 March 2009	**-**	**(10)**	**(10)**	**1,009**	**(8,662)**	**783**	**(6,880)**

Notes to the consolidated financial statements - supplementary information

26. Commitments and contingencies

a) Future capital expenditure

	2009 £m	2008 £m
Contracted for but not provided	**480**	461

b) Lease commitments

Total commitments under non-cancellable operating leases were as follows:

	2009 £m	2008 £m
Amounts due:		
In one year or less	**12**	11
In more than one year, but not more than two years	**10**	10
In more than two years, but not more than three years	**8**	8
In more than three years, but not more than four years	**7**	8
In more than four years, but not more than five years	**6**	7
In more than five years	**32**	38
	75	82

The majority of the leases are in respect of properties.

c) Amounts receivable under sublease arrangements

The total of future minimum sublease payments expected to be received under non-cancellable subleases is £2m (2008: £3m).

d) Other commitments, contingencies and guarantees

The value of other commitments, contingencies and guarantees at 31 March 2009 amounted to £150m (2008: £84m), including gas purchase commitments amounting to £70m (2008: £39m), and guarantees relating to certain property obligations of a National Grid group undertaking of £1m (2008: £5m).

e) Parent Company loan guarantees on behalf of subsidiaries

The Company has guaranteed the repayment of principal sums, any associated premium and interest on specific loans due from its financial subsidiaries to third parties. At 31 March 2009, the sterling equivalent amounted to £1,487m (2008: £1,159m).

f) Litigation and claims

In last year's Annual Report and Accounts, we reported a decision by the Gas and Electricity Markets Authority (GEMA) to levy on us a fine of £41.6m for a breach of the UK Competition Act 1998 in respect of term contracts with suppliers entered into by our UK metering services business in 2004. We also noted that we had appealed this decision to the Competition Appeal Tribunal (the Tribunal). On 29 April 2009, the Tribunal overturned the decision in part and reduced the fine to £30m but upheld the original decision in part.

On 29 May 2009, we lodged our application at the Tribunal for leave to appeal on points of law and on the amount of the penalty. As at this date therefore, we remain of the view that an outflow of economic benefits is not probable, and as a result, no provision has been made in these accounts either for the reduced fine of £30m, or for any other possible financial impact of the ruling.

In October 2008, we informed Ofgem that our mains replacement activity carried out within the UK's West Midland Alliance partnership may have been misreported. National Grid and Ofgem have jointly appointed Ernst & Young to carry out a full investigation to determine the extent of the issue. At present it is too early to determine the likely outcome of the investigation and any potential consequences.

27. Related party transactions

The following information is provided in accordance with IAS 24, Related party disclosures, as being material transactions with related parties during the year. These transactions are with fellow subsidiaries of National Grid and a pension plan, in the normal course of business and are summarised below.

	Parent		Other related parties		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Income:						
Goods and services supplied	**-**	-	**19**	25	**19**	25
Expenditure:						
Services received	**-**	-	**76**	68	**76**	68
Corporate services received	**-**	-	**21**	22	**21**	22
Charges in respect of pensions costs	**-**	-	**238**	(26)	**238**	(26)
Charges in respect of share-based payments	**-**	-	**6**	6	**6**	6
Interest received on borrowings from fellow subsidiaries	**-**	-	**(3)**	-	**(3)**	-
Interest paid on borrowings from fellow subsidiaries	**2**	33	**18**	13	**20**	46
	2	33	**356**	83	**358**	116
Outstanding balances at 31 March in respect of income, expenditure and settlement of corporation tax:						
Amounts receivable	**-**	-	**179**	99	**179**	99
Amounts payable	**-**	-	**209**	243	**209**	243
Advances to fellow subsidiaries (due within one year):						
At 1 April	**19**	-	**-**	75	**19**	75
Advances	**-**	19	**-**	-	**-**	19
Repayments	**-**	-	**-**	(75)	**-**	(75)
At 31 March	**19**	19	**-**	-	**19**	19
Advances to parent (due after more than one year):						
At 1 April and 31 March	**5,611**	5,611	**-**	-	**5,611**	5,611
Borrowings payable to fellow subsidiaries (amounts due within one year):						
At 1 April	**186**	1,314	**361**	203	**547**	1,517
Advances	**-**	-	**447**	288	**447**	288
Repayments	**(186)**	(1,128)	**(319)**	(130)	**(505)**	(1,258)
At 31 March	**-**	186	**489**	361	**489**	547

Amounts receivable from or payable to related parties in respect of sales and expenditure are ordinarily settled one month in arrears. The advance to the parent due after more than one year is not interest bearing. Other advances to and borrowings from fellow subsidiaries are repayable on demand and bear interest at commercial rates.

No amounts have been provided at 31 March 2009 (2008: £nil) and no expense has been recognised during the year (2008: £nil) in respect of bad or doubtful debts for related party transactions.

Details of guarantees provided in respect of related parties are provided in note 26.

Details of key management compensation are provided in note 3(c).

28. Actuarial information on pensions

The National Grid UK Pension Scheme is funded with assets held in a separate trustee administered fund. The scheme is subject to independent actuarial valuation at least every three years, on the basis of which the qualified actuary certifies the rate of employers' contribution which, together with the specified contributions payable by employees and the proceeds from the scheme's assets, are expected to be sufficient to fund the benefits payable under the scheme. The scheme provides final salary defined benefits for employees who joined prior to 31 March 2002 and defined contribution benefits for employees joining from 1 April 2002.

The latest full actuarial valuation was carried out by Watson Wyatt LLP at 31 March 2007. The aggregate market value of the scheme's assets was £12,923m and the value of the assets represented 97% of the actuarial value of benefits due to members, calculated on the basis of pensionable earnings and service at 31 March 2007 on an ongoing basis and allowing for projected increases in pensionable earnings. There was a funding deficit of £442m (£309m net of tax) on the valuation date in light of which National Grid agreed a recovery plan with the trustees.

The results of the actuarial valuation carried out at 31 March 2007 showed that, based on long-term financial assumptions, the contribution rate required to meet future benefit accrual was 32.4% of pensionable earnings (29.4% employers and 3% employees). In addition, the employers pay an allowance for administration expenses which was 3.2% of pensionable earnings for 2008/09, giving a total Company rate of 32.6% of pensionable earnings. These contribution rates will be reviewed at the next valuation on 31 March 2010.

In accordance with the recovery plan agreed with the trustees at the 2007 Valuation date, NGG paid contributions of £228m (£164m net of tax) in the year to 31 March 2009 and a further payment of £58m (£42m net of tax) in April 2009 to ensure that the deficit revealed at the 2007 valuation is paid in full.

Asset allocations and actuarial assumptions

The major categories of plan assets as a percentage of total plan assets were as follows:

	2009 %	2008 %
Equities	**33.9**	33.8
Corporate bonds	**34.7**	26.7
Gilts	**21.0**	29.9
Property	**5.5**	6.8
Other	**4.9**	2.8
Total	**100.0**	100.0

The expected long-term rate of return on assets has been set reflecting the price inflation expectation, the expected real return on each major asset class and the long-term asset allocation strategy adopted for the scheme. The expected real returns on specific asset classes reflect historical returns, investment yields on the measurement date and general future return expectations, and have been set after taking advice from the scheme's actuaries. The current target asset allocation for the scheme is 34% equities, 58% bonds and 8% property and other.

The principal actuarial assumptions used were:	**2009** %	2008 %
Discount rate (i)	**6.8**	6.6
Expected return on plan assets	**6.4**	6.1
Rate of increase in salaries (ii)	**3.8**	4.6
Rate of increase in pensions in payment and deferred pensions	**3.0**	3.8
Rate of increase in Retail Prices Index	**2.9**	3.7

(i) The discount rate for pension liabilities has been determined by reference to appropriate yields prevailing in the UK debt markets at the balance sheet date.

(ii) A promotional age related scale has been used where appropriate.

28. Actuarial information on pensions continued

The assumed life expectations for a retiree at age 65 are as follows:

	2009 Years	2008 Years
Today:		
Males	20.8	20.7
Females	23.2	23.0
In 20 years:		
Males	23.1	23.0
Females	25.5	25.3

Sensitivities analysed - all other assumptions held constant:

	Change in pension obligations		Change in annual pension cost	
	2009 £m	2008 £m	**2009 £m**	2008 £m
0.1% increase in discount rate	**143**	169	**1**	2
0.5% increase in long term rate of increase in salaries	**51**	67	**2**	2
Increase of one year to life expectancies at age 60	**269**	360	**1**	1

29. Supplementary information on derivative financial instruments

Derivatives are financial instruments that derive their value from the price of an underlying item such as interest rates, foreign exchange, credit spreads, or other indices. Derivatives enable their users to alter exposure to market or credit risks. We use derivatives to manage our treasury risks.

Treasury financial instruments

Derivatives are used for hedging purposes in the management of exposure to market risks. This enables the optimisation of the overall cost of accessing debt capital markets, and to mitigate the market risk which would otherwise arise from the maturity and other risk profiles of its assets and liabilities.

Hedging policies using derivative financial instruments are further explained in note 30. Derivatives that are held as hedging instruments are formally designated as hedges as defined in IAS 39. Derivatives may qualify as hedges for accounting purposes if they are fair value hedges or cash flow hedges. These are described as follows:

Fair value hedges

Fair value hedges principally consist of interest rate and cross-currency swaps that are used to protect against changes in the fair value of fixed-rate, long-term financial instruments due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the derivative and changes in the fair value of the item in relation to the risk being hedged are recognised in remeasurements within the income statement. If the hedge relationship is terminated, the fair value adjustment to the hedged item continues to be reported as part of the basis of the item and is amortised to the income statement as a yield adjustment over the remainder of the life of the hedged item.

Cash flow hedges

Exposure arises from the variability in future interest and currency cash flows on assets and liabilities which bear interest at variable rates or are in a foreign currency. Interest rate and cross-currency swaps are maintained to manage this exposure and, where they qualify, designated as cash flow hedges. Fair value changes on designated cash flow hedges are initially recognised directly in the cash flow hedge reserve, as gains or losses recognised in equity. Amounts are transferred from equity and recognised in the income statement as the income or expense is recognised on the hedged asset or liability.

Forward foreign currency contracts are used to hedge anticipated and committed future currency cash flows. Where these contracts qualify for hedge accounting, they are designated as cash flow hedges. On recognition of the underlying transaction in the financial statements, the associated hedge gains and losses deferred in equity are transferred and included with the recognition of the underlying transaction.

The gains and losses on ineffective portions of such derivatives are recognised immediately in remeasurements within the income statement.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement or on the balance sheet. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to remeasurements within the income statement.

Derivatives not in a formal hedge relationship

Our policy is not to use derivatives for trading purposes, however, due to the complex nature of hedge accounting under IAS 39, some derivatives may not qualify for hedge accounting, or are specifically not designated as a hedge where natural offset is more appropriate.

Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in remeasurements within the income statement.

30. Financial risk

Our activities expose us to a variety of financial risks: market risk (including foreign exchange risk; fair value interest rate risk and cash flow interest rate risk), credit risk and liquidity risk. The overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on financial performance. Derivative financial instruments are used to hedge certain risk

Risk management related to financial activities is carried out by a central treasury department under policies approved by the Boards of Directors of National Grid plc and NGG. This department identifies, evaluates and hedges financial risks in close co-operation with the operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investment of excess liquidity as discussed further in our treasury policy, described on page 24 of the Operating and Financial Review.

(a) Market risk

(i) Foreign exchange risk

NGG is exposed to foreign exchange risk arising from non-sterling future commercial transactions and non-sterling recognised assets and liabilities.

With respect to near term foreign exchange risk, we use foreign exchange forwards to manage foreign exchange transaction exposure. Our policy is to hedge a minimum percentage of known contracted foreign currency flows in order to mitigate foreign currency movements in the intervening period. Where cash forecasts are less certain, we generally cover a percentage of the foreign currency flows depending on the level of agreed probability for those future cash flows.

During the years ended 31 March 2009 and 2008, derivative financial instruments were used to manage foreign exchange risk as follows:

	2009				
	Sterling £m	**Euro £m**	**US dollar £m**	**Other £m**	**Total £m**
Cash and cash equivalents	**-**	**-**	**-**	**-**	**-**
Financial investments	**1,008**	**1**	**-**	**-**	**1,009**
Borrowings*	**(6,296)**	**(1,323)**	**(793)**	**(260)**	**(8,672)**
Pre-derivative position	**(5,288)**	**(1,322)**	**(793)**	**(260)**	**(7,663)**
Derivative effect	**(1,582)**	**1,332**	**773**	**260**	**783**
Net debt position	**(6,870)**	**10**	**(20)**	**-**	**(6,880)**

	2008				
	Sterling £m	Euro £m	US dollar £m	Other £m	Total £m
Cash and cash equivalents	5	-	-	-	5
Financial investments	518	-	-	-	518
Borrowings*	(5,584)	(336)	(504)	(392)	(6,816)
Pre-derivative position	(5,061)	(336)	(504)	(392)	(6,293)
Derivative effect	(1,103)	340	490	392	119
Net debt position	(6,164)	4	(14)	-	(6,174)

*Includes bank overdrafts

There was no significant currency exposure on other financial instruments, including trade receivables and payables and other receivables and payables.

30. Financial risk continued

(a) Market risk continued

(ii) Cash flow and fair value interest rate risk

Interest rate risk arises on our borrowings. Borrowings issued at variable rates expose NGG to cash flow interest rate risk. Borrowings issued at fixed rates expose NGG to fair value interest rate risk. Our interest rate risk management policy as further explained on page 25 is to minimise the finance costs (being interest costs and changes in the market value of debt) subject to certain constraints. Some of our borrowings issued are index-linked, that is their cost is linked to changes in the UK Retail Prices Index (RPI). We believe that these borrowings provide a good hedge for revenues and our regulatory asset values that are also RPI-linked.

Interest rate risk arising from our financial investments is primarily variable being mainly composed of short dated money funds.

The following table sets out the carrying amount, by contractual maturity, of borrowings that are exposed to interest rate risk before taking into account interest rate swaps:

	2009	2008
	£m	£m
Fixed interest rate borrowings		
In one year or less	**(702)**	(631)
In more than one year but not more than two years	**(1)**	(533)
In more than two years but not more than three years	**-**	-
In more than three years but not more than four years	**(21)**	(15)
In more than four years but not more than five years	**(752)**	-
In more than five years	**(2,952)**	(1,871)
	(4,428)	(3,050)
Floating interest rate borrowings (including RPI)	**(4,243)**	(3,766)
Non-interest bearing borrowings	**(1)**	-
Total borrowings	**(8,672)**	(6,816)

During the years ended 31 March 2009 and 2008, net debt was managed using derivative instruments to hedge interest rate risk as follows:

	2009				
	Fixed rate £m	**Floating rate £m**	**RPI (i) £m**	**Other (ii) £m**	**Total £m**
Cash and cash equivalents	**-**	**-**	**-**	**-**	**-**
Financial investments	**-**	**1,009**	**-**	**-**	**1,009**
Borrowings*	**(4,428)**	**(1,146)**	**(3,097)**	**(1)**	**(8,672)**
Pre-derivative position	**(4,428)**	**(137)**	**(3,097)**	**(1)**	**(7,663)**
Derivative effect	**1,407**	**(876)**	**249**	**3**	**783**
Net debt position (iii)	**(3,021)**	**(1,013)**	**(2,848)**	**2**	**(6,880)**

	2008				
	Fixed rate £m	Floating rate £m	RPI(i) £m	Other (ii) £m	Total £m
Cash and cash equivalents	-	5	-	-	5
Financial investments	-	518	-	-	518
Borrowings*	(3,050)	(1,012)	(2,754)	-	(6,816)
Pre-derivative position	(3,050)	(489)	(2,754)	-	(6,293)
Derivative effect	1,093	(982)	-	8	119
	(1,957)	(1,471)	(2,754)	8	(6,174)

*Includes bank overdrafts

(i) The post-derivative impact represents financial instruments linked to UK RPI.

(ii) Represents financial instruments which are not directly affected by interest rate risk, including investments in equity or other non-interest bearing instruments.

(iii) The post derivative impact includes 2009/10 maturing short dated derivative contracts.

30. Financial risk continued

(b) Credit risk

Credit risk is managed on a portfolio basis for National Grid as a whole. Credit risk arises from cash and cash equivalents, derivative financial instruments and deposits with banks and financial institutions, as well as credit exposures to wholesale and retail customers, including outstanding receivables and committed transactions.

Treasury related credit risk

Counterparty risk arises from the investment of surplus funds and from the use of derivative instruments. Our limits are managed by the central treasury department of National Grid plc, as explained in our treasury policy on page 24.

As at 31 March 2009 and 2008, we had a number of exposures to individual counterparties. In accordance with our treasury policies and exposure management practices, counterparty credit exposure limits are continually monitored and no individual exposure is considered significant in the ordinary course of treasury management activity. We do not expect any significant losses from non-performance by these counterparties.

The counterparty exposure under derivative financial contracts as shown in note 13 was £892m (2008: £229m); after netting agreements it was £847m (2008: £180m). This exposure is further reduced by collateral received as shown in note 16.

Wholesale and retail credit risk

Our principal commercial exposure is governed by the credit rules within the Uniform Network Code. These lay down the level of credit relative to the regulatory asset value for each credit rating. Sales to retail customers, such as those requiring connections, are usually settled in cash or using major credit cards. Management does not expect any significant losses of receivables that have not been provided for as shown in note 15.

(c) Liquidity analysis

We determine our liquidity requirements by the use of both short and long term cash flow forecasts. These forecasts are supplemented by a financial headroom analysis which is used to assess funding adequacy for at least a 12 month period.

The following is an analysis of the contractual undiscounted cash flows payable under financial liabilities and derivative assets and liabilities as at the balance sheet date:

At 31 March 2009	**Due within 1 year £m**	**Due between 1 and 2 years £m**	**Due between 2 and 3 years £m**	**Due 3 years and beyond £m**	**Total £m**
Non-derivative financial liabilities					
Borrowings	**(1,519)**	**-**	**-**	**(7,285)**	**(8,804)**
Interest payments on borrowings (i)	**(274)**	**(255)**	**(262)**	**(4,038)**	**(4,829)**
Other non-interest bearing liabilities	**(415)**	**-**	**-**	**-**	**(415)**
Derivative financial liabilities					
Derivative contracts - receipts	**450**	**125**	**57**	**674**	**1,306**
Derivative contract - payments	**(41)**	**(35)**	**(28)**	**(428)**	**(532)**
Total at 31 March 2009	**(1,799)**	**(165)**	**(233)**	**(11,077)**	**(13,274)**

At 31 March 2008	Due within 1 year £m	Due between 1 and 2 years £m	Due between 2 and 3 years £m	Due 3 years and beyond £m	Total £m
Non-derivative financial liabilities					
Borrowings	(1,188)	(709)	-	(5,172)	(7,069)
Interest payments on borrowings (i)	(230)	(191)	(171)	(3,304)	(3,896)
Other non-interest bearing liabilities	(712)	(3)	-	-	(715)
Derivative financial liabilities					
Derivative contract - receipts	91	64	20	2,414	2,589
Derivative contract - payments	(45)	(24)	(24)	(3,075)	(3,168)
Total at 31 March 2008	(2,084)	(863)	(175)	(9,137)	(12,259)

(i) The interest on borrowings is calculated based on borrowings held at 31 March without taking account of future issues. Floating rate interest is estimated using a future interest rate curve as at 31 March. Payments are included on the basis of the earliest date on which the Company can be required to settle.

30. Financial risk continued

(d) Sensitivity analysis

Financial instruments affected by market risk include borrowings, deposits and derivative financial instruments. The following analysis, required by IFRS 7, is intended to illustrate the sensitivity to changes in market variables, being UK interest rates and the UK Retail Prices Index.

The analysis excludes the impact of movements in market variables on the carrying value of provisions.

The sensitivity analysis has been prepared on the basis that the amount of net debt, the ratio of fixed to floating interest rates of the debt and derivatives portfolio, and the proportion of financial instruments in foreign currencies are all constant, and on the basis of the hedge designations in place at 31 March 2009 and 31 March 2008, respectively. As a consequence, this sensitivity analysis relates to the position at these dates and is not representative of the year then ended, as all of these items varied.

The following assumptions were made in calculating the sensitivity analysis:

- the balance sheet sensitivity to interest rates relates only to derivative financial instruments and available-for-sale investments, as debt and other deposits are carried at amortised cost and so their carrying value does not change as interest rates move;
- the sensitivity of accrued interest to movements in interest rates is calculated on net floating rate exposures on debt, deposits and derivative instruments;
- changes in the carrying value of derivatives from movements in interest rates designated as cash flow hedges are assumed to be recorded fully within equity;
- changes in the carrying value of derivative financial instruments not in hedging relationships only affect the income statement;
- all other changes in the carrying value of derivative financial instruments designated as hedges are fully effective with no impact on the income statement;
- debt with a maturity below one year is floating rate for the accrued interest part of the calculation;
- the floating leg of any swap or any floating rate debt is treated as not having any interest rate already set. Therefore, a change in interest rates affects a full twelve-month period for the accrued interest portion of the sensitivity calculations; and
- sensitivity to the Retail Prices Index does not take into account any changes to revenue or operating costs that are affected by the Retail Prices Index or inflation generally.

Using the above assumptions, the following table shows the illustrative effect on the income statement and items that are recognised directly in equity that would result from reasonably possible movements in changes in the UK Retail Prices Index and UK interest rates, after the effects of tax.

	2009		2008	
	Income statement -/+ £m	**Equity -/+ £m**	Income statement -/+ £m	Equity -/+ £m
UK Retail Prices Index +/- 0.50%	**10**	**-**	10	-
UK interest rates +/- 0.50%	**7**	**16**	5	12

The income statement sensitivities impact interest expense and financial instrument remeasurements.

(e) Capital and risk management

NGG's objective when managing capital is to safeguard its ability to continue as a going concern and to remain within regulatory constraints. The principal measure of balance sheet efficiency is gearing calculated as net debt expressed as a percentage of regulatory asset value. The gearing ratio at 31 March 2009 was 60% compared with 55% at 31 March 2008. We regularly review and maintain or adjust the capital structure as appropriate in order to manage the level of gearing.

Our licence and some of our bank loan agreements impose lower limits for the long-term credit ratings that the Company must hold. These requirements are monitored on a regular basis in order to ensure compliance.

31. Share options and reward plans

National Grid operates three principal forms of share option and award plans in which our employees and Directors participate. These are an employee Sharesave scheme, a Performance Share Plan (PSP) and Deferred Share Plan.

Active share plans

The Sharesave scheme is savings related where, under normal circumstances, share options are exercisable on completion of a three or a five-year Save-As-You-Earn contract. The exercise price of options granted represents 80% of the market price at the time of the invitation.

Under the PSP, awards have been made to Directors and approximately 121 senior employees. Awards made in 2004 have lapsed. For awards made from 2005, the criteria was amended so that 50% is based on National Grid's Total Shareholder Return (TSR) performance when compared to the FTSE 100 and 50% is based on the annualised growth of National Grid's earnings per share compared to the growth in RPI (the general index of retail prices for all items). Awards are delivered in National Grid plc shares.

Under the Deferred Share Plan, one half of any bonus earned by Executive Directors of National Grid plc and a predetermined part of any bonus earned by other Directors and senior employees is automatically deferred into National Grid shares. The shares are held in trust for three years before release.

Additional information in respect of active share schemes

	2009 000s	2008 000s
Performance share plan		
Awards of ordinary share equivalents at 1 April	**990**	1,134
Awards made	**402**	365
Lapses/forfeits	**(58)**	(346)
Exercises	**(54)**	(9)
Transfers (i)	**7**	(154)
Awards of ordinary share equivalents at 31 March	**1,287**	990
Conditional awards available for release at 31 March	**268**	-
Deferred share plan		
Awards of ordinary share equivalents at 1 April	**66**	45
Awards made	**47**	30
Lapses/forfeits	**-**	-
Exercises	**(14)**	-
Transfers (i)	**-**	(9)
Awards of ordinary share equivalents at 31 March	**99**	66
Conditional awards available for release at 31 March	**-**	-

(i) Transfers arise from employees moving between National Grid Gas and other companies in the National Grid group.

Non-active share plans

We also have a number of historical plans under which awards are still outstanding, but no further awards will be granted. These include the Executive Share Option Plan and the Share Matching Plan.

The Executive Share Option Plan applied to senior executives, including Executive Directors of National Grid plc. Options granted were subject to the achievement of performance targets related to National Grid's TSR over a three-year period and those for 2000 are subject to a final retest in 2010 after which they will lapse if the performance criteria is not met. The share options are generally exercisable between the third and tenth anniversaries of the date of grant if the relevant performance target is achieved.

The Share Matching Plan applied to Executive Directors of National Grid plc and other Directors and senior employees whereby a predetermined part of each participant's bonus entitlement is automatically deferred into National Grid plc shares (known as qualifying shares) and a matching award may be exercised under the Plan after a three-year period, provided the Director or senior employee remains employed by National Grid.

Additional information in respect of non-active share schemes

	2009 000s	2008 000s
Share matching plan		
Awards at 1 April	**20**	**26**
Awards exercised	**(4)**	**(6)**
Awards of ordinary share equivalents at 31 March	**16**	**20**
Conditional awards available for release at 31 March	**16**	**10**

31. Share options and reward plans continued

Share options

Movements in options to subscribe for ordinary shares under National Grid's various option schemes for the two years ended 31 March 2009 and 31 March 2008 is shown below:

	Sharesave scheme options		Executive Plan options		Total options
	Weighted average price £	millions	Weighted average price £	millions	millions
At 31 March 2007	4.16	12.4	4.34	0.1	12.5
Granted	6.55	1.7	-	-	1.7
Lapsed - expired	4.44	(0.4)	-	-	(0.4)
Exercised	3.24	(3.4)	4.42	(0.1)	(3.5)
Transfers (i)	-	-	4.56	0.1	0.1
At 31 March 2008	4.85	10.3	4.51	0.1	10.4
Granted	4.88	4.1	-	-	4.1
Lapsed - expired	5.97	(1.1)	-	-	(1.1)
Exercised	3.84	(1.3)	-	-	(1.3)
At 31 March 2009	**4.86**	**12.0**	**4.57**	**0.1**	**12.1**

Included within options outstanding at 31 March 2009 and 31 March 2008 were the following options which were exercisable:

At 31 March 2009	**4.85**	**0.1**	**4.40**	**0.1**	**0.2**
At 31 March 2008	3.81	0.2	4.34	0.1	0.3

(i) Transfers arise from employees moving between National Grid Gas and other companies in the National Grid group.

The weighted average remaining contractual life of options in the employee Sharesave scheme at 31 March 2009 was 2 years and 2 months. These options have exercise prices between £3.17 and £6.55.

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

	2009 £	2008 £
Sharesave scheme options	**6.99**	7.79
Executive Plan options	**6.81**	7.68

Additional information in respect of share options

Options outstanding and exercisable and their weighted average exercise prices for the respective ranges of exercise prices and years at 31 March 2009 are as follows:

	Weighted average exercise price of exercisable options £	Number exercisable	Weighted average exercise price of outstanding options £	Number outstanding	Exercise price per share pence	Normal dates of exercise years
Executive plan	-	-	5.27	16,693	526.00-531.50	2004-2011
	4.40	68,499	4.40	68,499	434.25-460.25	2000-2013
	4.40	68,499	4.57	85,192		

31. Share options and reward plans continued

Share-based payment charges

The charge to the income statement for the year ended 31 March 2009 was £6m (2008: £6m).

Awards under share option plans

The average share prices at the date of options being granted, the average price of the options granted and their estimated average fair values during each of the two financial years ended 31 March were as follows:

	2009	2008
Average share price	**684.0p**	846.0p
Average exercise price	**488.0p**	655.0p
Average fair value	**166.8p**	189.3p

These amounts have been calculated in respect of options where the exercise price is less than the market price at the date of grant.

The fair values of the options granted were estimated using the following principal assumptions:

	2009	2008
Dividend yield (%)	**5.0**	4.5
Volatility (%)	**22.4-26.1**	15.6-18.9
Risk-free investment rate (%)	**2.5**	4.2
Average life (years)	**3.9**	3.7

The fair values of awards under the Sharesave scheme have been calculated using the Black-Scholes European model. This is considered appropriate given the short exercise window of sharesave options. The fair values of awards made in 2008 and 2007 onwards have been calculated by reference to the 2006 Black-Scholes European model calculation.

Volatility was derived based on the following and is assumed to revert from its current implied level to its long run mean based historical volatility under (ii) below:

(i) implied volatility in traded options over National Grid plc's shares;
(ii) historical volatility of National Grid plc's shares from October 2002 (the date of the business combination of National Grid Group plc and Lattice Group plc), and
(iii) implied volatility of comparator companies where options in their shares are traded.

Awards under other share scheme plans

The average share prices and fair values at the date share awards were granted during each of the financial years ended 31 March were as follows:

	2009	2008
Average share price	**670.1p**	766.9p
Average fair value	**458.1p**	522.8p

The fair values of the awards granted were estimated using the following principal assumptions:

	2009	2008
Dividend yield (%)	**4.4**	4.4
Risk-free investment rate (%)	**2.5**	4.1

Fair values have been calculated using a Monte Carlo simulation model for awards with total shareholder return performance conditions made prior to 1 April 2006. The fair value of awards made in 2008 and 2007 has been calculated by reference to the 2006 Monte Carlo simulation model calculation. Fair values of awards with performance conditions based on earnings per share have been calculated using the share price at date of grant less the present value of dividends foregone during the performance period.

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

32. Ultimate parent company

National Grid Gas plc's immediate parent Company is National Grid Gas Holdings Limited. The ultimate parent Company and controlling party is National Grid plc. Both of these companies are incorporated in Great Britain and are registered in England and Wales. National Grid plc consolidates the accounts of National Grid Gas plc. Copies of the consolidated accounts of National Grid plc may be obtained from the Company Secretary, 1-3 Strand, London WC2N 5EH.

33. Principal subsidiary undertakings

	Principal activity	Holding
National Grid Gas Finance (No 1) plc	Financing	100%
National Grid Metering Limited	Gas metering services	100%
British Transco International Finance BV (incorporated in the Netherlands)	Financing	100%
British Transco Finance Inc. (incorporated in the US)	Financing	100%
British Transco Capital Inc. (incorporated in the US)	Financing	100%
British Transco Finance (No. 1) Limited	Financing	100%
British Transco Finance (No. 2) Limited	Financing	100%
British Transco Finance (No. 3) Limited	Financing	100%
British Transco Finance (No. 5) Limited	Financing	100%
xoserve Limited	Gas transportation transaction services	56.57%

A full list of all subsidiaries and associated undertakings is available from the Company Secretary of the Company.

Company accounting policies

for the year ended 31 March 2009

A. Basis of preparation of individual financial statements under UK GAAP

These individual financial statements of the Company have been prepared in accordance with applicable UK accounting and financial reporting standards and the Companies Act 1985.

The individual financial statements of the Company have been prepared on a historical cost basis, except for the revaluation of financial instruments.

These financial statements are presented in pounds sterling because that is the currency of the primary economic environment in which the Company operates.

The Company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The Company has taken the exemption from preparing a cash flow statement under the terms of FRS 1 (revised 1996) 'Cash Flow Statements'.

In accordance with exemptions under FRS 8 'Related party disclosures', the Company has not disclosed transactions with related parties, as the Company's financial statements are presented together with its consolidated financial statements. Furthermore, in accordance with exemptions under FRS 29 'Financial Instruments: Disclosures', the Company has not presented the financial instruments disclosures required by the standard, as disclosures which comply with the standard are included in the consolidated financial statements.

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.

B. Foreign currencies

Transactions in currencies other than the functional currency of the Company 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. Gains and losses arising on retranslation of monetary assets and liabilities are included in the profit and loss account.

C. Tangible fixed assets

Tangible fixed assets are included in the balance sheet at their cost less accumulated depreciation. Costs include payroll costs and finance costs incurred which are directly attributable to the construction of tangible fixed assets.

Tangible fixed assets include assets in which the Company's interest comprises legally protected statutory or contractual rights of use.

Additions represent the purchase or construction of new assets, extensions to, or significant increases in, the capacity of tangible fixed assets.

Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the life of the assets.

Depreciation is not provided on freehold land or assets in the course of construction. Other tangible fixed assets are depreciated principally on a straight-line basis, at rates estimated to write off their book values over their estimated useful economic lives. In assessing estimated useful economic lives, which are reviewed on a regular basis, consideration is given to any contractual arrangements and operational requirements relating to particular assets. Unless otherwise determined by operational requirements, the depreciation periods for the principal categories of tangible fixed assets are, in general, as shown in the table below:

Depreciation periods	Years
Freehold and leasehold properties	up to 50
Plant and machinery:	
– Mains, services and regulating equipment	30 to 100
– Meters and metering equipment	5 to 18
Motor vehicles and office equipment	3 to 10

D. Fixed asset investments

Investments held as fixed assets are stated at cost less any provisions for impairment.

E. Impairment of fixed assets

Impairments of fixed assets are calculated as the difference between the carrying values of the net assets of income generating units, including where appropriate, investments, and their recoverable amounts. Recoverable amount is defined as the higher of net realisable value or estimated value in use at the date the impairment review is undertaken. Net realisable value represents the amount that can be generated through the sale of assets. Value in use represents the present value of expected future cash flows discounted on a pre-tax basis, using the estimated cost of capital of the income generating unit.

Impairment reviews are carried out if there is some indication that impairment may have occurred, or where otherwise required to ensure that fixed assets are not carried above their estimated recoverable amounts. Impairments are recognised in the profit and loss account, and, where material, are disclosed

as exceptional. Impairment reversals are recognised when, in management's opinion, the reversal is permanent.

F. Taxation

Current tax for the current and prior periods is provided at the amount expected to be paid (or recovered) using the tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Current tax assets and liabilities arising from transfer pricing adjustments, which are expected to be fully recovered through group relief, are initially estimated and recognised in the current year where material. Further adjustments are recognised when tax returns are submitted to the tax authorities. In the prior year, current tax asset and liabilities arising from transfer pricing adjustments, which were expected to be fully recovered through group relief, were recognised when tax returns were submitted to the tax authorities.

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or the right to pay less tax, at a future date, at tax rates expected to apply when the timing differences reverse, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

G. Stocks

Stocks are stated at cost less provision for deterioration and obsolescence.

H. Environmental costs

Environmental costs, based on discounted future estimated expenditures expected to be incurred, are provided for in full. The unwinding of the discount is included within the profit and loss account as a financing charge.

I. Revenue

Revenue represents the sales value derived from the transmission and distribution of gas and the provision of gas metering services during the year, including an assessment of services provided, but not invoiced as at the year end. It excludes value added tax and intra-group sales.

Where revenue for the year exceeds the maximum amount permitted by regulatory agreement and adjustments will be made to future prices to reflect this over-recovery, a liability for the over-recovery is not recognised as such an adjustment to future prices relates to the provision of future services. Similarly, an asset is not recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery.

J. Replacement expenditure

Replacement expenditure is recognised within operating costs and represents the cost of planned maintenance of mains and services assets by replacing or lining sections of pipe. This expenditure is principally undertaken to repair and maintain the safety of the network and is written off as incurred. Expenditure that enhances the performance of mains and services assets is treated as an addition to tangible fixed assets.

K. Pensions

The substantial majority of the Company's employees are members of the defined benefit section of the National Grid UK Pension Scheme. There is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to the Company. Accordingly, the Scheme is recognised in these Company financial statements as if it were a defined contribution scheme. The pension charge for the year represents the contributions payable to the Scheme for the period. A share of the assets and liabilities or the actuarial gains and losses of the Scheme are not recognised in these Company financial statements.

L. Leases

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

M. 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 assets of the Company after deducting all of its liabilities and is recorded at the proceeds received, net of direct issue costs.

Loans receivable are carried at amortised cost using the effective interest rate method less any allowance for estimated impairments. A provision is established for impairments when there is objective evidence that the Company will not be able to collect all amounts due under the original terms of the loan. Interest income, together with losses when the loans are impaired, is recognised on an effective interest rate basis in the profit and loss account.

Current asset financial investments are recognised at fair value plus directly related incremental transaction costs and are subsequently carried at fair value on the balance sheet. 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 net profit or loss for the period. Investment income on investments classified as available-for-sale is recognised in the profit and loss account as it accrues.

Borrowings, which include interest-bearing loans, UK Retail Prices Index (RPI) linked debt and overdrafts, are recorded at their initial fair value which normally reflects the proceeds

received, net of direct issue costs less any repayments. Subsequently these are stated at amortised cost, using the effective interest rate method. Any difference between proceeds and the redemption value is recognised over the term of the borrowing in the profit and loss account using the effective interest rate method.

Derivative financial instruments are recorded at fair value, and where the fair value of a derivative is positive, it is carried as a derivative asset and where negative, as a liability. Assets and liabilities on different transactions are only netted if the transactions are with the same counterparty, a legal right of set-off exists and the cash flows are intended to be settled on a net basis. Gains and losses arising from changes in fair value are included in the profit and loss account in the period they arise.

Where derivatives are embedded in other financial instruments that are closely related to those instruments, no adjustment is made with respect to such derivative clauses. Otherwise the derivative is recorded separately at fair value on the balance sheet.

The fair values on financial instruments measured at fair value that are quoted in active markets are based on bid process for assets held and offer prices for issued liabilities. When independent prices are not available, fair values are determined by using valuation techniques which are consistent with techniques commonly used by the relevant market. The techniques use observable market data.

N. Hedge accounting

The Company enters into derivative financial instruments ('derivatives') and non-derivative financial instruments in order to manage interest rate and foreign currency exposures, with a view to managing these risks associated with the Company's underlying business activities and the financing of those activities. The principal derivatives used include interest rate swaps, forward rate agreements, currency swaps and forward foreign currency contracts.

Hedge accounting allows derivatives to be designated as a hedge of another (non-derivative) financial instrument, to mitigate the impact of potential volatility in the profit and loss account. The Company uses two hedge accounting methods.

Firstly, 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 profit and loss account. Amounts deferred in equity in respect of cash flow hedges are subsequently recognised in the profit and loss account in the same period in which the hedged item affects net profit or loss.

Secondly, 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 profit and loss account. An offsetting amount is recorded as an adjustment to the carrying value of hedged items, with a corresponding entry in the profit and loss account, to the extent that the change 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 profit and loss account as they arise.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, 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 profit and loss account in the same periods in which the previously hedged item affects net profit or loss. For fair value hedges the cumulative adjustment recorded to its carrying value at the date hedge accounting is discontinued is amortised to the profit and loss account using the effective interest rate method.

If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the profit and loss account immediately.

O. Parent Company guarantees

The Company has guaranteed the repayment of the principal and any associated premium and interest on specific loans due from certain subsidiary undertakings to third parties. In the event of default or non-performance by the subsidiary, the Company recognises such guarantees as insurance contracts, at fair value with a corresponding increase in the carrying value of the investment.

P. Share-based payments

National Grid issues equity-settled share-based payments to certain employees of the Company. Equity-settled share-based payments are measured at fair value at the date of grant based on an estimate of the number of shares that will eventually vest. This fair value 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.

Q. Restructuring costs

Costs arising from the Company's restructuring programmes primarily relate to redundancy costs. Redundancy costs are charged to the profit and loss account in the period in which the Company becomes irrevocably committed to incurring the costs and the main features of the restructuring plan have been announced to affected employees.

R. Emission allowances

Emission allowances, which relate to the emissions of carbon dioxide, are recorded as an intangible asset within current assets and are initially recorded at cost, and subsequently at the lower of cost and net realisable value. For allocations of emission allowances granted by the UK Government, cost is deemed to be equal to fair value at the date of allocation.

Receipts of such grants are treated as deferred income and are recognised in the income statement in the period in which carbon dioxide emissions are made. A provision is recorded in respect of the obligation to deliver emission allowances and charges are recognised in the income statement in the period in which carbon dioxide emissions are made.

S. Dividends

Interim dividends are recognised when they become payable to the Company's shareholders. Final dividends are recognised in the financial year in which they are approved.

Company balance sheet

at 31 March

	Notes	2009 £m	2008 £m
Fixed assets			
Tangible assets	6	**6,810**	6,539
Investments	7	**17**	17
		6,827	6,556
Current assets			
Stocks	8	**34**	31
Debtors (amounts falling due within one year)	9	**449**	377
Debtors (amounts falling due after more than one year)	9	**5,617**	5,611
Derivative financial instruments (amounts falling due within one year)	10	**122**	81
Derivative financial instruments (amounts falling due after more than one year)	10	**688**	101
Current asset investments		**1,031**	524
		7,941	6,725
Creditors (amounts falling due within one year)			
Borrowings	13	**(1,793)**	(1,741)
Derivative financial instruments	10	**(67)**	(27)
Other creditors		**(817)**	(877)
	11	**(2,677)**	(2,645)
Net current assets		**5,264**	4,080
Total assets less current liabilities		**12,091**	10,636
Creditors (amounts falling due after more than one year)			
Borrowings	13	**(6,871)**	(5,057)
Derivative financial instruments	10	**(42)**	(83)
Other creditors		**(734)**	(689)
	12	**(7,647)**	(5,829)
Provisions for liabilities and charges	14	**(957)**	(900)
Net assets employed		**3,487**	3,907
Capital and reserves			
Called up share capital	15	**45**	45
Share premium account	16	**204**	204
Cash flow hedge reserve	16	**3**	(35)
Other reserves	16	**1,332**	1,332
Profit and loss account	16	**1,903**	2,361
Total shareholders' funds		**3,487**	3,907

Commitments and contingencies are shown in note 17 to the Company financial statements.

The notes on pages 84 to 90 form part of the individual financial statements of the Company, which were approved by the Board of Directors on 5 June 2009 and were signed on its behalf by:

Paul Whittaker Director

Adam Wiltshire Director

Notes to the Company financial statements

1. Adoption of new accounting standards

New financial reporting standards (FRS) and abstracts adopted in 2008/09

During the year the Company has adopted the following FRSs and abstracts. None of these had a material impact on the Company's results or assets and liabilities.

Amendments to FRS 26 and FRS 29 on reclassification of financial assets.	Permit reclassification of financial assets in certain circumstances.

New FRS not yet adopted

The Company has yet to adopt the following FRS. However, it is not expected to have a material impact on the Company's results or assets and liabilities.

Amendment to FRS 20 on share-based payments	Clarifies the definition of vesting conditions and the accounting treatment of cancellations. Vesting conditions are defined as either service conditions or performance conditions. Cancellations by employees are accounted for in the same way as cancellations by the Company. The amendment to FRS 20 has been adopted with effect from 1 April 2009.
Amendment to FRS 25 on puttable financial instruments and obligations arising on liquidation	Addresses the classification as a liability or as equity certain puttable financial instruments and instruments, or components thereof, which impose upon an entity an obligation to deliver a pro rata share of net assets on liquidation. The amendments to FRS 25 will be adopted on 1 April 2010.
Amendment to FRS 26 Financial Instruments: Recognition and measurement on eligible hedged	Prohibits designating inflation as a hedgeable component of an instrument, unless cash flows relating to the separate inflation component are contractual and also prohibits the designation of a purchased option in its entirety as the hedge of a one-sided risk in a forecast transaction. The amendment to FRS 26 will be adopted on 1 April 2010.
Amendment to FRS 8 on related party disclosures	Changes the definition of related party to be the same as that in law and provides an exemption only in respect of wholly-owned subsidiaries, rather than 90% subsidiaries as previously permitted. The amendment to FRS 8 will be adopted on 1 April 2010.
Improvements to FRS 2008	Contains amendments to various existing standards. The amendments are effective, in most cases, from 1 January 2009, or otherwise for annual periods beginning on or after 1 July 2009.
UITF 46 on hedges of a net investment in a foreign operation	Clarifies that hedged risk may be designated at any level in a group and hedging instruments may be held by any Company in a group (except the foreign entity being hedged), that net investment hedge accounting may not be adopted in respect of a presentation currency and that on disposal the amounts to be reclassifed from equity to profit or loss are any cumulative gain or loss on the hedging instrument and the cumulative translation difference on the foreing operation disposed of. UITF 46 has been adopted by the Company with effect from 1 April 2009.
Amendment to FRS 29	Incorporates the changes made to IFRS 7 to require enhanced disclosures about fair value measurements and liquidity risk, and incorporates the credit risk disclosures for loans and receivables.

2. Auditors' remuneration

Auditors' remuneration in respect of the Company is set out below:

	2009 £m	2008 £m
Audit services		
Audit fee of Company	**0.3**	0.5
Other services		
Other services supplied pursuant to legislation	**0.2**	0.7

Comparatives have been restated to present items on a basis consistent with the current year classification.

Other services supplied pursuant to legislation represents fees payable for services in relation to engagements which are required to be carried out by the auditor. In particular, this includes fees for audit reports on regulatory returns and fees for reports under section 404 of the US Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley).

3. Number of employees, including Directors

	2009 Average number	2008 Average number
United Kingdom - continuing operations	**6,016**	5,691

4. Directors' emoluments

Details of Directors' emoluments are provided in note 3(d) to the consolidated financial statements.

5. Pensions

Substantially all the Company's employees are members of the defined benefit section of the National Grid UK Pension Scheme . There is no contractual arrangement or stated policy for charging the net defined benefit cost of the scheme to the Company. Accordingly, the Company accounts for the scheme as if it were a defined contribution scheme.

The disclosures required by FRS 17 are provided in notes 5 and 28 to the consolidated financial statements.

6. Tangible fixed assets

	Land and buildings £m	Plant and machinery £m	Assets in the course of construction £m	Motor vehicles and office equipment £m	Total £m
Cost at 1 April 2008	92	9,237	551	729	10,609
Additions	7	565	8	69	649
Disposals	-	(16)	-	(12)	(28)
Transfers	10	238	(235)	(13)	-
Cost at 31 March 2009	109	10,024	324	773	11,230
Depreciation at 1 April 2008	(28)	(3,517)	-	(525)	(4,070)
Depreciation charge for the year	(9)	(297)	(1)	(59)	(366)
Disposals	-	4	-	12	16
Transfers	(6)	12	-	(6)	-
Reclassifications	-	(6)	-	6	-
Depreciation at 31 March 2009	(43)	(3,804)	(1)	(572)	(4,420)
Net book value at 31 March 2009	**66**	**6,220**	**323**	**201**	**6,810**
Net book value at 31 March 2008	64	5,720	551	204	6,539

The net book value of land and buildings comprised:

	2009 £m	2008 £m
Freehold	**41**	41
Short leasehold (under 50 years)	**25**	23
	66	64

The cost of tangible fixed assets at 31 March 2009 included £124m (2008: £96m) relating to interest capitalised.

Included within creditors (amounts falling due within one year) and creditors (amounts falling due after more than one year) are contributions to the cost of tangible fixed assets amounting to £17m (2008: £19m) and £655m (2008: £631m) respectively.

7. Investments

	Shares in subsidiary undertakings £m
Cost at 31 March 2008 and 31 March 2009	17

The names of the principal subsidiary undertakings are included in note 33 to the consolidated financial statements.

8. Stocks

	2009 £m	2008 £m
Raw materials and consumables	**34**	31

9. Debtors

	2009 £m	2008 £m
Amounts falling due within one year:		
Trade debtors	**44**	32
Amounts owed by fellow subsidiary undertakings	**183**	122
Other debtors	**4**	40
Prepayments and accrued income	**218**	183
	449	377
Amounts falling due after more than one year:		
Other debtors	**6**	-
Amounts owed by immediate parent undertaking	**5,611**	5,611
	5,617	5,611
Total debtors	**6,066**	5,988

10. Derivative financial instruments

The fair value of derivative financial instruments shown on the balance sheet is as follows:

	2009 Assets £m	2009 Liabilities £m	2009 Total £m	2008 Assets £m	2008 Liabilities £m	2008 Total £m
Current	**122**	**(67)**	**55**	81	(27)	54
Non-current	**688**	**(42)**	**646**	101	(83)	18
	810	**(109)**	**701**	182	(110)	72

For each class of derivative the sterling equivalent notional value of the pay leg is as follows:

	2009 £m	2008 £m
Forward rate agreements	**(3,345)**	-
Interest rate swaps	**(2,924)**	(2,800)
Cross-currency interest rate swaps	**(1,525)**	(906)
Foreign exchange forward contracts	**(15)**	(176)
	(7,809)	(3,882)

11. Creditors (amounts falling due within one year)

	2009 £m	2008 £m
Derivative financial instruments (note 10)	**67**	27
Borrowings (note 13)	**1,793**	1,741
Trade creditors	**259**	258
Accruals	**102**	159
Amounts owed to Group undertakings	**8**	39
Amounts owed to fellow subsidiary undertakings	**204**	239
Corporation tax	**31**	27
Social security and other taxes	**63**	87
Other creditors	**30**	22
Deferred income	**120**	46
	2,677	2,645

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

	2009 £m	2008 £m
Derivative financial instruments (note 10)	**42**	83
Borrowings (note 13)	**6,871**	5,057
Other creditors	**18**	3
Deferred income	**716**	686
	7,647	5,829

Deferred income mainly comprises contributions to capital projects.

13. Borrowings

The following table analyses the Company's borrowings:

	2009 £m	2008 £m
Amounts falling due within one year:		
Bank loans and overdrafts	**286**	47
Bonds	**625**	631
Borrowings from Group undertakings	**393**	480
Borrowings from fellow subsidiary undertakings	**487**	581
Other loans	**2**	2
	1,793	1,741
Amounts falling due after more than one year:		
Bank loans	**602**	584
Bonds	**5,641**	4,210
Borrowings from Group undertakings	**458**	151
Other loans	**170**	112
	6,871	5,057
Total borrowings	**8,664**	6,798

	2009 £m	2008 £m
Total borrowings are repayable as follows:		
In one year or less	**1,793**	1,741
More than one year, but not more than two years	**1**	489
More than two years, but not more than three years	**250**	-
More than three years, but not more than four years	**221**	-
More than four years, but not more than five years	**752**	215
More than five years, other than by instalments	**5,647**	4,353
	8,664	6,798

The notional amount outstanding of the Company's debt portfolio at 31 March 2009 was £8,166m (2008: £6,576m).

None of the Company's borrowings are secured by charges over assets of the Company.

14. Provisions for liabilities and charges

	Environmental £m	Emissions £m	Restructuring £m	Deferred taxation £m	Other £m	Total £m
At 1 April 2008	44	5	21	784	46	900
Charged to profit and loss account	13	6	34	8	16	77
Transferred to reserves	-	-	-	16	-	16
Utilised	(3)	-	(12)	-	(15)	(30)
Released	-	(9)	-	-	-	(9)
Unwinding of discount	2	-	-	-	1	3
At 31 March 2009	**56**	**2**	**43**	**808**	**48**	**957**

Environmental provision

The environmental provision represents the net present value of the estimated statutory decontamination costs of old gas manufacturing sites owned by National Grid Gas (discounted using a nominal rate of 2.0%). The anticipated timing of the cash flows for statutory decontamination cannot be predicted with certainty, but they are expected to be incurred over the next 50 years.

There are a number of uncertainties that affect the calculation of the provision for gas site decontamination, including the impact of regulation, the accuracy of the site surveys, unexpected contaminants, transportation costs, the impact of alternative technologies and changes in the discount rate. We have made our best estimate of the financial effect of these uncertainties in the calculation of the provision, but future material changes in any of the assumptions could materially impact on the calculation of the provision and hence the income statement.

The undiscounted amount of the provision at 31 March 2009 relating to gas site decontamination was £85m (2008: £69m), being the best undiscounted estimate of the liability having regard to the uncertainties referred to above.

Emissions provision

The provision for emission costs is expected to be settled using emission allowances granted or purchased.

Restructuring provision

At 31 March 2009, £5m of the total restructuring provision (2008: £6m) consisted of provisions for the disposal of surplus leasehold interests and rates payable on surplus properties. The expected payment dates for property restructuring costs remain uncertain. The remainder of the restructuring provision related to business reorganisation costs, to be paid during 2009 and 2010.

Other provisions

Other provisions at 31 March 2009 include £12m (2008: £17m) in respect of property transfer costs related to the sales of four UK gas distribution networks and £21m (2008: £18m) in respect of employer liability claims. The payment dates for the property transfer costs are uncertain but should largely be over the next two years. In accordance with insurance industry practice, the estimates for employer liability claims are based on experience from previous years and, therefore, there is no identifiable payment date associated with these items.

Deferred taxation comprises:

	2009 £m	2008 £m
Accelerated capital allowances	**796**	784
Other timing differences	**12**	-
	808	784

Deferred tax assets in respect of capital losses of £24m (2008: £18m) have not been recognised as their future recovery is uncertain or not currently anticipated. The capital losses are available to carry forward indefinitely. The capital losses can be offset against specific types of future capital gains.

There are no other significant unrecognised deferred tax assets or liabilities (2008: £nil).

15. Share capital

	Number of shares 2009 millions	Number of shares 2008 millions	2009 £m	2008 £m
At 31 March 2007 and 2008 - ordinary shares of 1 $^{2}/_{15}$p each				
Allotted, called up and fully paid	**3,944**	3,944	**45**	45
Authorised	**6,052**	6,052	**69**	69

National Grid Gas plc is a wholly owned subsidiary undertaking of National Grid Gas Holdings plc.

16. Reserves

	Cash flow hedge reserve £m	Share premium account £m	Capital redemption reserve £m	Profit and loss account £m
At 1 April 2008	(35)	204	1,332	2,361
Loss for the year	-	-	-	(164)
Dividends	-	-	-	(300)
Net credit recognised directly in reserves	38	-	-	-
Share-based payments	-	-	-	6
At 31 March 2009	**3**	**204**	**1,332**	**1,903**

The Company is prohibited from declaring a dividend or other distribution unless it has certified that it is in compliance in all material respects with certain regulatory obligations, including a requirement to ensure it has sufficient financial resources and facilities to enable it to carry on its business and a requirement to use all reasonable endeavours to maintain an investment grade credit rating.

The Company has not presented its own profit and loss account as permitted by section 230 of the Companies Act 1985. The Company's loss after taxation was £164m (2008: £258m profit).

17. Commitments and contingencies

a) Future capital expenditure

As at 31 March 2009, the Company had placed contracts for capital expenditure (tangible fixed assets) amounting to £480m (2008: £460m).

b) Lease commitments

At 31 March 2009, the Company's total operating lease commitments for the financial year ending 31 March 2010 amounted to £12m (2008 commitments for 2009: £11m) and are analysed by lease expiry date as follows:

	Land and buildings		Other		Total	
	2009 £m	2008 £m	**2009 £m**	2008 £m	**2009 £m**	2008 £m
Expiring:						
In one year or less	**1**	1	**1**	1	**2**	2
In more than one year, but not more than five years	**1**	1	**3**	1	**4**	2
In more than five years	**6**	6	**-**	1	**6**	7
	8	8	**4**	3	**12**	11

The Company's total commitments under non-cancellable operating leases were payable as follows:

	2009 £m	2008 £m
Amounts:		
In one year or less	**12**	11
In more than one year, but not more than two years	**10**	10
In more than two years, but not more than three years	**8**	8
In more than three years, but not more than four years	**7**	8
In more than four years, but not more than five years	**6**	7
In more than five years	**32**	38
	75	82

c) Other commitments and contingencies

The value of other commitments, contingencies and guarantees at 31 March 2009 amounted to £150m (2008: £84m), including gas purchase commitments amounting to £70m (2008: £39m), and guarantees relating to certain property obligations of a National Grid group undertaking of £1m (2008: £5m).

d) Parent Company loan guarantees on behalf of subsidiary undertakings

The Company has guaranteed the repayment of principal sums, any associated premium and interest on specific loans due from its financial subsidiaries to third parties. At 31 March 2009, the sterling equivalent amounted to £1,487m (2008: £1,159m).

e) Litigation and claims

In last year's Annual Report and Accounts, we reported a decision by the Gas and Electricity Markets Authority (GEMA) to levy on us a fine of £41.6m for a breach of the UK Competition Act 1998 in respect of term contracts with suppliers entered into by our UK metering services business in 2004. We also noted that we had appealed this decision to the Competition Appeal Tribunal (the Tribunal). On 29 April 2009, the Tribunal overturned the decision in part and reduced the fine to £30m but upheld the original decision in part.

On 29 May 2009, we lodged our application at the Tribunal for leave to appeal on points of law and on the amount of the penalty. As at this date therefore, we remain of the view that an outflow of economic benefits is not probable, and as a result, no provision has been made in these accounts either for the reduced fine of £30m, or for any other possible financial impact of the ruling.

In October 2008, we informed Ofgem that our mains replacement activity carried out within the UK's West Midland Alliance partnership may have been misreported. National Grid and Ofgem have jointly appointed Ernst & Young to carry out a full investigation to determine the extent of the issue. At present it is too early to determine the likely outcome of the investigation and any potential consequences.

18. Related parties

Subsequent to the sale of Advantica Limited, a former fellow subsidiary of National Grid plc, on 31 August 2007, the Company purchased services amounting to £nil from Advantica (2008: £9m).

Glossary and definitions

References to NGG, the 'Company', 'we', 'our', and 'us', refer to National Grid Gas plc itself or to National Grid Gas plc and its subsidiaries collectively, depending on context.

bcm
Billion cubic metres

FRS
UK Financial Reporting Standard

GAAP
Generally accepted accounting principles

GW
Gigawatt, 10^9 watts

GWh
Gigawatt hours

HSE
Health and Safety Executive

IAS
International Accounting Standard

IFRIC
International Financial Reporting Standards Interpretations Committee

IFRS
International Financial Reporting Standard

KPI
Key Performance Indicator

LNG
Liquefied natural gas

Lost time injury
A work-related injury which causes a person to be away from work for at least one normal shift after the shift on which the injury occurs, because the person is unfit to perform his or her duties

mcm
Million cubic metres

National Grid
National Grid plc, the ultimate parent Company of National Grid Gas plc and its controlling party

Ofgem
The Office of Gas and Electricity Markets

tonnes CO_2 equivalent
Measure of greenhouse gas emissions in relation to the impact of carbon dioxide

RAV
Regulatory asset value

TW
Terawatt, 10^{12} watts

TWh
Terawatt hours

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