

NATIONAL GRID PLC
Form 20-F
June 07, 2016
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended 31 March 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Date of event requiring this shell company report _____

For the transition period from _____ to _____

Commission file number: 001-14958

NATIONAL GRID PLC

(Exact name of Registrant as specified in its charter)

England and Wales

(Jurisdiction of incorporation or organization)

1-3 Strand, London WC2N 5EH, England

(Address of principal executive offices)

Alison Kay

011 44 20 7004 3000

Facsimile No. 011 44 20 7004 3004

Group General Counsel and Company Secretary

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National Grid plc

1-3 Strand London WC2N 5EH, England

(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

| Title of each class | Name of each exchange on which registered |
|--|--|
| Ordinary Shares of 11 17/43 pence each | The New York Stock Exchange* |
| American Depositary Shares, each representing five Ordinary Shares of 11 17/43 pence each | The New York Stock Exchange |
| 6.625% Guaranteed Notes due 2018 | The New York Stock Exchange |
| 6.30% Guaranteed Notes due 2016 | The New York Stock Exchange |
| Preferred Stock (\$100 par value-cumulative): | |
| 3.90% Series | The New York Stock Exchange |
| 3.60% Series | The New York Stock Exchange |

* Not for trading, but only in connection with the registration of American Depositary Shares representing Ordinary Shares pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Securities Exchange Act of 1934: None.

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Securities Exchange Act of 1934: None.

The number of outstanding shares of each of the issuer's classes of capital or common stock as of 31 March 2016 was

| | |
|--|---------------|
| Ordinary Shares of 11 17/43 pence each | 3,924,038,086 |
|--|---------------|

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days: Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files): Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

This constitutes the annual report on Form 20-F of National Grid plc (the Company) in accordance with the requirements of the US Securities and Exchange Commission (the SEC) for the year ended 31 March 2016 and is dated 7 June 2016. Details of events occurring subsequent to the approval of the annual report on 18 May 2016 are summarised in section Further Information which forms a part of this Form 20-F. The content of the Group's website (www.nationalgrid.com/uk) should not be considered to form part of this annual report on Form 20-F.

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| Our financial results are reported in sterling. We convert our US business results at the average exchange rate during the year, which for 2015/16 was \$1.47 to £1 (2014/15 \$1.58 to £1). | £4,096m | 63.5p |
| | +6% | +10% |
| | 2014/15: £3,863m | 2014/15: 57.6p* |
| | Operating profit | Earnings per share |
| We use adjusted profit measures which exclude the impact of exceptional items and remeasurements. These are used by management to assess the underlying performance of the business. Reconciliations to statutory financial information are shown on page 196. | £4,085m | 69.0p |
| | +8% | +30% |
| | 2014/15: £3,780m | 2014/15: 53.2p* |
| | Operational highlights | |
| Online report | Capital expenditure | Group safety performance |
| The PDF of our Annual Report and Accounts 2015/16 includes a full search facility. You can find the document by visiting the investor relations section at www.nationalgrid.com and using a word search. | £3,893m | 0.10 IFR |
| | +12% | 0.03 improvement |
| | 2014/15: £3,470m | 2014/15: 0.13 IFR |

Further information

Throughout this report you can find links to further detail within this document or online. Please look out for the following icon:

Greenhouse gas emissions
(million tonnes carbon dioxide equivalent)

7.3

+0%

2014/15: 7.3

Employee engagement score

76%

+1%

2014/15: 75%

* Comparative earnings per share (EPS) data has been restated for the impact of scrip dividend issues

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Our strategy

Our strategy is to be a recognised leader in the development and operation of safe, reliable and sustainable energy infrastructure, to meet the needs of our customers and communities and to generate value for our investors.

Deliver operational excellence

Achieve world-class levels of safety, reliability, security and customer service.

Engage our people

Create an inclusive, high-performance culture by developing all our employees.

Stimulate innovation

Promote new ideas to work more efficiently and effectively.

Engage externally

Work with external stakeholders to shape UK, EU and US energy policy.

Embed sustainability

Integrate sustainability into our decision-making to create value, help preserve natural resources and respect the interests of our communities.

Drive growth

Grow our core businesses and develop future new business opportunities.

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National Grid Annual Report and Accounts 2015/16

The Strategic Report includes an overview of our strategy and business model, the principal risks we face and information about our performance. In addition to the financial review included within this section, we provide additional analysis and commentary, including the performance of our operating segments, within the unaudited commentary sections of the Financial Statements. This additional analysis forms part of our Strategic Report.

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Corporate Governance

The Corporate Governance Report, introduced by our Chairman, contains details about the activities of the Board and its committees during the year. We include reports from the Audit, Nominations, Remuneration, Finance, and Safety, Environment and Health Committees. We also include details of our shareholder engagement activities.

| | |
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Financial Statements

Our Financial Statements include: the independent auditors' reports; consolidated financial statements prepared in accordance with IFRS as adopted by the EU; related commentary and notes to the consolidated financial statements; and the Company's financial statements prepared in accordance with FRS 101.

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We use a number of technical terms and abbreviations within this document. For brevity, we do not define terms or provide explanations every time they are used; please refer to the glossary for this information as well as an important notice in relation to forward-looking statements with our cautionary statement.

| | | |
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We are one of the world's largest investor-owned utilities focused on transmission and distribution activities in electricity and gas in both the UK and the US. We play a vital role in connecting millions of people to the energy they use, safely, reliably and efficiently. We are organised into four operating segments, along with other activities.

UK Electricity Transmission

We own and operate the electricity transmission network in England and Wales, with day-to-day responsibility for balancing supply and demand. We operate but do not own the Scottish networks. Our networks comprise approximately 7,200 kilometres (4,470 miles) of overhead line, 1,500 kilometres (932 miles) of underground cable and 338 substations.

UK Gas Transmission

We own and operate the gas national transmission system in Great Britain, with day-to-day responsibility for balancing supply and demand. Our network comprises approximately 7,660 kilometres (4,760 miles) of high pressure pipe and 24 compressor stations. In 2015/16, the gas throughput across the system was more than 80 billion cubic metres.

Adjusted operating profit

£4,096m

2014/15: £3,863m

Adjusted operating profit

£1,173m

2014/15: £1,237m

Adjusted operating profit

£486m

2014/15: £437m

Capital expenditure

£3,893m

Capital expenditure

£1,084m

Capital expenditure

£186m

2014/15: £3,470m

2014/15: £1,074m

2014/15: £184m

**UK regulated return on equity
(RoE) %**

| | | |
|----|---|-------------------------|
| 02 | National Grid Annual Report and Accounts 2015/16 | Strategic Report |
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We own and operate four gas distribution networks comprising approximately 131,000 kilometres (81,400 miles) of pipeline. We transport gas from the national transmission system to around 10.9 million consumers on behalf of 39 shippers.

US Regulated

Electricity: We jointly own and operate transmission facilities across upstate New York, Massachusetts, New Hampshire, Rhode Island and Vermont. We own and operate electricity distribution networks in upstate New York, Massachusetts and Rhode Island. The assets we operate include 174 kilometres (108 miles) of underground cable, 491 transmission substations and 688 distribution substations.

Gas: We own and operate gas distribution networks across the northeastern US, located in upstate New York, New York City, Long Island, Massachusetts and Rhode Island. We forecast, plan for and procure around 16 billion standard cubic metres of gas each year.

Other Activities

Our other activities mainly relate to non-regulated businesses and other commercial operations not included within the business segments including: interconnectors; UK-based gas metering activities; UK property management; a UK LNG import terminal; US LNG operations; US unregulated transmission pipelines; and corporate activities.

Adjusted operating profit

£878m

2014/15: £826m

Adjusted operating profit

£1,185m

2014/15: £1,164m

Adjusted operating profit

£374m

2014/15: £199m

Capital expenditure

£549m

Capital expenditure

£1,856m

Capital expenditure

£218m

2014/15: £498m

2014/15: £1,501m

2014/15: £213m

US Regulated RoE

(calculated on a calendar year)

%

National Grid Annual Report and
Accounts 2015/16

At a glance

03

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Chairman's statement

Balancing the three elements of the energy trilemma – security of supply, the cost of energy and environmental sustainability – continues to contribute towards a dynamic environment in the energy industry.

Being responsible and sustainable is central to both what we do and how we do it

As we continue to invest in the future performance of our business, we are striving to meet the challenges of the energy trilemma. For this year's Annual Report, we have described the challenge in more detail, highlighting developments during 2015/16 and our response. You can read more about this on pages 8–9.

Responsible business

www.nationalgrid.com/responsibility

As part of our response, we need a strong leadership team that combines a deep knowledge of the industry with fresh insight. Over the past year we have had a number of changes to the Company's leadership, which I believe have secured continuity, while complementing the strong range of skills and experience we need for the challenges and opportunities ahead.

Our KPIs

pages 18–21

In November, we announced that Steve Holliday had informed the Board that he wished to retire as CEO and leave the Company in 2016. Steve stepped down as CEO at the end of March and was succeeded by John Pettigrew, who was previously Executive Director of our UK operations.

Steve, who will remain on the Board until 22 July to support John with the transition, has made a significant contribution to the energy sector and National Grid. Under his leadership the Company has delivered excellent returns for shareholders, helping establish National Grid's place as one of the world's leading utilities.

Throughout his tenure as CEO, Steve has remained committed to our people, our customers and the communities we serve. This commitment has included leading the drive for greater levels of safety, as well as playing a leading role in the debate on creating employment opportunities for young people championing the role businesses can play in providing good careers advice and encouraging the growth of STEM education and engineering.

John's appointment followed a very thorough and rigorous selection process, carried out by the Nominations Committee. The Committee, and subsequently the Board, was unanimous in its support for John, given his experience covering our UK and US operations. He was the architect of our strategy for delivery and performance under the UK regulatory regime, RIIO. He also played a pivotal role in introducing improvements and demonstrating strong leadership within both the US Electricity Transmission and Distribution businesses.

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In focus

The Board is proposing
a recommended full-year
dividend of

43.34p

Corporate Governance

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We will also be welcoming Nicola Shaw onto the Board as Executive Director, UK from 1 July 2016. Apart from the appointment of Dean Seavers on 1 April 2015, as we described in last year's Annual Report and Accounts, there have been no other changes to the Board composition over the past year.

John and Nicola's appointments highlight the importance of succession planning and this will remain an important area of focus for the Nominations Committee and the Board. Effective succession planning for both Executive and Non-executive Director positions helps make sure we have the right mix of skills and experience to manage change as the Company evolves.

Viability statement

During 2015/16 the Board reviewed and approved the Company's principal risks. This played an important part in the Board's approval of the new viability statement required by the 2014 UK Corporate Governance Code. You can read more about our viability statement on page 30.

Our UK Gas Distribution business

The Board regularly reviews the composition and balance of the Company's portfolio. As part of this, we have begun a process for the potential sale of a majority stake in our UK Gas Distribution business.

We believe that the Company can deliver best value to shareholders through maintaining a portfolio of businesses with strong operational performance, alongside annual asset growth of around 5-7%, based on a long-term assumption of 3% in respect of UK RPI. The sale of a majority stake in our UK Gas Distribution business is expected to increase this growth rate towards the upper end of the range.

Following completion of a sale, the Board expects to return substantially all of the net proceeds to shareholders. We also expect to maintain the strong balance sheet that allows the Group to continue to fund its investment programme. The process is likely to be completed in early 2017.

Dividend

Our dividend policy aims to grow the ordinary dividend at least in line with the rate of RPI inflation each year. Accordingly, the Board has recommended an increase in the final dividend to 28.34 pence per ordinary share (\$2.0445 per American Depositary

Share). If approved, this will bring the full-year dividend to 43.34 pence per ordinary share (\$3.1768 per American Depositary Share), an increase of 1.1% over the 42.87 pence per ordinary share in respect of the financial year ended 31 March 2015.

Responsible business

At the start of 2016, the United Nations 17 goals to transform our world officially came into force. The Sustainable Development Goals call on all countries to promote prosperity while protecting the planet. Business has an important role to play in helping achieve these goals. By being responsible and sustainable we can all make a positive difference to people's lives and to our planet.

At National Grid, being responsible and sustainable is central to both what we do and how we do it. In the UK we are now an accredited Living Wage employer. We have come to the end of our two-year employee chosen charity partnership with Macmillan Cancer Support. I am very pleased to say that our UK employees have raised more than £600,000 and this money has been used by Macmillan to provide fuel grants for more than 3,000 people living with or recovering from cancer. I am looking forward to seeing which charity our employees choose next for us to support.

In the US, our energy efficiency programmes are making a real difference in helping our customers reduce their energy use. The American Council for an Energy-Efficient Economy (ACEEE) scored all three states in which we operate among the top 10 for energy efficiency.

As you can read on page 18, we have added new KPIs to our reporting, so we can more fully reflect the issues that really matter to the Company and our stakeholders. For our 2015/16 Annual Report, we have included KPIs for our community engagement and for the work we do in support of education and skills. Both of these issues are important to us. We want to see the communities in which we operate thrive, and we want to see more young people studying STEM subjects because there are not enough young people coming through into engineering.

You can find more information about our approach to being a responsible business on our website.

We know there are areas where we can improve. As John describes in his CEO review, we did not meet some of our customer satisfaction targets, and we must continue to build on our safety performance.

Looking ahead

We support the work that Ofgem is undertaking to explore the introduction of onshore competition. However, we believe that competition should only be taken forward where it is in the best interests of consumers.

As the energy market continues to evolve, the role of the GB System Operator (SO) has also been a matter of debate with both Ofgem and DECC and we are currently in detailed discussion on what greater independence for the SO means in practice. We recognise the need to continue strengthening the management of potential conflicts of interest between our Transmission Operator (TO) and SO roles, but do not believe that creating an independent SO is in the interests of consumers, given the need to focus on security of supply.

Due to the nature of our business, we recognise that our critical national infrastructure systems are a potential target for cyber threats. We will continue to invest in strategies that aim to protect our business in the UK and US, and which keep pace with the increasing scale and sophistication of threats.

We also need to continue raising awareness of cyber security across the Company, addressing our attitudes and behaviour towards it as an issue, making security breaches less likely to happen.

I would like to extend my deepest appreciation to the management team and all our employees for their hard work, dedication and commitment to the Company's success.

Sir Peter Gershon

Chairman

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Accounts 2015/16

Chairman's statement

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Chief Executive's review

It's an exciting time to be part of the energy industry, and I'm looking forward to working with my leadership team on the opportunities that lie ahead.

I'm delighted to have been asked by the Board to take over as CEO of National Grid and lead the Company into its next chapter.

Having joined the Company 25 years ago, as a graduate, I've been fortunate that the opportunities and challenges I've had from moving around all parts of the organisation, in both the UK and US, have never failed to motivate and inspire me – both personally and professionally.

I've also been fortunate to have worked closely with Steve Holliday over the past ten years. Under Steve's leadership, the Company has transformed its performance and culture, helping place National Grid at the heart of the energy industry. He leaves a great legacy for us to build on.

I would like to thank Ian Galloway for his tremendous support as UK Chief Operating Officer while we were seeking to make an appointment to the UK Executive Director role.

Our performance during 2015/16

Our business has delivered a strong performance during 2015/16.

In the UK, we have had our safest year ever, while in the US our performance continues to improve – we have seen fewer injuries and had fewer people taking time off due to an injury than ever before. However, we want to build on this performance and further reduce risks. We will focus on the causes of incidents and find more opportunities to learn from them and share best practice.

I firmly believe that through a high performance culture we will continue to find better ways of serving our customers – setting expectations, being honest about what we can deliver, then consistently delivering on our promises. However, customer needs are evolving with much greater engagement, awareness, and a desire to manage their energy use.

That's why we are developing the way we think and work at National Grid – improving our end-to-end processes, removing waste and focusing on the things that create value for our customers. We have done more work during the year to develop this high performance culture and it will remain an important part of how we develop as a Company.

Our employees continue to show their commitment to the communities we serve. Our UK and US businesses have delivered over 18,000 interactions with young people, encouraging the

I now look forward to continuing the great work we are doing with our customers, shareholders, partners and employees to meet the challenges and opportunities of the changing UK and US energy landscapes.

On 1 July, Nicola Shaw joins National Grid as Executive Director for our UK business. Nicola joins us from High Speed 1, where she was CEO for the last five years, managing and maintaining the UK's high-speed railway infrastructure. I very much look forward to working with her when she joins our business.

Reliability across our networks has remained very strong throughout the year. In the US, our electricity distribution system delivered solid performance with continued recognition of our storm response processes. In the UK, despite the ongoing concerns over tightening electricity margins, our SO business has managed the challenges extremely well.

Our commitment to our customers is critical to our future success. In the UK, we have exceeded our two electricity and gas transmission customer satisfaction targets. In the US, we did not meet our targets due to customer concerns about higher than normal winter bills.

development of the skills and capabilities needed to gain meaningful employment. Overall, we invest time and resources equivalent to a value over £14 million each year in the communities where we work.

Our UK business

As Sir Peter describes, we have begun a process for the potential sale of a majority stake in our UK Gas Distribution business. We have been working on how we separate Gas Distribution from National Grid, so we can create a stand-alone business that is ready for sale. We want to make sure it has the people, assets, systems and technology it needs to be successful in the future.

In the UK, where there are continuing concerns about electricity capacity margins, we contracted additional balancing services of 2.4 GW for the winter period to be available to help manage periods of peak demand.

This includes 133 MW from demand side balancing reserve arrangements, including businesses that signed up for reducing demand at peak periods if called on – for example, by turning off air conditioning for a period – in return for payment.

We have also launched the Power Responsive programme, which is designed to help growth in DSR. You can read more about this on

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I look forward to continuing
the great work we are
doing with our customers, shareholders, partners
and employees

In focus
Employee

engagement score

76%

(2014/15: 75%)

Our KPIs

pages 18 21

Principal operations

pages 31 43

On 12 May 2016, Ofgem announced a mid-term review. As expected, the scope of this review is narrow with no changes to key financial parameters. We welcome Ofgem's continued commitment to the clarity and certainty offered by the eight-year RIIO framework. Ofgem will run a consultation process this summer, with any changes to be implemented in April next year.

In addition, the Company has been working with DECC and Ofgem to consider how to evolve the current SO model, to make it more independent, while remaining cost effective. In doing so, it is vital that there is no disruption to the pivotal role we play as SO in balancing the network.

Our US business

America's gas and electricity networks, most of which were originally constructed during the nation's ambitious post-World War II building boom, have served us well over the last half-century.

But times have changed. We need to advance the country's natural gas and electricity infrastructure beyond its 20th century limitations, by creating a more customer-centric, resilient, agile, efficient and environmentally sound energy network.

We call our approach to this Connect21, and you can read more about our work to support it on pages 38-41. For example, we've created our New Energy Solutions team, which is looking at how we promote cleaner energy, improving efficiency, affordability, and choice for customers by delivering state-mandated initiatives.

In order to continue investing in our networks and improving our service to customers, we filed three rate cases in 2015—one in Massachusetts and two in downstate New York. These three proposals are undergoing a thorough review process by the regulators in each state.

Also during 2015/16, we backed the Environmental Protection Agency's (EPA) proposed Carbon Pollution Standards for New and Existing Power Plants (known as the Clean Power Plan). As we and other organisations have requested, the EPA's final Plan provides states with compliance flexibility and makes sure that early emissions reductions via investments in renewable resources and energy efficiency strategies are counted.

Our people

The initiatives and achievements I've described are testament to the hard work of our people. I believe that developing the skills and capabilities of our employees is crucial to our success, so I'm really pleased that we delivered more than 154,000 days of technical, safety, leadership and personal effectiveness training across our global workforce during 2015/16.

I was also delighted to see that in our most recent employee engagement survey we achieved an engagement score of 76%—our highest since we started conducting Group-wide surveys of our people.

I would like to thank all my colleagues at National Grid for their contribution and ongoing commitment to our business.

Priorities for the year ahead

Maximising value from our core businesses and delivering safe, reliable networks will continue to be our top priorities. In addition, in 2016/17 we are focused on completing the sale of a majority stake in our UK Gas Distribution business and will continue to file for new rates to support our US business.

Longer-term priorities

Customer first

We must be close to our customers, so we can respond to their changing needs and deliver an outstanding service. As customer requirements evolve, so must National Grid. This will bring further opportunities to grow and drive value.

Performance optimisation

Everyone in our Company should see performance optimisation as part of the day job—constantly working efficiently and doing things better. If we are to succeed, we must maintain and further strengthen the Group's high performance culture.

Growth

We have strong growth potential and see opportunities in all our regions and businesses. We expect to sustain a high level of investment in our regulated business in the UK and US as well as exploring new business opportunities over the medium term. We will, however, only invest in projects that meet our strict investment criteria and represent the best value for shareholders.

Evolve for the future

With the growing rate of renewables, distributed generation and, over time, energy storage, our industry is changing. We need to make sure we are at the forefront of this, continuing our involvement in industry discussions so we can keep abreast of the changes, and make sure we evolve for the future.

John Pettigrew
Chief Executive

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Chief Executive's review

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Our operating environment

The cost of energy

In Saratoga, New York, we have supported customer Quad Graphics with an energy efficiency incentive offer of \$1,095,000. Our support is helping achieve significant energy savings while boosting productivity.

Read more on page 41.

Security of supply

When we assessed the margin for the winter of 2015/16, we procured additional commercial tools that raised the margin to a tight but manageable 5.1%.

Read more on page 34.

Our operating environment is shaped by the trilemma, which has become the standard way to assess energy systems, as it simply articulates the three distinct objectives that need to be met in providing energy to consumers, but which are often in tension.

Regulatory changes are a response to choices that governments make in seeking to appropriately balance these often conflicting objectives.

Sustainability

Decarbonising domestic heat remains one of the major challenges in society's energy trilemma, so our Gas Distribution business is developing sources of renewable gas that can be transported through our existing networks.

Read more on page 36.

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| | The cost of energy | Security of supply | Sustainability |
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| Commentary | <p>The cost of the energy we use is an issue for consumers, industry, energy providers, regulators and governments.</p> <p>Consumers expect a reliable energy system that delivers gas and electricity when and where it is needed. They pay for the cost of this infrastructure and improvements to it through the network costs part of their energy bills. The costs are subject to regulatory approval.</p> | <p>The energy system is in a phase of transition from high to low carbon. Coal plants are closing down and being replaced with nuclear, renewables and gas.</p> <p>During the transition, electricity margins need to be monitored and actively managed as we move to a generation mix with greater volumes of intermittent generation.</p> | <p>Evidence shows our climate is changing because of the emission of greenhouse gases resulting from human activity. The bulk of emissions derive from the demand for energy for power, heating and transport.</p> |
| Developments | <p>The UK Competition and Markets Authority has concluded its investigation into the energy market and set out numerous remedies,</p> | <p>Energy security is the UK Government's number one priority on energy. It is reviewing the capacity market and incentives so that market</p> | <p>Negotiations for a new international agreement on climate change concluded in Paris at the 21st session of the Conference of Parties (COP21)</p> |

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| | <p>including proposals to address locational pricing on the electricity transmission network.</p> <p>In May 2016, Ofgem stated that it will undertake a mid-period review of the RIIO outputs for our transmission businesses.</p> <p>In the US, consumers have experienced rising costs for energy over the past three winters. Regulators are seeking to encourage investment in infrastructure and new technology to bring down costs and help consumers manage their energy use.</p> | <p>arrangements bring forward new generation of all technologies at the right time so that new generation capacity is built. The Government also signed an agreement for a new nuclear power station at Hinkley Point.</p> <p>In the US, regulators are seeking investment in infrastructure to improve the security and resilience of energy networks while also decarbonising those networks.</p> | <p>in December 2015. A commitment to have clear goals and a system of governance and review were put in place.</p> <p>The published advice of the Climate Change Committee is that the UK's fifth carbon budget should be a target of 57% reduction on 1990 levels between 2028 and 2032. Legislation is expected to be proposed in summer 2016.</p> <p>The US EPA's Clean Power Plan sets standards for power plants and agrees state level targets for reductions in carbon emissions.</p> |
| <p>Our response</p> | <p>UK response</p> <p>We are investing up to £16 billion over the eight years to 2021 to make sure Britain's energy system is fit and ready to support a low-carbon economy. Despite this significant increase in investment, our network costs will remain flat in real terms over the coming years.</p> <p>All network costs are heavily scrutinised through the UK energy regulator Ofgem and are the only part of consumers bills that are regulated. Ofgem's incentives encourage innovation, so if we are more efficient, consumers share the</p> | <p>UK response</p> <p>We are supporting the UK Government by providing analysis through our role as delivery body for Electricity Market Reform (EMR).</p> <p>We have put in place new products to ensure that the SO has the right tools to maintain supplies over winter. We are developing DSR products that reduce reliance on traditional generation sources.</p> <p>We have also started construction on two new interconnectors (see page 43).</p> | <p>Group response</p> <p>Reducing greenhouse gas emissions forms part of the Company's KPIs (see page 21).</p> <p>UK response</p> <p>We have facilitated the connection of 4.5 GW of solar PV generation at the distribution network level, working with industry to remove barriers to entry and find solutions to network operability issues.</p> <p>We have set out our vision for the Future of Gas, exploring</p> |

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| <p>benefits.</p> <p>US response</p> <p>Improving the customer experience and helping ratepayers manage their energy costs is a critical component of our business operations. To help reduce New England’s energy costs, we are partnering with the developer of one major proposed regional pipeline expansion project to improve transport capacity, upgrade existing facilities, and enhance market area storage assets.</p> | <p>US response</p> <p>In addition to supporting new investments in gas and electricity infrastructure projects, we have submitted grid modernisation proposals that aim to improve the region’s reliability, sustainability and affordability of its energy supply and services. We have filed rate cases in Massachusetts and New York proposing to update our distribution rates.</p> | <p>opportunities to bring forward bio-substitute natural gas and compressed natural gas vehicle fuels.</p> <p>US response</p> <p>We continue to support the EPA’s Clean Power Plan, the Northeast’s cap-and-trade scheme of the Regional Greenhouse Gas Initiative, and other state-level initiatives. We also support technological partners and innovative tools, such as energy storage, electric transportation and distributed generation, which can help meet sustainability and energy diversity objectives.</p> |
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What we do

Electricity The electricity industry connects generation sources to homes and businesses through transmission and distribution networks. Companies that pay to use transmission networks buy electricity from generators and sell it to consumers.

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Real-time balancing

Through our Electricity Network Control Centre we balance the UK's energy needs in real time. Read more about this on pages 34 35.

Generation

Generation is the production of electricity from fossil fuel and nuclear power stations, as well as renewable sources such as wind and solar. In the US, we own and operate 50 fossil fuel-powered stations on Long Island and 7.9 MW of solar generation in Massachusetts. We do not own or operate any electricity generation in the UK.

We sell the electricity generated by our plants on Long Island to LIPA under a

Transmission

Transmission systems generally include overhead lines, underground cables and substations. They connect generation and interconnectors to the distribution system.

We own and operate the transmission network in England and Wales. We operate but do not own the Scottish networks. We are also working in a joint venture with Scottish Power Transmission to construct an

long-term power supply agreement. The contract allows us to recover our efficient operating costs and provides a return on equity on our investment in the generation assets.

interconnector to reinforce the GB transmission system between Scotland and England and Wales.

For solar generation, we recover our costs and a reasonable return from customers in Massachusetts through a solar cost-adjustment factor. This is added to the electricity rate, net of revenues earned from the solar assets.

In the US, we jointly own and operate transmission facilities spanning upstate New York, Massachusetts, New Hampshire, Rhode Island and Vermont.

System operator

As system operator (SO) for England and Wales, we coordinate and direct electricity flows onto and over the transmission system, balancing generation supply and user demand. Where necessary, we pay sources of supply and demand to increase or decrease their generation or usage.

We have the same role for the two high voltage electricity transmission networks in Scotland and we are SO for the offshore electricity transmission regime.

Interconnectors

Transmission grids are often interconnected so that energy can flow from one country or region to another. This helps provide a safe, secure, reliable and affordable energy supply for citizens and society across the region. Interconnectors also allow power suppliers to sell their energy to customers in other countries.

Great Britain is linked via interconnectors with France, Ireland, Northern Ireland and the Netherlands. We own part of the interconnectors with France and the Netherlands. We are also now entering the construction phase for two new interconnectors, between the UK and Belgium and the UK and Norway. We are continuing to work on developing additional interconnector projects, which we believe will deliver significant benefits to consumers. These include opportunities for interconnection with Iceland, Denmark and a further link with France.

We also jointly own and operate a 224 kilometre interconnector between New England in the US and Canada.

Distribution

Distribution systems carry lower voltages than transmission systems over networks of overhead lines, underground cables and substations. They take over the role of transporting electricity from the transmission network, and deliver it to consumers at a voltage they can use.

We do not own or operate electricity distribution networks in the UK.

In the US, our distribution networks serve around 3.5 million customers in upstate New York, Massachusetts and Rhode Island.

Supply

The supply of electricity involves buying electricity and selling it on to customers. It also involves customer services, billing and the collection of customer accounts.

Our charges for SO services in the UK are subject to a price control approved by Ofgem. System users pay us for connection, for using the system and balancing services.

As electricity transmission SO, our price control includes incentives to minimise the costs and associated risks of balancing the system through buying and selling energy, as well as procuring balancing services from industry participants.

In the US, similar services are provided by independent system operators.

We sell capacity on our UK interconnectors through auctions and on our US interconnector through wholesale markets and bilateral contracts.

We do not sell electricity to consumers in the UK.

All our customers in the US can select a competitive supplier for the supply component of electricity utility services. Where customers choose National Grid, they pay us for distribution and electricity costs. Where they choose to buy electricity from third parties, they pay us for distribution only and pay the third-party supplier for the electricity. Our base charges for electricity supply are calculated to recover the purchased power costs.

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What we do

Gas The gas industry connects producers, processors, storage, transmission and distribution network operators, as well as suppliers to industrial, commercial and domestic users.

Biomethane milestone

We connected the UK's first 100% renewable biomethane HGV filling station in Leyland, Lancashire

(see page 37).

Production and importation

We do not produce gas in either the UK or the US. Gas used in the UK is mainly sourced from gas fields in the North and Irish seas, piped from Europe and imported as LNG.

There are seven gas reception terminals, three LNG importation terminals and three interconnectors connecting Great Britain via undersea pipes with Ireland, Belgium and the Netherlands. Importers bring LNG from the Middle East, the Americas and other places.

Distribution

In the UK, gas leaves the transmission system and enters the distribution networks at high pressure. It is then transported through a number of reducing pressure tiers until it is finally delivered to consumers.

There are eight regional gas distribution networks in the UK, four of which are owned by National Grid. In the US, gas is delivered by the interstate pipeline companies to local distribution networks. Each local distribution company has a

Gas used in the US is produced mainly in North America. We import LNG from a number of countries.

geographically defined service territory and is the only local distribution company within that territory. Local distribution companies are regulated by the relevant local state's utility commission.

In the UK, we own and operate Grain LNG, an importation terminal and storage facility at the Isle of Grain in Kent, which charges customers under long-term contracts for various services. These include access to our importation terminal, storage facilities and capacity rights.

Our networks deliver gas to 10.9 million consumers in the UK and 3.6 million customers in the US.

In the US, we own and operate LNG storage and vaporisation facilities, as well as an LNG storage facility in Providence, Rhode Island, where we store gas for third parties for a fee. We also buy gas directly from producers and LNG importers for resale to our customers.

Pipeline shippers bring gas from producers to suppliers, who in turn sell it to customers.

Transmission

The transmission systems generally include pipes, compressor stations and storage facilities, including LNG storage. They connect production through terminals to the distribution systems.

We do not supply gas in the UK. However, we own National Grid Metering, which provides meters and metering services to supply companies, under contract.

System operator

As SO we are responsible for the high pressure gas NTS in Great Britain. We have responsibility for the residual balancing activities on the NTS and for keeping the physical system within safe operating limits.

In the UK, gas enters the transmission system through importation and reception terminals and interconnectors and may include gas previously held in storage. Compressor stations located along the network play a vital role in keeping large quantities of gas flowing through the system, particularly at times of high demand.

In the UK, customers pay the supplier for the cost of gas and for its transportation. We transport the gas through our network on behalf of shippers, who pay us transportation charges.

In the US, gas distribution companies, including National Grid, sell gas to consumers connected to their distribution systems.

Our price control, set by Ofgem, includes

The gas transmission system has to be kept constantly in balance, which is achieved by

In most cases in the US, where customers choose National Grid, they pay us for distribution and gas costs.

incentives that aim to maintain and improve our daily operational efficiency and are subject to renegotiation at set intervals.

buying, selling and using stored gas. This means that, under normal circumstances, demand can be met. We are the sole owner and operator of gas transmission infrastructure in Great Britain. In the US, we hold a minority interest in two interstate pipelines: Millennium Pipeline Company and Iroquois Gas Transmission System. Interstate pipelines are regulated by the Federal Energy Regulatory Commission (FERC).

Where they choose to buy gas from third parties, they pay us for distribution only and pay the third-party supplier for the gas and upstream transportation capacity.

Also in the US, except for residential consumers in Rhode Island, customers may purchase their supply from independent providers with the option of billing for those purchases to be provided by us.

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Our vision and strategy

Our vision is to connect you to your energy today,
 trusted to meet your energy needs tomorrow.

Our strategy is to be a recognised leader in the development and operation of safe, reliable and sustainable energy infrastructure, to meet the needs of our customers and communities and to generate value for our investors.

Our strategic objectives set out what we believe we need to do to achieve our vision and strategy. Further information on all our KPIs is provided on pages 18-21.

| Strategic objective | Deliver operational excellence | Engage our people | Stimulate innovation |
|----------------------------|---|--|---|
| Description | Achieve world-class levels of safety, reliability, security and customer service. | Create an inclusive, high-performance culture by developing all our employees. | Promote new ideas to work more efficiently and effectively. |

How we deliver

Our customers, communities and other stakeholders demand safe, reliable and secure supply of their energy. This is reflected in our regulatory contracts where we are measured and rewarded on the basis of meeting our commitments to customers and other stakeholders.

It is through the hard work of our employees that we will achieve our vision, respond to the needs of our stakeholders and create a competitive advantage. Encouraging engaged and talented teams that are in step with our strategic objectives is vital to our success.

Our commitment to innovation allows us to run our networks more efficiently and effectively and achieve our regulatory incentives. Across our business, we explore new ways of thinking and working to benefit every aspect of what we do.

Pursuing excellence in all our operational processes will allow us to manage our assets efficiently, deliver network improvements quickly and provide services that meet the changing demands of our customers.

Our presence within the communities we serve, the people we work with and our opportunities to grow both individually and as a business are all important to making National Grid a great place to work.

Embedding innovation and new technology into our operations helps us deliver continuous improvements in the quality and cost of our services.

Relevant KPIs

Employee injury frequency rate

Number of employee lost time injuries per 100,000 hours worked in a 12 month period. Our ambition is to achieve a world-class safety performance of below 0.1.

Employee engagement index

A measure of how engaged our employees feel, based on the percentage of favourable responses to certain indicator questions repeated annually in our employee engagement survey.

Network reliability

The reliability of our electricity and gas networks.

Network reliability

The reliability of our electricity and gas networks.

Workforce diversity

Percentage of women and ethnic minorities in our workforce.

Customer satisfaction

A measure of customer satisfaction across our segments and differing customer groups.

Group return on equity

Measure of value generation for our shareholders.

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| | | | |
|----------------------------|---|--|---|
| Strategic objective | Engage externally | Embed sustainability | Drive growth |
| Description | Work with external stakeholders to shape UK, EU and US energy policy. | Integrate sustainability into our decision-making to create value, help preserve natural resources and respect the interests of our communities. | Grow our core businesses and develop future new business options. |

How we deliver

Policy decisions by regulators, governments and others directly affect our business. We engage widely in the energy policy debate, so our position and perspective can influence future policy direction. We also engage with our regulators to help them provide the right mechanisms so we can deliver infrastructure that meets the changing needs of our customers and stakeholders.

Our long-term sustainability strategy sets our ambition to deliver these aims and to embed a culture of sustainability within our organisation.

This culture allows us to make decisions that balance affordability with helping to protect and preserve natural resources and benefit the communities in which we operate. We remain committed to our targets of a 45% reduction in Scope 1 and Scope 2 greenhouse gas emissions by 2020 and 80% by 2050.

We continue to maximise value from our existing portfolio, while exploring and evaluating opportunities for growth. Making sure our portfolio of businesses maintains the appropriate mix of growth and cash generation is necessary to meet the expectations of our shareholders.

We review investment opportunities carefully and will only invest where we can reasonably expect to earn acceptable returns.

Combining this disciplined approach with operational and procurement efficiencies gives us the best possible opportunity to drive strong returns and meet our commitments to investors.

Relevant KPIs

Climate change

A measure of our reduction of Scope 1 and Scope 2 greenhouse gas emissions of the six primary Kyoto greenhouse gases (excluding electricity transmission and distribution line losses).

Regulated asset base growth

Maintaining efficient growth in our regulated assets ensures we are well positioned to provide consistently high levels of service to our customers and increases our revenue allowances in future years.

Adjusted EPS

Adjusted earnings represent profit for the year

| | | |
|--|--|---|
| | | attributable to equity shareholders. This excludes exceptional items and remeasurements (see page 111). |
| | | Adjusted earnings per share provides a measure of shareholder return that is comparable over time. |

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Accounts 2015/16

Our vision and strategy

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Our KPIs

Delivering our strategy The Board uses a range of financial and non-financial metrics, reported periodically, against which we measure Group performance.

| KPI and definition | Adjusted EPS | Group return on equity (RoE) | Regulated asset base growth |
|---------------------------|--|--|--|
| | <p>Adjusted earnings represent profit for the year attributable to equity shareholders. This excludes exceptional items and remeasurements (see page 111).</p> <p>Adjusted earnings per share provides a measure of shareholder return that is comparable over time.</p> | <p>We measure our performance in generating value for our shareholders by dividing our annual return by our equity base.</p> <p>This calculation provides a measure of the performance of the whole Group compared with the amounts invested by the Group in assets attributable to equity shareholders.</p> | <p>Maintaining efficient growth in our regulated assets ensures we are well positioned to provide consistently high levels of service to our customers and increases our revenue allowances in future years.</p> |
| Our performance | Adjusted EPS pence ¹ | | |

Commentary

| | Group return on equity % | Total regulated asset base and regulated asset base growth £bn |
|--|--|--|
| <p>For the year ended 31 March 2016, adjusted earnings attributable to equity shareholders increased by £197 million to £2,386 million. This increase in earnings resulted in an adjusted earnings per share of 63.5p, an increase of 10.2% on 2014/15.</p> <p>The earnings increase was driven by a £233 million increase in adjusted operating profit. With the exception of our UK Electricity Transmission business, operating profit increased in all of our business segments.</p> <p>Overall adjusted net finance costs were £20 million lower than 2014/15 at £1,013 million. The effective tax rate for the year was 24.0%.</p> | <p>Group RoE has increased during the year to 12.3%, from 11.8% in 2014/15. During the year, the UK regulated businesses delivered a solid return of 13.3% in aggregate (2014/15: 13.7%), including an assumption of 3% long run average RPI inflation. US returns (calculated on a calendar year) of 8.0% were slightly down on last year, reflecting high winter gas leak and snow removal costs at the start of 2015, together with rate base growth.</p> <p>Further details of how this is calculated are on page 202.</p> | <p>Our UK regulated asset value (RAV) and US rate base increased by £1.8 billion (5%) to £38.8 billion. This reflects the continued high levels of investment in our networks in both the UK and US, together with the impact of the stronger US dollar.</p> |

Target

The adjusted EPS target set as part of executive remuneration for Annual Performance Plan (APP) was more than met with 100% of maximum achieved (see page 76).

The Group RoE target set as part of executive remuneration for APP was more than met with 100% of maximum achieved (see page 76).

The Group RoE is one of the performance measures for the Long Term Performance Plan, outturns for which are calculated on a three year basis.

No specific target. Our overall aim is to achieve between 5% and 7% of regulated asset base growth each year.

| | | | | |
|-----------------------------|----------|--------|--------|-----------|
| UK Electricity Transmission | | | | |
| UK Gas Transmission | T | 100 | 100 | achieved |
| UK Gas Distribution | T | 99.999 | 99.999 | achieved |
| US Electricity Transmission | B | 99.9 | 99.972 | no target |
| US Electricity Distribution | B | 99.9 | 99.995 | no target |

Key:

T Target

B No target set or set individually by each jurisdiction.

Accordingly, we set a base and report performance above the base.

Value added in the year increased by £0.1 billion to £1.8 billion.

Of the £1.8 billion value added in 2015/16, £1,337 million was paid to shareholders as cash dividends and £267 million as share repurchases (offsetting the scrip issuance during the year), with £183 million retained in the business.

See page 23 for further details.

In the UK we improved our employee safety performance during 2015/16, with an employee injury frequency rate of 0.07. Our US business improved its safety performance, with an employee injury frequency rate of 0.11.

Overall, our Company-wide employee injury frequency rate has fallen to 0.10 and has been consistently around this level throughout the year. In real terms, this means 17 fewer employees had a lost time injury this year than last.

We aim to deliver reliability by: planning our capital investments to meet challenging demand and supply patterns; designing and building robust networks; risk-based maintenance and replacement programmes; and detailed and tested incident response plans. In the UK, our networks performed well. Ahead of winter 2015/16, we assessed the margin and procured additional electricity system balancing tools on both supply and demand-side. We successfully used our new demand side tool for the first time and saw the market respond to market notifications. In the US, despite numerous winter snow storms and summer wind storms in parts of New England and New York, our network resilience held up well. We invested millions of dollars in our electricity infrastructure to improve resilience and help reduce the impact of service interruptions.

See UK Principal operations: pages 31 37

and US Principal operations: pages 38 41

No specific target. Our overall aim is to sustainably grow value added over the long term while maintaining performance of our other financial KPIs.

We have met our ambition of achieving below 0.1 in the UK but not in the US.

We achieved our targets, which are set out in the table for our UK networks, and are set individually for each of our US jurisdictions.

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Our KPIs continued

Delivering our strategy The Board uses a range of financial and non-financial metrics, reported periodically, against which we measure Group performance.

| | | | |
|----------------------------------|--|--|---|
| <p>KPI and definition</p> | <p>Skills and capabilities</p> <p>We support developing the skills and capabilities of young people through skills-sharing employee volunteering, especially in the STEM subjects, because it supports our future talent recruitment and our desire to see young people gain meaningful employment.</p> | <p>Workforce diversity</p> <p>Percentage of women and ethnic minorities in our workforce.</p> | <p>Community engagement and investment in education</p> <p>Working with our communities is important in creating shared value for us as a business and the people we serve. We use the London Benchmarking Group (LBG) measurement framework to provide an overall community investment figure which includes education.</p> |
| <p>Our performance</p> | <p>Skills and capabilities</p> | <p>Workforce diversity %</p> | <p>Community engagement and investment in education £</p> |

Commentary

| | | |
|--|--|--|
| <p>We measure quality (>1 hour) interactions with young people on STEM subjects. In the UK we have had 9,733 interactions with young people on STEM subjects, and 8,675 interactions in the US.</p> | <p>We continue to closely track the demographics of our employee population in terms of gender and ethnicity.</p> <p>To find out more about how we promote an inclusive and diverse workforce go to page 44.</p> | <p>In the UK our community engagement and investment in education is £7,984,720, and in the US it is £6,566,647 and £3,073 in other countries. This is a financial measurement of a number of activities including the time our employees give through volunteering, the money our employees raise through fundraising and also the support we give to our charity partners. Overall our Company-wide investment is £14,554,440.</p> |
|--|--|--|

Target

| | | |
|---|--|---|
| <p>No specific target. Our overall aim is to encourage young people to get involved in the STEM subjects.</p> | <p>No specific target. We aim to develop and operate a business that has an inclusive and diverse culture.</p> | <p>We do not have a specific target on how much we invest in this area; our overall aim is to make sure we are creating shared value for the communities that we serve and work in.</p> |
|---|--|---|

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Strategic Report

Employee engagement index

A measure of how engaged our employees feel, based on the percentage of favourable responses to certain indicator questions repeated annually in our employee engagement survey.

Employee engagement index %

Climate change

Scope 1 and Scope 2 greenhouse gas emissions of the six primary Kyoto greenhouse gases (excluding electricity transmission and distribution line losses). Our target is to reduce our greenhouse gas emissions by 45% by 2020 and 80% by 2050, compared with our 1990 emissions of 19.6 million tonnes.

Greenhouse gas emissions

Million tonnes carbon dioxide equivalent

Customer satisfaction

The table summarises how we measure customer satisfaction:

| | Methodology | Measure |
|-----------|---|------------------|
| UK | Use RIIO-related metrics agreed with Ofgem | Score out of 10 |
| US | J.D. Power and Associates customer satisfaction surveys | Quartile ranking |

The table below focuses on the past two years. Detailed data for the prior four years is provided on page 18 of our 2014/15 Annual Report and Accounts, which you can find in the investors section of our Company website.

Performance

| | 14/15 | 15/16 | Target |
|--|--------------|--------------|---------------|
|--|--------------|--------------|---------------|

| | | | |
|---------------------------------|-----|-----|------------------|
| UK Electricity Transmission | 7.4 | 7.5 | 6.9 ¹ |
| UK Gas Transmission | 7.6 | 7.6 | 6.9 ¹ |
| UK Gas Distribution | 8.3 | 2 | 8.3 ¹ |
| US Gas Distribution Residential | 4th | | To improve |
| US Gas Distribution Commercial | 3rd | | To improve |
| US Electricity Residential | 3rd | 3rd | To improve |
| US Electricity Commercial | 2nd | 4th | To improve |

1. Figures represent our baseline targets set by Ofgem for reward or penalty under RIIO.

2. Our customer satisfaction results are now reported on an annual basis with the results being published later this year.

We measure employee engagement through our employee engagement survey. The results of our 2016 survey, which was completed by 87% of our employees, have helped us identify specific areas where we are performing well and those areas we need to improve. Our engagement index has risen one point to 76% favourable. Managers receive a scorecard that aims to create greater leadership accountability and we produce survey reports and action plans at company, regional, business unit, function and team levels.

Our Scope 1 greenhouse gas emissions for 2015/16 equate to 7.0 million tonnes carbon dioxide equivalent (2015: 7 million tonnes) and our Scope 2 emissions (excluding electricity transmission and distribution line losses) equate to 0.3 million tonnes (2015: 0.3 million tonnes); combined this is a 62% reduction against our 1990 baseline. These are equivalent to an intensity of around 496 tonnes per £million of revenue (2015: 478). Our Scope 3 emissions for 2015/16 were 35.6 million tonnes. We measure and report in accordance with the World Resources Institute and World Business Council on Sustainable Development Greenhouse Gas Protocol: Corporate Accounting and Reporting Standard (Revised Edition) for all six Kyoto gases, using the operational approach for emissions accounting. 100% of our Scope 1 and 2 emissions and

Our customer satisfaction KPI comprises seven components; Ofgem's UK electricity and gas transmission and distribution customer satisfaction scores and four J.D. Power and Associates customer satisfaction surveys in the US. We have exceeded the two UK Electricity and Gas Transmission targets; the outcome for the third UK Gas Distribution survey will be published later this year.

In the US, we did not achieve our targets. Customers were again concerned about higher-than-normal winter bills as a result of electricity commodity price increases and higher gas usage due to cold weather. In an effort to rebuild trust and customer satisfaction, we put in place a customer outreach and education programme similar to last year that focused on energy-saving solutions and bill management.

| | | |
|---|--|---|
| | <p>95% of our Scope 3 emissions are independently assured against ISO 14064-3 Greenhouse Gas assurance protocol. This statement is available on our Company website.</p> | |
| <p>We achieved our target of increasing engagement compared with the previous year.</p> | <p>We forecast that we will continue to significantly exceed (better) the 45% by 2020 reduction target. We expect the 2050 target to be extremely challenging.</p> | <p>Our targets for each business area are set out in the table above.</p> |

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Financial review

National Grid delivered another strong performance in 2015/16. This included significant levels of investment in our gas and electricity assets providing important services for millions of customers in the UK and US.

Additional commentary

on financial KPIs

Adjusted operating profit

Adjusted operating profit for the year ended 31 March 2016 was £4,096 million, up £233 million (6%) compared to last year. With the exception of our UK Electricity Transmission business, operating profit increased in all of our business segments.

Adjusted operating profit by segment £m

For the year ended 31 March 2016, adjusted operating profit in the UK Electricity Transmission segment decreased by £64 million to £1,173 million. Revenue was £223 million higher, mainly reflecting the recovery of higher pass-through costs such as payments to other UK network owners and system balancing costs. In addition, £43 million of legal settlement revenue in 2014/15 was not repeated this year. As mentioned above,

UK Gas Distribution adjusted operating profit increased by £52 million to £878 million. Revenue was £51 million higher, principally reflecting increased regulatory revenue allowances. In part, these allowances were increased to compensate for expected increases in taxation costs reflecting a change to the tax treatment of replacement expenditure. Regulated controllable costs were £21 million higher due to inflation, recruitment, property costs and higher charges from strategic partners to cover connections and flexible winter resourcing. Depreciation and amortisation costs were £12 million higher reflecting the continued capital investment programme. Pass-through costs charged to customers were £11 million lower this year, and other costs were £23 million lower than prior year, which included provisions for additional asset protection costs.

Within our US Regulated business, adjusted operating profit increased by £21 million to £1,185 million. The effect of the stronger dollar was to increase operating profit in the year by £81 million. Excluding this impact from exchange rate movements, revenue decreased by £1,051 million, principally as a result of lower commodity costs passed on to customers and unfavourable timing of recoveries year on year, partly offset by higher increased revenue allowances under the

This section

provides additional commentary on our KPIs and other performance metrics we use to monitor our business performance. Analysis of our financial performance and position as at 31 March 2016, including detailed commentary on the performance of our operating segments, is located in the financial statements. However, this analysis still forms part of our Strategic Report financial review.

pass-through costs were £209 million higher. Regulated controllable costs were £28 million higher due to inflation and salary growth, together with legal cost recoveries in the prior year, higher tower maintenance costs and transformation costs associated with our System Operator business. Depreciation and amortisation costs were £14 million higher, reflecting the continued capital investment programme, and other costs were £36 million higher than prior year including additional asset impairments this year and lower scrap and disposal proceeds.

UK Gas Transmission adjusted operating profit increased by £49 million to £486 million. Revenue was £25 million higher, including over-recovery of allowed revenues in the year, partly offset by lower pass-through cost recoveries. After deducting pass-through costs, net revenue was £46 million higher than prior year. Regulated controllable costs were £10 million higher than last year, mainly as a result of inflation, higher gas system service charges and organisational change costs. Depreciation and amortisation costs were £6 million higher, reflecting ongoing investment. Other operating costs were £19 million lower than last year, mostly reflecting additional costs in 2014/15 relating to the closure of LNG facilities.

Niagara Mohawk three-year rate plan and the benefit of capex trackers. The reduction in revenue was mostly offset by a £1,027 million reduction in pass-through costs (excluding the impact of foreign exchange). Regulated controllable costs reduced by £71 million at constant currency, partly as a result of lower gas leak and compliance work this year and additional costs incurred last year to improve data quality and bring regulatory filings up to date. Depreciation and amortisation costs were £51 million higher this year at constant currency as a result of ongoing investment in our networks. Pension costs were £15 million higher at constant currency, while other operating costs were £41 million higher at constant currency, including higher asset removal costs.

Adjusted operating profit in Other activities was £175 million higher at £374 million. In the US, adjusted operating profit was £143 million higher, reflecting lower spend on upgrades to our finance systems which were completed last year. In addition, we benefited from a £49 million gain on disposal of our investment in the Iroquois pipeline, and a reduction in the costs associated with our investment in Clean Line. In the UK, adjusted operating profit was £32 million higher mainly as a result of strong auction revenues in our French interconnector (IFA) business and higher property sales proceeds.

Adjusted earnings

For the year ended 31 March 2016, adjusted net finance costs were £20 million lower than they were in 2014/15 at £1,013 million, with lower UK RPI inflation, continued focus on management of cash balances, and the benefit of last year's debt buybacks offsetting the impact of the stronger US dollar and increasing net debt.

[See pages 197 to 199 for commentary on our financial performance and position for the year ended 31 March 2015 compared with 31 March 2014. We have also included analysis of our UK regulated financial performance by segment on page 108.](#)

In focus

[Use of adjusted profit measures](#)

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[Commentary on the consolidated income statement](#)

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[Commentary on results of our principal operations by segment](#)

Our adjusted tax charge was £58 million higher than it was in 2014/15. This was mainly due to higher profits before tax. The effective tax rate for 2015/16 was 24.0% (2014/15: 24.2%).

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[Further details of how our performance metrics are calculated](#)

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Strategic Report

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Reconciliations of adjusted profit measures

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The earnings performance described on the previous page has translated into adjusted earnings of £2,386 million, up £197 million on last year. This equates to adjusted earnings per share (EPS) of 63.5 pence, up 5.9 pence (10%) on 2014/15.

Scrip restatement

In accordance with IAS 33, all EPS and adjusted EPS amounts for comparative periods have been restated as a result of shares issued via scrip dividends.

Measurement of financial performance

We describe and explain our results principally on an adjusted basis and explain the rationale for this on page 196. We present results on an adjusted basis before exceptional items and remeasurements. See page 196 for further details and reconciliations from the adjusted profit measures to IFRS, under which we report our financial results and position. A reconciliation between reported operating profit and adjusted operating profit is provided below. Further commentary on movements in the income statement is provided on page 95.

| | Year ended 31 March | | |
|---|---------------------|---------|---------|
| £m | 2016 | 2015 | 2014 |
| Total operating profit | 4,085 | 3,780 | 3,735 |
| Exceptional items | 22 | | (55) |
| Remeasurements commodity contracts | (11) | 83 | (16) |
| Adjusted operating profit | 4,096 | 3,863 | 3,664 |
| Adjusted net finance costs | (1,013) | (1,033) | (1,108) |
| Share of post-tax results of joint ventures | 59 | 46 | 28 |
| Adjusted taxation | (753) | (695) | (581) |
| Attributable to non-controlling interests | (3) | 8 | 12 |
| Adjusted earnings | 2,386 | 2,189 | 2,015 |
| Adjusted EPS (pence) | 63.5 | 57.6 | 53.1 |

Group return on equity (RoE)

We measure our performance in generating value for our shareholders by dividing our annual return by our equity base.

Group RoE has increased during the year to 12.3%, from 11.8% in 2014/15. During the year, the UK regulated businesses delivered a solid operational return of 13.3% in aggregate (2014/15: 13.7%), including an assumption of 3% long run average RPI inflation. US operational returns (calculated on a calendar year) of 8.0% were slightly down on last year, reflecting high winter gas leak and snow removal costs at the start of 2015, together with rate base growth.

Overall, other activities in the Group delivered a good performance, including an improved result from the French and BritNed interconnectors, higher property sales, the gain on sale of our interest in the Iroquois pipeline and lower US other costs following the completion of our financial system upgrade last year. Treasury performance also helped the result, through lower RPI accretions on the Group's index linked debt, ongoing focus on effective cash management and the benefit of last year's debt repurchases. Together, these helped to offset the headwind from a lower cost of debt allowance under the tracker within the UK price controls.

Regulated asset base growth

In total, our UK regulated asset value (RAV) and US rate base increased by £1.8 billion (5%) to £38.8 billion. This reflects the continued high levels of investment in our networks in both the UK and US, together with the impact of the stronger US dollar.

The UK RAV increased by £0.7 billion, reflecting significant capital expenditure, together with inflation, although RPI inflation at 1.6% (March to March), was below our 3% long term expectation. UK RAV growth also included capitalised efficiencies or performance RAV of £115 million this year.

US rate base has increased by £1.1 billion this year. Of this, £0.4 billion was due to foreign exchange movements increasing the rate base reported in sterling. Excluding foreign exchange, rate base increased by £0.7 billion, reflecting a significant year of US investment.

Value added

Our dividend is an important part of returns to shareholders along with growth in the value of the asset base attributable to equity investors. These are reflected in the value added metric that underpins our approach to sustainable decision-making and long-term incentive arrangements.

Overall value added in the year was £1.8 billion or 47.6 pence per share as set out below:

| | Year ended 31 March | | |
|----------------------------------|---------------------|-------------|---------------|
| £bn at constant currency | 2016 | 2015 | Change |
| UK regulated assets ¹ | 26.0 | 25.5 | +0.5 |
| US regulated assets ¹ | 14.1 | 13.9 | +0.2 |
| Other invested capital | 1.9 | 1.5 | +0.4 |
| Total assets | 42.0 | 40.9 | +1.1 |
| Dividend paid | | | +1.3 |
| Share buyback | | | +0.3 |
| Movement in goodwill | | | |
| Net debt | (25.3) | (24.4) | -0.9 |
| Value added | | | +1.8 |
| Value added per share | | | 47.6p |

1. Includes assets held outside RAV and rate base.

Value added in the year was higher than 2014/15 (£1.7 billion or 44.7p per share), primarily as a result of higher inflation on UK regulated assets (March 2016 RPI of 1.6%, prior year 0.9%), together with the gain on disposal of our share of the Iroquois pipeline. Of the £1.8 billion value added in 2015/16, £1,337 million was paid to shareholders as cash dividends and £267 million as share repurchases (offsetting the scrip issuance during the year), with £183 million retained in the business.

The Board is confident that growth in assets, earnings and cash flows, supported by improving cash efficiency and an exposure to attractive regulatory markets, should help the Group to maintain strong, stable credit ratings and a consistent prudent level of gearing, while delivering attractive returns for shareholders.

Table of Contents**Financial review** continued**Other performance measures****UK regulated return on equity**

UK RoE has decreased 40bps to 13.3%. This reduction in RoE reflects a reduction in incentive performance year on year, particularly as a result of the end of the gas permit incentive scheme last year. Totex out-performance was at a similar level to last year. This performance represents 320bps of outperformance over allowed returns.

UK return on equity %**US regulated return on equity**

US RoE for calendar year 2015 decreased 40bps to 8.0%, reflecting high winter gas leak and snow removal costs at the start of

The UK RoCE has decreased from 8.6% to 8.1% in 2015/16. This reduction reflects one-off benefits of legal settlements last year in Electricity Transmission that did not repeat and the reduction in gas permit and legacy incentive revenues in our Gas Transmission business in the year. Excluding these two items, operational performance, incentives and returns are at similar levels to last year.

US RoCE has decreased by 30bps in the year to 5.7%. Regulated financial performance was at a similar level to last year, however the overall return has decreased as high levels of capital investment have driven rate base growth.

Capital expenditure

For the year ended 31 March 2016, capital expenditure of £3,893 million was £423 million higher than last year. The Group also invested £63 million in the St William Homes joint venture with Berkeley Group and £53 million in other joint ventures including a new electricity interconnector between the UK and Belgium.

In focus**Commentary on the consolidated cash flow statement**

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Commentary on borrowings

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2015, together with rate base growth as a result of record capital investment spend.

Our US Regulated business continues to increase levels of investment in both electricity and gas distribution reinforcement. Capital expenditure in 2015/16 was £355 million higher than last year, and reflected higher spend on gas mains replacement, gas customer growth, system reinforcement and initial spend on a solar project in Massachusetts, together with the impact of a stronger US dollar.

US return on equity¹ %

1. Calculated on a calendar year basis.

UK Gas Distribution capital expenditure was £51 million higher than last year, reflecting an increased level of mains replacement work, in line with our target to replace a pre-determined length of main over the course of the RIIO-GD1 period.

Return on capital employed

RoCE provides a performance comparison between our regulated UK and US businesses and is one of the measures that we use to monitor our portfolio of businesses. The table below shows our RoCE for our businesses over the last five years:

Capital expenditure £m

Return on capital employed %

Dividend growth

We remain committed to our dividend policy to grow the dividend at least in line with the rate of average RPI inflation each year for the foreseeable future.

During the year we generated £1.9 billion of business net cash flow after our capital expenditure programmes. This has enabled the growth of the dividend in line with average RPI, being 1.1% (2014/15: 2.0%; 2013/14: 2.9%), taking into account the recommended final dividend of 28.34 pence.

During the year, the Company has repurchased shares in the market with the overall goal being to reduce the dilutive effect of the scrip as much as possible to the extent that is consistent with maintaining the Group's strong financial position as reflected in its credit rating.

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US regulation

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Net debt and credit metrics

We expect capital investment programmes and network enhancement will continue to be funded by market borrowings. We continue to borrow at attractive rates when needed and the level of net debt remains appropriate for the size of our business.

During 2015/16, net debt has increased by £1.4 billion. This is driven by net business cash inflows (after capex) of £1.9 billion, more than offset by outflows from interest, dividends, tax and other financing flows of £2.6 billion, with other non cash movements such as foreign exchange and accretion increasing net debt by a further £0.7 billion.

A key measure we use to monitor financial discipline is retained cash flow divided by adjusted net debt (RCF/net debt). This is a measure of the operating cash flows we generate, before capital investment but after dividends paid to shareholders, compared with the level of debt we hold. The principal adjustments made to net debt are in respect

Regulatory financial performance**Timing and regulated revenue adjustments**

As described on pages 176 to 182, our allowed revenues are set in accordance with our regulatory price controls or rate plans. We calculate the tariffs we charge our customers based on the estimated volume of energy we expect will be delivered during the coming period. The actual volumes delivered will differ from the estimate. Therefore, our total actual revenue will be different from our total allowed revenue. These differences are commonly referred to as timing differences.

If we collect more than the allowed revenue, the balance must be returned to customers in subsequent periods, and if we collect less than the allowed level of revenue we may recover the balance from customers in subsequent periods. In the US, a substantial portion of our costs are pass-through costs (including commodity and energy efficiency costs) and are fully

of pension deficits and hybrid debt instruments. RCF/net debt was 11.5% for the year (2014/15: 11.2%; 2013/14: 10.5%). For the current year, we have used this measure to actively manage scrip uptake through buying back shares when supported by sufficient headroom. Deducting the costs of buying back these shares reduces RCF/net debt to 10.5% for the year.

Our long-term target range for RCF/net debt is to exceed 9.0%, which is consistent with the A3 rating threshold used by Moody's, the rating agency.

We additionally monitor interest cover, which is a measure of the cash flows we generate compared with the net interest cost of servicing our borrowings. Interest cover for the year was 5.5 times (2014/15: 5.1 times; 2013/14: 4.1 times).

Our target long-term rate for interest cover is in excess of 3.0 times.

recoverable from our customers. Timing differences between costs of this type being incurred and their recovery through revenue are also included in timing.

The amounts calculated as timing differences are estimates and subject to change until the variables that determine allowed revenue are final.

Our operating profit for the year includes a total estimated in-year over-collection of £25 million (2014/15: £64 million under-collection). Our closing balance at 31 March 2016 was £48 million over-recovered. In the UK, there was cumulative under-recovery of £87 million at 31 March 2016 (2015: under-recovery of £177 million). In the US, cumulative timing over-recoveries at 31 March 2016 were £135 million (2015: £150 million over-recovery). The majority of that balance will be returned to customers next year.

In addition to the timing adjustments described above, as part of the RIIO price controls in the UK, outperformance against allowances as a result of the totex incentive mechanism, together with changes in output-related allowances included in the original price control, will almost always be adjusted in future revenue recoveries, typically starting in two years' time.

Our current IFRS revenues and earnings include these amounts that will need to be repaid or recovered in future periods. Such adjustments will form an important part of the continuing difference between reported IFRS results and underlying economic performance based on our regulatory obligations.

For our UK regulated businesses as a whole, regulated revenue adjustments totalled £262 million in the year (2014/15: £174 million). This is based on our estimates of: work carried out in line with allowances; in expectation of future allowances; or work avoided altogether either as a result of us finding innovative solutions or of the need being permanently removed. In the US, accumulated regulatory entitlements to future revenue net of over- or under-recoveries amounted to £1,335 million at 31 March 2016 (2015: £1,528 million). These entitlements cover a range of different areas, with the most significant being environmental remediation and pension assets, as well as deferred storm costs.

All regulatory entitlements are recoverable (or repayable) over different periods, which are agreed with the regulators to match the expected payment profile for the liabilities. As at 31 March 2016, these extend until 2071.

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Internal control and risk management

The Board is committed to protecting and enhancing our reputation and assets, while safeguarding the interests of our shareholders. It has overall responsibility for the Group's system of risk management and internal control.

National Grid is exposed to a variety of uncertainties that could have a material adverse effect on the Group's financial condition, our operational results, our reputation, and the value and liquidity of our shares.

The Board oversees risk management, and, as part of this role, it sets and monitors the amount of risk the Company is prepared to seek or accept at any given time in pursuing our strategic objectives (our risk appetite). The Board also regularly monitors and reviews our internal controls and risk management processes. You can read more about this on page 29.

This year we refined our risk management processes as a result of changes implemented by the UK Corporate Governance Code 2014 (the Code). Most notably, we now specifically test the impact of our principal risks on a reasonable worst case basis, alone and in clusters, over a five-year assessment period. The aim of this is to establish their impact on the Group's ability to continue operating and meet its liabilities over the assessment period. The reason for selecting a five-year assessment period and the results of this exercise are described in the viability statement on page 30.

and the actions being taken to manage and monitor them. They assess each risk by considering the financial and reputational impacts, and how likely the risk is to materialise. The identified risks are collated in risk registers and reported at functional and regional levels of the Group. The risk registers also describe the adequacy of our existing risk controls.

An important feature of our risk management process is our three lines of defence model. Each business function owns and is responsible for managing its own particular risks (the first line of defence). A central risk management team (the second line of defence) acts as an advisory function and also provides independent challenge and review. This team partners with the business functions through nominated risk liaisons and collaborates with assurance teams and specialists, such as safety and compliance management. Our internal audit function then audits selected controls and mitigation activities (the third line of defence).

Regional senior management regularly reviews and debates the outputs of the bottom-up risk management process and agrees the prioritisation of the risks. The main risks for the UK and US businesses are highlighted in regional risk profiles and reported to the CEO.

Risk management approach

Our Group-wide corporate risk management process provides a framework through which we can consistently identify, assess and prioritise, manage, monitor and report risks, as shown in the diagram below. The process is designed to support the delivery of our vision and strategy, as described on pages 16 17.

Our main strategic uncertainties or principal risks for the Company are developed through discussing the Group risk profile with the Executive leadership team and the Board. These risks are reported and debated with the Executive Committee and Board every six months.

Our process involves a continuous cycle of bottom-up review and reporting and top-down review and feedback.

The Board participates in risk workshops to make sure that the principal risks remain closely aligned to our strategic aims and that no important risks (or combination of risks) are being overlooked. This year, several sessions were conducted to discuss our principal risks and to assess the potential of those risks to impact the Company s

All our business functions participate in the bottom-up risk management process. They identify the main risks to our business model and to achieving their business objectives

Risk management process

Feedback and reporting

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Strategic Report

viability over the next five years. Through the testing and review process we decided to adopt two new principal risks in relation to emerging technology and the potential impact of sustained inflation and deflation in the US and UK respectively.

The outcomes from each level of the risk review process are fed back to the relevant teams and incorporated as appropriate into the next cycle of our ongoing process as shown on page 26.

Our principal risks

Accepting that it is not possible to identify, anticipate or eliminate every risk that may arise and that risk is an inherent part of doing business, our risk management process aims to provide reasonable assurance that we understand, monitor and manage the main uncertainties that we face in delivering our objectives.

This includes consideration of inherent risks, which exist because of the nature of day-to-day operations in our industry, and financial risks, which exist because of our financing activities. The principal risks we face are provided below. An overview of the key inherent risks we face are provided on pages 183–186, as well as our key financial risks, which are incorporated within the Notes to our consolidated financial statements on pages 102 to 167.

Our corporate risk profile contains the principal risks that the Board considers to be the main uncertainties currently facing the Group as we endeavour to achieve our strategic objectives. We have provided an overview of these risks below, together with examples of the relevant controls and current mitigating actions we are taking.

Strategic objective Risk description

Example of mitigations

Drive growth

Failure to identify and execute the right opportunities to deliver our growth strategy.

We regularly monitor and analyse market conditions, competitors and their potential strategies, the advancement and proliferation

Failure to grow our core business and have viable options for new business over the longer term would adversely affect the Group's credibility and jeopardise the achievement of intended financial returns.

Our ability to achieve our ambition for growth is subject to a wide range of external uncertainties, including the availability of potential investment targets and attractive financing and the impact of competition for onshore transmission in both the UK and US; and internal uncertainties, such as the performance of our operating businesses and our business planning model assumptions.

Sustained deflation/inflation in the UK/US.

Sustained deflation in the UK would result in a loss of inflationary indexation of UK RIIO networks RAV. In the US our asset base is not indexed by inflation, therefore higher inflation erodes value even if our cost of service is periodically updated through rate case filings.

of new energy technologies, as well as the performance of our Group portfolio. We are also looking to access new sources of finance and capabilities through partnering.

We have internal processes for reviewing and approving investments in new businesses, disposals of existing ones and organic growth investment opportunities. These processes are reviewed regularly to make sure our approach supports our short- and long-term strategies. We undertake due diligence exercises on investment or partnering opportunities and carry out post-investment reviews to make sure we learn lessons for the future.

The primary measures we have to manage this risk include our business planning process (five-year plan approved each year by the Board), annual portfolio review by the Board, financing strategies (including hedging policies approved by the Finance Committee) and regulatory strategies (e.g. US rate case filing schedule).

Engage externally

Failure to secure satisfactory regulatory outcomes/ failure to influence future energy policy.

Policy decisions by regulators, governments and others directly affect our business. We must engage widely in the energy policy debate, making sure our position and perspective help to shape future policy direction.

In both the UK and the US we strive to maintain a good understanding of the regulatory agenda and emerging issues, so that robust, public interest aligned responses can be selected and developed in good time. Our reputation as a competent operator of important national infrastructure is critical to our ability to do this.

Engage our people

Failure to secure skills and leadership capacity (including effective succession planning) required to deliver our vision and strategy.

Strategic workforce planning allows us to effectively inform our strategic resourcing plans.

It is through the high-quality work of our employees that we will achieve our vision, respond to the changing needs of our stakeholders and create a competitive advantage. Obtaining and fostering an engaged and talented team that has the knowledge, training, skills and experience to deliver on our strategic objectives is vital to our success. We must attract, integrate and retain the talent we need at all levels of the business.

Our entry level talent development schemes (graduate training and apprenticeships) are a potential source of competitive advantage in the market place.

Improvements to our talent processes mean that we are now much better at identifying talent and accelerating development of future leaders (e.g. our Accelerated Development Programme).

The rigour of our succession planning and development planning process has been improved, particularly at senior levels and is now being applied deeper into the organisation.

We are involved in a number of initiatives to help secure the future engineering talent required (see page 44).

We continue to promote inclusion and diversity.

We monitor employee engagement and formally solicit employee opinions via a Group-wide employee survey annually.

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Internal control and risk management continued

| Strategic objective | Risk description | Example of mitigations |
|---------------------------------------|--|--|
| Deliver operational excellence | <p>Failure to deliver appropriate information systems and data integrity.</p> <p>The Company is increasingly reliant on technology to support and maintain our business-critical processes. We must be able to rely on the performance of these systems and the underlying data to demonstrate the value of our business to our shareholders, meet our obligations under our regulatory agreements, and comply with agreements with bond holders and other providers of finance.</p> | <p>Following the implementation of a new US enterprise resource planning system at the end of 2012, we undertook a significant effort to combat programme difficulties. This system is now stabilised and enhancements to drive business value have been successfully implemented throughout 2015.</p> <p>Over the financial year we have implemented improved project management practices for IS projects.</p> <p>We have taken action to bring back in-house knowledge of critical systems, processes and data.</p> <p>We have rebuilt the US Program Delivery organisation, to build back programme delivery skills.</p> <p>Globally, our Information Management Framework is being rolled out to improve data management.</p> |

Data and its effective management is also central to our compliance action plan, which is being rolled out across the Group.

We experience a catastrophic/major cyber security breach.

We use industry best practices as part of our cyber security policies, processes and technologies.

Due to the nature of our business we recognise that our critical national infrastructure (CNI) systems may be a potential target for cyber threats. We must protect our business assets and infrastructure and be prepared for any malicious attack.

Our cyber security programme is a global programme of work which started in 2010 and continues to be modified and updated to this day. This programme is intended to reduce the risk that a cyber threat could adversely affect the Company's business resilience.

We continually invest in cyber strategies that are commensurate with the changing nature of the security landscape. This includes collaborative working with DECC and the Centre for Protection of National Infrastructure (CPNI) on key cyber risks and development of an enhanced CNI security strategy and our involvement in the US with developing the National Institute of Standards and Technology Cyberspace Security Framework.

Catastrophic asset failure.

We continue to commit significant resources and financial investment to maintain the integrity of our assets and we strive to continuously improve our key process safety controls.

Safety is paramount. Some of the assets that we own and operate are inherently hazardous and process safety incidents, while extremely unlikely, may occur.

We continue to implement our Group-wide process safety management system to ensure a robust and consistent framework of risk management exists across our higher hazard asset portfolio.

We have a mature insurance strategy that uses a mix of self-insurance, captives and direct (re)insurance placements. This provides some financial protection in respect of property damage, business interruption and liability risks. Periodically, independent surveys of key assets are undertaken, which provide risk engineering knowledge and best practices to the Group with the aim to further reduce our exposure to hazard risks.

We fail to effectively respond to the threats and opportunities presented by emerging technology, particularly the challenge of adapting our networks to meet the challenges of increasing distributed energy resources.

We have relaunched our dedicated Group Technology Team within the Strategy Function.

We undertake biannual reviews and briefings of emerging trends and developments and their implications for the Company with the Board.

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Our internal control process

We have a number of processes to support our internal control environment. These processes are managed by dedicated specialist teams, including risk management, ethics and compliance management, corporate audit and internal controls, and safety, environment and health. Oversight of these activities is provided through regular review and reporting to the appropriate Board committees as outlined in the Corporate Governance section on pages 46-67.

Reviewing the effectiveness of our internal control and risk management

Each year the Board reviews the effectiveness of our internal control systems and risk management processes covering all material systems, including financial, operational and compliance controls, to make sure they remain robust. The latest review covered the financial year to 31 March 2016 and the period to the approval of this Annual Report and Accounts. It included:

the Certificate of Assurance from the CEO to the Board following consideration by the Audit Committee, which provides overall assurance around the effectiveness of our risk management and internal controls systems;

where appropriate, assurance from our committees, with particular reference to the

Our internal control and risk management processes comply with the requirements of the UK Corporate Governance Code. They are also the basis of our compliance with obligations set by Sarbanes-Oxley and other internal assurance activities.

Internal control over financial reporting

We have specific internal mechanisms to govern the financial reporting process and the preparation of the Annual Report and Accounts. Our financial controls guidance sets out the fundamentals of internal control over financial reporting, which are applied across the Company.

Our financial processes include a range of system, transactional and management oversight controls. In addition, our businesses prepare detailed monthly management reports that include analysis of their results, along with comparisons to relevant budgets, forecasts and prior year results. These are presented to, and reviewed by, senior management within our Finance function.

These reviews are supplemented by quarterly performance reviews, attended by the CEO and Finance Director. These reviews consider historical results and expected future

reports received from the Audit, and Safety, Environment and Health Committees on reviews undertaken at their meetings; and

assurances about the certifications required under the Sarbanes-Oxley Act 2002 (Sarbanes-Oxley) as a result of our US reporting obligations.

The Board evaluated the effectiveness of management's processes for monitoring and reviewing internal control and risk management. It noted that no significant failings or weaknesses had been identified by the review and confirmed that it was satisfied the systems and processes were functioning effectively.

performance and involve senior management from both operational and financial areas of the business. Each month, the Finance Director presents a consolidated financial report to the Board.

As part of our assessment of financial controls in previous years, we identified a number of weaknesses in our US financial control framework. We are making progress in remediating these weaknesses. For more information, including our opinion on internal control over financial reporting, see page 183.

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Accounts 2015/16

**Internal control and risk
management**

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Viability statement

The Board's consideration of the longer-term viability of the Company is an extension of our business planning process, which includes financial forecasting, a robust risk management assessment, regular budget reviews and scenario planning. This activity is strengthened by a culture throughout the Company of review and challenge. Our vision and business strategy aim to make sure that our operations are sustainable and our finances are sustainable and robust.

As part of National Grid's risk appetite framework, each year the Board reviews our target risk appetite levels and reflects on whether our decision-making behaviours over the past year have aligned with these targets. The Board confirmed that the Company's behaviours over the past year had been in line with our target risk appetite.

We believe that five years is the most appropriate timeframe over which the Board should assess the long-term viability of the Company. The following factors have been taken into account in making this decision:

1. We have reasonable clarity over a five-year period, allowing an appropriate assessment of our principal risks to be made;
2. The Board considered whether there are specific, foreseeable risk events relating to the principal risks that are likely to materialise within a five to ten year period, and which might be substantial enough to affect the Company's viability and therefore should be

The Board has considered the proposed sale of a majority share in our UK Gas Distribution business and has concluded that it will not have an adverse impact on the viability of the Company. It will continue to assess the strategic risks that the proposed sale presents when considering the approval of the transaction.

The Board has discussed the potential financial and reputational impact of the principal risks against our ability to deliver the Company's business plan. This describes and tests the significant solvency and liquidity risks involved in delivering our strategic objectives within our business model.

The Board has also reviewed the stress testing of the principal risks. The Board started by considering our reputational and financial risk capacity. It then considered how that capacity might be tested by the principal risks. Each of the principal risks was tested for its individual impact based on assessing reasonable worst case scenarios over a five-year period, and considering reputational impacts and financial impacts (to the nearest £500m). The figure of £500m was selected because our financial risk capacity is very substantial and the Board was satisfied that this figure was appropriate in the context of an exercise aimed at testing threats to viability.

In addition to testing individual principal risks, the Board also considered the impact of a cluster of the principal risks materialising over the assessment period. They focused on

taken into account when setting the assessment period. No risks of this sort were identified; and the effect these could have on our reputation and stakeholder trust and how that could impact our business.

3. It matches our business planning cycle.

We have set out the details of the principal risks facing our Company on pages 26 to 29, described in relation to our ability to deliver our strategic objectives. We identify our principal risks through a robust assessment that includes a continuous cycle of bottom-up reporting and review, and top-down feedback and horizon scanning. Through this assessment, priorities are elevated appropriately and transparently. This process is described in more detail on pages 26 to 27.

Over the course of the year the Board has also considered the following specific areas of our principal risks in detail:

In assessing the impact of the principal risks on the Company, the Board has considered the fact that we operate in stable markets and the robust financial position of the Group, including the ability to sell assets, raise capital and suspend or reduce the payment of dividends. It has also considered Ofgem's legal duty to have regard for the need to fund licenced National Grid Gas plc and National Grid Electricity Transmission plc activities.

Each Director was satisfied that they had sufficient information to judge the viability of the Company. Based on the assessment described above and on page 27, the Directors have a reasonable expectation that the Company will be able to continue operating and meet its liabilities over the period to May 2021.

Principal risk

Securing satisfactory regulatory outcomes and influencing future energy policy.

Matters considered by the Board

Updates and reviews of:

the regulatory situation in the US (including the position with our rate case filings);

the impact of the UK General Election on our business;

our regulatory position in the UK, including our RIIO mid-period review strategy;

the impact of the introduction of onshore competition in the UK;

the future of our System Operator and Transmission Owner roles;

the possible impact of greater European integration of energy markets; and

the potential impact of Brexit on our business.

Failure to deliver appropriate information systems and reliable data.

An update on our global IS systems.

We experience a catastrophic/major cyber breach.

An update on cyber security risks and a review of critical questions to be addressed.

Failure to respond effectively to the threats and opportunities presented by emerging technology, particularly the challenge of adapting our networks to meet the challenges of increasing distributed energy resources.

A Board review of our US business and consideration of potential investment opportunities. Two Board strategy sessions to consider our growth strategy and looking at emerging technology and other industry developments.

Failure to identify and execute the right opportunities to deliver our growth strategy.

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In focus

Safety performance

7,700+

employees and contractors completed a driver safety programme on the risk of distractions while driving

Our networks

We continue to invest in new infrastructure and update our existing networks to deliver energy safely and reliably to our customers.

KPIs pages 18 - 21

Electricity Transmission

page 32

When I look at the different aspects of the UK's energy landscape, it seems that one factor is a constant. Whether it's the sources of energy, or regulatory and government policy developments, or the expectations of customers and industry stakeholders, the common factor that emerges is change.

For us at National Grid, a large part of our success depends on our ability to keep pace with it and adapt to it.

This year we've seen significant regulatory developments. Ofgem launched a consultation on extending competition in electricity transmission. We support this work and recognise that introducing competition is a good way to deliver value for consumers, if the right conditions are met. We outlined this in our response and will continue to use our experience to make sure a thorough assessment is undertaken before any change is finalised.

We have also been working alongside DECC and Ofgem to consider how to evolve the current SO model, to make it more flexible and more independent while remaining cost effective. In

Set against all these developments, I'm delighted that our UK businesses have continued to perform well during the last year with continued world class safety levels and network reliability, as well as further developing our interconnector businesses with two new projects. You can read more about our UK operating highlights over the next six pages.

We can't be complacent though. If we are to be trusted to provide a safe and reliable service today, to deliver a clean and sustainable future for energy, and to deliver on our promises to customers, we need to improve our performance.

This is why performance has been such an important area of focus for our UK businesses during 2015/16 and it remains a priority for the year ahead, as you can read below.

Looking ahead to 2016/17

The coming year promises to be a challenge as we continue to respond and adapt to change across our businesses. Our priorities are very clear. We will create and subsequently sell a

| | | |
|---|---|---|
| <p>Gas Transmission page 33</p> <p>Gas Distribution page 37</p> <p>Innovation We secured over £22m of funding for three major innovative projects. Read more about how this will be invested on pages 32-37</p> | <p>doing so, it is vital that there is no disruption to the pivotal role National Grid plays as SO in keeping the energy market working.</p> <p>In May 2016, Ofgem announced a mid-period review of the RIIO-T1 price control looking at three specific output measures in gas and electricity transmission. The scope of this review is narrow with no changes to key financial parameters. Ofgem will now run a consultation process this summer, with any changes to be implemented in April 2017.</p> <p>We've seen significant change inside the Company too. In November 2015 we announced our plans to commence a process to sell a majority stake in our Gas Distribution business. Since then we have been working on how we separate Gas Distribution from National Grid and create a stand-alone business ready for sale; making sure it has the right people, assets, systems and technology it needs to be successful in the future.</p> | <p>majority stake in a stand-alone Gas Distribution business and continue to work externally to influence future regulatory changes, while meeting the ever-changing needs of our stakeholders.</p> <p>It's important for us to be prepared for the possible introduction of competition in electricity transmission, that our people understand its implications, and that we are ready to review and respond to the mid-period review consultation. I am confident that as a business we will be ready for these changes.</p> <p>At the same time we will continue our drive to improve performance, and make sure we develop a high performance culture to serve our customers as best we can.</p> |
|---|---|---|

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Principal operations

Electricity Transmission We own and manage the electricity transmission system in England and Wales. Our networks comprise approximately 7,200 kilometres (4,470 miles) of overhead line, 1,500 kilometres (932 miles) of underground cable and 338 substations.

Market context

Although demand for electricity is generally increasing around the world, in the UK it is expected to remain broadly flat over the next five to 10 years.

Changes in the sources and characteristics of generation connecting to our network, such as wind and nuclear generation, mean we need to respond by developing the way we balance and operate our network to accommodate these sources.

Over the last two years, some generators have delayed their connection dates to the network and this means our future investment profile for electricity transmission is flatter than in previous years. However, we are ready to respond to connection dates when we need to. We will continue to renew our network to deliver the network reliability our customers require as efficiently as possible.

Working with the stakeholder advisory group we have identified and recommended four projects to receive funding from the Visual Impact Provision project. These projects are in National Parks and Areas of Outstanding Natural Beauty across England and Wales and we have now started feasibility studies to review the existing overhead lines and develop proposals that will help further enhance these areas.

The North West Coast Connection Project continues to progress and maintain engagement with a broad range of stakeholders. This includes holding community information events along the preferred route corridor and meeting government officials, local authorities and focus groups to build support for the statutory formal consultation.

We have developed a mobile application which allows our operations teams to provide instant

In focus

Electricity transmitted across our network

253,981

(GWh)

Circuit breaker replacement programme

We have piloted a new approach to circuit breakers aiming to halve the time and cost of our replacements over the RIIO-T1 period. Completing additional condition assessments and interface engineering allows our new high voltage circuit breakers to be installed on top of existing structures, saving more than four weeks of time. We expect this new innovative approach to reduce our

What we ve achieved in 2015/16

The overall reliability of supply for our transmission system in 2015/16 was 99.999998%.

We have delivered an excellent safety performance; our safest year on record. Our lost time injury rate reduced by over 60% and our high potential incident rate fell by nearly 10%. We have focused on our key risk areas, such as safe driving and working at height and continue to work with our contractors to share best practice in safety management.

Following a seven year period of consultation, community engagement and planning applications we received a development consent order (DCO) for the construction of a new transmission circuit to connect the nuclear power station at Hinkley Point. To connect the power station to the network we will be removing existing pylons and constructing new overhead lines, undergrounding and using the award-winning T-Pylon.

We were granted a £12 million award from this year s Network Innovation Competition (NIC) which will be used to convert a substation at Deeside into an off-grid research facility. This will replicate a live substation and allow us to test the effects of future low-carbon generation on the network with no risk to security of supply. Once complete this will be the first facility of its kind in Europe.

feedback on supplier performance. This is designed to save time, improve supplier performance and reduce costs in our supply chain, helping to deliver further value for consumers.

RHO-T1 costs by more than £100m.

Priorities for the year ahead

Change: prepare for the potential challenge of increased competition in the transmission market, making sure we can deliver for our customers in both competitive and monopoly markets.

Programme delivery: increase the amount of work we can deliver, and reduce our costs through improving processes.

Operational efficiency: continue our drive for efficiency so we can improve productivity. **Project delivery:** complete delivery of key projects such as the London Power Tunnels.

Safety: maintain our world class safety performance.

We are ready to respond to connection dates when we need to

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Strategic Report

Gas Transmission We own and manage the gas national transmission system in Great Britain, with day-to-day responsibility to maintain a safe, reliable, and available operation. Our network comprises approximately 7,660 kilometres (4,760 miles) of high pressure pipe and 24 compressor stations. In 2015/16 the gas throughput across the system was more than 80 billion cubic metres.

In focus

X20,000

The gas throughput across the system in 2015/16 was more than 80 billion cubic metres, enough to fill Wembley Stadium more than 20,000 times.

Efficient robotics

Our pioneering robotics will negotiate complex pipework, withstanding extreme

Market context

The UK's gas market and sources of gas are changing. Domestic demand has fallen over the last five years and a significant increase is not expected in future years. The UK continental shelf (UKCS) now makes up less than half our total gas supply, with the remainder coming from Norway, continental Europe, or further afield via shipped imports of LNG.

Overall, supply capacity now exceeds peak demand by more than 30%, giving our customers significant flexibility over which sources of gas they choose to meet demand. Flexible sources of supply, such as LNG

What we've achieved in 2015/16

We have increased our annual network investment by a further £18 million and maintained excellent levels of network availability throughout the year.

We are committed to safety and are working to improve the fall protection equipment on all our trailers following our first lost time injury in more than two and a half years, when a contractor sustained a minor injury unloading a lorry in December 2015.

We have undertaken a detailed review of our end-to-end processes, focusing on removing waste and increasing value for our customers.

pressures. By avoiding unnecessary excavations, this technology has the potential to save almost £60 million in 20 years and generate carbon savings of over 2,000 tonnes.

importation terminals, interconnectors and storage sites, can respond to demand more quickly than traditional UKCS supplies. Therefore, our network needs to be able to respond to changing day-to-day and within-day supply and demand patterns.

One result from this efficiency work has been our ability to increase the volume of in-house maintenance work we deliver. We have also reduced the time we expect to take in connecting customers to the NTS as a result of these process improvements.

We also need to prepare for an uncertain energy landscape in the long term. UK reliance on imported gas supplies will vary depending on the level of gas supply from the UKCS and the development of indigenous gas sources.

We received a further £4.8 million from Ofgem's NIC to support our customer low-cost connections project. This project will introduce new technology that changes the connections process for customers, making it easier and reducing the cost for new customers to connect to the NTS.

We are working closely with our customers and stakeholders to meet these operational challenges. We are focused on continuing to develop our network and services to meet their needs safely, reliably and efficiently.

We are investing in our Aylesbury, Huntingdon and Peterborough compressor stations to make sure they comply with the stricter environmental limits set out in the Industrial Emissions Directive (IED). We plan to complete the necessary upgrade works to all our sites affected by this legislation by 2023.

Priorities for the year ahead

Safety: build on, and further improve our safety culture and statistics through a review of our risk management approach.

Reliability: increase the amount of maintenance and replacement work on our assets, in line with our RIIO commitments and develop an improved asset health risk methodology.

Efficiency: improve the quality of data on our assets to enable better decisions on investments and to drive

efficiencies in our project work. In response to customer feedback, work to reduce the time taken to connect customers to our network.

Innovation: continue to create value for customers and the wider industry through innovation, development and implementation.

Emissions compliance projects: meet the IED requirements by delivering our agreed asset enhancement and replacement programme.

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Principal operations

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We play a leading role in helping develop the UK's future energy strategy

Power Responsive

In June 2015, we launched the Power Responsive programme, designed to help drive demand side response (DSR) growth through greater customer awareness and clear participation policies. We believe DSR will play an increasingly vital role in building a secure, affordable, sustainable electricity system by providing greater flexibility.

Power Responsive offers a means for suppliers, businesses and policy makers to collaborate, build awareness and deliver improved DSR solutions, helping to reduce total energy costs. The goal is to achieve 30-50% of balancing capability from the demand side by 2020.

System Operator

As System Operator (SO) we are responsible for making sure Britain's gas and electricity is transported safely and efficiently from where it is produced to where it is consumed, when it is needed. We make sure that supply and demand are balanced in real time and we facilitate the connection of assets to the transmission system.

Market context

Sources of energy are changing. In electricity, an increase in renewable generation such as wind, solar and tidal power, together with a decrease in more conventional generation such as coal and gas, is leading to greater variability and uncertainty. In gas, the changing location of gas being input into the transmission system will drive greater need for flexibility as the traditional north-south flow diminishes.

Building on customer and stakeholder feedback, we have reviewed our operations and restructured our organisation to deliver what our customers need. Our customer survey process has been improved, so we can better understand our performance and develop action plans to improve the services we deliver.

We continue to balance the UK's energy needs in real time. We contracted additional balancing services of 2.4 GW for the 2015/16 winter period to be available to help manage periods of peak demand. This includes 133 MW from demand side balancing reserve arrangements.

In our role as Electricity Market Reform delivery body we facilitated the market capacity auction, which secured over 46 GW of capacity at a final clearing price of £18 per kW per year. It was also the first time that interconnectors participated.

You can find out more about the programme and case studies from customers signed up to DSR at www.powerresponsive.com

This makes our role in matching supply and demand more challenging, so we work with the market to make sure we have appropriate tools in place to balance the transmission system. We work with our customers and stakeholders to shape the future of the energy market, providing analysis and insight into the changing nature of energy. We also facilitate changes to the market frameworks to accommodate new technologies and ways of working, while considering how the role of the SO should evolve over time.

The SO is at the forefront of this debate helping to find solutions with industry.

What we have delivered in 2015/16

We continue to play a leading role in helping develop the UK's future energy strategy, and that of Europe. Our approach includes working with customers and stakeholders on initiatives such as the translation of new EU code requirements for gas, the development of new demand side services in the form of the Power Responsive programme, the harmonisation of gas trading arrangements across Europe, our Future Energy Scenarios reports, and System Operability Framework workshops and webinars.

Priorities for the year ahead

We will continue to find better ways to provide timely, cost effective and innovative solutions to balance supply and demand for gas and electricity.

Market developments

We will continue to work with Ofgem and DECC as they develop proposals to help meet the energy challenges of the future, including options for greater SO independence and ensuring there is no disruption to the vital role of the SO. We will work closely with our stakeholders as proposals for roles and responsibilities of the SO become clearer.

Customers and stakeholders

We will continue to develop our longer-term strategy to understand the issues that will affect our customers and stakeholders in the future, and plan how we will best support them.

Delivering energy

We will continue to support the evolution of market frameworks in the UK and Europe to enable new types of generation and demand to come forward in response as the energy landscape changes.

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Strategic Report

Gas Distribution We own and operate four of the eight regional gas distribution networks in Great Britain. Our networks comprise approximately 131,000 kilometres (81,400 miles) of gas distribution pipeline and we transport gas from the national transmission system to around 10.9 million consumers on behalf of 39 gas shippers.

In focus

263TWh

Gas consumption in our networks

We manage the National Gas Emergency number (0800 111 999) on behalf of all gas distribution networks.

We handled nearly 2.3 million calls during 2015/16, across the emergency number, enquiry lines, appliance repair helpline and meter enquiry service.

Market context

We manage our networks to keep our customers safe and warm. We are incentivised through RIIO to operate efficiently and deliver services that our customers and stakeholders value.

Ofgem is able to make comparisons across all eight networks. It establishes outputs they are expected to deliver so we all maintain a safe and reliable network; make a positive contribution to sustainability and protect the environment; provide connections to supply new consumers and support new gas entry points into the network; meet their social obligations; and provide an agreed standard of service to consumers and other stakeholders.

We collaborate with the industry on issues, such as innovation, safety and the future of networks to deliver outcomes that customers value.

The most innovative during 2015/16 was Raynham Farms, Norfolk, which saw the first plastic pipe local transmission system connection in the UK.

We also connected the UK's first HGV filling station to the high pressure local transmission system. This new facility in Leyland, Lancashire, supplies 100% renewable biomethane and will therefore play an important part in the UK's rapidly growing renewable refuelling infrastructure. Our industry-leading work on the future of the gas network will ensure the gas distribution business features heavily in the nation's energy infrastructure for many years to come.

We have been preparing our business for the introduction of domestic smart meters, which, following a UK Government coordinated rollout, we expect will be standard across the country by the end of 2020.

Improving customer communications

To provide our customers with a safe and secure supply of gas we continue to invest in the network by replacing the existing metal gas mains pipes, which supply around 150,000 homes every year, with new hard-wearing plastic pipes.

A trial of a new suite of customer communication materials resulted in a 51% reduction in the number of complaints and enquiries in the trial areas. We will introduce these communication materials across all our networks in 2016/17 with the aim of improving our overall customer satisfaction performance, which is not yet at the level we would like.

Gas remains an important part of the current and future energy mix and we are working with our customers and stakeholders to develop our networks to accommodate gas from new sources, such as biomethane.

What we ve achieved in 2015/16

We remain committed to our ambition to be the best gas distribution business in Britain and continue to focus on delivering a safe and reliable service for our customers.

This year we were prosecuted for incidents at Scunthorpe and Dugdale and, after pleading guilty, accepted fines of £3m. We acknowledged that we did not do our job properly on these occasions and have since changed the way certain activities are carried out.

We have worked on improving the services we provide for our customers that make us a more efficient business. Responding to feedback from our employees and stakeholders, we have been improving the mobile technology used by our workforce and reducing the number and size of the holes we dig in the roads. These initiatives improve customer satisfaction and will also help us to continue delivering our RIIO outputs.

We have continued to connect different sources of gas to our network, particularly biomethane. Since the first connection in October 2013, we have now completed 22 biomethane

We have invested further in technology for our strategic partners. The Tier One Replacement System (TORS) enables us to replace the pipes beneath our feet without the need for excavations. TORS promises a revolution in working practices and less disruption for our customers. Following trials, we are looking to use this technology in 2016/17 and further improve safety, network efficiency and customer satisfaction.

Priorities for the year ahead

Maintain a stable and strong business throughout the process for the potential sale, to maximise shareholder value and continue to deliver a safe and reliable network.

Create a truly customer-focused business by removing inconsistencies in service delivery, reducing the number and size of excavations, and introducing the new customer communication materials.

Optimise our processes and work more collaboratively to continue to operate an efficient network for employees and customers.

Create further value in the business to improve financial stability and customer satisfaction, and increase operational efficiency.

connections in our networks.

We will also strive to have our safest year yet, and continue to work with the UK Government on the future role of gas and increase the use of new technologies.

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In focus

3.5m

electricity consumers in New England and upstate New York.

174km

(108 miles) of underground cable, 491 transmission substations and 668 distribution substations we operate in New England and upstate New York.

15 year

Our Power Supply Agreement (PSA) with LIPA is for 3,634 MW of capacity, comprising eight dual fuel (gas/oil-fired) steam units at three sites, 11 dual fuel combustion turbine units, and 27 oil-fired combustion turbine/diesel units.

27.5TWh

of electricity we forecast, plan for and procure annually across three states.

I believe there's something special about living, working, and playing in the communities we serve. We have approximately 15,000 employees serving the energy needs of more than seven million customers in our service territories in Massachusetts, New York and Rhode Island.

Our shared sense of community has taught us that today's customer is savvy, forward-thinking, and deeply mindful of the environment. We all want the same thing to keep our communities healthy and prosperous. Together we can do it by working to solve what I believe is the greatest challenge of our time—climate change—while delivering innovation and economic development.

This makes our next steps as an energy provider straightforward: we need to make sure our energy becomes cleaner, more efficient, resilient and reliable, and with more customer choices.

We are taking the lead on innovating ways to make solar connections easier and more affordable. We support the Deepwater Wind project off the coast of Block Island, the first offshore wind project in the US. We are also proponents of the Maine Green Line, which would use a submarine cable to transmit wind power from northern Maine to Massachusetts, supplemented by imports of hydropower from Canada.

In both New England and New York, we are planning for new or expanded gas pipelines. You can read about what we're doing in each of our service territories in our regulated business section, pages 39 to 41.

In 2015, we received a number of accolades: ACEEE scored all three states in which we operate in the top 10 in energy efficiency; we are number five in the nation for solar megawatts installed per customer (according to the Solar Electric Power Association); and we were named the number one green utility in the US according to Newsweek's Top Green

3.6m consumers received services from our gas distribution networks including 24,341 new gas heating customers in 2015/16.

We've promised to meet the energy needs of our customers in New England and New York. Let me tell you how we've done that over the past year, and what we have planned for the future.

Companies in the World 2015 .

Looking forward

Connect21 remains our strategy to build and operate a better energy distribution network for the 21st century digital economy. Also gas forms a bridge that will help take us to a decarbonised future. It supports our intent to bring on more intermittent renewable energy generation until reliable large-scale energy storage technologies become available.

A balanced approach

Our energy is becoming cleaner. All three of the states we serve have established goals of 80% reductions in emissions economy-wide versus 1990 levels by 2050. These states have already made progress toward their targets, but almost all emission reductions have come from cleaning up power generation.

While aggressive, our strategy establishes a platform for a decarbonised energy supply chain without economic disruption in local communities.

We are also committed to working towards a decarbonised energy network by 2050. It's why we advocate for a balanced solution that includes renewables, energy efficiency, and increasing gas transmission.

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Strategic Report

US Regulated business

We filed three rate cases in 2015 – one in Massachusetts and two in downstate New York

What we do and where we do it

Electricity

We jointly own and operate transmission facilities across upstate New York, Massachusetts, New Hampshire, Rhode Island and Vermont. We own and operate electricity distribution networks in upstate New York, Massachusetts and Rhode Island.

Gas

We own and operate gas distribution networks across the northeastern US, located in upstate New York, New York City, Long Island, Massachusetts and Rhode Island.

What we've achieved during 2015/16

Safety

Our safety performance continues to improve. Through to March 2016 we've seen a 9% reduction in the number of injuries requiring medical attention and a 26% reduction in the number of injuries requiring employees to be out of work. We believe these improvements are the result of our safety plans, aimed at reducing key risks and preventing incidents, along with enhanced and targeted communications on lessons learned and intended to prevent reoccurrence.

During 2016/17, we will continue to build on safety plans with a significant focus on the prevention of soft tissue injuries, slips/trips/ falls, and road traffic collisions.

Rate cases

We filed three rate cases in 2015 – one in Massachusetts and two in downstate New York.

In Massachusetts, we proposed to set new electricity distribution rates that will allow us to continue investing in our electricity infrastructure and improving service to our 1.3 million electricity customers. This submission covers only the distribution rates, found in the delivery portion of National Grid's electricity bills. This is the cost of delivering electricity to our customers and includes costs such as poles, wires, utility trucks, customer computer systems and taxes—all the costs to operate our business.

In New York, we proposed to update and reset our gas delivery rates that will allow us to continue investing in our natural gas networks and improving service to our 1.8 million gas customers in Brooklyn, Queens and Staten Island and Long Island/Rockaway Peninsula.

These proposals will let us:

- modernise and enhance the safety, reliability and resilience of our gas infrastructure;
- upgrade our gas network to deliver economic and environmental benefits;
- extend our gas expansion programme and add more gas heating customers each year;
- improve customer service capabilities; and
- deliver economic development funding and promote STEM education programmes.

These three proposals are undergoing a thorough review process by our regulators in each state. If approved, new charges will take effect from 1 October 2016 in Massachusetts and 1 January 2017 in New York.

Additionally, the New York Public Service Commission (PSC) will soon decide on two important items related to Niagara Mohawk. In December 2015, we filed a capex petition for Niagara Mohawk, which builds upon similar successful interim capex filings done for KEDNY and KEDLI in the past, and seeks to provide funding for \$1.4bn of capex across FY17 and FY18. This extension filing should allow us to use deferral account money, so that customer rates do not increase until we make our next full rate filing. Secondly, we are also waiting for approval for our Niagara Mohawk's financing plans, which will enable us to fund future construction and meet the mandatory redemptions. The petitions also afforded us with an opportunity to replace higher cost debt when economic to do so.

New Energy Solutions

In July, we announced the creation of our New Energy Solutions (NES) team. This team is focusing on driving cleaner energy, improving efficiency, affordability, and choice for customers. The goal of NES is to deliver state-mandated initiatives such as New York State's Reforming the Energy Vision (REV) and Grid Modernization (GridMod) in Massachusetts. It is also driving other innovative energy initiatives, like large-scale solar, electric vehicles, and battery storage.

Our jurisdictions

Each of our jurisdictions has projects under way to develop economic and environmental health in three ways: by driving economic growth; providing cleaner energy; and advancing innovative technologies. The following highlights some of our 2015/16 achievements.

Massachusetts

Year one of a two-year smart energy solutions smart grid pilot achieved a 98% retention rate from the original 15,000 customers who started in the pilot, a 72% customer satisfaction rate, and for active participants, an average energy saving of \$100 or more.

Earlier this year, we submitted a proposal for a two-pipeline solution to address natural gas constraints in New England that included contracts with Access Northeast and the Northeast Energy Direct gas pipeline project. MADPU began a review of those proposals.

In April, Kinder Morgan decided not to move forward with Northeast Energy Direct. We have begun work to identify alternative solutions that can help meet the needs of our current and future gas customers.

The project was part of a two-pipeline solution intended to provide additional gas delivery capacity into the region for electricity generators. So, to stabilise electricity supply prices for our customers, Spectra's proposed Access Northeast project now becomes increasingly critical for the region.

Customers have been subjected to billions of dollars in electricity price increases over the last three winters. Supply prices are market-driven and are largely due to the increased demand for natural gas. An increase in supply capacity will help meet demand and lower prices for our customers.

We installed 28 miles of new gas mains, replaced 150 miles of gas mains, and added more than 6,900 new natural gas customers.

New York

In December 2015, we energised the Five Mile Road substation in rural Cattaraugus County, south of Buffalo. The \$51.7 million project was several years in the making, and brings increased reliability and capability to the Company's bulk power transmission network across the southwest portion of New York state. It also involved upgrades to existing transmission circuits in the region.

We opened a new gas control centre on Long Island. This monitors and controls the gas system in our downstate and upstate regions. It also houses the Academy, a centre for technical and management training. High school students are welcome here through

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Principal operations continued

US Regulated business

our Engineering Pipeline Program, to explore engineering safety, natural gas operations, electric power systems and smart grid technologies.

We awarded our two largest energy efficiency grants since our energy efficiency incentive programme began in 2009. With a \$1.8 million incentive, Finch Paper in Glens Falls, New York purchased new equipment to remove bark and chip wood, reduce its energy use, yield more fibre, and secure a long-term supply of eight-foot logs, the company's primary raw material. Quad Graphics in Saratoga Springs, New York used a \$1.1 million grant to install a more efficient printing press that has increased production by more than 60%.

We continue to invest more in replacing gas mains. The NYPSC approved \$414 million gas infrastructure investment in Long Island to speed up the replacement of ageing pipe and extend the use of natural gas to more customers. We added more

Along with three other leading energy companies, we announced in January 2016, a proposal The Wind and Hydro Response to deliver 400 MW of reliable, cost-effective clean energy to New England. The Wind and Hydro Response is our answer to a request for clean energy solutions that was issued jointly by state agencies and electricity distribution companies (including National Grid) in Massachusetts, Rhode Island and Connecticut.

Priorities for the year ahead

Our Connect21 journey continues to evolve with these three priorities for 2016/17: Performance excellence, customer value, and future customer expectations.

Performance excellence: Continue our safety compliance and performance excellence journey. Drive new ways of working, including performance excellence, compliance improvement programmes, and safety plans.

Solar initiative in Massachusetts

Our Solar Phase II initiative installs large solar systems on sites we believe will bring the most benefit to the electric distribution system, regardless of the construction challenges it may pose.

Approved by MADPU in 2014, the initiative allows us to install up to 20 MW of utility-owned solar capacity.

During 2015/16 we partnered with local solar developers and municipalities to secure 18 sites in 12 municipalities across Massachusetts for projects ranging from 650 kW to 1 MW. So far, we have constructed and connected four sites, providing 3.3 MW of solar capacity to the grid.

than 15,600 new gas customers.

Rhode Island

As part of our sea2shore project, we've begun installing an underwater 34.5 kV cable in preparation for Deepwater Wind, the nation's first offshore wind farm. The approximate 20-mile underwater cable will link Deepwater's five turbine project off Block Island to the mainland power grid.

The 30 MW wind farm has the capacity to generate enough power for 17,000 homes and will also include a fibreoptic line, bringing high-speed internet service to Block Island for the first time. The wind farm is expected to start operating this autumn.

We added seven miles of new gas mains, replaced 50 miles of gas mains, and added more than 1,800 new natural gas customers.

FERC

Partnering with Eversource, we completed the interstate reliability project, completing the New England East West Solution—a suite of projects designed to strengthen the reliability of the regional power grid.

Our costs for the project, \$267.6 million, include station upgrades and the installation of a 75-mile, 345 kV transmission line along rights-of-way in Connecticut, Massachusetts and Rhode Island.

Customer value: Maximise and communicate customer value. Deliver tangible value to customers as identified and measured by our service-level agreements.

Future customer expectations: Anticipate future customer needs and transform our customer experience. Leverage jurisdictional model, digital customer experience, Connect21 platform, New Energy Solutions, and REV/Grid Mod filings.

In focus

Connect21

Connect21 is our strategy to advance America's natural gas and electricity infrastructure beyond its 20th century limitations, and create a more customer-centric, resilient, agile, efficient and environmentally sound energy network.

16.5bn

standard cubic metres of gas that we forecast, plan for and procure annually.

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Strategic Report

Principal operations continued

Other activities

We sold two sites this year, creating the potential for more than 1,750 new homes in London

In focus

31%

Approximate percentage of UK gas from LNG imports, up from 27% in 2014.

LNG ship reloading

During 2015/16, we completed our first LNG ship reload where more than 157,000m³ of LNG, at

Interconnectors

The England-France interconnector (IFA) is a 2,000 MW HVDC link between the French and British transmission systems with ownership shared between National Grid and Réseau de Transport d'Électricité. Average availability for 2015/16 was 92.94%, up from 90.46% in 2014/15. A substantial proportion of the flow continues to be in the import direction, from France to Great Britain.

In July 2015, we launched a new process that gives customers vital

Metering

National Grid Metering (NGM) provides installation and maintenance services to energy suppliers in the regulated market in Great Britain. It maintains an asset base of around 13.4 million domestic, industrial and commercial meters.

Customer satisfaction scores for NGM remain positive for both its domestic, industrial and commercial businesses. We continue to work with our customers on areas for improvement by exploring additional products and services so we can respond to the rapidly changing non-domestic sector.

around -158°C, was transferred onto another ship for onward transport. The reload process, coupled with the storage capability available at Grain, provides greater flexibility for customers.

Creating potential for new homes

In April 2015 we sold our site at Leaside Road, Tottenham to the London Borough of Enfield. The 17 acre site has potential for 840 homes. We dismantled two gas holders before the sale, using clay from the London Power Tunnels project to fill in the holder bases.

In the same month we sold our 90 acre site at Ebbsfleet Green to Redrow homes. The site has potential for 950 homes and forms part of the wider garden city proposal championed by Chancellor of the Exchequer George Osborne.

information before an outage, meaning they are more able to accurately react and adjust their market position improving the service they receive from IFA.

BritNed is a joint venture between National Grid and TenneT, the Dutch transmission system operator. It owns and operates a 1,000 MW HVDC link between England and the Netherlands. As with IFA, a substantial proportion of the flow is in the import direction from the Netherlands to Great Britain.

Following Board approval for the Belgium (Nemo Link) and Norway (North Sea Link) interconnectors in 2015, construction is now under way for both projects.

Nemo Link, developed between National Grid Interconnector Holdings Ltd and Elia, the Belgium transmission system operator, will connect Richborough in the UK and Herdersbrug in Belgium. The subsea cable will be 130 kilometres in length and have the capacity of 1 GW. Nemo Link is due to be operational in 2019.

North Sea Link (NSL) will connect Blyth in the UK and Kvilldal in Norway. Developed between National Grid and Statnett, the Norwegian transmission system operator, at 720 kilometres, NSL will be the world's longest subsea cable and will have a capacity of 1.4 GW. NSL is expected to be operational in 2021.

We continue to evaluate the opportunity of participating directly in the smart metering market by providing an end-to-end, dual-fuel smart metering offering to energy suppliers.

UK Property

National Grid Property is responsible for the management, clean-up and disposal of surplus sites in the UK, most of which are former gas works.

During 2015/16, we sold two sites and exchanged contracts on several high-profile land disposals with our joint venture partners under St William Homes LLP. Our estate management, gas holder dismantling and contaminated land clean-up programmes continue to reduce operational risk across our portfolio. In April 2016 BNP Paribas Real Estate took on our new real estate management services.

Xoserve

Xoserve delivers transactional services on behalf of all the major gas network transportation companies in Great Britain, including National Grid. Xoserve is jointly owned by National Grid, as majority shareholder, and the other gas distribution network companies. Xoserve celebrated its 10 year anniversary as a company on 1 May 2015.

US non-regulated businesses

Some of our US businesses are not subject to state or federal rate-making

Grain LNG

Grain LNG is one of three LNG importation facilities in the UK. It operates under long-term contracts with customers and provides importation services of ship berthing, temporary storage and re-gasification into the national transmission system.

Our road tanker loading facility was commissioned in November 2015. The new loading hub offers a more environmentally-friendly alternative fuel and allows road tanker operators to load and transport LNG in bulk.

authority. These include interests in some of our LNG road transportation, some gas transmission pipelines (our minority equity interests in these are not regulated) and certain commercial services relating to solar installations, fuel cells and other new technologies that are an important part of our future.

Corporate activities

Corporate activities comprise central overheads, Group insurance and expenditure incurred on business development.

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Our people

If we are to achieve our strategic objectives, we need to make sure our employees have the right skills and capabilities.

Safeguarding the future

We remain committed to helping address the significant skills challenge facing the engineering profession in both the UK and US.

In the UK, engineering companies are projected to need 182,000 people with engineering skills each year until 2022, according to the 2016 Engineering UK Report yet the estimated shortfall is 69,000 annually.

A particular concern has been the low number of young women interested in engineering. Our initiatives include our residential work experience week, which in 2015 extended to around 100 young people, balanced 50/50 between girls and boys. 99% of the students said that the experience increased their interest in engineering, while 69% of the female students said that it persuaded them to follow a career in the energy industry.

We are helping schools, parents and children see engineering as a modern, dynamic, desirable career with a great future. Our employees act as education ambassadors who volunteer their time for a range of activities in the classroom and at science and engineering fairs, most notably on STEM enrichment, careers education and our work experience programmes.

In the US, we completed the sixth year of our National Grid Engineering Pipeline Program, designed to inspire high school students to pursue an engineering education and career. To date, 258 promising students have participated in the programme.

We promoted STEM education and careers to more than 300 middle and high school students during our Engineering our Future initiative. We also partner with seven local community colleges to deliver programmes designed to produce future electric line workers.

We have begun a partnership with the State University of New York to develop a Natural Gas Technician Certificate Program, designed to address future hiring needs for our gas operations.

We are continuing our partnership with the Center for Energy Workforce Development on its energy industry fundamentals .

Our US work experience opportunities include summer internships. Some interns start their journey into the energy industry through our Engineering Our Future programme and go on to join our Company through our graduate development programme.

We also offer summer internships in the UK, as well as 12 month industrial placements to undergraduates in their penultimate year. These programmes offer students the opportunity to experience our Company before deciding to join the organisation as graduates.

Building skills and expertise

Providing high-quality development opportunities for our employees is essential for us to construct, maintain and operate our electricity and gas networks safely and reliably. This year, our Academy has delivered 154,025 days of technical, safety, leadership and personal effectiveness training across our global workforce.

In January 2016, we inducted 75 high-potential employees onto our accelerated development programme; designed to enhance our leadership succession planning.

We have also developed our performance leadership programme, designed to help strengthen our performance leadership capability for leaders who manage functions or organisations.

Promoting an inclusive and diverse workforce

Our inclusion and diversity activities include attraction and recruitment, development, leadership, role modelling and cultural change.

A number of UK leaders were paired with mentors representing a range of diverse characteristics, allowing them to increase their knowledge of a particular area of diversity. Feedback was very positive and a further wave of the programme is planned.

In the US, we have continued to promote inclusiveness through programmes designed to raise awareness of unconscious bias and disability employment. Senior leaders have also shared personal experiences about inclusion through a series of videos.

We support 10 employee resource groups in the US, and six in the UK, that encompass inclusion and diversity. These groups are chaired by senior business leaders, so they can shape change within the business and the communities we serve, while providing professional development to the members.

In addition to our well-established Springboard and Spring Forward programmes for women, we are introducing a programme targeted at other under-represented groups – mainly ethnic minorities. We are also piloting a new online professional development platform for women and an initiative in the US is introducing more women into our field force.

Externally, we continue to be recognised as an employer of choice and work in partnership with a number of organisations that promote inclusion and diversity.

National Grid employees were named as the EY Young Energy Professional of the year 2015; a finalist in the Black British business awards; and one of six women profiled in the EY Women in Power and Energy Index 2015.

At the end of 2015, we were one of the first FTSE organisations to publish UK gender pay data.

In the UK, we have signed up to the Living Wage Foundation. We have committed to making sure our employees and those of our new suppliers are paid at least the Living Wage and have also pledged to take this further than the accreditation requires, including a commitment that our apprentices, interns and graduates at National Grid are also paid at least the Living Wage.

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Strategic Report

In focus

1.8m

Number of engineers, technicians and crafts people needed in the UK over the period 2012 - 2022.

7

Number of US local community colleges with whom we partner to deliver utility technology training programmes.

KPIs

pages 18 - 21

Board diversity

page 62

EmployAbility

In the UK, the EmployAbility programme targeted at young people with special needs is a notable example of the work done by our employee resource groups. The programme has now expanded to offer work experience internships at a number of our sites, and has garnered public recognition for its innovation and impact. Our US business has now launched its own pilot of the EmployAbility programme.

Troops to energy jobs

We work with veterans through the US troops to energy jobs programme, designed to help veterans make the transition from military service to the energy industry. Through our role with the US Joining Forces initiative, launched by the White House, we are aiming for 10% of our new hires to come from veterans over the next 10 years.

Our UK employees raised
over £600,000 in support
of Macmillan, our chosen
charity partner

The table below shows the breakdown by gender at different levels of the organisation. We have included information relating to subsidiary directors, as this is required by the Companies Act 2006 (Strategic Report and Directors Reports) Regulations 2013. We define senior management as those managers who are at the same level, or one level below, our Executive Committee. It also includes those who are directors of subsidiaries, or who have responsibility for planning, directing or controlling the activities of the Company, or a strategically significant part of the Company, and are employees of the Company.

| | Financial year ended 31 March 2016 | | | | |
|-------------------------------|------------------------------------|--------|--------|-----------|-------------|
| | Male | Female | Total | Male % | Female % |
| Our Board | 8 | 3 | 11 | 72.7 | 27.3 |
| Senior management Whole | 189 | 63 | 252 | 75 | 25 |
| Company* | 19,177 | 5,891 | 25,068 | 76.5 | 23.5 |

*This measure is also one of our Company KPIs. See page 20 for more information.

Health and wellbeing

During 2015/16 we have continued to raise awareness of mental wellbeing across our UK business.

We have a leading role in the Business in the Community Workwell campaign that is focusing on mental wellbeing in the workplace, and also an alumni network supporting the Time to Change campaign.

More than 670 of our employees have pledged to support this campaign, and others have shared their personal stories, encouraging colleagues to talk about mental health. During 2015/16, we have trained more than 250 employees on mental health first aid.

Initiatives designed to improve employees' understanding of good nutrition have included a nutritional challenge. Our wellbeing kiosks were used more than 16,000 times by our employees during 2015/16, recording data such as blood pressure and weight.

In the US, our focus on soft tissue injury prevention included a sports therapy initiative. Our educational programmes focused on diseases such as diabetes and cancer.

Our employee engagement survey results continue to show that employees have a good awareness of our wellbeing programmes.

Volunteering

Our employees continue to share their skills, time and expertise through skills-based volunteering and fundraising activities.

In the UK, employees provided more than 14,000 hours of support to community projects. They participated in a number of fundraising activities to help our employee chosen charity partnership with Macmillan Cancer Support reach its fundraising target. Their efforts helped us exceed our target, raising more than £600,000, which provided 3,121 emergency fuel grants to people affected by cancer. We also raised more than £17,000 for Special Olympics Great Britain by organising a summer games event and supported the organisation's Athletes Leadership Programme.

In the US, our Power to Serve employee volunteering programme supports our stewardship and safety principles. It seeks to acknowledge existing community service, as well as to create new volunteer opportunities for employees.

Human rights

National Grid does not have a specific policy relating to human rights, but respect for human rights is incorporated into our employment practices and our values, which include respecting others and valuing diversity. See page 194 for more information.

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Corporate Governance contents

Sir Peter Gershon

Chairman

Corporate Governance contents

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Dear Shareholders,

This has been an interesting and exciting year for the Company and the Board, with the Board agenda focusing on some significant topics. External influences on the Board agenda included cyber security, the future of the System Operator, political developments and how the referendum on continued UK membership of the EU will affect the Company. The Board has also been spending time on the Company's strategy for the short and long term, the Group's principal risks and risk appetite, US rate case filings and the proposed sale of our UK Gas Distribution business, all of which are referenced in more detail later in this report.

Changes to the UK Corporate Governance Code 2014 (the Code)

Following the changes introduced in the Code and the Financial Reporting Council's (FRC) guidance on risk management, the risk team and Audit Committee reviewed our risk processes to make sure we have effective systems and processes in place to meet the new requirements. You can read more about our processes on pages 26 and 27.

The Board also reviewed and approved the Company's principal risks. This has been a very valuable process for the Board and played an important part in its approval of the viability statement required by the Code. You can

read our new viability statement on page 30. After many recent changes to the Code, including the final draft of the UK Corporate Governance Code 2016, I welcome the FRC's commitment to avoid further updates to the Code until at least 2019, which will allow the UK governance landscape to settle and establish itself.

External Board evaluation

This year we appointed Independent Audit to undertake a formal and rigorous externally facilitated Board and committee evaluation. With the recent changes to the Code we thought it would be appropriate for the evaluation to focus on risk. Independent Audit concluded that the Board was working well and that it benefits from a good mix of experience from both the UK and US. They noted there was a good balance between strategic, operational and regulatory matters, with good engagement supported by thorough work by management. They made a number of recommendations in relation to risk, principally focused on cascading risk management further down the business.

The results of the evaluation were presented to the Board in April, and a number of recommendations to take forward were considered by the Board in May. We will be monitoring the outcome during the year and will report on progress in next year's Annual Report and Accounts. You can find more information about the evaluation on pages 52 and 53.

Cyber security

During the year, the Board considered the threats we face and the effectiveness of our cyber security strategy to mitigate the inherent risks. In June 2015, the Board received an in-depth presentation so it could gain a comprehensive overview of the Company's long-term strategy on this issue. The focus was on establishing guiding principles for cyber security, deciding what questions the Board should be asking of the cyber security team and the development of a new cyber programme. This will improve the existing programme and help enhance the level of security to protect the business and to keep pace with the increasing scale and sophistication of threats. The Board will be receiving cyber security training and additional updates later in the year.

Board changes

As previously announced, Steve Holliday retired as Chief Executive on 31 March 2016, and will step down from the Board on 22 July 2016. He was succeeded as Chief Executive by John Pettigrew. Steve will leave National Grid after nearly a decade as Chief Executive and 15 years on the Board. Following John's appointment, we will also welcome Nicola Shaw on to the Board as Executive Director, UK from 1 July 2016.

In my role as Chairman, I am responsible for making sure the Board operates effectively, by promoting effective relationships and open communication between Directors. This is particularly important as the membership of the Board changes and new relationships are formed. Maintaining and promoting a culture of openness and debate and making sure the Board work together as a team are also important aspects considered during an appointment process.

The Nominations Committee oversaw the rigorous selection process in the search for Steve's successor and for our new Executive Director, UK. You can read more about this on page 61. These appointments were key to the Board and the fit with the current membership and how the individuals combine to add value was an important consideration in the decision-making process.

Sir Peter Gershon

Chairman

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Corporate Governance

Our Board

**Sir Peter Gershon CBE
FREng (69)**

Chairman ^{N (ch)}

Appointed: 1 August 2011 as Deputy Chairman and became Chairman with effect from 1 January 2012

Tenure: 4 years

Career: Sir Peter is a Fellow of the Royal Academy of Engineering and has held a number of senior positions across multiple industries. His previous appointments include Chief Executive of the Office of Government Commerce, Managing Director of Marconi Electronic Systems and a member of the UK Defence Academy Advisory Board. Sir Peter is currently Chairman of Tate & Lyle plc and a Non-executive

**John Pettigrew FEI, FIET
(47)**

Chief Executive ^F

Appointed: 1 April 2014 and became Chief Executive with effect from 1 April 2016

Tenure: 2 years

Career: A Fellow of the Energy Institute and of the Institution of Energy and Technology, John joined the Company in 1991 and has over 25 years of experience at National Grid in a variety of senior management roles. John's previous appointments include Director of Engineering from 2003, Chief Operating Officer and Executive Vice President for the US Electricity Distribution & Generation business between 2007 and

Steve Holliday FREng (59)

Executive Director

Appointed: National Grid Group plc on 30 March 2001, to the Board in October 2002 and as Chief Executive from January 2007 through to 31 March 2016

Tenure: 15 years[^]

Career: A Fellow of the Royal Academy of Engineering, Steve was an Executive Director at British Borneo Oil and Gas before joining National Grid in 2001. Most recently Steve was Chairman of the UK Business Council for Sustainable Energy, a Prince's National Ambassador and Non-executive Director of Marks and Spencer Group plc. Steve is currently Chairman of Crisis UK and

Key

A Audit Committee

F Finance Committee

N Nominations Committee

R Remuneration Committee

S Safety, Environment and Health Committee

Chairman of the Aircraft Carrier Alliance Management Board and most recently a Trustee of The Sutton Trust Board.

2010, Chief Operating Officer for UK Gas Distribution between 2010 and 2012, and UK Chief Operating Officer from 2012 to 2014. John was appointed to the role of Chief Executive on 1 April 2016.

of the Energy, and Efficiency Industrial Partnership, Vice Chairman for Business in the Community and of The Careers and Enterprise Company and Lead Non-executive Director and Board member for the Department for Energy, Food and Rural Affairs (DEFRA).

(ch) Chairman of committee

Skills and experience: Sir Peter has significant board level experience gained across multiple industries, with considerable experience in Government through previous roles. He also has significant experience of general management both in the city and internationally and brings to the Board an in-depth understanding of the high-tech industry.

Skills and experience:

Through his wide variety of roles in the UK and US businesses John has extensive knowledge of the Company as well as the engineering and utilities industries as a whole. He has an in-depth understanding of the Government and regulatory landscape.

Skills and experience: Steve has significant knowledge and experience of the energy and utilities industries in the UK and internationally. He has considerable board level, Government and regulatory experience.

^ Including National Grid Group plc

Tenure as at 31 March 2016

Charts and committee membership are as at 18 May 2016

Andrew Bonfield (53)

Finance Director ^{F, S}

Appointed: 1 November 2010

Tenure: 5 years

Career: Andrew is a chartered accountant with significant financial experience having previously been Chief Financial Officer at Cadbury plc until March 2010; he also spent five years as Executive Vice President & Chief Financial Officer of Bristol-Myers Squibb Company. As well as

Dean Seavers (55)

Executive Director, US

Appointed: 1 April 2015

Tenure: 1 year

Career: Dean began his career at the Ford Motor Company and held various senior management positions at Tyco International Ltd. before joining General Electric Company/United Technologies Corporation. He was President and Chief Executive Officer of General Electric Security and then

Alison Kay (52)

Group General Counsel & Company Secretary

Appointed: 24 January 2013

Career: Alison has undertaken several roles since joining National Grid in 1996 including UK General Counsel and Company Secretary from 2000 to 2008 and Commercial Director, UK Transmission from 2008 to 2012. Before joining National Grid she was a corporate/commercial solicitor in private practice.

this, Andrew also has previous experience in the energy sector as Finance Director of BG Group plc and is currently a Non-executive Director of Kingfisher plc.

Skills and experience:

Andrew brings significant finance experience to the Board and has extensive knowledge of international industries. Through his appointments in senior positions across several industries, Andrew has an in-depth knowledge of the energy and utilities industries both in the UK and internationally, in particular the US energy market.

President, Global Services of United Technologies Fire & Security. Dean was also a member of the Board of Directors of the National Fire Protection Association from 2010 to 2014 and lead network member at City Light Capital from 2011 to 2015 and President and Chief Executive at Red Hawk Fire & Security, LLC from 2012 to 2014. Dean is currently a Board member of Red Hawk Fire & Security, LLC.

Skills and experience:

Dean has a wide range of financial and customer experience. He has significant general management experience with a particular focus on change and performance improvement programmes. Dean also has extensive knowledge of international markets, the city, corporate finance and financial services.

Skills and experience:

Alison is an experienced commercial lawyer bringing a wealth of practical advice and guidance to her current role. She has developed expertise in regulatory and contractual law and legal risk management through her experience at National Grid. She also brings rigour around corporate governance and reporting to the Board, gained partly through her current role and also in her previous role as Secretary to the boards of the subsidiary companies, National Grid Gas plc and National Grid Electricity Transmission plc.

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Corporate Governance continued

| Key | Nora Mead Brownell (69) | Jonathan Dawson (64) | Therese Esperdy (55) |
|---|--|--|---|
| | Non-executive Director ^{N, R, S} | Non-executive Director ^{F, N, R, (ch)} | Non-executive Director ^{A, F, (ch), N} |
| A Audit Committee | Independent | Independent | Independent |
| F Finance Committee | Appointed: 1 June 2012 | Appointed: 4 March 2013 | Appointed: 18 March 2014, and appointed to the Board of National Grid USA from 1 May 2015 |
| N Nominations Committee | Tenure: 3 years | Tenure: 3 years | Tenure: 2 years |
| R Remuneration Committee | Career: A key individual in the US energy industry, Nora has significant experience gained in a variety of roles including Commissioner of the Pennsylvania Public Utility Commission and the Federal Energy Regulatory Commission (FERC) and former President of the National Association of Regulatory Utility Commissioners. Most recently, Nora sat on the Boards of ONCOR Electric Delivery Holding Company LLC and Comverge, Inc. Nora is | Career: Jonathan started his career in the Ministry of Defence before moving to Lazard where he spent more than 20 years. He was a Non-executive Director of Galliford Try plc, National Australia Group Europe Limited and Standard Life Investments (Holdings) Limited. Most recently he was Chairman of the Remuneration Committee, Non-executive and Senior Independent Director of Next plc until May 2015. Jonathan | Career: Having started her banking career at Lehman Brothers, Therese joined Chase Securities in 1997 and then held a variety of senior roles at JP Morgan Chase & Co. These included appointments as Head of US Debt Capital Markets and Global Head of Debt Capital Markets, co-head of Banking, Asia Pacific and Global Chairman of the |
| S Safety, Environment and Health Committee | | | |
| (ch) Chairman of committee | | | |

| | | | |
|--|---|--|--|
| <p>^ Including National Grid Group plc</p> <p>Tenure as at 31 March 2016</p> | <p>currently a member of the Board of Spectra Energy Partners LP, Direct Energy Advisory Board and the Advisory Board of Morgan Stanley Infrastructure Partners as well as a partner in ESPY Energy Solutions, LLC.</p> | <p>is currently a Non-executive Director of Jardine Lloyd Thompson Group plc and Chairman and a founding partner of Penfida Limited.</p> | <p>Financial Institutions Group.</p> |
| <p>Charts and Committee membership are as at 18 May 2016</p> | <p>Skills and experience: Through her Non-executive directorships, Nora brings extensive experience in US Government and regulation and has significant expertise in the US utilities industry in particular through her role as a Commissioner with FERC.</p> | <p>Skills and experience: Jonathan has a wide range of city experience with a significant and in-depth understanding of the corporate finance, pensions and banking industries.</p> | <p>Skills and experience: Therese has significant experience in city, corporate finance and banking through her previous appointments. She also has a wide range of international experience having worked in a number of international markets.</p> |
| <p>Board gender</p> | | | |
| <p>Executive and Non-executive Directors</p> | <p>Paul Golby CBE FREng (65)</p> <p>Non-executive Director ^{A, N, R, S, (ch)}</p> <p>Independent</p> <p>Appointed: 1 February 2012</p> <p>Tenure: 4 years</p> <p>Career: A fellow of the Royal Academy of Engineering, Paul has held a variety of roles within the energy and utilities industries. Paul was an Executive Director of Clayhithe plc, before later joining E.ON UK plc where he was Chief Executive and later Chairman.</p> | <p>Ruth Kelly (48)</p> <p>Non-executive Director ^{A, F, N}</p> <p>Independent</p> <p>Appointed: 1 October 2011</p> <p>Tenure: 4 years</p> <p>Career: Ruth began her career in Government where she held various senior roles, including Secretary of State for Transport, for Communities and Local Government, for Education and Skills as well as Financial Secretary to the Treasury. She was also a</p> | <p>Mark Williamson (58)</p> <p>Non-executive Director and Senior Independent Director ^{A, (ch), N, R}</p> <p>Independent</p> <p>Appointed: 3 September 2012</p> <p>Tenure: 3 years</p> <p>Career: A qualified accountant with significant financial experience, Mark was Chief Accountant and then Group Financial Controller of Simon Group plc before joining</p> |

He was also a Non-executive Chairman of AEA Technology Group plc. Paul is currently the Chairman of EngineeringUK, the UK National Air Traffic System, the Engineering and Physical Sciences Research Council and a member of the Council for Science and Technology. Most recently, Paul was appointed as Chairman of Costain Group plc on 5 May 2016.

Skills and experience: Paul has experience in energy utilities, Government and regulatory industries. Paul also has a wide range of board level experience gained through his Chief Executive and Chairman appointments.

senior executive at HSBC until August 2015. Ruth is currently appointed as Governor for the National Institute of Economic and Social Research and Pro Vice Chancellor at St Mary's University; she has also been a Non-executive Director on the Financial Conduct Authority Board since April 2016.

Skills and experience: Ruth brings in-depth knowledge of Government and regulatory practice; she also has experience in banking and corporate finance.

International Power plc as Group Financial Controller and later as Chief Financial Officer. Mark was a Non-executive Director at Alent plc where he was Chairman of the Audit Committee and Senior Independent Director. Mark is currently the Chairman of Imperial Brands PLC.

Skills and experience: Mark has extensive city, international accounting and finance experience in addition to senior and board level experience across multiple industries. Mark's experience in energy utilities amongst other industries has provided a good understanding of Government and regulatory matters.

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Key

Lines of reporting

Board/Board

committees

Executive Committee

to Board/Board

committees

Management

committees to

Executive Committee/

Board committees

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**Lines of
communication**

Corporate Governance

Board composition

The successful delivery of our strategy depends upon attracting and retaining the right talent. This starts with having a high-quality Board. Balance is an important requirement for the composition of the Board, not only in terms of the number of Executive and Non-executive Directors, but also in terms of expertise, diversity and backgrounds.

While traditional diversity criteria such as gender and ethnicity are important, we also value diversity of skills, experience, knowledge and thinking styles. You can read about our Board diversity policy in the Nominations Committee report on page 61.

This year we said goodbye to Steve Holliday as Chief Executive and welcomed John Pettigrew as his successor. We will also be welcoming Nicola Shaw onto the Board as Executive Director, UK, from 1 July 2016. Apart from the appointment of Dean Seavers on 1 April 2015, as noted in last year's Annual Report and Accounts, there have been no other changes to the Board composition that have come into effect during the financial year. We continue to look forward, with succession planning being an important focus for the Nominations Committee and the Board.

Our Board and its committees

The Board delegates authority to its Board committees to carry out certain tasks on its behalf, so that it can operate efficiently and give the right level of attention and consideration to relevant matters.

The committee structure, reporting and communication lines are set out in the diagram below and the role and responsibilities of the committees are set out in their respective terms of reference, available on our website. Committee agendas and schedules of items to be discussed at future meetings are prepared in accordance with the terms of reference of each committee and take account of other topical and ad-hoc matters.

In addition to the vertical lines of reporting, the committees communicate and work together where required. For example, during the appointment process for John Pettigrew the Remuneration Committee worked closely with the Nominations Committee.

At Board committee meetings, items are discussed and, as appropriate, endorsed, approved or recommended to the Board, by the committee. Following Board committee meetings, the chairman of each committee provides the Board with a summary of the main decisions and discussion points so the non-committee members are kept up to date with the work undertaken by each Board committee.

Below the Board committees are a number of management committees, including the Executive Committee. You can read more about some of the management committees, including the membership and operation of the Executive

Committee, on page 63.

Reports from each of the Board committees together with details of their activities during the year are set out on the following pages.

Board and committee interactions

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Corporate Governance continued

Looking back. Examples of Board focus during the year included:

| Areas of focus | Commentary | |
|---|--|--|
| Cyber security | The Board is responsible for overseeing cyber security, and this year the Board has seen an increase in their focus on this issue. As mentioned in the Chairman's letter, the cyber security team provided the Board with a detailed overview in relation to cyber security, so that the Board had increased visibility and understanding of the Company's long-term strategy on cyber security. | The focus was on the guiding principles and on determining what questions the Board should be asking of the cyber security team. The Board's discussions concluded that they needed to have greater visibility of cyber security and there should be training for the Board members in dealing with cyber security risks. |
| Proposed majority sale of the UK Gas Distribution business | The Board regularly reviews the composition of the Company's portfolio. As part of this review the Board received a strategy briefing in September, outlining the proposed commencement of a process for the potential sale of a majority stake in the UK Gas Distribution business. | The discussion included: various transaction options; detailed financial impacts; significant challenges to be addressed; the communication strategy; return of proceeds to shareholders and the future dividend policy; and the transaction timeline. Following discussion and challenge on a number of issues, the Board unanimously agreed to the commencement of the sale process. The Board has been kept up to date on progress. |
| Principal risks and viability | The risk team provided updates on the UK Corporate Governance Code 2014 requirement | mitigation of the principal risks; and how we would test the impact of the risks on the |

for the Company to produce a viability statement. Discussions at Board meetings included: a review of the Company's principal risks; the viability statement period; the management and

Company, including through the use of scenario planning. In May 2016, the Audit Committee recommended the viability statement to the Board which was approved.

US regulatory rate case filings

In April 2015, the Board received an update on work being undertaken by the US finance and regulatory groups for the preparation of the Company's first rate case filings since 2012. During the year the Board received regular progress reports on the rate case filings for our downstate New York gas companies, KEDNY and KEDLI, and also Massachusetts Electric. An overview of each filing was received by the Board before they were submitted,

including a term sheet outlining the key metrics of each submission. An extension request for the rate case filing in Niagara Mohawk was also seen by the Board before filing. This extension proposed electricity and natural gas delivery prices for customers being frozen at current levels through to March 2018 while allowing the Company to increase investments to enhance its gas and electricity systems.

European energy and the politics of energy

The Board received an update on important UK and EU political developments prior to the UK General Election in May 2015. Following the General Election, the Board received a paper on the potential implications for the Company and an engagement plan. The Board was also

kept up to date on the referendum on the continued UK membership of the EU and the potential effects of exiting Europe, including on the development of interconnector projects and on our continuing involvement and benefits of being in the Integrated Energy Market.

The future of the System Operator

The future of the SO has been considered previously by the Board and was reviewed again in detail in September 2015. In particular, Ofgem's Integrated Transmission Planning and Regulation (ITPR) project and emerging DECC thinking on the possible creation

of a super System Operator were developments the Board considered. Additional updates on progress were provided in January, March and April 2016 when the Board received updates on future option modelling following discussions with Government.

UK onshore competition

In addition to defining our role on the future of the SO, the Board has recently discussed the Company's position on where consenting activity to support competitively tendered onshore transmission should be undertaken. In conclusion, the Company's view was that competition should only be taken forward where it was in the interests of consumers.

In March 2016, the Board discussed specific questions posed by Ofgem in relation to the Company's position on onshore competition and discussed working with Ofgem to explore an enduring consenting solution, taking into account shareholder and consumer benefits.

Strategy sessions

In addition to time allocated during the year at Board meetings, the Board participated in two interactive strategy sessions involving a combination of a full Board discussion and breakout groups. The Board's focus was on the

state of the market in the UK and US, future opportunities for the Company including business development, merger and acquisition opportunities, and how the Company's core capabilities could be used to best effect.

Site visits

In January 2016, the Non-executive Directors visited the Company's UK cyber security operations centre, which provided an insight into its day-to-day operations and highlighted awareness of the direct security threats to the Company as they occur and are analysed 24 hours a day. Other visits by the Directors included safety site visits, including a visit to Power Plant Operations to celebrate over 10 years of no accidents, a field visit in Brooklyn to one of our LNG trucking provider locations to see facilities

and meet management, and a site tour in Eakring. Another visit was to the Western Link project to review the Scotland/England interconnector and new sub-station. In September 2016, the Board members will be visiting our Buffalo, New York office which will include a site tour. These visits provide the opportunity for Directors to meet local management teams, discuss aspects of the business with employees, and gain insight into our day-to-day business.

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In focus

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meetings held with institutional and private investors during the year in 11 countries

Further detail on

www.investors.nationalgrid.com

Looking forward. The Board's focus for next year is expected to include:

regular reviews of safety activities;
updates on the UK Gas Distribution sale process;
European energy update following the outcome of the UK's EU referendum;
UK and US operational business overviews;

continued detailed review of strategy and financing;
the outcome of US rate case filings;
implications of the ITPR project on our activities;
future options for the SO;
cyber security updates and training;
innovation;
results and follow up on the action planning from the external Board and committee evaluation;
the 2016 UK Winter Outlook; and
results of the 2016 employee engagement survey.

Directors induction programme

Following new appointments to the Board, the Chairman, Chief Executive and Group General Counsel & Company Secretary arrange a comprehensive induction programme. The programme is tailored based on experience and background and the requirements of the role.

John Pettigrew has been a Board member since April 2014. Following his succession to the role of Chief Executive he has been meeting external and internal stakeholders and external advisors and brokers as necessary. From 1 April 2016 John became a member of the Finance Committee and he will receive training and development as appropriate. He will also attend other committee meetings where appropriate. A tailored induction programme will be created for Nicola Shaw and monitored accordingly.

Director development and training

As our internal and external business environment changes, it is important to make sure that Directors' skills and knowledge are refreshed and updated regularly. Our Chairman is responsible for the ongoing development of all Directors.

To strengthen the Directors' knowledge and understanding of the Company, Board meetings regularly include updates and briefings on specific aspects of the Company's activities, such as the development of our new cyber security programme and updates on the UK's EU referendum. Updates on corporate governance and regulatory matters are also provided at Board meetings and there are training and development opportunities available for our Directors. Additionally, the Non-executive Directors are expected to visit at least one operational site annually.

Investor engagement

We believe it is important to maintain effective channels of communication with our debt and equity institutional investors and individual shareholders. This helps us to understand their views about the Company and allows us to make sure they are provided with timely and appropriate information on our strategy, performance, objectives, financing and other developments.

Institutional investors

We carry out a comprehensive engagement programme for institutional investors and research analysts, providing the opportunity for our current and potential investors to meet with executive and operational management.

This includes:

meetings, presentations and webinars;
attendance at investor conferences across the world;
holding road shows in major investor centres, mainly in the UK, Europe and the US; and
offering the opportunity for individual stewardship meetings.

In the last year, our engagement programme has focused on clarifying our Group growth expectations. This included communicating the rationale behind our decision to commence the proposed sale of the majority stake in our UK Gas Distribution business, and explaining to investors how we expect the Company to continue to perform against its regulatory contracts in both the UK and US businesses.

In November, we arranged a meeting in London to provide institutional investors and research analysts with an opportunity to meet our US leadership team, led by Dean Seavers, and to understand more about the current performance of our US business and its outlook. A copy of the presentation and associated materials are available in the Investors section of our website.

The Board receives regular feedback on investor perceptions and opinions about the Company. Specialist advisors and the Director of Investor Relations provide updates on market sentiment.

Additionally, each year, the Board receives the results of an independent audit of investor perceptions. Interviews are carried out with investors to establish their views on the performance of the business and management. The findings and recommendations of the audit are then discussed by the Board.

Debt investors

Over the last year senior group treasury representatives have met debt investors in Europe, Canada and the US to discuss various topics such as our full-year results and upcoming US rate case filings.

We also communicated with our debt investors through regular announcements and the debt investor section of our website. This contains bond information, credit ratings and materials relating to the subsidiary year-end reports. The website also contains information about our long-term debt maturity profile, so investors can see our future refinancing needs.

Individual shareholders

Engagement with individual shareholders, who represent more than 95% of the total number of shareholders on our share register, is led by the Group General Counsel & Company Secretary.

Shareholders are invited to learn more about the Company through our shareholder networking programme. The programme includes visits to UK operational sites and presentations by senior managers and employees over two days. UK resident shareholders can apply to take part in this programme via the Investors section of our website.

For information on the 2016 Annual General Meeting, please see page 66.

Table of Contents**Corporate Governance** continued**Board and committee membership and attendance**

The table below sets out the Board and committee attendance during the year to 31 March 2016. Attendance is shown as the number of meetings attended out of the total number of meetings for the individual Director during the year.

If any Directors are unable to attend a meeting, they are encouraged to communicate their opinions and comments on the matters to be considered via the Chairman of the Board or the relevant committee chairman. Instances of non-attendance during the year were considered and determined as being reasonable in each case due to the individual circumstances. In relation to the Board meeting non-attendances, John Pettigrew and Steve Holliday were

precluded from attending the ad hoc Board meeting in November as it related to CEO succession and they were therefore both conflicted from attending. Dean Seavers was unable to attend a Board meeting due to personal reasons. Non-attendance at the Committee meeting was due to the short notice of the Nominations and Remuneration Committees ad hoc meetings and members having prior commitments, and also for personal reasons.

The Board has determined that Mark Williamson, Chairman of the Audit Committee, has recent and relevant financial experience; is a suitably qualified audit committee financial expert within the meaning of the SEC requirements; and is independent within the meaning of the New York Stock Exchange listing rules.

| Director | Board Meetings | Audit | Finance | Nominations | Remuneration | Safety, Environment & Health |
|-----------------------------|-----------------------|--------------|----------------|--------------------|---------------------|---|
| Sir Peter Gershon | 10 of 10 | | | 7 of 7 | | |
| Steve Holliday ¹ | 9 of 10 | | 3 of 4 | | | |
| John Pettigrew ² | 9 of 10 | | | | | |
| Andrew Bonfield | 10 of 10 | | 4 of 4 | | | 4 of 4 |
| Dean Seavers | 9 of 10 | | | | | |
| Nora Mead Brownell | 10 of 10 | | | 7 of 7 | 6 of 6 | 4 of 4 |
| Jonathan Dawson | 10 of 10 | | 4 of 4 | 7 of 7 | 6 of 6 | |
| Therese Esperdy | 10 of 10 | 5 of 5 | 4 of 4 | 7 of 7 | | |
| Paul Golby | 10 of 10 | 5 of 5 | | 7 of 7 | 5 of 6 | 4 of 4 |
| Ruth Kelly | 10 of 10 | 5 of 5 | 4 of 4 | 6 of 7 | | |
| Mark Williamson | 10 of 10 | 5 of 5 | | 7 of 7 | 6 of 6 | |
| Attendance notes | | | | | | |

1. Steve Holliday stepped down as Chief Executive with effect from 31 March 2016.
2. John Pettigrew became Chief Executive with effect from 1 April 2016.

Board and committee evaluation

We are back to the first year of the Company's three-year performance evaluation cycle. The last externally facilitated evaluation took place in 2012/13. In line with the Code, for the year 2015/16 we have undertaken a formal and rigorous externally facilitated Board effectiveness review. We appointed Independent Audit to undertake the evaluation. Independent Audit, which has no other connection to the Company, considered the Board and committees performance with a particular focus on risk.

The evaluation was conducted between November 2015 and April 2016 and included:

- an initial planning meeting with the Chairman, Group General Counsel & Company Secretary and Independent Audit to agree the approach and expectations of the evaluation;
- one-to-one interviews based on the same set of questions conducted by Independent Audit with the Board members, Group General Counsel & Company Secretary, Head of Secretariat and other members of senior management who regularly interact with the Board and its committees;
- Independent Audit attending the Board meeting in January to observe behaviours and interactions;
- a review of the 2015 Board and committee papers and minutes, and a selection of other relevant governance documents to form a view of the effectiveness of the Board and its committees;
- the preparation of a report by Independent Audit which was initially shared with the Chairman and Group General Counsel & Company Secretary; and
- the presentation of results presented for discussion at the Board in April with the proposed recommendations presented in May.

The effectiveness of each of the Board committees was taken into account in the evaluation. All committees received an update on the external evaluation and discussed any recommended actions. The evaluation identified a number of specific recommendations to take forward for the Audit and Nominations Committees. Independent Audit concluded that the Board was working well even though it had seen changes in membership over the past few years and thought the Board now benefitted from a good mix of experience in both the UK and US. The Board agenda demonstrated there was balance between strategic, operational and regulatory matters, with good engagement of the Board members supported by thorough work by management. They also made a number of recommendations in relation to risk, principally focused on cascading risk management further down the business.

Actions for 2016/17

Independent Audit concluded there were six main recommendations for further development. In May the Board discussed and agreed the following actions:

- to give a renewed push to improve Board and committee papers, including the enforcement of standards of papers and timely submissions;
- to bring out strategic themes more clearly in the Board papers, pre-read papers and the Chief Executive's report;

the Chairman will discuss with the Non-executive Directors the strategy items on the draft agenda for the next following meeting and articulate the views from the Non-executive Directors as to what is required at the Board meeting including any questions that need answering;
integrate risk more effectively into strategy development and planning;
continue to consider the skills and capabilities needed on the Board for executing the Company's future strategy; and
to review whether there is enough focus on people on the Board agenda.

| | | |
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**Board and
committee
evaluation cycle**

Individual performance

As part of our annual evaluation process, Mark Williamson, as Senior Independent Director, led a review of the Chairman’s performance. The Non-executive Directors, with input from the Executive Directors, assessed his ability to fulfill his role as Chairman. It was concluded that the Chairman continued to show effective leadership of

the Board and his actions continued to influence the Board and the wider organisation. Mark Williamson discussed the feedback and development opportunities with the Chairman.

Progress against actions from 2014/15

Progress against the actions from last year’s internally facilitated evaluation have been monitored by the Group General Counsel & Company Secretary and the Chairman throughout the year and an update on progress was provided at the April Board meeting. A commentary against each action from last year’s review is set out below.

Last year an evaluation of committee performance was also conducted by the Chairman of each of the Board committees, following a similar process to that conducted by the Board. Where relevant, action plans were prepared for the committees and progress against the actions was monitored throughout the year.

Update on actions from last year

| Area | Actions | Commentary |
|--------------------|--|---|
| Environment | Optimise the boardroom layout to create a more inclusive environment | For all meetings the Group General Counsel & Company Secretary makes sure the boardroom layout is appropriate |

for members and presenters.

**Responsibility: Board members/
Group General Counsel &
Company Secretary**

to enable open discussion and promote an effective meeting. The Group General Counsel & Company Secretary also highlights any new presenters to the Board in the Chairman's briefing material and the relevant Executive Director introduces the presenter to the meeting.

Environment

Continue to create a more open boardroom atmosphere and culture.

**Responsibility: Chairman/
Board members**

The Chairman manages the boardroom environment throughout meetings, encouraging open discussion on all matters and making sure all Board members are involved. A definite upward trend of contribution by all Board members has been seen. The Group General Counsel & Company Secretary makes sure there is appropriate time allocated to all agenda items and makes arrangements to foster an open atmosphere and culture.

Board discussions

Maximise the effectiveness of Board discussions.

**Responsibility: Chairman/
Executive Directors/Group
General Counsel & Company
Secretary**

The information going to the Board is reviewed every six months through meetings between the Chairman, the Chief Executive and the Group General Counsel & Company Secretary. The new reporting framework delivered by external specialists last year has continued to provide the Board and committees with clearer, more concise papers. This has helped improve Board discussions and decision making. At the December 2015 Executive Committee meeting the Group General Counsel & Company Secretary updated the Executive members on the role they play in drafting the papers. We will continue to review and make sure only relevant information is provided to the Board. A further refresh of the Board paper process will commence this year.

After large discussion items, the Chairman summarises the key points from the discussion. He also confirms what is expected next, if anything, and if there are any actions for relevant Board members.

Board discussions

Use a diversity of thinking styles.

The Board members have become more flexible with their questioning taking into account their thinking styles, which varies according to the topic. At the post meetings

**Responsibility: Chairman/
Board members**

with the Non-executive Directors, the Chairman makes sure they provide feedback on behaviours displayed during the meeting.

Board focus

Continue to manage the strategy agenda.

Significant time has been scheduled for strategy on the Board meeting agendas. In addition, we usually hold two half-day strategy sessions during the year which take place on a separate day to the Board meeting, to make sure the strategy discussions are productive and stimulating. In July 2016 there will be a full strategy away day.

**Responsibility: Chairman/
Chief Executive/Group General
Counsel & Company Secretary**

Additionally, the Chief Executive has developed a detailed schedule of Board strategy updates for the forthcoming year and has recently circulated to the Board the material to be covered at the July strategy day.

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Corporate Governance continued

Mark Williamson

Committee chairman

Audit Committee

Review of the year

This report aims to provide an insight into the work of the Audit Committee over the year in relation to the UK and US businesses, the external auditors, and our role within the Company's internal assurance functions, as well as the significant issues debated by the Committee during the year.

US business review

Last year, I reported on the work undertaken and progress made in relation to the US financial controls environment. This has remained a focus for the Committee this year and we expect the strengthened US leadership team to substantially complete the US finance transformation plan by 31 March 2017.

In September, the US finance senior leadership team joined the Committee meeting to give an in-depth update on the initiatives underpinning the US finance team transformation plan with each senior leader presenting on their area of responsibility. This provided us with an opportunity to hear directly from members of the team, raise questions and challenge as necessary.

I also took the opportunity in September to visit the Service Delivery Centre in Syracuse, New York to meet the US Shared Services and Finance teams. The visit highlighted the credit and collections process, a critical component of the larger revenue recognition process employed by the Company. I received presentations highlighting the work performed by each team, accomplishments, and areas of focus,

together with an in-depth review of the credit and collections activities.

Additionally, in February I joined a video conference with the Finance Director and US finance leadership team for a progress update and to discuss the sustainable improvements being made to the overall US financial controls environment. The Finance Director and the US Chief Financial Officer have continued to keep the Committee up to date on progress with regular reports throughout the year on priorities and proposed improvements to support the transformation plan.

UK business review

While the US financial controls environment has remained an area of focus for the Committee, during the year we have also received regular updates of the overall Group control environment, including a presentation from the UK finance team on the status of the UK finance change programme.

Following the introduction of RIIO, the UK business has undergone significant change, which in turn demanded a different level of support from the UK finance team. The change programme is intended to improve the capability and capacity of the function to better support the business in a RIIO environment. The Committee challenged management on the status of the change programme and the revised processes and controls.

Audit tender

Overseeing the competitive tender process for the external audit was a significant undertaking for the Committee and management. You can read more about the process on page 56. I kept the Board up to date on our progress and in November recommended to the Board, for its consideration, that Deloitte LLP be appointed as our new external auditors. Our current auditors, PricewaterhouseCoopers LLP, will continue in their role and undertake the audit for the year ending 31 March 2017, subject to reappointment by shareholders at the 2016 AGM. The appointment of Deloitte will be recommended to our shareholders for consideration at the 2017 AGM. We look forward to working with Deloitte in the future.

Looking forward, we will continue to receive updates on the UK Gas Distribution sale and will support the Board as appropriate in relation to this potential transaction.

Mark Williamson

Committee chairman

Table of Contents**Corporate Governance****Examples of Committee focus during the year included:**

| Areas of focus | Commentary | |
|----------------------------|--|--|
| Risk management | <p>The Committee has been delegated responsibility by the Board for monitoring and assessing the effectiveness of our risk management processes. During the year, the risk team undertook a review of our risk processes to make sure we have effective systems and processes in place to meet the requirements of the 2014 UK Corporate Governance Code and the FRC guidance on Risk Management, Internal Control and Related Financial and Business Reporting. Going forwards, the Committee will also receive reports to be considered by the Board on risk process developments to enable the Committee to keep fully appraised of changes in the risk profile of the Company and to allow it to monitor the management of risk throughout the year.</p> | <p>The Committee continues to monitor the effectiveness of the risk management and internal control processes during the year and reports to the Board on the outcome of its annual review which covers all material controls, including financial, operational and compliance controls.</p> <p>You can read more about our risk management process and the review of effectiveness on pages 26 to 29. Details of our internal control systems, including those relating to the financial reporting process, can be found on pages 29 and 183.</p> |
| Viability statement | <p>Following the new requirement in the Code, the Annual Report and Accounts must now include a viability statement, which you can find on page 30.</p> | <p>risk processes and proposed improvements to make sure there were effective systems and processes in place to support the Board in making this statement.</p> |
| | <p>The viability statement requires the Board to confirm that it has assessed the Company's principal risks and viability. At its meeting in September, the Committee considered the</p> | <p>At the Committee meeting in May, it considered the viability statement and recommended the statement to the Board for approval at its May meeting.</p> |

outcome of a review of the Company's

Going concern statement

In addition, the Committee considered the Group's short-term liquidity and capital and considered it appropriate to adopt the going concern basis in the financial statements. The Board considered and

approved the Committee's recommendation at its May meeting. The Company's going concern statement is set out on page 102, note 1A.

Fair, balanced and understandable

The Committee considered the requirement of the Code to ensure that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable in the

context of the applicable accounting standards and confirmed this view to the Board.

Financial reporting

The Committee monitors the integrity of the Company's financial information and other formal documents relating to its financial performance and makes appropriate recommendations to the Board before publication.

year-on-year basis and across the Company. In this respect, the Committee also considers the estimates and judgements made by management when accounting for non-standard transactions, including the treatment of exceptional items. See page 57 for further details.

An important factor in the integrity of financial statements is making sure that suitable and compliant accounting policies are adopted and applied consistently on a

Disclosure Committee reports

When reviewing the half and full-year announcements, the Committee considers reports of the Disclosure Committee. The Disclosure Committee also reports the results of its evaluation of the effectiveness of the Company's

disclosure controls to the Audit Committee. See page 63 for more information on the role of the Disclosure Committee.

Sarbanes-Oxley Act 2002 testing and

The Committee receives regular updates on the status of testing and considers the impact

See page 29 for the Company's statement on the effectiveness of internal control over

attestations

of deficiencies reported in the past year.

financial reporting.

Cyber security risk management

Responsibility for reviewing the governance processes in relation to cyber security has been delegated to the Committee by the Board. An update on the status of our

cyber security risk management process and cyber security strategy was presented to the Committee in September.

Compliance management

Compliance management is part of the Global Assurance function, which incorporates ethics, risk management, licence management and records management. Biannual reports to the Committee focus on compliance with external legal obligations and regulatory commitments. Additional detail has been added to the reports this year, providing information on trends, root cause of incidents, and action tracking to help prioritise and prevent recurrence.

The Committee also received an update on the compliance improvement programme in September. The objective of the programme is to make sure the Company understands its external compliance obligations, that effective control frameworks are in place, and that compliance issues are managed with the right level of priority. The paper also set out the steps to help further embed compliance activities within the business. Strengthening existing control frameworks will be an important part of progressing compliance performance improvements in the business.

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Corporate Governance continued

| Areas of focus | Commentary | |
|---|--|---|
| Confidential reporting procedures and whistleblowing | The Committee reviews these procedures annually to make sure that complaints are treated confidentially and that a proportionate, independent investigation is carried out in all cases. | The Committee also receives annual reports on the Company’s anti-bribery procedures and reviewed their adequacy. It noted that no material instances of non-compliance had been identified. |
| Internal audit charter | In accordance with best practice, the Corporate Audit Charter was reviewed against the Institute of Internal Auditors (IIA) international standards and the IIA model charter. | This review assessed the purpose, authority and responsibility, as defined in the charter, to make sure they are sufficient to enable the Corporate Audit function to complete its objectives. Minor changes to the charter were approved by the Committee in November. |
| Performance review | The 2015/16 Board and committee evaluation was conducted externally by Independent Audit and included a high level review of the Board committees. | The recommended actions for the Audit Committee were considered by the Committee in May and an action plan agreed. |
| | The Committee in action audit tender | Throughout the process, we were mindful of the need to preserve the independence of the |

PwC have been the Company's external auditors since the merger with Lattice Group plc in 2002, and were the incumbent external auditors of both the merging parties. Their performance has been reviewed annually by the Committee since that time.

external audit. Each potential firm was required to disclose all existing relationships with the Company and explain their proposals to make sure these relationships would not cause any conflict of interest in line with SEC and proposed EU rules on auditor independence.

As described in last year's Annual Report and Accounts, it was decided to tender the audit this year having considered the Competition and Market Authority Order requiring FTSE 350 companies to hold an audit tender every 10 years as well as the final European Commission (EC) regulations, which came into EU legislation in June 2014. Based on the EC transitional arrangements, the final year in which PwC could have been appointed as the Group's auditors would have been for the year ending 31 March 2020. As such PwC were not invited to be part of the tender process.

In early November, each potential firm presented to a panel (comprising the Committee, other members of the Board and senior finance team members and chaired by the Chairman of the Committee) setting out why they should be selected to be our external auditors. These sessions provided the panel with the opportunity to question each firm and follow up on queries from their written submissions.

The following tender process was undertaken:

The Committee discussed the outcome of the presentations and views of other members of the panel at its November meeting and recommended that Deloitte LLP was the most suitable firm to be our next auditors based on the principal evaluation criteria of audit quality, team experience and cultural fit. This recommendation from the Committee was subsequently approved by the Board at its November meeting.

a pre-qualification questionnaire was issued to interested parties;

the submissions were scored by the finance and procurement teams against a detailed scoring mechanism focusing on areas such as audit quality, relevant industry experience and understanding of our business;

Deloitte's appointment, subject to approval at the 2017 AGM, will be effective for the year ending 31 March 2018. The timing of the change in auditors will help ensure both an orderly transition and compliance with external regulations on the provision of non-audit services.

the scores were presented to the Committee in July together with a proposed short list of firms; and

at its July meeting, the Committee discussed and agreed the short list of firms and approved the issue of a formal Request for Proposal (RFP) to the short-listed firms.

PwC, National Grid's current external auditor, will continue in their role until Deloitte's appointment. They have expressed their willingness to continue as auditors of the Company for the year ending 31 March 2017

The key stages of the RFP were as follows:

meetings were held between the potential firms and members of the Board and senior finance team to set out the requirements for the audit and provide a better understanding of the expectations of key stakeholders and our business;

references for the proposed key team members of each firm were sought;

technology workshops were held with finance team members to give the potential firms the opportunity to demonstrate their audit technology tools and their relevance to the Company; and

written tender documents were submitted by each firm covering specific areas including audit approach, risk identification, audit scope, independence and the proposed audit fee.

and the Committee has therefore recommended to the Board that a resolution proposing the re-appointment of PwC as external auditors be put to shareholders at the 2016 AGM. There are no contractual obligations restricting our choice of external auditors and we have not entered into any auditor liability agreement.

The Statutory Audit Services for Large Companies Market Investigation (Mandatory Use of Competitive Tender Processes and Audit Committee Responsibilities) Order 2014 statement of compliance. The Company confirms that it complied with the provisions of the Competition and Markets Authority's Order for the financial year under review.

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Corporate Governance

Significant issues

The most significant issue the Committee considered in relation to the financial statements during the year was the US financial control environment and in particular these related to property, plant and equipment. The Committee also considered a paper presented by management highlighting the Company's policy for presenting items as exceptional and the immediate accounting implications of the proposed sale of a majority stake in our UK Gas Distribution business.

The independent auditors' report (pages 85 to 92) also includes some other areas of focus, including the accuracy and valuation of treasury derivative transactions, accounting for net pension obligations, revenue recognition, and valuation of environmental provisions which were not considered in detail by the Committee during the year, as nothing significant arose that warranted extensive Committee attention.

US financial control environment

The Committee has continued to devote a significant amount of time to reviewing the actions management are taking to improve the US financial controls environment. The two main areas of focus and challenge by the Committee on this issue were:

progress made by management against the measures taken to remediate the US financial control deficiencies. In particular the Committee asked management to produce a clear timetable for clearing the control deficiencies; and the status of the US finance organisational design programme, in particular, understanding the structure of the new US finance senior leadership team and management's plans to fill key vacancies.

Presentation of exceptional items

There were two specific items that the Committee considered this year in respect of exceptional items:

as part of the half-year results announcement, the Committee considered the treatment of the £49m gain recognised when National Grid exchanged its share of the Iroquois pipeline joint venture for shares in Dominion Midstream Partners, LP. The Committee was satisfied that this item should not be recognised as exceptional based on the size of the transaction; and

at year end, the Committee considered the treatment of the costs incurred in preparation for the UK Gas Distribution sale. The Committee agreed with management's proposal that these be treated as exceptional to reflect the nature of the costs. This presentation would be consistent with the treatment of the overall profit on the sale when the transaction completes.

Potential sale of majority stake in the UK Gas Distribution business

The Committee considered the immediate accounting implications following the announcement of the sale plans in November. In particular, the Committee was satisfied with the conclusion reached that, based on the separation work remaining and the overall status of the transaction, the assets and liabilities did not need to be classified as held for sale at 31 March 2016. The Committee will continue to monitor this during 2016/17 as the potential transaction progresses.

External audit

The Committee is responsible for overseeing relations with the external auditors, including the proposed external audit plan, the approval of fees, and makes recommendations to the Board on their appointment or reappointment. Details of total remuneration paid to auditors for the year, including audit services, audit-related services and other non-audit services, can be found in note 3(e) of the consolidated financial statements on page 110.

Auditor independence and objectivity

The independence of the external auditors is essential to the provision of an objective opinion on the true and fair view presented in the financial statements. Auditor independence and objectivity is safeguarded by a number of control measures, including:

- limiting the nature and value of non-audit services performed by the external auditors;
- ensuring that employees of the external auditors who have worked on the audit in the past two years are not appointed to senior financial positions within the Company in line with our internal code;
- monitoring the changes in legislation related to auditor objectivity and independence to help ensure we remain compliant;
- providing a business conduct helpline that employees can use to report any concerns, including those relating to the relationships between Company personnel and the external auditor;
- the rotation of the lead engagement partner at least every five years (a new lead engagement partner was appointed for the 2015/16 financial year);
- PwC's internal independence rules and processes, which have been designed to exceed professional standards and focus on both personal independence and scope of services;
- independent reporting lines from PwC to the Committee and the opportunity to meet with the Committee independently; and
- an annual review by the Committee of the structures, policies and practices in place to make sure the external auditors' objectivity and independence is maintained.

Audit quality

To maintain audit quality and provide comfort on the integrity of financial reporting, the Committee reviews and challenges the proposed external audit plan, including its scope and materiality prior to approval, to make sure that PwC has identified all key risks and developed robust audit procedures and communication plans.

The Committee also considers PwC's response to accounting, financial control and audit issues as they arise, and meets with them at least annually without management present, providing the external auditors with the opportunity to raise any matters in confidence.

National Grid Annual Report and
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Audit Committee

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Corporate Governance continued

Auditor appointment

An annual review is conducted by the Committee of the level and makeup of the external audit and non-audit fees and the effectiveness, independence and objectivity of the external auditors.

The annual review includes consideration of:

audit quality and the external audit process globally;
the auditors' performance and delivery against the audit plan;
the expertise of the firm and our relationship with them including the level of challenge; and
the initial results of online questionnaires completed by the Chairman, Committee members, Executive Directors and senior representatives from the finance team. The questions focused on: the quality of service; sufficiency of resources; planning and execution of the audit; communication and interaction; and overall satisfaction.

Following this year's annual review, the Committee was satisfied with the effectiveness, independence and objectivity of the external auditors, and recommended to the Board their reappointment for a further year. A resolution to reappoint PwC and giving authority to the Directors to determine their remuneration will be submitted to shareholders at the 2016 AGM.

Internal (corporate) audit

The corporate audit function provides independent, objective assurance to the Audit, Safety, Environment and Health and Executive Committees on whether our existing control and governance frameworks are operating effectively in order to meet our strategic objectives. Assurance work is conducted and managed in accordance with the IIA international standards for the Professional Practice of Internal Auditing and Code of Ethics.

To keep the Committee informed of trends identified from the assurance work and to update on progress against the corporate audit plan, the Head of Corporate Audit reports to the Committee at least twice each year. These reports present information on specific audits, as appropriate, summarise common control themes arising from the work of the team and update on progress with implementing management actions. Where control issues are identified, senior leaders may be invited to attend Committee meetings to provide commentary on the actions they are taking to improve the control environment within their area of responsibility.

In order to meet the objectives set out in the Corporate Audit Charter, audits of varying types and scopes are conducted as part of the annual corporate audit plan. The audit plan is based on a combination of risk-based and

cyclical reviews, together with a small amount of work that is mandated, typically by US regulators.

Inputs to the audit plan include risk registers, corporate priorities, external research of emerging risks and trends, and discussions with senior management to make sure the plan aligns with the Committee and Company's view of risk. The audit plan is considered and approved by the Committee annually and progress against the plan is monitored throughout the year.

The Committee is responsible for the appointment and removal of the Head of Corporate Audit. The Committee met privately with the Head of Corporate Audit during the year.

Non-audit services provided by the external auditors

In accordance with our policy, non-audit services provided by the external auditors above a threshold of £50,000 require approval in advance by the Committee.

Below this threshold, all requests must be approved in advance by the Finance Director but do not require Committee pre-approval. This reduces the administrative burden on the Committee. A full list of all Committee and Finance Director approved non-audit work requests is presented to the Committee annually to ensure the Committee is aware of all non-audit services provided.

Additionally, the Committee receives quarterly reports from management on non-audit services and other consultants' fees to monitor the types of services being provided and fees incurred.

Approval for the provision of non-audit services is given on the basis the service will not compromise independence and is a natural extension of the audit, or if there are overriding business or efficiency reasons making the external auditors most suited to provide the service. Certain services are prohibited from being performed by the external auditors, as required under the Sarbanes-Oxley Act 2002.

Total non-audit services provided by PwC during the year ended 31 March 2016 were £8.9 million (2015: £0.9 million), representing 63% (2015: 7%) of total audit and audit-related fees (see note 3(e)). The increase in the year relates to two significant projects: vendor due diligence and separation support in respect of the potential UK Gas Distribution transaction and data scrub work on financial information prior to inclusion in US rate case filings. For both of these projects it was concluded that the work would be most efficiently performed by the external auditor based on their understanding of our businesses and that most of the information used was derived from audited financial statements. Both projects were discussed by the Committee and pre approved by the Chairman of the Audit Committee prior to work commencing.

Total audit and audit-related fees include the statutory fee and fees paid to PwC for other services that the external auditors are required to perform, such as regulatory audits and Sarbanes-Oxley Act attestation. Non-audit

fees represent all other services provided by PwC not included in the above.

Non-audit services provided by PwC in the year included tax compliance services in territories other than the US (£0.5 million), the significant majority of which related to the UK.

The Committee considered that tax compliance services were most efficiently provided by the external auditors, as much of the information used in preparing computations and returns was derived from audited financial information. In order to maintain the external auditors' independence and objectivity, management reviewed and considered PwC's findings and PwC did not make any decisions on behalf of management.

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Corporate Governance

Therese Esperdy

Committee chairman

Finance Committee

Review of the year

This was my first full year as Committee chairman, during which we have focused on our funding programme taking into account international market conditions, as well as overseeing the early stages of the treasury and other finance related aspects of the proposed sale of a majority stake in our UK Gas Distribution business.

At the end of the year, we said farewell to Steve Holliday as a member of the Committee as he stepped down from his Chief Executive role, and from the start of April we welcomed John Pettigrew to the Committee as he transitioned into that role. I would like to thank Steve for his contribution to this Committee as part of his wider leadership of National Grid over many years.

2015/16 has also seen changes within the treasury team, with a new Group Tax and Treasury Director taking on the role in early 2016. With accompanying changes in the UK and US treasury teams I look forward to working with the new management team to build on the strong base they have inherited.

The Committee has met with management and employees across the treasury, tax, pensions and insurance functions in both the UK and US through the course of our

routine meetings. In addition, all members of the Committee met separately with the new Group Tax and Treasury Director as part of his induction into the role.

As part of our continuous review of counterparty risk, in June we received a presentation from external advisors on the banking market initiatives designed to improve the capital position of banks. Following the Committee's approval to simplify our liquidity policies last year, the revised policy was successfully implemented and we reviewed performance during the year.

The Committee approved the issuance of a non-dilutive convertible bond in September. This innovative funding transaction demonstrates our focus on funding diversification and cost effectiveness, and was recognised with the Deal of the Year Award for 2015 by the Association of Corporate Treasurers.

During the year, the Committee received an update on the activities and performance of our captive insurance companies, which highlighted the cost savings generated by these arrangements. We also reviewed the future strategy for the insurance function, our outsource arrangements, and the ongoing plans for the captive insurance companies.

In the second half of the year, the Committee spent time on the financing related aspects of the proposed sale of a majority stake in our UK Gas Distribution business. This included reviewing the pension and tax aspects of the proposed transaction, together with planning our approach to the associated liability management exercise. This will continue to be a major focus for the Committee in the year ahead.

In April 2016, the Committee received an external update on the potential impact of the forthcoming referendum on the UK's membership of the European Union. We assessed the treasury and other issues that might arise, together with their potential impact on the Company.

We will also continue to review our ongoing funding needs, liquidity management, pension funding and our future insurance strategy.

Examples of key matters the Committee considered during the year included:

- funding requirements and financing for the business plan;
- setting and reviewing treasury policies;
- treasury performance updates;
- UK and US tax updates;
- update on US energy procurement activities and electricity and gas trading activities in the UK;
- foreign exchange policy and interest rate risk management;
- the draft going concern statement for the half- and full-year results prior to consideration by the Board;
- update on pension and post-retirement healthcare arrangements; and
- insurance renewal programme and overall insurance strategy.

The Committee in action

rebalancing our debt portfolio

The Committee has had oversight of management's plans to rebalance our debt portfolio relating to the potential sale of a majority stake in our UK Gas Distribution business.

We initially reviewed and challenged management's overall strategy for the restructuring programme, and subsequently received presentations over multiple meetings on the proposed methodology and risks associated with delivering it.

Various options were considered and we concurred with management's proposed approach on this important issue. We will continue to oversee progress in the coming year.

Therese Esperdy

Committee chairman

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Corporate Governance continued

Paul Golby

Committee chairman

**Safety, Environment and
Health Committee**

Review of the year

Over the year the Safety, Environment and Health Committee has seen the Company make further progress in process safety management and the safety performance of both the UK and US businesses. The US has closed the gap on the UK in terms of combined employee and contractor Lost Time Injuries and the Company overall now has an injury frequency rate of 0.10.

Road traffic collisions remain higher than we would like in both the UK and the US. Starting in the UK, the Company has therefore required many of its employees to attend safe driver training with the aim of reducing incidents. We have also benchmarked our approach to safe driving externally and ascertained that it represents good industry practice.

The Committee receives reports from the Engineering Assurance Committee (EAC) every six months. In particular, we considered work being done by the EAC in succession planning for the Company's engineering employee population. Following recommendations from the Committee, the collection and analysis of data on the Company's engineers was accelerated to facilitate the development of a strategy for recruitment and retention of employees, which recognises the value of engineering qualifications particularly in relation to safety critical roles.

We have continued to focus on process safety and establishing a safety management system across both UK and US businesses. We also received reports on the measures being introduced at key US LNG plants located close to areas that have pockets of relatively dense population. This includes the installation of automatic shutdown mechanisms and, for four plants, dike remodelling to improve the containment of LNG in the low probability event of an incident.

We continued to monitor the Company's approach to compliance with US gas safety regulations (see the Committee in action box opposite). The Committee spent time reviewing how the Company benchmarks its performance against that of other bodies, both in the utilities sector and elsewhere in the fields of safety, environment and health. It also considered other areas in which it may be beneficial to extend such benchmarking.

In terms of the environment, we have continued to monitor our strategy and approach to sustainability. In particular, we have looked at how we are working with governments and bodies to influence regulations that directly affect our business.

Our performance to date in reducing greenhouse gas (GHG) emissions has been successful and we expect to exceed our 2020 reduction target significantly. However, the necessary reductions in GHG emissions to meet our 2050 target will be a greater challenge. Following the UN Climate Change Conference in Paris in December 2015 (COP21), the Committee met to consider the outcomes of the conference and how these affect the Company.

Further work is planned for 2016/17, as the impact on national legislation is expected to become clearer and we review our emissions reduction strategy and our ability to meet our 2050 GHG reduction targets.

We also considered the Company's health and wellbeing strategy and the work being undertaken to improve data management, implement better line management awareness training and provide support and guidance to employees.

Examples of other matters the Committee reviewed during the year included:

- ongoing monitoring of safety performance and significant incidents in the UK and US;
- update on lessons learnt and steps taken following a fatality of a member of the public in the UK in April 2014, for which the Company was fined £2m in December 2015;
- compliance and risk reporting for safety, environment and health;
- the introduction and application by the Company of the accounting for sustainability (A4S) methodology for new projects;
- programmes for musculo-skeletal injury prevention and mental well-being in the UK; and
- the impact that the so called 'Obama Care' laws may have on the provision of health care plans for our US employees.

The Committee in action US gas pipeline safety management

Following several years of very significant pipeline incidents, the US Congress and regulators have changed their approach to enforcing gas pipeline safety legislation, becoming impatient with companies that are not showing continuous improvement in compliance-related matters. This is demonstrated by a recent series of compliance orders in New York State, record-setting penalties nationwide and further demands for compliance improvement plans.

The Company's response has been to heighten its focus on compliance and investment in people, training and systems to meet these requirements through new gas enablement initiatives and the setting up of a gas pipeline safety monitoring system. This will involve using the Company's process safety management system and expanding its approach to gas distribution assets. The US business has reviewed its standards and procedures and has worked to build a consistent and integrated approach to gas pipeline safety compliance across the Company.

Over the past couple of years, the Committee has monitored the progress of these measures, stressing the importance of compliance with legislation rather than tolerance of fines. It has encouraged the Company to improve communications with regulators in order to help shape solutions to evolving regulatory issues. These include recent changes to New York State's definition of service lines, affecting where jurisdictional piping responsibility ends and therefore where the Company's responsibility for gas pipeline safety commences and ends.

Paul Golby

Committee chairman

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Corporate Governance

Sir Peter Gershon

Committee chairman

Nominations Committee

Review of the year

During the year, succession planning has been the main area of focus for the Committee. The process of building a strong and effective Board requires a good balance of continuity and refreshment and the Committee has borne this in mind in its deliberations.

Appointment of new Chief Executive

As described in my foreword to the Corporate Governance report, during the year we have undertaken a rigorous recruitment process to appoint a successor to Steve Holliday, which resulted in the appointment of John Pettigrew as our new Chief Executive. You can read more about the Chief Executive succession search and appointment process in the **Committee in action** box opposite.

Succession planning

The Committee also spent time considering succession planning over the long term, for both Executive and Non-executive Director positions, to make sure we have the right mix of skills and experience for the future. The main focus of these discussions was to take account of the recruitment process for the Chief Executive role and

subsequently the appointment of our new Executive Director, UK, following John's appointment as Chief Executive. Following a thorough and rigorous appointment process, Nicola Shaw was appointed to the role of Executive Director, UK and we will be welcoming Nicola on to the Board from 1 July 2016; see opposite for more details on this search and appointment process.

Diversity

Balance and fit with current Board members are important considerations in recruitment to the Board. Therefore part of the selection process for Board appointments is for the Committee to review the existing skills and experience of the Board and to also undertake external benchmarking and a review of potential external candidates. The Board also takes into account the need to make sure there is appropriate diversity, including diversity in thinking styles. Further details on the Company's approach to diversity are set out overleaf.

Board and Committee membership

Following the changes in Board membership, the composition of the committees was also reviewed. As a result of his appointment as Chief Executive, John Pettigrew joined the Finance Committee with effect from 1 April 2016.

Examples of other matters the Committee considered during the year included:

Executive succession planning focusing on the identification, development and readiness of successors to the Executive Committee in particular; and a review of the Chairman's performance, led by Mark Williamson, the Senior Independent Director.

The Committee in action **Chief Executive succession search and appointment process**

A formal process was undertaken by the Committee over a three year period in order to find an appropriate successor to Steve Holliday as Chief Executive. Luke Meynell, an external advisor, initially of Russell Reynolds Associates and subsequently of The Zygos Partnership, supported the Committee to make sure there was rigour and challenge to our process which was as follows:

- a Chief Executive role profile was prepared and agreed by the Committee;
- the external advisor conducted initial searches and assessed a long list of internal and external candidates against the agreed profile to produce a shortlist of potential candidates;
- shortlisted internal candidates were considered and interviews and assessments were undertaken;
- the Chairman and some of the Non-executive Directors met the potential external candidates;
- following a review of the ratings from all the interviews and assessments the Committee agreed its preferred internal candidate;
- the preferred candidate was benchmarked against external candidates;
- following discussion of the impact of the proposed appointment on the succession plans of the Company, the Committee confirmed its preferred candidate and recommended John Pettigrew for appointment as Chief Executive to the Board;
- the Board approved the appointment as recommended.

Search and appointment process

Executive Director, UK

A formal recruitment process was also undertaken for the replacement of John Pettigrew as Executive Director, UK, as follows.

The Nominations Committee appointed Korn Ferry as the search consultancy. With input from the Committee members a role and person specification was agreed.

Korn Ferry conducted initial searches for potential external candidates, with eight candidates being put forward for the role. Following this, a series of interviews were undertaken by the Chairman and members of the Board and Executive Committee. The Committee considered the outcomes from the interviews and selected two candidates for further consideration.

Final interviews with the two candidates were carried out by Steve Holliday, John Pettigrew, Ruth Kelly, Mark Williamson and members of the Executive Committee. Additionally, the two shortlisted candidates were externally assessed by YSC, a business management consultancy that undertakes executive director profiling assessments.

Following discussion, the Nominations Committee recommended Nicola Shaw as its preferred candidate for appointment to the Board. The Board approved the appointment as recommended and Nicola will join the Board on 1 July 2016.

In addition to providing external search consultancy services to the Company, Korn Ferry also provide HR consultancy services.

Sir Peter Gershon

Chairman

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Corporate Governance continued**Board diversity and the Davies Review**

At National Grid, we believe that creating an inclusive and diverse culture supports the attraction and retention of talented people, improves effectiveness, delivers superior performance and enhances the success of the Company.

We currently have 27% women on our Board and 22% women on our Executive Committee. The number of women in senior management positions and throughout the organisation is set out on page 45 along with examples of the initiatives to promote and support inclusion and diversity throughout our Company.

Our Board diversity policy promotes this culture and reaffirms our aspiration to meet and exceed the target of 25% of Board positions being held by women by 2015, as set out by Lord Davies. In October 2015, Lord Davies published his final report on women in the boardroom and recommended a new voluntary target of 33% of board positions to be held by women by 2020. In April 2016, the Nominations Committee discussed progress made against our Board diversity policy and noted the new target.

In February 2014, the Nominations Committee set out eight measurable objectives to support our Board diversity policy. During the year, the Committee reviewed the Board diversity policy and progress made against the objectives which support the implementation of the policy as set out below.

Objectives

- 1 The Board aspired to exceed the target of 25% of Board positions to be held by women by 2015.

Progress

Objective met. We currently have 27% women on our Board, which will increase to 33% when Nicola Shaw joins in July 2016. Lord Davies recommended in his final report that the target be increased to a voluntary 33% target by 2020. The Board has noted this new target.

- 2** All Board appointments will be made on merit, in the context of the skills and experience that are needed for the Board to be effective. **Objective met.** The appointment of John Pettigrew as Chief Executive and Nicola Shaw as Executive Director, UK were made on merit.
- 3** We will only engage executive search firms who have signed up to the Voluntary Code of Conduct on Gender Diversity. **Objective met.** Korn Ferry, Russell Reynolds Associates and The Zygos Partnership are signed up to the Voluntary Code of Conduct on Gender Diversity.
- 4** Where appropriate, we will assist with the development and support of initiatives that promote gender and other forms of diversity among our Board, Executive Committee and other senior management. **Objective met.** See page 44 for further details.
- 5** Where appropriate, we will continue to adopt best practice in response to the Davies Review. **Ongoing as appropriate.** The Nominations Committee reviewed and noted the recommendations of the Lord Davies report published in October 2015 and best practice will be adopted as appropriate and reported on next year.
- 6** We will review our progress against the Board diversity policy annually. **Objective met.** Ongoing.
- 7** We will report on our progress against the policy and our objectives in the Annual Report and Accounts along with details of initiatives to promote gender and other forms of diversity among our Board, Executive Committee and other senior management. **Objective met.** Ongoing.
- 8** We will continue to make key diversity data, both about the Board and our wider employee population, available in the **Objective met.** Ongoing.

Annual Report and Accounts.

Progress against the objectives, the policy and the new targets will continue to be reviewed annually and reported in the Annual Report and Accounts.

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Accounts 2015/16

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Corporate Governance

**Executive Committee
membership key**

1 John Pettigrew

Chief Executive and
Committee chairman

2 Andrew Bonfield

Finance Director

3 Stephanie Hazell

Group Strategy &
Corporate
Development Director

4 Alison Kay

Group
General Counsel &
Company Secretary

5 Richard Adduci

Chief Information Officer

6 George Mayhew

Group Corporate Affairs
Director

7 Dean Seavers

Executive Director, US

8 Mike Westcott

Group Human Resources
Director

9 Steve Holliday

Executive Director

Management committees

To help make sure we allocate time and expertise appropriately, the Company has a number of management committees, which include the Executive Committee, Disclosure Committee, Investment Committee, Group Ethics and Compliance Committee, Global Retirement Plan Committee and Group Security, and Resilience Committee. These committees provide reports, where relevant, to the appointing committee in line with our governance framework on the responsibilities they have been delegated. See page 49 for management committee reporting lines.

Executive Committee

There are currently nine Committee members, with Steve Holliday remaining a member of the Committee until he leaves the Company in July 2016. As previously announced, Nicola Shaw will become a member of the Committee with effect from 1 July 2016, on joining the Company as Executive Director, UK. The Committee members have a broad range of skills and expertise, which are updated through training and development. Some members also hold external non-executive directorships, giving them valuable board experience. The Committee officially met 12 times this year, but the members interact much more regularly. Those members of the Committee who are not Directors regularly attend Board and committee meetings for specific agenda items. This means that knowledge is shared and all members are kept up to date with business activities and developments.

Led by the Chief Executive, the Executive Committee oversees the safety, operational and financial performance of the Company. It is responsible for making day-to-day management and operational decisions it considers necessary to safeguard the interests of the Company and to further the strategy, business objectives and targets established by the Board. It approves expenditure and other financial commitments within its authority levels and discusses, formulates and approves proposals to be considered by the Board.

Disclosure Committee

The role of the Disclosure Committee is to assist the Chief Executive and the Finance Director in fulfilling their responsibility for overseeing the accuracy and timeliness of the disclosures made – whether in connection with our presentations to analysts, financial reporting obligations, or other material stock exchange announcements, including the disclosure of price sensitive information.

The Committee in action – rate case filings

During the year, the Committee reviewed and discussed our proposed rate case filings for both Massachusetts electricity operations (MECO) and our downstate New York gas companies (KEDNY/KEDLI). These filings aim to increase our allowed revenue in line with increased operating costs since base rates were reset after the last full rate review for each company (2010 for MECO, 2008 for KEDNY/KEDLI) and also to fund future investment needed to meet our customers requirements and improve reliability.

A key focus of the Committee discussions was on understanding the impact of the requested rate increases on our customers, and considering stakeholder perspectives. Following discussion, the proposals were approved for filing at the October meeting for MECO and at the January meeting for KEDNY/KEDLI.

This year the Committee met to consider the announcements of the full- and half-year results and reported on relevant matters to the Audit Committee. In doing so it spent time considering the Company’s disclosure obligations relating to the announcement of the proposed UK Gas Distribution sale process and the expected impact this would have on the Company’s growth rate.

The Committee also reports the results of its evaluation of the effectiveness of the Company’s disclosure controls to the Audit Committee.

The Committee is chaired by the Finance Director and its members are the Group General Counsel & Company Secretary, the Global Tax and Treasury Director, the Global Financial Controller, the Director of Investor Relations, the Head of Corporate Audit and the Deputy Group General Counsel, with other attendees as appropriate.

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Corporate Governance continued

Statement of compliance with the UK

Corporate Governance Code

The UK Listing Rules require that listed companies must include in their annual report a statement of whether the Company has complied with all the relevant provisions of the UK Corporate Governance Code. The UK Corporate Governance Code was published in September 2014 (the Code), available in full at www.frc.org.uk.

For the year ended 31 March 2016, the Board considers that it has complied in full with the provisions of the Code. Our statement of compliance opposite explains the main aspects of the Company’s governance structure to give a greater understanding of how the Company has applied the principles and complied with the provisions in the Code. The main report also explains compliance with the Disclosure Rules and

A. Leadership

A.1 The role of the Board

Our Board is collectively responsible for the effective oversight of the Company and its businesses. It also determines the strategic direction, business plan, objectives, principal risks, viability of the Company and governance structure that will help achieve the long-term success of the Company and deliver sustainable shareholder value.

The Board sets the risk appetite and principal risks for the Company and takes the lead in areas such as safeguarding the reputation of the Company and its financial policy, as well as

A.4 Role of the Non-executive Directors

Our Senior Independent Director acts as a sounding board for the Chairman and serves as an intermediary for the other Directors, as well as shareholders when required.

Independent of management, our Non-executive Directors bring diverse skills and experience, vital to constructive challenge and debate. Exclusively, they form the Audit, Nominations and Remuneration Committees, and their views are actively sought when developing proposals on strategy.

Transparency Rules. The index on page 67 sets out where to find each of the disclosures required in the Directors' Report in respect of Listing Rule 9.8.4, together with the Board's sign-off on the report.

making sure we maintain a sound system of internal control and risk management (see pages 26 to 29).

Around the Board meetings, the Chairman holds meetings with the Non-executive Directors without the Executive Directors present.

There is a clear schedule of matters reserved for the Board and a schedule of delegation, which were both updated in January 2016. The schedule of matters reserved for the Board is available on our website, together with other governance documentation.

A.2 A clear division of responsibilities

The Board supports the separation of the roles of the Chairman and Chief Executive. The key responsibilities are clearly documented and reviewed when appropriate. The Chairman manages and leads the Board. The Chief Executive is responsible for the executive leadership and day-to-day management of the Company and the Group's businesses, to ensure the delivery of the strategy agreed by the Board.

A.3 Role of the Chairman

The Chairman, who was independent on appointment, is responsible for the leadership and management of the Board and its governance. He makes sure the Board is effective in its role by promoting a culture of openness and debate, facilitating the effective contribution of all Directors and helping to

maintain constructive relations between Executive and Non-executive Directors. The Chairman sets the Board's agenda making sure consideration is given to the main challenges and opportunities facing the Company, and adequate time is available to discuss all items, including strategic issues.

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Corporate Governance

B. Effectiveness

B.1 The composition of the Board

The Board believes it operates effectively with an appropriate balance of independent Non-executive and Executive Directors who have the right balance of skills, experience, independence and knowledge of the Company.

Details of our Board, their individual biographies and Committee membership are set out on pages 47 and 48. Board and Committee attendance during the year to 31 March 2016 is set out on page 52.

The independence of the Non-executive Directors is

With the agreement of the Board, Executive Directors gain experience of other companies operations, governance frameworks and boardroom dynamics through non-executive appointments. The fees for these positions are retained by the individual.

For further details about the Directors service contracts and letters of appointment, see page 74 of the Directors Remuneration Report.

B.4 Development

All new Directors are provided with a full induction programme when they are appointed to the Board. Details of Director

B.6 Evaluation

See pages 52 and 53 for more information on our externally facilitated Board evaluation, undertaken by Independent Audit Limited.

During the year, the Chairman met each Director individually to discuss their contribution, performance over the year and training and development needs. Following these meetings, Sir Peter confirmed to the Nominations Committee that he considered that each Director demonstrated commitment to the role and their performance continued to be effective.

considered at least annually along with their character, judgement, commitment and performance on the Board and relevant committees. The Board took into consideration the Code and indicators of potential non-independence, including length of service.

The Board considered Paul Golby's independence separately following the announcement of his appointment as Chairman of Costain Group plc (a major supplier to the Company). The situational conflict was authorised (including putting in place protective measures to ensure the conflict is appropriately managed) and his independence was confirmed.

At year end, all of the Non-executive Directors, with the exception of the Chairman, whose independence is only determined on appointment, have been determined by the Board to be independent.

B.2 Appointments to the Board

The Nominations Committee, which comprises the Chairman and Non-executive Directors leads the process for Board appointments and makes recommendations to the Board. The process for the appointment of John Pettigrew as Chief Executive and Nicola Shaw as Executive Director, UK were formal, rigorous and transparent. Further details of each appointment

induction and development can be found on page 51.

B.5 Information and support

The Group General Counsel & Company Secretary makes sure that appropriate and timely information is provided to the Board and its Committees and is responsible for advising and supporting the Chairman and the Board on all governance matters. All Directors have access to the Group General Counsel & Company Secretary and may take independent professional advice at the Company's expense in conducting their duties.

To support discussion and decision making, Board and committee members receive papers sufficiently in advance of meetings so that they can prepare for and consider agenda items. Additionally, the Chairman holds a short meeting with the Non-executive Directors before each Board meeting to discuss the focus of the upcoming meeting as well as afterwards to share feedback from the meeting. Similarly, the Chief Executive holds a short meeting with the Executive Directors and the Group General Counsel & Company Secretary after each meeting and shares the feedback from these meetings with the Chairman.

Last year we engaged external specialists to review our current papers and develop a new

At a private meeting of the Non-executive Directors, Mark Williamson, as Senior Independent Director, led a review of the Chairman's performance. The Non-executive Directors, with input from the Executive Directors, assessed his ability to fulfil his role as Chairman and considered the arrangements he has in place, given he is also chairman of a FTSE 250 company and the Aircraft Carrier Alliance Management Board and a Trustee of The Sutton Trust Board. They concluded that Sir Peter's performance continued to be effective.

B.7 Election/re-election

Each Director is subject to election at the first AGM following their appointment, and re-election at each subsequent AGM. Following recommendations from the Nominations Committee the Board considers all Directors continue to be effective, committed to their roles and have sufficient time available to perform their duties. Therefore, in accordance with the Code, Nicola Shaw will seek election and all other Directors will seek re-election at the 2016 AGM as set out in the Notice of Meeting, with the exception of Steve Holliday who is retiring from the Company with effect from 22 July 2016.

process, succession planning and the role of the Nominations Committee can be found on page 61.

B.3 Time commitment

Non-executive Directors are advised of the time commitment expected from them on appointment. External commitments, which may impact existing time commitments, must be agreed with the Chairman. Details of external appointments are set out in the biographies on pages 47 and 48.

As part of the evaluation of the Chairman, the Non-executive Directors, with input from the Executive Directors, assessed his ability to fulfill his role as Chairman, taking into account other significant appointments.

reporting framework for the Board and its Committees. This has continued to result in clearer more concise reporting, allowing more time for quality discussions and questions. A clear set of guidelines are in place to assist the Executive Directors and management on the content and presentation of papers to the Board and committees. A further refresh of the Board paper process will commence this year.

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Corporate Governance continued

Statement of compliance with the UK

Corporate Governance Code continued

C. Accountability

C.1 Financial and business reporting

The requirement for Directors to state that they consider the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable remains a key consideration in the drafting and review process. The coordination and review of the Annual Report is conducted in parallel with the formal audit process undertaken by the external auditors and the review by the Board and its committees (of relevant sections).

The drafting and assurance process supports the Audit Committee's and

D. Remuneration

D.1 The level and components of remuneration

The Remuneration Committee is responsible for recommending to the Board the remuneration policy for Executive Directors and other members of the Executive Committee and for the Chairman, and for implementing this policy. The aim is to align remuneration policy to Company strategy and key business objectives and make sure it reflects our shareholders', customers' and regulators' interests.

The Remuneration Report on pages 68 to 81 outlines the activities of the Committee during the year and sets

E. Relations with shareholders

E.1 Dialogue with shareholders

The Board as a whole is responsible for making sure that satisfactory dialogue with shareholders takes place. We believe that effective channels of communication with the Company's debt and equity institutional investors and individual shareholders are very important. More information about our approach to relations with shareholders can be found on page 51.

E.2 Constructive use of General Meetings

The AGM provides a key opportunity for the Board to communicate with

Board's assessment of the overall fairness, balance and clarity of the Annual Report and the statement of Directors' responsibilities as set out on page 84. The independent auditor's report is on pages 85 to 92 and the Company's business model is on pages 14 and 15.

out excerpts of the Directors' remuneration policy table as approved by shareholders at the 2014 AGM.

and meet shareholders. Shareholders are able to learn more about the Company through exhibits and can ask questions directly of the Board. Company representatives and our Registrar are also on hand to answer any questions shareholders might have.

C.2 Risk management and internal control

The Board has carried out a robust assessment of the principal risks facing the Company including those that would threaten the business model, future performance, solvency or liquidity. Further details can be found on pages 27 and 28.

For further information on the work of the Remuneration Committee and Directors' remuneration packages see the Directors' Remuneration Report on Our AGM will be held on Monday pages 68 to 81. The Committee's terms of reference are available on our website.

Our AGM will be held on Monday 25 July 2016 at The International Convention Centre in Birmingham and broadcast via our website. The Notice of Meeting for the 2016 AGM, available on our website, sets out in full the resolutions for consideration by shareholders, together with explanatory notes and further information on the Directors standing for election and re-election.

The Board also sets the Company's risk appetite, internal controls and risk management processes. The Board undertakes a review of their effectiveness annually. Further details are set out on pages 26-29.

The activities of the Audit Committee, which assists the Board with its responsibilities in relation to risk and assurance, are set out on pages 54 to 58.

C.3 Audit Committee and auditors

The Audit Committee report on pages 54 to 58 sets out details of how the Committee has discharged its duties during the year, matters reviewed by the Committee and how it ensures the auditor's objectivity, effectiveness and continued independence. The Audit Committee report also explains the

audit tender process that was undertaken during the year.

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Directors Remuneration Report

Jonathan Dawson

Committee chairman

Annual statement from the

Remuneration Committee chairman

Overview

At the Company's AGM in 2015 more than 97% of votes cast were to approve the Remuneration Report for that year. As with last year we are not proposing any changes to the formal remuneration policy for National Grid and so this year there is only a vote on the implementation of this policy.

The key elements of our policy are:

significant weighting towards long-term incentives versus short-term incentives; the bulk of senior executive remuneration to be paid in National Grid shares, with all of the Long Term Performance Plan (LTTP) paid only in shares, and half of the Annual Performance Plan (APP) paid in shares; very high levels of personal shareholding required to be held by senior executives 500% of pre-tax salary for the CEO and 400% for other Executive Directors; three-year performance period for measuring potential awards under the LTTP coupled with a holding period of a further two years irrespective of whether the mandatory personal shareholding target has been attained; and performance metrics for the LTTP are RoE (measuring management's performance in generating profit from the business) and Value Growth (measuring

management's longer term performance in creating shareholder value).

We believe that our policy ensures that the rewards paid to senior executives are closely matched with shareholders' experience. In particular, we regard it as very important that senior executives see their annual remuneration in the context of a long-term build-up of their investment in National Grid and that the growth in value of their shareholding and the dividends paid on those shares represent a material personal financial exposure to the success of the Company. As a result we think that the overall remuneration structure illustrates a high level of alignment with shareholders, and promotes an appropriate focus on long-term value within the Company.

Performance for the year

APP

National Grid has had another successful year overall. Record capital investment of £3.9 billion has been undertaken, split equally between the UK and US, and a programme of critical rate case filings has been successfully initiated in the US. As in prior years, the EPS figure used for APP purposes, 62.3 pence, differs slightly from the reported figure of 63.5 pence as it is adjusted for the impact of timing, scrip dividend uptake and exchange rate effects. It has also been reduced to take account of the absence of an increase in the UK corporate tax rate originally included in the Group budget. The overall impact of these adjustments was a decrease of 1.2 pence. Similarly, the Group RoE figure used for the APP calculation, 12.0%, has been reduced by 0.3 percentage points to take account of the absence of the increase in the UK corporate tax rate referred to above. Notwithstanding this, the EPS of 62.3 pence and Group RoE of 12.0% both met or exceeded the stretch performance levels set by the Committee at the start of the year, benefitting from realised gains achieved from the exchange of National Grid USA's share in the Iroquois pipeline joint venture and strong results from our Other businesses led by the performance of the French interconnector. In the UK, the regulated businesses delivered good returns of 13.3%. Regulated US RoE was 8.0%, which reflected steady performance though was down on last year due to continued cost pressures as the business awaits outcomes of rate case filings. This figure, however, does not capture the gains achieved from the exchange of National Grid USA's share in the Iroquois pipeline joint venture referred to above, and therefore has been adjusted by the Committee to reflect half of this gain for US participants in the APP, which the Committee believes properly reflects performance.

As a result, in respect of the financial measures for the APP (representing 70% of the value of the APP) the Committee made awards to Executive Directors ranging from 75% to 100% of the maximum potential for financial performance. The balance of the award (30% by value) is represented by individual executives' assessed performance against specific objectives set by the Committee at the start of the year, resulting in awards ranging from 80% to 86% of the maximum potential for individual performance. In aggregate, therefore, Executive Directors' APP awards fall in the range of 95% to 119% of salary. This compares with last year's APP awards where the range was 65% to 119% of salary.

Because of commercial sensitivity we retrospectively disclose annual targets for the APP, which are set out on page 76. This year, we have sought to enhance our disclosure, including the retrospective disclosure of threshold and stretch performance levels for EPS and Group RoE, which now sits alongside the disclosure of our LTPP threshold and stretch performance levels. Target performance levels for both EPS and Group RoE were higher than for 2014/15; however, the target performance levels for UK RoE and US RoE were reduced, due to the expected returns under the RIIO framework in the UK and the impact of the timing of rate plan filings in the US. We have decided to maintain the same performance metrics for the 2016/17 APP awards and we will repeat our retrospective disclosure of performance levels in next year's remuneration report.

LTPP

The LTPP that vested in 2015/16 was that awarded in 2012. Vesting outcomes ranged from 63% to 76% of maximum. Before making its final determination of executives' annual and long-term awards, the Committee gives careful consideration to a number of important non-financial measures including our safety performance, reliability and levels of customer satisfaction in both the UK and the US, and considers whether a downward adjustment should be made to any executive's award. This year the Committee concluded that there was no reason to make any adjustment. As our Executive Director, US, Dean Seavers, only joined the Board at the beginning of 2015/16, he has not received any vested LTPP for this year, and will not do so until 2017.

The award made in 2015 is the second award in respect of the LTPP granted under the new remuneration policy in 2014. This is a three-year plan with a maximum award of 350% of salary for the CEO and 300% for the other Executive Directors. Its outcome will only be known

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following the results for the year ending March 2017. I reported last year that, at the end of the first performance year, Group RoE and Value Growth were on target in relation to the parameters set by the Committee, with UK RoE around stretch and US RoE below threshold. For this year the position is broadly comparable in respect of both the 2014 and 2015 LTPP grants. Taking account of performance to date of the 2014 and 2015 LTPP awards, the Committee has decided to make no changes to the performance metrics and targets for the 2016 LTPP award.

Executive Director shareholdings

Two years ago, we introduced high levels of shareholding requirements for our Executive Directors, in order to further align them to our shareholders. At 31 March 2016, both Andrew Bonfield and Steve Holliday have exceeded these shareholding requirements. As John Pettigrew and Dean Seavers were appointed to the Board relatively recently, neither of them has yet met their shareholding requirements and will therefore not be given permission to sell shares until they have done so, other than to pay tax on receipt of the vested shares or in exceptional circumstances.

salary was not increased in 2015. John Pettigrew's salary was increased by 7% to move his salary closer towards market as Executive Director, UK in 2015. In line with regional managerial pay budgets in 2016, salary increases in 2016 are 2% for Andrew Bonfield and 2.5% for Dean Seavers.

Impact of the expected sale of a majority interest in the UK Gas Distribution business

Ahead of the expected sale of a majority interest in the Gas Distribution business in 2016/17, the Committee is considering the impact on inflight LTPP and APP awards, and will make appropriate adjustments to relevant metrics within both the parameters and the spirit of the remuneration policy following any such sale. We will report this to you in next year's remuneration report.

Conclusion

As I reported last year, remuneration continues to be in a transitional phase since the APP maximum has been lowered to 125%

Changes to the Board

Following the announcement of Steve Holliday's retirement as CEO, John Pettigrew was promoted to CEO with effect from 1 April 2016. John's salary has been set at £825,000. His APP opportunity remains at 125% of salary, and his LTPP opportunity has increased to 350% of salary from 2016 onwards. Steve stepped down as CEO on 31 March 2016 but will remain on the Board until 22 July to facilitate a successful transition. In March, we announced that Nicola Shaw will join the Board as our new UK Executive Director on 1 July 2016, succeeding John. Nicola's salary has been set at £450,000. Her APP opportunity is 125% of salary and her LTPP opportunity is 300% of salary. Nicola will be eligible to receive a 2016 LTPP award. In addition, she will receive a cash payment of up to £485,000 to compensate her for incentive cash awards that were due to vest in June 2016 that she has foregone on leaving her former employer. Subject to their individual performance, the Committee intends to increase each of John's and Nicola's salaries towards market level by way of future phased increases from 2017 in excess of those awarded to other Company employees. All of these arrangements are in line with the approved policy on recruitment remuneration and have already been announced.

Annual salary review

Steve Holliday's and Andrew Bonfield's annual salaries were increased by approximately 1% in 2015. In line with the US managerial pay budget, Dean Seavers' annual

of salary from 150% while the LTPP represents previous bases of measurements, timescales and policy limits. This transition will continue for a further year when the final element of the 2013 LTPP vests in 2017 and the 2014 LTPP (the first awarded under the current remuneration policy) matures.

As with last year, we are not seeking any changes to the current remuneration policy, which will expire at the 2017 AGM. The Committee has begun to address whether the current policy should be proposed without any material changes or whether some modification may be required to reflect changes in the market and the evolution of the Company. I will report on the outcome of this review next year when we will seek your authority for a new three-year policy mandate.

Regarding the 2015/16 year, the Committee believes that it has correctly implemented the approved policy and that the remuneration earned last year by senior executives properly reflects the performance of the Company and the value generated for shareholders. Accordingly, I commend this remuneration report to you on behalf of the Committee, and ask for your support for the resolution to approve the report at the AGM.

Jonathan Dawson

Committee chairman

At a glance

Performance

A comparison of the total 2015/16 single total figure of remuneration to the maximum remuneration if variable pay had vested in full is set out below.

| Total remuneration | Maximum remuneration | 2015/16 single figure remuneration |
|---------------------------|-----------------------------|---|
| | £ 000 | £ 000 |
| Executive Director | | |
| Andrew Bonfield | 4,077 | 3,228 |
| Steve Holliday | 6,478 | 5,151 |
| John Pettigrew | 1,815 | 1,569 |
| Dean Seavers | 1,883 | 1,684 |

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Corporate Governance continued

At a glance continued

| Key features of policy | Annual report on remuneration for 2015/16 |
|--|--|
| <p>Targeted broadly at mid-market against FTSE 11-40 for UK Executive Directors and general industry and energy services companies with similar revenue for US Executive Directors</p> | <p>Salary increases of 0.7% for 2015 Salary increases of 2.5% for 2016 Hired Nicola Shaw as new Executive Director, UK on an annual base salary of £450,000 Appointed John Pettigrew as CEO on an annual base salary of £825,000</p> |
| <p>Maximum opportunity is 125% of salary 50% paid in cash, 50% paid in shares, which must be retained until later of two years and meeting shareholding requirement Subject to both clawback and malus</p> | <p>70% based on financial metrics (35% EPS, 35% RoE), 30% based on individual objectives Group RoE for CEO and Finance Director; UK RoE for Executive Director, UK; US RoE for Executive Director, US Individual objectives cover: safety and compliance; Group and financial strategy; business growth; operational excellence; customer experience; employee engagement; capability development; and stakeholder relations</p> |

| | |
|---|---|
| <p>Maximum award level is 350% of salary for CEO and 300% for other Executive Directors Vesting subject to long-term performance conditions. Shares must be retained until later of two years from vesting and meeting shareholding requirement Subject to both clawback and malus</p> | <p>50% value growth, 50% RoE Group RoE for CEO and Finance Director; even split of Group and UK RoE for Executive Director, UK; even split of Group and US RoE for Executive Director, US Three-year performance period</p> |
| <p>External appointees participate in Defined Contribution (DC) plan or cash in lieu of pension; internal appointees retain current benefits, subject to capping of pensionable pay increases for Defined Benefit (DB) plans Pensionable pay is salary only in UK and salary and APP in US in alignment with the market Other benefits as appropriate</p> | <p>UK DB (Steve Holliday, John Pettigrew): maximum of two-thirds final capped pensionable pay or (Steve Holliday) one thirtieth accrual UK cash allowance (Andrew Bonfield): 30% of salary US DC (Dean Seavers): 9% of pensionable pay with additional match of up to 4% Other benefits include private medical insurance, life assurance, and, for UK Executive Directors, either a fully expensed car or a cash alternative to a car and the use of a driver when required</p> |
| <p>500% of salary for CEO 400% of salary for other Executive Directors</p> | <p>Steve Holliday and Andrew Bonfield have both met their shareholding requirements John Pettigrew and Dean Seavers were appointed to the Board relatively recently, and therefore have not yet met their shareholding requirements</p> |

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Corporate Governance

Directors remuneration policy approved by shareholders in 2014

Key aspects of the Directors remuneration policy, along with elements particularly applicable to the 2015/16 financial year are shown on pages 71-74 for ease of reference only. This policy was approved for three years from the date of the 2014 AGM held on 28 July 2014. A shareholder vote on the remuneration policy is not required in 2016. Please note that the information shown has been updated to take account of the fact that the policy is now approved and current rather than proposed. A copy of the full remuneration policy is available on the Company website at www.investors.nationalgrid.com/reports/2013-14.

There may be circumstances from time to time when the Committee will consider it appropriate to apply some judgement and exercise discretion in respect of the approved policy. This ability to apply discretion is highlighted where relevant in the policy, and the use of discretion will always be in the spirit of the approved policy.

Our peer group

The Committee benchmarks its remuneration policy against appropriate peer groups annually to make sure we remain competitive in the relevant markets. The primary focus for reward benchmarking is the FTSE 11-40 for UK-based Executive Directors and general industry and energy services companies with similar levels of revenue for US-based Executive Directors. These peer groups are considered appropriate for a large, complex, international and predominantly regulated business.

Approved policy table Executive Directors

Salary

Purpose and link to strategy: to attract, motivate and retain high-calibre individuals, while not overpaying.

| Operation | Maximum levels | Performance metrics, weighting and time period applicable |
|---|---|---|
| <p>Salaries are targeted broadly at mid-market level.</p> <p>They are generally reviewed annually. Salary reviews take into account:</p> <ul style="list-style-type: none"> business and individual contribution; the individual's skills and experience; scope of the role, including any changes in responsibility; and market data in the relevant comparator group. | <p>No prescribed maximum annual increase.</p> <p>Any increases are generally aligned to salary increases received by other Company employees and to market movement. Increases in excess of this may be made at the Committee's discretion in circumstances such as a significant change in responsibility; progression in the role; and alignment to market level.</p> | <p>Not applicable.</p> |

Benefits

Purpose and link to strategy: to provide competitive and cost-effective benefits to attract and retain high-calibre individuals.

| Operation | Maximum levels | Performance metrics, weighting and time period applicable |
|--|---|---|
| <p>Benefits provided include:</p> <ul style="list-style-type: none"> company car or a cash alternative (UK only); use of a driver when required; private medical insurance; | <p>Benefits have no predetermined maximum, as the cost of providing these varies from year to year.</p> | <p>Not applicable.</p> |

life assurance;
personal accident insurance;
opportunity to purchase additional benefits under flexible benefits schemes available to all employees;
and
opportunity to participate in the following HM Revenue & Customs (UK) or Internal Revenue Service (US) tax-advantaged all-employee share plans:

Participation in tax-approved all-employee share plans is subject to limits set by the relevant tax authorities from time to time.

Sharesave: UK employees may make monthly contributions from net salary for a period of three or five years. The savings can be used to purchase shares at a discounted price, set at the launch of each plan period.

Share Incentive Plan (SIP): UK employees may use gross salary to purchase shares. These shares are placed in trust.

Incentive Thrift Plans (401(k) plans): US employees may participate in these tax-advantaged savings plans. They are DC pension plans in which employees can invest their own and Company contributions.

Employee Stock Purchase Plan (ESPP) (423(b) plan): eligible US employees may purchase ADSs on a monthly basis at a discounted price.

Other benefits may be offered at the discretion of the Committee.

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Corporate Governance continued

Directors remuneration policy approved by shareholders in 2014 continued

Pension Purpose and link to strategy: to reward sustained contribution and assist attraction and retention.

| Operation | Maximum levels | Performance metrics, weighting and time period applicable |
|--|---|---|
| <p>Pension for a new Executive Director will reflect whether they are internally promoted or externally appointed.</p> <p>If internally promoted:</p> <ul style="list-style-type: none"> retention of existing DB benefits without enhancement, except for capping of pensionable pay increases following promotion to Board; or retention of existing UK DC benefits or equivalent cash in lieu; or retention of existing US DC benefits plus 401(k) plan match, provided through 401(k) plan and | <p>UK DB a maximum pension on retirement, at age 60, of two thirds final capped pensionable pay or up to one thirtieth accrual. On death in service, a lump sum of four times pensionable pay and a two thirds dependant pension is provided.</p> <p>UK DC annual contributions of 30% of salary. Life assurance provision of four times pensionable salary and</p> | <p>Not applicable.</p> |

| | |
|---|--|
| <p>non-qualified plans.</p> <p>If externally appointed:</p> | <p>a spouse's pension equal to one third of the Director's salary are provided on death in service.</p> |
| <p>UK DC benefits or equivalent cash in lieu; or US DC benefits plus 401(k) plan match.</p> | <p>US DB an Executive Supplemental Retirement Plan provides for an unreduced pension benefit at age 62. For retirements at age 62 with 35 years of service, the pension benefit would be approximately two thirds of pensionable pay. Upon death in service, the spouse would receive 50% of the pension benefit (100% if the participant died while an active employee after the age of 55).</p> |
| <p>Andrew Bonfield, John Pettigrew and Dean Seavers are treated in line with the above policy.</p> | |
| <p>Steve Holliday is provided with final salary pension benefits. For service prior to 1 April 2013, pensionable pay is normally the base salary in the 12 months prior to leaving the Company. For service from 1 April 2013 increases to pensionable pay are capped at the lower of 3% or the increase in inflation. The pension scheme rules allow for indexed prior salaries to be used for all members. He participates in the unfunded scheme in respect of benefits in excess of the Lifetime Allowance.</p> | |
| <p>In line with market practice, pensionable pay for UK-based Executive Directors includes salary only and for US-based Executive Directors it includes salary and APP award.</p> | <p>US DC 9% of base salary plus APP with additional 401(k) plan match of up to 4%.</p> |

Annual Performance Plan

Purpose and link to strategy: to incentivise and reward the achievement of annual financial and strategic business targets and the delivery of annual individual objectives.

| Operation | Maximum levels | Performance metrics, weighting and time period applicable |
|---|---|--|
| <p>Performance metrics and targets are agreed at the start of each financial year. Performance metrics are aligned with strategic business priorities. Targets are set with</p> | <p>The maximum award is 125% of salary.</p> | <p>A significant majority of the APP is based on performance against corporate financial</p> |

reference to the budget. Awards are paid in June.

For APP awards made in 2013/14, 50% of any award was deferred into shares in the Deferred Share Plan (DSP). The DSP has no performance conditions and vests after three years, subject to continued employment. These shares are subject to forfeiture for leavers in certain circumstances.

The DSP was discontinued for APP awards made in respect of years from 2014/15. Instead, 50% of awards are paid in shares, which (after any sales to pay tax) must be retained until the shareholding requirement is met, and in any event for two years after receipt.

Awards are subject to clawback and malus provisions.

measures, with the remainder based on performance against individual objectives. Individual objectives are role-specific.

The Committee may use its discretion to set measures that it considers appropriate in each financial year and reduce the amount payable, taking account of significant safety or customer service standard incidents, environmental and governance issues.

The payout levels at threshold, target and stretch performance levels are 0%, 50% and 100% respectively.

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Corporate Governance

Long Term Performance Plan Purpose and link to strategy: to drive long-term performance, aligning Executive Director incentives to key strategic objectives and shareholder interests.

| Operation | Maximum levels | Performance metrics, weighting and time period applicable |
|--|--|--|
| <p>Awards of shares may be granted each year, with vesting subject to long-term performance conditions.</p> | <p>The maximum award for the CEO is 350% of salary and it is 300% of salary for the other Executive Directors.</p> | <p>For awards between 2011 and 2013 the performance measures and weightings were:</p> |
| <p>The performance metrics have been chosen as the Committee believes they reflect the creation of long-term value within the business. Targets are set each year with reference to the business plan.</p> | <p>For awards made between 2011 and 2013, the maximum award for the CEO was 225% of salary and 200% for the other Executive Directors.</p> | <p>adjusted EPS (50%) measured over three years; TSR relative to the FTSE 100 (25%) measured over three years; and UK or US RoE relative to allowed regulatory returns (25%) measured over four years.</p> |
| <p>Awards are subject to clawback and malus provisions. Notwithstanding the level of award achieved against the performance conditions, the Committee may use its discretion to reduce the amount vesting, and in particular</p> | | |

will take account of compliance with the dividend policy.

From 2014, the performance measures are:

For awards granted from 2014, participants must retain vested shares (after any sales to pay tax) until the shareholding requirement is met, and in any event for a further two years after vesting.

value growth and Group RoE (for the CEO and Finance Director); and value growth, Group RoE and UK or US RoE (for the UK and US Executive Directors respectively).

All are measured over a three-year period.

The weightings of these measures may vary year to year, but would always remain such that the value growth metric would never fall below a 25% weighting and never rise above a 75% weighting.

Between 2011 and 2013, 25% of the award vested at threshold and 100% at stretch, with straight-line vesting in between. From 2014, only 20% of the award vests at threshold.

Approved policy table Non-executive Directors (NEDs)

Fees for NEDs

Purpose and link to strategy: to attract NEDs who have a broad range of experience and skills to oversee the implementation of our strategy.

| Operation | Maximum levels | Performance metrics, weighting and time period applicable |
|-----------|----------------|---|
| | | Not applicable. |

NED fees (excluding those of the Chairman) are set by the Executive Committee in conjunction with the Chairman; the Chairman's fees are set by the Committee.

There are no maximum fee levels.

Fee structure:

The benefits provided to the Chairman are not subject to a predetermined maximum cost,

Chairman fee;

as the cost of providing these

basic fee, which differs for UK- and US-based NEDs; varies from year to year.

committee membership fee;

committee chair fee; and

Senior Independent Director fee.

Fees are reviewed every year and are benchmarked against those in companies of similar scale and complexity.

NEDs do not participate in incentive or pension plans and, with the exception of the Chairman, are not eligible to receive benefits. The Chairman is covered by the Company's private medical and personal accident insurance plans and receives a fully expensed car or cash alternative to a car, with the use of a driver, when required.

There is no provision for termination payments.

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Corporate Governance continued

Directors remuneration policy approved by shareholders in 2014 continued

Shareholding requirement

The requirement of Executive Directors to build up and hold a relatively high value of National Grid shares ensures they share a significant level of risk with shareholders and their interests are aligned.

From 2014/15, Executive Directors are required to build up and retain shares in the Company. The level of holding required is 500% of salary for the CEO and 400% of salary for the other Executive Directors.

Unless the shareholding requirement is met, Executive Directors will not be permitted to sell shares, other than to pay tax or in exceptional circumstances.

Policy on recruitment remuneration

Salaries for new Executive Directors appointed to the Board will be set in accordance with the terms of the approved remuneration policy in force at the time of appointment, and in particular will take account of the appointee's skills and experience as well as the scope and market rate for the role.

Where appropriate, salaries may be set below market level initially, with the Committee retaining discretion to award increases in salary in excess of those of the wider workforce and inflation to bring salary to a market level over time, where this is justified by individual and Company performance.

Benefits consistent with those offered to other Executive Directors under the approved remuneration policy in force at the time of appointment will be offered, taking account of local market practice. The Committee may also agree that the Company will meet certain costs associated with the recruitment, for example legal fees, and the Committee may agree to meet certain relocation expenses or provide tax equalisation as appropriate.

Pensions for new Executive Directors appointed to the Board will be set in accordance with the terms of the approved remuneration policy in force at the time of appointment.

Ongoing incentive pay (APP and LTPP) for new Executive Directors will be in accordance with the approved remuneration policy in force at the time of appointment. This means the maximum APP award in any year would be 125% of salary and the maximum LTPP award would be 300% of salary (350% of salary for a new CEO).

For an externally appointed Executive Director, the Company may offer additional cash or share-based payments that it considers necessary to buy out current entitlements from the former employer that will be lost on recruitment to National Grid. Any such arrangements would reflect the delivery mechanisms, time horizons and levels of conditionality of the remuneration lost.

In order to facilitate buy-out arrangements as described above, existing incentive arrangements will be used to the extent possible, although awards may also be granted outside of these shareholder-approved schemes if necessary and as permitted under the Listing Rules.

For an internally appointed Executive Director, any outstanding variable pay element awarded in respect of the prior role will continue on its original terms.

Fees for a new Chairman or Non-executive Director will be set in line with the approved policy in force at the time of appointment.

Policy on payment for loss of office

In line with our policy, all Executive Directors have service contracts which are terminable by either party with 12 months' notice.

The contracts contain provisions for payment in lieu of notice, at the sole and absolute discretion of the Company. Such payments are limited to payment of salary only for the remainder of the notice period. In the UK such payments would be phased on a monthly basis, over a period no greater than 12 months, and the Executive Director would be expected to mitigate any losses where employment is taken up during the notice period. In the US, for tax purposes the policy is to make any payment in lieu of notice as soon as reasonably practicable, and in any event within two and a half months of the later of 31 December and 31 March immediately following the notice date.

In the event of a UK Director being made redundant, statutory compensation would apply and the relevant pension plan rules may result in the early payment of an unreduced pension.

On termination of employment, no APP award would generally be payable and any DSP awards would generally lapse. However, the Committee has the discretion to deem an individual to be a 'good leaver', in which case an APP award would be payable on the termination date, based on performance during the financial year up to termination, and DSP awards would vest on the termination date. Examples of circumstances in which a Director would be treated as a 'good leaver' include redundancy, retirement, illness, injury, disability and death. Any APP award would be prorated and would be subject to performance achieved against the objectives for that year.

On termination of employment, outstanding awards under the share plans will be treated in accordance with the relevant plan rules approved by shareholders. Share awards would normally lapse. 'Good leaver' provisions apply at the Committee's discretion and in specified circumstances, including redundancy, retirement, illness, injury, disability and death, where awards will be released to the departing Executive Director or, in the case of death, to their estate. Long-term share plan awards held by 'good leavers' may vest subject to performance measured at the normal vesting date and are prorated. Such awards would vest at the same time as for other participants.

The Chairman's appointment is subject to six months' notice by either party; for the other Non-executive Directors, notice is one month. No compensation is payable to Non-executive Directors if required to stand down.

| | | |
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Corporate Governance

Annual report on remuneration

Statement of implementation of remuneration policy in 2015/16

Role of Remuneration Committee

The Committee is responsible for recommending to the Board the remuneration policy for Executive Directors and the other members of the Executive Committee and for the Chairman, and for implementing this policy. The aim is to align remuneration policy to Company strategy and key business objectives and ensure it reflects our shareholders , customers and regulators interests. The members of the Remuneration Committee in 2015/16 were Nora Mead Brownell, Jonathan Dawson (chair), Paul Golby and Mark Williamson.

The Committee activities during the year

| Meeting | Main areas of discussion |
|----------------|--|
| April | 2014/15 individual objectives scoring for Executive Committee Discussion of 2015/16 objectives for Executive Committee Review of Executive Committee shareholdings Review of Committee terms of reference |
| May | Annual salary review and LTPP proposals for Executive Committee 2014/15 APP financial outturns and individual performance and confirmation of awards |

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Final approval of 2015/16 objectives for Executive Committee
 Final approval of APP targets for 2015/16 financial year
 Review of gender and ethnicity pay statistics

October Approval of remuneration package for incoming CEO and of payments on retirement for outgoing CEO

November Update on corporate governance and disclosure issues and review of AGM outcomes
 Directors Remuneration Report planning for 2016
 Review of competitive benchmarking for secondary comparator groups
 Review of gender and ethnicity pay statistics disclosure for external website
 Update on 2015/16 APP and outstanding LTPPs

March Approval of remuneration package for incoming Executive Director, UK
 Benchmarking data review for Executive Committee remuneration
 2016 Directors Remuneration Report review of first draft
 Discussion of metrics and targets for APP and LTPP for 2016/17
 Review of objectives for Executive Committee for APP 2016/17

Single total figure of remuneration Executive Directors (audited information)

The following table shows a single total figure in respect of qualifying service for 2015/16, together with comparative figures for 2014/15:

| | Salary | Benefits in kind | | APP | LTPP | Pension | Other | Total | | | | |
|---------|---------|------------------|---------|---------|---------|---------|---------|---------|---------|---------|-------|-------|
| | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 | | | | |
| | 2015/16 | 2014/15 | 2015/16 | 2014/15 | 2015/16 | 2014/15 | 2015/16 | 2014/15 | 2015/16 | 2014/15 | | |
| Andrew | 736 | 727 | 61 | 58 | 865 | 854 | 1,345 | 1,271 | 221 | 218 | 3,228 | 3,119 |
| onfield | 1,033 | 1,021 | 41 | 40 | 1,222 | 1,210 | 2,125 | 2,004 | 730 | 523 | 5,151 | 4,797 |

| | | | | | | | | | | | | | |
|----------------|-------|-------|-----|-----|-------|-------|-------|-------|-------|-------|-----|--------|-------|
| Steve Holliday | | | | | | | | | | | | | |
| John Pettigrew | 503 | 475 | 14 | 18 | 503 | 527 | 406 | 396 | 143 | 451 | | 1,569 | 1,800 |
| Dean Seavers | 678 | | 39 | | 649 | | | | 148 | 170 | | 1,684 | |
| Total | 2,950 | 2,223 | 155 | 116 | 3,239 | 2,591 | 3,876 | 3,671 | 1,242 | 1,192 | 170 | 11,632 | 9,700 |

Notes:

Salary: Base salaries were last increased on 1 June 2015. At this time Andrew Bonfield and Steve Holliday received salary increases of approximately 1%, in line with the salary increases given to other managerial employees of the Company in the UK. John Pettigrew was given an increase of 7% to move closer towards market as Executive Director, UK in 2015/16. Dean Seavers joined the Board on 1 April 2015 and was not given a salary increase at 1 June 2015, in line with other managerial employees of the Company in the US. Dean Seavers' base salary has been converted at \$1.4744:£1 for 2015/16.

Benefits in kind: Benefits in kind include private medical insurance, life assurance, and for UK Executive Directors, either a fully expensed car or a cash alternative to a car and the use of a driver when required. For Andrew Bonfield, it also includes the benefits of Sharesave options granted during the year. For Dean Seavers, this amount includes relocation payments.

Other: For Dean Seavers, Other includes the second \$250,000 cash payment for forfeited bonuses from his former employer.

LTTP: A portion of the 2012 LTTP award vested in July 2015, and the remainder is due to vest in July 2016. The above value for 2015/16 is based on the share price (818 pence) on the vesting date (1 July 2015) for that portion that vested on 1 July 2015, and the average share price over the three months from 1 January 2016 to 31 March 2016 (958 pence) for that portion due to vest on 1 July 2016. The 2014/15 LTTP amount has been restated to reflect the actual amounts vested on 1 July 2015 for RoE, rather than the estimate shown in last year's Annual Report. Due to a lower share price at vesting of 818 pence (\$64.17 per ADS) versus the estimate of 899 pence (\$70.33 per ADS), the actual value at vesting was £29,358, £46,335, and £12,441 lower than the estimate for Andrew Bonfield, Steve Holliday and John Pettigrew respectively.

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Corporate Governance continued

[Annual report on remuneration continued](#)**[Performance against targets for APP 2015/16 \(audited information\)](#)**

APP awards are earned by reference to the financial year and paid in June. Fifty percent of awards are paid in shares which (after any sales to pay tax) must be retained until the shareholding requirement is met, and in any event for two years after receipt. In relation to both the financial measures and individual objectives, threshold, target and stretch performance levels are pre-determined and pay out at 0%, 50% and 100% respectively and on a straight-line basis in between threshold and target performance and target and stretch performance. Individual objectives of the Executive Directors reflect the primary focus areas within the Company's overall strategic priorities:

building on our strong safety performance;
the drive for business growth in the UK and US;
delivery of operational excellence and improvement in overall Company performance and service to customers;
promotion of innovative ideas to work more efficiently and effectively;
strengthening the talent pipeline and keeping all our employees fully engaged; and
working with external stakeholders to shape energy policy and embed sustainability into our decision-making to preserve natural resources and focus on environmental issues.

The outcomes of APP awards earned in 2015/16, along with detail of individual objectives, are shown in the figures below:

| | Proportion of max opportunity | Threshold | Target | Stretch | Actual | Proportion of max achieved |
|------------------------|-------------------------------------|-----------|--------|---------|--------|----------------------------------|
| Adjusted EPS (p/share) | 35% | 56.2 | 59.2 | 62.2 | 62.3 | 100% |

| | | | | | | |
|-----------------------|-----|------|-------|--------------------|------|--------|
| Group RoE (%) | | 11.2 | 11.6 | 12.0 | 12.0 | 100% |
| UK RoE (%) | 35% | | 13.25 | | 13.3 | 55% |
| US RoE (%) | | | 8.25 | | 8.25 | 50% |
| Individual objectives | 30% | | | See adjacent table | | 80 86% |

Notes:

Overall: Group RoE pertains to the CEO and Finance Director, whilst UK RoE and US RoE pertain to the Executive Director, UK and Executive Director, US, respectively. RoE in some form comprises 35% of the total maximum APP opportunity.

Adjusted EPS: Adjusted EPS actual is reduced by 1.2 pence to account for the impact of timing, absence of a budgeted rise in the UK corporate tax rate, and the impact of scrip dividend uptake and currency adjustments.

Group RoE: Group RoE actual is reduced by 30 basis points to account for the absence of a budgeted rise in the UK corporate tax rate.

US RoE: US RoE actual is adjusted to capture half of the realised gains achieved from the exchange of National Grid USA's share in the Iroquois pipeline joint venture.

| | Andrew Bonfield | Steve Holliday | John Pettigrew | Dean Seavers |
|---------------------------------------|--------------------|-------------------|-------------------|-----------------|
| Safety | | | | |
| Group strategy | | | | |
| Financial strategy | | | | |
| Business growth | | | | |
| Operational excellence | | | | |
| Customer experience | | | | |
| Employee engagement | | | | |
| Capability development | | | | |
| Stakeholder relations | | | | |
| Proportion of maximum achieved | 80% | 82% | 86% | 80% |

2015/16 APP as proportion of base salary

2015/16 LTPP performance (audited information)

The LTPP value included in the 2015/16 single total figure relates to vesting of the conditional LTPP award granted in 2012. The 2012 award is determined based on differing performance periods and vesting dates:

performance over the three years ending 31 March 2015 for the EPS measure (50% weighting), which vested on 1 July 2015;
performance over the three years ending 30 June 2015 for the TSR measure (25% weighting), which vested on 1 July 2015; and
performance over the four years ending 31 March 2016 for the UK RoE measure and 31 December 2015 for the US RoE measure (25% weighting overall, split by Executive Director as shown overleaf), which will vest on 1 July 2016.

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The performance achieved against the targets, including the expected vesting percentage for the RoE measures, was:

| Performance measure | Threshold vesting | 25% | Maximum vesting | 100% | Actual/expected vesting | Actual/expected |
|---|--|-----|--|------|---|--------------------------------|
| | | | | | | proportion of maximum achieved |
| TSR ranking (25% weighting) | Ranked at median of the comparator group (FTSE 100) | | 7.5 percentage points or more above median | | 2.99 percentage points above median | 55.0% |
| Adjusted EPS (50% weighting) | EPS growth exceeds RPI increase by 3 percentage points | | EPS growth exceeds RPI increase by 8 percentage points or more | | Exceeded RPI increase by 6.3 percentage points | 74.4% |
| UK RoE (12.5% weighting for the CEO and Finance Director; 25% weighting for the Executive Director, UK) | RoE is equal to the average allowed regulatory return | | RoE is 2 percentage points or more above the average allowed regulatory return | | Exceeded average allowed regulatory return by 3.2 percentage points | 100.0% |

0%

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US RoE (12.5% weighting for the CEO and Finance Director; 25% weighting for the former Executive Director, US) RoE is 1 percentage point below the average allowed regulatory return RoE is 1 percentage point or more above the average allowed regulatory return 1.1 percentage points below the average allowed regulatory return

The amounts vesting under the 2012 LTTP during the year and included in the 2015/16 single total figure are shown in the table below.

The valuation is based on the following share prices:

818 pence (\$64.17 per ADS) on the vesting date of 1 July 2015 for the EPS and TSR elements of the award; and average share price over the three months from 1 January 2016 to 31 March 2016 of 958 pence (\$69.23 per ADS) for the RoE element of the award.

| | Original number of share awards in 2012 LTTP | Overall vesting percentage (including expected vesting for RoE measure) | Number of awards vesting (including expected vesting for RoE measure) | Total value of awards expected vesting for RoE Dividend measure) and dividend equivalent shares | Dividend equivalent shares | (£ 000) |
|-----------------|--|---|---|---|----------------------------|---------|
| Andrew Bonfield | 213,095 | 63.45% | 135,203 | 23,787 | | 1,345 |
| Steve Holliday | 336,702 | 63.45% | 213,628 | 37,586 | | 2,125 |
| John Pettigrew | 52,395 | 75.95% | 39,793 | 7,136 | | 406 |

Dean Seavers

Last year's Directors Remuneration Report covering remuneration for 2014/15 included an estimated vesting of the US and UK RoE portions of the 2011 LTTP award. These awards vested on 1 July 2015 and the performance achieved against the performance targets was the same as the expected vesting disclosed in the 2014/15 report. As a result of the actual achievement against the performance targets being the same as estimated, the vesting percentage and number of awards vesting are the same as disclosed in the 2014/15 report. However, the actual number of dividend equivalent shares varied as did the total value of awards vesting due to share price changes between the estimate and the actual date of vesting of the RoE portion. Specifically, the actual price on 1 July 2015 was 818 pence (\$64.17 per ADS) rather than the estimate of 899 pence (\$70.33 per ADS) disclosed in the 2014/15 report based on the average price from 1 January 2015 to 31 March 2015. As a result, the actual numbers of dividend equivalent shares granted for the 2011 LTTP were 22,454, 35,440 and 7,261 and the actual values of the awards at vesting were £29,358, £46,335 and £12,441 lower than originally estimated for Andrew Bonfield, Steve Holliday and John Pettigrew respectively.

Total pension benefits (audited information)

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The table below provides details of the Executive Directors' pension benefits. Steve Holliday and John Pettigrew participate in a Defined Benefit pension plan, whilst Andrew Bonfield receives cash in lieu of participation in a pension plan, and Dean Seavers participates in a Defined Contribution arrangement. The UK-based Executive Directors in a Defined Benefit pension participate in a salary sacrifice arrangement (FPS), under which the individual's salary is reduced by an amount equal to the employee pension contribution that would have been paid into the scheme. An equivalent contribution is paid into the scheme by the employer. There are no additional benefits in the event of early retirement.

| | Total contribution to DC arrangement £ 000 | Cash in lieu of pension contribution £ 000 | Accrued DB pension over year to 31 March 2016 £ 000 pa | Increase in accrued DB pension over year to 31 March 2016 £ 000 pa | Reduction in salary due to FPS £ 000 | Increase in pension benefit calculated using BIS methodology £ 000 | Value of pension benefit £ 000 | Normal retirement date |
|-----------------|---|---|---|---|---|---|-----------------------------------|------------------------|
| Andrew Bonfield | | 221 | | | | | 221 | 17/08/2027 |
| Steve Holliday | | | 591 | 39 | 62 | 2 | 730 | 26/10/2016 |
| John Pettigrew | | | 151 | 7 | 29 | 23 | 143 | 26/10/2031 |
| Dean Seavers | 148 | | | | | | 148 | 30/08/2025 |

Notes:

Steve Holliday: In addition to the accrued DB pension at 31 March 2016 above, there is an accrued lump sum entitlement of £129,000 as at 31 March 2016. The increase to the accumulated lump sum, net of inflation, was £2,000 in the year to 31 March 2016. The increase in accrued DB pension over the year shown above is net of inflation, as UK pensions in payment or deferment increase in line with inflation.

John Pettigrew: In addition to the accrued DB pension at 31 March 2016 above, there is an accrued lump sum entitlement of £452,000 as at 31 March 2016. The increase to the accumulated lump sum, net of inflation, was £23,000 in the year to 31 March 2016. The increase in accrued DB pension over the year shown above is net of inflation, as UK pensions in payment or deferment increase in line with inflation.

Dean Seavers: The average exchange rate for 2015/16 was \$1.4744:£1. Through his participation in the 401(k) plan in the US (a DC arrangement) the Company made contributions worth £27,400. The Company also made contributions worth £121,049 to the Non-Qualified Executive Supplemental Retirement Plan which pays the portion of core contributions that cannot be paid under the qualified plan due to IRS limitations. The plan also provides a supplemental top-up benefit through additional company contributions to yield an overall company contribution of 9% of pensionable pay, including both the qualified and non-qualified plan benefits. The retirement date shown is the typical retirement age in the US. The 401(k) plan does not have a retirement age. Benefits can be taken without penalty on leaving the Company from age 55 (subject to vesting requirements) or can be rolled over into another qualifying plan.

BIS calculation: In accordance with BIS methodology, the pension benefit for Andrew Bonfield and Dean Seavers is calculated as the aggregate of contributions made to a DC arrangement and cash in lieu of pension contributions. Also in accordance with BIS methodology, the pension benefit for Steve Holliday and John Pettigrew is calculated as the increase in accrued DB pension over the year shown above multiplied by 20 plus the increase in the lump sum shown above, less the reduction in salary due to FPS. Each element is calculated separately and rounded to produce the numbers in the table above.

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Annual report on remuneration continued

Single total figure of remuneration Non-executive Directors (audited information)

The following table shows a single total figure in respect of qualifying service for 2015/16, together with comparative figures for 2014/15:

| | Fees | | Other emoluments | | Total | |
|--------------------|---------|---------|------------------|---------|---------|---------|
| | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 |
| | 2015/16 | 2014/15 | 2015/16 | 2014/15 | 2015/16 | 2014/15 |
| Nora Mead Brownell | 94 | 91 | | | 94 | 91 |
| Jonathan Dawson | 99 | 96 | | | 99 | 96 |
| Therese Esperdy | 128 | 91 | | | 128 | 91 |
| Sir Peter Gershon | 494 | 488 | 15 | 16 | 509 | 504 |
| Paul Golby | 103 | 81 | | | 103 | 81 |
| Ruth Kelly | 82 | 79 | | | 82 | 79 |
| Mark Williamson | 121 | 118 | | | 121 | 118 |
| Total | 1,121 | 1,044 | 15 | 16 | 1,136 | 1,060 |

Therese Esperdy: Fees for 2015/16 include £22,917 in fees for serving on the National Grid USA Board.

Sir Peter Gershon: Other emoluments comprise private medical insurance, cash in lieu of a car and the use of a driver when required.

In accordance with the Company's expenses policies, Non-executive Directors receive reimbursement for their reasonable expenses for attending Board meetings. In instances where those costs are treated by HMRC as taxable benefits, the Company also meets the associated tax cost to the Non-executive Directors through a PAYE settlement agreement with HMRC.

The total emoluments paid to Executive and Non-executive Directors in the year was £13 million (2014/15: £15 million).

LTTP (conditional award) granted during the financial year (audited information)

The face value of the awards is calculated using the volume-average weighted share price at the date of grant (25 June 2015) (£8.5147 per share and \$66.9618 per ADS).

| LTTP | Basis of award | Face value in £'000 | Proportion vesting at threshold performance | Number of shares | Performance period end date |
|-----------------|----------------|---------------------|---|------------------|-----------------------------|
| Andrew Bonfield | 300% of salary | £2,211 | 20% | 259,668 | June 2018 |
| Steve Holliday | 350% of salary | £3,622 | 20% | 425,440 | June 2018 |
| John Pettigrew | 300% of salary | £1,525 | 20% | 179,072 | June 2018 |
| Dean Seavers | 300% of salary | \$3,000 | 20% | 44,801 (ADSs) | June 2018 |

Performance conditions for LTTP awards granted during the financial year (audited information)

| Performance measure | Weighting | | | | Conditional share awards granted 2015 | | |
|---------------------|-----------------|----------------|----------------|--------------|--|-------------|---|
| | Andrew Bonfield | Steve Holliday | John Pettigrew | Dean Seavers | Threshold | 20% vesting | Maximum 100% vesting |
| Group RoE | 50% | 50% | 25% | 25% | | 11.0% | 12.5% or more |
| UK RoE | | | 25% | | 1 percentage point above the average allowed regulatory return | | 3.5 percentage points or more above the average allowed regulatory return |
| US RoE | | | | 25% | 90% of the average allowed regulatory return | | 105% or more of the average allowed regulatory return |
| Value growth | 50% | 50% | 50% | 50% | | 10.0% | 12.0% or more |

Payments for loss of office (audited information)

There were no payments made for loss of office during 2015/16.

Payments to past Directors (audited information)

Nick Winser stepped down from the Board at the 2014 AGM and left the Company on 31 July 2015. Tom King stepped down from the Board and left the Company on 31 March 2015. Mr Winser and Mr King held awards over shares and ADSs, respectively, which were pro-rated according to their departure date. The vesting of all these awards will occur at the normal vesting dates subject to satisfaction of their specified performance conditions at that time. Portions of these awards vested on 1 July 2015 and pertain to the RoE portion of the 2011 LTPP and the TSR and EPS portions of the 2012 LTPP.

| | Pro-rated number of share awards in 2011 (RoE portion) and 2012 LTPP | 2012 LTPP Vesting percentage | Number of awards vesting | Dividend equivalent shares | Total value of awards vesting and dividend equivalent shares (£ 000) |
|-------------|---|-------------------------------------|---------------------------------|-----------------------------------|---|
| Tom King | 44,846 (ADSs) | 56.12% | 25,168 (ADSs) | 4,063 (ADSs) | 1,202 |
| Nick Winser | 166,305 | 76.37% | 127,000 | 24,035 | 1,235 |

Shareholder dilution

Where shares may be issued or treasury shares reissued to satisfy incentives, the aggregate dilution resulting from executive share-based incentives will not exceed 5% in any 10-year period. Dilution resulting from all incentives, including all-employee incentives, will not exceed 10% in any 10-year period. The Committee reviews dilution against these limits regularly and under these limits the Company, as at 31 March 2016, had headroom of 4.01% and 7.98% respectively.

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Corporate Governance

Statement of Directors shareholdings and share interests (audited information)

The Executive Directors are required to build up and hold a shareholding from vested share plan awards. Deferred share plan awards are not taken into account for these purposes until the end of the deferral period. Shares are valued for these purposes at the 31 March 2016 price, which was 987 pence per share (\$71.42 per ADS).

The following table shows how each Executive Director complies with the shareholding requirement and also the number of shares owned by the Non-executive Directors, including connected persons, as Non-executive Directors do not have a shareholding requirement.

The shareholding is as at 31 March 2016 and the salary used to calculate the value of shareholding is the gross annual salary as at 31 March 2016:

The normal vesting dates for the conditional share awards subject to performance conditions are 1 July 2016; 1 July 2016 and 1 July 2017; 1 July 2017; and 1 July 2018 for the LTPP 2012, LTPP 2013, LTPP 2014 and LTPP 2015 respectively.

The normal vesting dates for the conditional share awards subject to continuous employment are 13 June 2016 and 17 June 2017 for the DSP 2013 and DSP 2014 respectively.

In each of April and May 2016 a further 15 shares were purchased on behalf of Andrew Bonfield, Steve Holliday and John Pettigrew via the Share Incentive Plan (an HMRC approved all-employee share plan), thereby increasing their beneficial interests. There have been no other changes in Directors shareholdings between 1 April 2016 and 18 May 2016.

Both Andrew Bonfield and Steve Holliday have met their shareholding requirement of 400% and 500% of base salary, respectively. As both John Pettigrew and Dean Seavers were relatively new in post, they have not yet met their requirements and will not be allowed to sell shares other than to pay tax on receipt of vested shares or in exceptional circumstances until this requirement is met.

| Directors | Share ownership requirements (multiple of salary) | Number of shares owned outright (including connected persons) | Number of shares held as a multiple of current salary | Number of options granted under conditions (Sharesave Plan) | Conditional share awards subject to performance (LTPP 2012, 2013, 2014 and 2015) | Conditional share awards subject to continuous performance (DSP 2013 and 2014) |
|-----------|---|---|---|---|--|--|
|-----------|---|---|---|---|--|--|

Executive Directors

| | | | | | | |
|---------------------|------|-----------|--------|-------|-----------|---------|
| Andrew Bonfield | 400% | 317,711 | 426% | 6,651 | 756,209 | 92,754 |
| Steve Holliday | 500% | 1,306,289 | 1,246% | 3,542 | 1,224,546 | 126,771 |
| John Pettigrew | 400% | 198,749 | 386% | 4,286 | 417,251 | 28,691 |
| Dean Seavers (ADSs) | 400% | 1,225 | 9% | | 85,767 | |

Non-executive Directors

| | | | | | | |
|---------------------------|--|--------|-----|--|--|--|
| Nora Mead Brownell (ADSs) | | 5,000 | n/a | | | |
| Jonathan Dawson | | 36,586 | n/a | | | |
| Therese Esperdy (ADSs) | | 1,600 | n/a | | | |
| Sir Peter Gershon | | 83,363 | n/a | | | |
| Paul Golby | | 2,500 | n/a | | | |
| Ruth Kelly | | 800 | n/a | | | |
| Mark Williamson | | 4,726 | n/a | | | |

Notes:

Overall: Sharesave options are valued using fair values. Andrew Bonfield was the only Director who made a gain on the exercise of share options during the year.

Andrew Bonfield: On 31 March 2016 Andrew Bonfield held 6,651 options granted under the Sharesave plan. 2,022 options were granted at a value of 749 pence per share and they can be exercised at 749 pence per share between April 2020 and September 2020. 1,208 options were granted at a value of 745 pence per share and they can be exercised at 745 pence per share between April 2019 and September 2019. On 1 April 2016, he exercised a Sharesave option over 3,421 shares at the option price of 455 pence per share for expiration in September 2016 at a gain of £18,549. For Andrew Bonfield, the number of conditional share awards subject to performance conditions is as follows: LTPP 2012: 53,273; LTPP 2013: 194,798; LTPP 2014: 248,470; LTPP 2015: 259,668. The number of conditional share awards subject to continuous employment is as follows: DSP 2013: 45,706; DSP 2014: 47,048.

Steve Holliday: On 31 March 2016 Steve Holliday held 3,524 options granted under the Sharesave plan. 1,502 options were granted at a value of 599 pence per share, and they can be exercised at 599 pence per share between April 2017 and September 2017. 2,022 options were granted at a value of 749 pence per share and they can be exercised at 749 pence per share between April 2020 and September 2020. For Steve Holliday, the number of conditional share awards subject to performance conditions is as follows: LTPP 2012: 84,175; LTPP 2013: 307,793; LTPP 2014: 407,138; LTPP 2015: 425,440. The number of conditional share awards subject to continuous employment is as follows: DSP 2013: 57,118; DSP 2014: 69,653.

John Pettigrew: On 31 March 2016 John Pettigrew held 4,286 options granted under the Sharesave plan. 1,252 options were granted at a value of 599 pence per share, and they can be exercised at 599 pence per share between April 2019 and September 2019. 3,034 options were granted at a value of 749 pence per share and they can be exercised at 749 pence per share between April 2020 and September 2020. The number of conditional share awards subject to performance conditions is as follows: LTPP 2012: 13,098; LTPP 2013: 63,361; LTPP 2014: 161,720; LTPP 2015: 179,072. The number of conditional share awards subject to continuous employment is as follows: DSP 2013: 14,341; DSP 2014: 14,350.

Dean Seavers: The number of conditional share awards subject to performance conditions is as follows: LTPP 2014: 40,966; LTPP 2015: 44,801.

Dean Seavers, Nora Mead Brownell and Therese Esperdy: Holdings and, for Dean Seavers, awards are shown as ADSs and each ADS represents five ordinary shares.

External appointments and retention of fees

The table below details the Executive Directors who served as non-executive directors in other companies during the year ended 31 March 2016 and were allowed to retain fees for their services:

| | Company | Retained fees (£) |
|-----------------|----------------|-------------------|
| Andrew Bonfield | Kingfisher plc | 82,400 |

Relative importance of spend on pay

This chart shows the relative importance of spend on pay compared with other costs and disbursements (dividends, tax, net interest and capital expenditure). Given the capital-intensive nature of our business and the scale of our operations, these costs were chosen as the most relevant for comparison purposes. All amounts exclude exceptional items and remeasurements.

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Performance graph and table

This chart shows National Grid plc's seven-year annual total shareholder return (TSR) performance against the FTSE 100 Index since 31 March 2009. The FTSE 100 Index has been chosen because it is the widely recognised performance benchmark for large companies in the UK. The Company's TSR has outperformed that of the FTSE 100 for the last five years and underpins the pay shown for the CEO in the table below, using current and previously published single total remuneration figures.

The TSR level shown at 31 March each year is the average of the closing daily TSR levels for the 30-day period up to and including that date. It assumes dividends are reinvested.

CEO's pay in the last seven financial years

Steve Holliday was the CEO throughout this seven-year period.

Total shareholder return

| 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 |
|---------|---------|---------|---------|---------|---------|---------|
|---------|---------|---------|---------|---------|---------|---------|

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| | | | | | | | |
|--|---------|--------|--------|--------|--------|--------|--------|
| Total single figure £ 000 | 3,931 | 3,738 | 3,539 | 3,170 | 4,801 | 4,845 | 5,151 |
| APP (proportion of maximum awarded) | 95.33% | 81.33% | 68.67% | 55.65% | 77.94% | 94.80% | 94.60% |
| PSP/LTPP (proportion of maximum vesting including expected vesting | 100.00% | 65.15% | 49.50% | 25.15% | 76.20% | 55.81% | 63.45% |

for RoE measure)

Percentage change in CEO s remuneration

The table below shows how the percentage change in the CEO s salary, benefits and APP between 2014/15 and 2015/16 compares with the percentage change in the average of each of those components of remuneration for non-union employees in the UK. The Committee views this group as the most appropriate comparator group, as the CEO is UK-based and this group excludes employees represented by trade unions, whose pay and benefits are negotiated with each individual union.

| | Salary | | | Taxable benefits | | | APP | | |
|---|---------|---------|----------|------------------|---------|----------|---------|---------|----------|
| | £ 000 | £ 000 | Increase | £ 000 | £ 000 | Increase | £ 000 | £ 000 | Increase |
| | 2015/16 | 2014/15 | | 2015/16 | 2014/15 | | 2015/16 | 2014/15 | |
| Steve Holliday | 1,033 | 1,021 | 1.2% | 41 | 40 | 2.5% | 1,222 | 1,210 | 1.0% |
| UK non-union employees (increase per employee) | | | 1.9% | | | 7.9% | | | (9.1)% |

Note:

The APP for UK non-union employees decreased, which is a reflection of the reduction in payout level for the UK RoE measure which forms a key part of the APP for this population.

Statement of implementation of remuneration policy in 2016/17

The remuneration policy adopted at the 2014 AGM will continue to be implemented during 2016/17 as described below. Steve Holliday is retiring in July 2016 and will be stepping down from the Board at that time. He will be treated as a 'good leaver' in line with our remuneration policy. He is intending to draw from his pension from October 2016.

Salary

Salary increases will normally be in line with the increase awarded to other employees in the UK and US, unless there is a change in role or responsibility. In line with the policy on recruitment remuneration, salaries for new directors may be set below market level initially and aligned to market level over time (provided the increase is merited by the individual s contribution and performance). John Pettigrew s base salary was increased to £825,000 upon his appointment as CEO. This was some £210,000 below that of Steve Holliday, the retiring CEO.

| | From 1 June 2016 | From 1 June 2015 | Increase |
|-------------------------------------|-------------------------|-------------------------|-----------------|
| Andrew Bonfield | £751,740 | £737,000 | 2.0% |
| Steve Holliday | £1,035,000 | £1,035,000 | 0% |
| Nicola Shaw from 1 July 2016 | £450,000 | | n/a |
| John Pettigrew from 1 April 2016 | £825,000 | £508,250 | 62.3% |
| Dean Seavers | \$1,025,000 | \$1,000,000 | 2.5% |

APP measures for 2016/17

The APP targets are considered commercially sensitive and consequently will be disclosed after the end of the financial year in the 2016/17 annual report on remuneration. Steve Holliday will be eligible to receive a prorated portion of the 2016/17 APP.

| | Weighting |
|-----------------------|------------------|
| Adjusted EPS | 35% |
| Group or UK or US RoE | 35% |
| Individual objectives | 30% |

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Steve Holliday will not receive a 2016 LTPP award. John Pettigrew's 2016 award will increase to 350% of salary.

| | Andrew Bonfield | John Pettigrew | Dean Seaver | Nicola Shaw | Threshold | 20% vesting | Maximum | 100% vesting |
|------------------|------------------------|-----------------------|--------------------|--------------------|--|--------------------|---|---------------------|
| Group RoE | 50% | 50% | 25% | 25% | | 11.0% | | 12.5% or more |
| UK RoE | | | | 25% | 1 percentage point above the average allowed regulatory return | | 3.5 percentage points or more above the average allowed regulatory return | |
| US RoE | | | 25% | | 90% of the average allowed regulatory return | | 105% or more of the average allowed regulatory return | |
| Value growth | 50% | 50% | 50% | 50% | | 10.0% | | 12.0% or more |
| NEDs fees | | | | | | | | |

Committee chair fees are in addition to committee membership fees. Therese Esperdy was appointed as a Non-executive Director to the National Grid USA Board on 1 May 2015 with an annual fee of £25,000 in addition to her current NED fees.

| | £ 000 | | |
|-------------------------------|------------------|------------------|----------|
| | From 1 June 2016 | From 1 June 2015 | Increase |
| Chairman | 500 | 495 | 1% |
| Senior Independent Director | 22 | 22 | 0% |
| Board fee (UK-based) | 66 | 64 | 3% |
| Board fee (US-based) | 78 | 76 | 3% |
| Committee membership fee | 9 | 9 | 0% |
| Chair Audit Committee | 19 | 17 | 12% |
| Chair Remuneration Committee | 19 | 17 | 12% |
| Chair (other Board committee) | 12.5 | 12.5 | 0% |

Advisors to the Remuneration Committee

The Committee received advice during 2015/16 from independent remuneration consultants New Bridge Street (NBS), a trading name of Aon Hewitt Ltd (part of Aon plc). NBS were selected as advisors by the Committee from 1 August 2013 following a competitive tendering process.

Work undertaken by NBS included updating the Committee on trends in compensation and governance matters and advising the Committee in connection with benchmarking of the total reward packages for the Executive Directors and other senior employees. NBS are a member of the Remuneration Consultants Group and have signed up to that group's Code of Conduct. The Committee is satisfied that any potential conflicts were appropriately managed. NBS does not provide any other advice or services to the Company. In the year to 31 March 2016 the Committee paid a total of £77,820 to NBS, with fees being charged on a time incurred basis.

The Committee also received specialist advice from the following organisations:

Alithos Limited: provision of TSR calculations for the LTPP (£10,417 paid in 2015/16);

Linklaters LLP: advice relating to share schemes and to Directors' service contracts (£44,621 paid in 2015/16); and

Willis Towers Watson: advice relating to the benchmarking of the total reward packages for the Executive Committee and the Chairman (£58,509 paid in 2015/16).

The Committee reviews the objectivity and independence of the advice it receives from its advisors each year. It is satisfied that they all provided credible and professional advice.

The Committee considers the views of the Chairman on the performance and remuneration of the CEO; and of the CEO on the performance and remuneration of the other members of the Executive Committee. The Committee is also supported by the Group General Counsel & Company Secretary who acts as Secretary to the Committee, the Group HR Director, the Group Head of Reward & Performance and the Group Head of Pensions. No other advisors have provided significant services to the Committee in the year.

Voting on 2013/14 Directors' Remuneration Policy at 2014 AGM

The voting figures shown refer to votes cast at the 2014 AGM and represent 61.76% of the issued share capital. In addition, shareholders holding 74 million shares abstained.

| | For | Against |
|---------------------|---------------|------------|
| Number of votes | 2,223,573,203 | 85,131,552 |
| Proportion of votes | 96.31% | 3.69% |

Voting on 2014/15 Annual Remuneration Report at 2015 AGM

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The voting figures shown refer to votes cast at the 2015 AGM and represent 62.61% of the issued share capital. In addition, shareholders holding 30 million shares abstained.

| | For | Against |
|---------------------|---------------|----------------|
| Number of votes | 2,240,539,614 | 63,053,994 |
| Proportion of votes | 97.26% | 2.74% |

The Directors Remuneration Report has been approved by the Board and signed on its behalf by:

Jonathan Dawson

Chairman of the Remuneration Committee

18 May 2016

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Financial Statements

Introduction to the Financial Statements

Throughout these financial statements we have provided explanations of the disclosures and why they are important to the understanding of our financial performance and position. In places we have also highlighted Our strategy in action , drawing out the key elements of our business model (set out in the Strategic Report on pages 14 to 15), and showing how the disclosures reflect this strategy.

Audit opinions

We have two audit opinions on our financial statements, reflecting our listing on both the London Stock Exchange and the New York Stock Exchange. Due to the different reporting requirements for each listing, our auditors are required to confirm compliance with each set of standards in a prescribed format. The audit opinion as required under our UK listing (starting on page 85) continues to provide more detail as to how our auditors have planned and conducted their audit, as well as their views on significant matters they have noted and that were discussed by the Audit Committee.

Notes

Notes to the financial statements provide additional information required by statute, accounting standards or other regulations to assist in a more detailed understanding of the primary financial statements. In many notes we have included an accounting policy that describes how the transactions or balance in that note have been measured, recognised and disclosed. The basis of preparation section (note 1) provides details of accounting policies that apply to transactions and balances in general. There are also additional specific disclosure requirements due to our US listing which are included in the notes.

Unaudited commentary

We have presented with the financial statements certain analysis as part of the Strategic Report of our Annual Report. This approach provides a clearer narrative, a logical flow of information and reduces duplication. We have created a combined financial review, including a commentary on items within the primary statements, on pages 94 to 101. Unless otherwise indicated, all analysis provided in the financial statements is on a statutory IFRS basis. All information in ruled boxes styled in the same manner as this one does not form part of the audited financial statements. This has been further highlighted by including the word **unaudited** at the start of each box header. Unaudited commentary boxes appear on pages 95 to 97, 99, 101, 107 to 108, 117, 119 and 131.

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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, the Directors' Report, including the Remuneration Report and the Strategic Report, 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 and the Remuneration Report in accordance with United Kingdom Accounting Standards, comprising Financial Reporting Standard 101 Reduced Disclosure Framework (FRS 101), and applicable law United Kingdom Generally Accepted Accounting Practice (UK GAAP). In preparing the consolidated financial statements, the Directors have also elected to comply with IFRS, issued by the International Accounting Standards Board (IASB). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company on a consolidated and individual basis and of the profit or loss of the Company on a consolidated basis for that period.

In preparing these 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 issued by the IASB and IFRS 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, on a consolidated and individual basis, will continue in business, in which case there should be supporting assumptions or qualifications as necessary.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and 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 2006 and Article 4 of the IAS Regulation, and the Company financial statements and the Remuneration Report comply with the Companies Act 2006. 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.

The Directors are responsible for the maintenance and integrity of the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Having made the requisite enquiries, so far as the Directors in office at the date of the approval 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.

Each of the Directors, whose names and functions are listed on pages 47 and 48, confirms that:

to the best of their knowledge, the consolidated financial statements and the Company financial statements, which have been prepared in accordance with IFRS as issued by the IASB and IFRS as adopted by the European Union and UK GAAP FRS 101 respectively, give a true and fair view of the assets, liabilities, financial position and profit of the Company on a consolidated and individual basis; to the best of their knowledge, the Strategic Report contained in the Annual Report and Accounts 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; and they consider that the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's position and performance, business model and strategy.

Directors' Report

The Directors' Report, prepared in accordance with the requirements of the Companies Act 2006 and the UK Listing Authority's Listing Rules, and Disclosure Rules and Transparency Rules, comprising pages 08 to 81 and 174 to 202, was approved by the Board and signed on its behalf.

Strategic Report

The Strategic Report, comprising pages 02 to 45, was approved by the Board and signed on its behalf.

By order of the Board

Alison Kay

Group General Counsel & Company Secretary

18 May 2016

Company number: 4031152

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Financial Statements

Report of Independent Registered Public Accounting Firm

to the Board of Directors and Shareholders of National Grid plc

Audit opinion for Form 20-F

In our opinion, the accompanying consolidated statement of financial position and the related consolidated income statement, consolidated statement of comprehensive income, consolidated cash flow statement and consolidated statement of changes in equity, present fairly, in all material respects, the financial position of National Grid plc and its subsidiaries at 31 March 2016 and 31 March 2015, and the results of their operations and their cash flows for each of the three years in the period ended 31 March 2016 in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board and in conformity with International Financial Reporting Standards as adopted by the European Union.

Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of 31 March 2016, based on criteria established in Internal Control – Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Additional Information section appearing on page 183 of the 2016 Annual Report and Accounts.

Our responsibility is to express opinions on these financial statements and on the Company’s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those

policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

[PricewaterhouseCoopers LLP](#)

London

United Kingdom

18 May 2016

National Grid Annual Report and
Accounts 2015/16

Financial Statements

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Table of Contents**Consolidated income statement**

for the years ended 31 March

| | Notes | 2016 £m | 2016 £m | 2015 £m | 2015 £m | 2014 £m | 2014 £m |
|---|-------|----------------|-----------------|------------|------------|------------|------------|
| Revenue | 2(a) | | 15,115 | | 15,201 | | 14,809 |
| Operating costs | 3 | | (11,030) | | (11,421) | | (11,074) |
| Operating profit | | | | | | | |
| Before exceptional items and remeasurements | 2(b) | 4,096 | | 3,863 | | 3,664 | |
| Exceptional items and remeasurements | 4 | (11) | | (83) | | 71 | |
| Total operating profit | 2(b) | | 4,085 | | 3,780 | | 3,735 |
| Finance income | 5 | | 22 | | 36 | | 36 |
| Finance costs | | | | | | | |
| Before exceptional items and remeasurements | 5 | (1,035) | | (1,069) | | (1,144) | |
| Exceptional items and remeasurements | 4,5 | (99) | | (165) | | 93 | |
| Total finance costs | 5 | | (1,134) | | (1,234) | | (1,051) |
| Share of post-tax results of joint ventures and associates | 14 | | 59 | | 46 | | 28 |
| Profit before tax | | | | | | | |
| Before exceptional items and remeasurements | 2(b) | 3,142 | | 2,876 | | 2,584 | |
| Exceptional items and remeasurements | 4 | (110) | | (248) | | 164 | |
| Total profit before tax | 2(b) | | 3,032 | | 2,628 | | 2,748 |
| Tax | | | | | | | |
| Before exceptional items and remeasurements | 6 | (753) | | (695) | | (581) | |
| Exceptional items and remeasurements | 4,6 | 315 | | 78 | | 297 | |
| Total tax | 6 | | (438) | | (617) | | (284) |
| Profit after tax | | | | | | | |
| Before exceptional items and remeasurements | | 2,389 | | 2,181 | | 2,003 | |
| Exceptional items and remeasurements | 4 | 205 | | (170) | | 461 | |
| Profit for the year | | | 2,594 | | 2,011 | | 2,464 |
| Attributable to: | | | | | | | |
| Equity shareholders of the parent | | | 2,591 | | 2,019 | | 2,476 |
| Non-controlling interests | | | 3 | | (8) | | (12) |

| | | | | |
|---------------------------------|------|--------------|-------|-------|
| Earnings per share ¹ | | 2,594 | 2,011 | 2,464 |
| Basic | 7(a) | 69.0p | 53.2p | 65.2p |
| Diluted | 7(b) | 68.7p | 52.9p | 64.9p |

1. Comparative amounts have been restated to reflect the impact of additional shares issued as scrip dividends.

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Table of Contents**Financial Statements****Unaudited commentary on the consolidated income statement**

The consolidated income statement shows all revenue earned and costs incurred in the year, with the difference being the overall profit for the year.

Revenue

Revenue for the year ended 31 March 2016 decreased by £86m to £15,115m. This decrease was driven by lower revenues in our US Regulated business, partly offset by revenue growth across all of our other businesses, in particular UK Electricity Transmission. US Regulated revenues were £493m lower year on year due to lower commodity costs passed on to customers and unfavourable timing of recoveries. This was partly offset by higher increased revenue allowances under the Niagara Mohawk three year rate plan and the benefits of capex trackers and the stronger US dollar. UK Electricity Transmission revenue increased by £223m, mostly reflecting the recovery of higher pass-through costs such as payments to other UK network owners and system balancing costs.

Operating costs

Operating costs for the year ended 31 March 2016 of £11,030m were £391m lower than the prior year. This decrease in costs included a £72m impact in exceptional items and remeasurements, which is discussed below. Excluding exceptional items and remeasurements, operating costs were £319m lower, principally due to lower pass-through costs such as gas and electric commodity costs in the US and additional costs incurred last year in the US to improve data quality and bring regulatory filings up to date, partially offset by higher depreciation as a result of newly commissioned assets and the impact of the stronger US dollar on sterling results.

Net finance costs

For the year ended 31 March 2016, net finance costs before exceptional items and remeasurements were £20m lower than 2014/15 at £1,013m, mainly as a result of lower UK RPI inflation, continued focus on management of cash

balances and the benefit of last year's debt repurchases, partially offset by increased borrowings and the impact of the stronger US dollar.

Tax

The tax charge on profits before exceptional items and remeasurements was £58m higher than 2014/15. This was mainly a result of increased taxable profits in the year. The effective tax rate for the year was 24.0% (2014/15: 24.2%).

Exceptional items and remeasurements

Operating costs for the year ended 31 March 2016 included an £11m gain on remeasurement of commodity contracts, together with £22m exceptional costs associated with the Gas Distribution sales process. In the previous year, operating costs included a net £83m loss on remeasurements.

Finance costs for the year ended 31 March 2016 included a loss of £99m on financial remeasurements, relating to net losses on derivative financial instruments. For the previous year ended 31 March 2015, we incurred exceptional debt redemption costs of £131m and a loss of £34m on financial remeasurements. Exceptional tax for 2015/16 was a credit of £315m which represents tax credits on the exceptional items and remeasurements above, together with a deferred tax credit on the recalculation of deferred tax liabilities as a result of the reduction in the UK tax rate from 20% to 18%.

Adjusted earnings and EPS

Adjusted earnings and EPS, which exclude exceptional items and remeasurements, are provided to reflect the business performance subtotals used by the Company. The following chart shows the five year trend in adjusted profit attributable to equity shareholders of the parent (adjusted earnings) and adjusted earnings per share. See page 196 for a reconciliation of adjusted basic EPS to EPS.

Adjusted earnings and adjusted EPS¹

1. Adjusted earnings and adjusted EPS are attributable to equity shareholders of the parent.

The above earnings performance translated into adjusted EPS growth in 2015/16 of 5.9p (10%).

In accordance with IAS 33, all earnings per share and adjusted earnings per share amounts for comparative periods have been restated for shares issued via scrip dividends.

Exchange rates

Our financial results are reported in sterling. Transactions for our US operations are denominated in dollars, so the related amounts that are reported in sterling depend on the dollar to sterling exchange rate. The table below shows the average and closing exchange rates of sterling to US dollars.

| | 2015/16 | 2014/15 | % change |
|-------------------------------------|---------|---------|----------|
| Weighted average (income statement) | 1.47 | 1.58 | (7)% |
| Year end (balance sheet) | 1.44 | 1.49 | (3)% |

The movement in foreign exchange during 2015/16 has resulted in a £560m increase in revenue, a £73m increase in adjusted operating profit and a £67m increase in operating profit.

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Table of Contents**Consolidated statement of comprehensive income**

for the years ended 31 March

| | Notes | 2016 £m | 2015 £m | 2014 £m |
|--|-------|--------------|------------|------------|
| Profit for the year | | 2,594 | 2,011 | 2,464 |
| Other comprehensive income/(loss) | | | | |
| Items that will never be reclassified to profit or loss: | | | | |
| Remeasurements of net retirement benefit obligations | 22 | 539 | (771) | 485 |
| Tax on items that will never be reclassified to profit or loss | 6 | (125) | 299 | (172) |
| Total items that will never be reclassified to profit or loss | | 414 | (472) | 313 |
| Items that may be reclassified subsequently to profit or loss: | | | | |
| Exchange adjustments | | 69 | 175 | (158) |
| Net gains/(losses) in respect of cash flow hedges | | 50 | (154) | 63 |
| Transferred to profit or loss in respect of cash flow hedges | | 29 | 13 | 27 |
| Net gains on available-for-sale investments | | 43 | 41 | 6 |
| Transferred to profit or loss on sale of available-for-sale investments | | | (8) | (14) |
| Tax on items that may be reclassified subsequently to profit or loss | 6 | (32) | 11 | (2) |
| Total items that may be reclassified subsequently to profit or loss | | 159 | 78 | (78) |
| Other comprehensive income/(loss) for the year, net of tax | | 573 | (394) | 235 |
| Total comprehensive income for the year | | 3,167 | 1,617 | 2,699 |
| Attributable to: | | | | |
| Equity shareholders of the parent | | 3,164 | 1,624 | 2,711 |
| Non-controlling interests | | 3 | (7) | (12) |
| | | 3,167 | 1,617 | 2,699 |

[Unaudited commentary on consolidated statement of comprehensive income](#)

The consolidated statement of comprehensive income records certain items as prescribed by the accounting rules. For us, the majority of the income or expense included here relates to movements in actuarial assumptions on pension schemes and the associated tax impact. These items are not part of profit for the year, yet are important to allow the reader to gain a more comprehensive picture of our performance as a whole.

Remeasurements of net retirement benefit obligations

We had a net gain after tax of £414m (2014/15: net loss of £472m) on our pension and other post-retirement benefit schemes which is due to changes in key assumptions made in the valuation calculation of pension liabilities and differences between the expected and actual pension asset returns.

Exchange adjustments

Adjustments are made when we translate the results and net assets of our companies operating outside the UK, as well as debt and derivative transactions designated as a net investment hedge of our foreign currency operations. The net movement for the year resulted in a gain of £69m (2014/15: £175m gain).

Net gains/(losses) in respect of cash flow hedges

The value of derivatives held to hedge cash flows is impacted by changes in expected interest rates and exchange rates. The net gain for the year was £50m (2014/15: £154m loss).

Table of Contents**Financial Statements****Consolidated statement of changes in equity**

for the years ended 31 March

| | Share capital £m | Share premium account £m | Retained earnings £m | Other equity reserves ¹ £m | Total shareholders equity £m | Non- controlling interests £m | Total equity £m |
|---|---------------------|--------------------------------|-------------------------|---|---------------------------------------|--|-----------------------|
| At 1 April 2013 | 433 | 1,344 | 13,133 | (4,681) | 10,229 | 5 | 10,234 |
| Profit for the year | | | 2,476 | | 2,476 | (12) | 2,464 |
| Total other comprehensive income/(loss) for the year | | | 313 | (78) | 235 | | 235 |
| Total comprehensive income/(loss) for the year | | | 2,789 | (78) | 2,711 | (12) | 2,699 |
| Equity dividends | | | (1,059) | | (1,059) | | (1,059) |
| Scrip dividend related share issue ² | 6 | (8) | | | (2) | | (2) |
| Issue of treasury shares | | | 14 | | 14 | | 14 |
| Purchase of own shares | | | (5) | | (5) | | (5) |
| Other movements in non-controlling interests | | | (4) | | (4) | 15 | 11 |
| Share-based payment | | | 20 | | 20 | | 20 |
| Tax on share-based payment | | | 7 | | 7 | | 7 |
| At 31 March 2014 | 439 | 1,336 | 14,895 | (4,759) | 11,911 | 8 | 11,919 |
| Profit for the year | | | 2,019 | | 2,019 | (8) | 2,011 |
| Total other comprehensive (loss)/income for the year | | | (472) | 77 | (395) | 1 | (394) |
| Total comprehensive income/(loss) for the year | | | 1,547 | 77 | 1,624 | (7) | 1,617 |
| Equity dividends | | | (1,271) | | (1,271) | | (1,271) |
| Scrip dividend related share issue ² | 4 | (5) | | | (1) | | (1) |
| Purchase of treasury shares | | | (338) | | (338) | | (338) |
| Issue of treasury shares | | | 23 | | 23 | | 23 |
| Purchase of own shares | | | (7) | | (7) | | (7) |
| Other movements in non-controlling interests | | | (3) | | (3) | 11 | 8 |
| Share-based payment | | | 20 | | 20 | | 20 |
| Tax on share-based payment | | | 4 | | 4 | | 4 |
| At 31 March 2015 | 443 | 1,331 | 14,870 | (4,682) | 11,962 | 12 | 11,974 |

| | | | | | | | |
|---|------------|--------------|---------------|----------------|---------------|-----------|---------------|
| Profit for the year | | | 2,591 | | 2,591 | 3 | 2,594 |
| Total other comprehensive income for the year | | | 414 | 159 | 573 | | 573 |
| Total comprehensive income for the year | | | 3,005 | 159 | 3,164 | 3 | 3,167 |
| Equity dividends | | | (1,337) | | (1,337) | | (1,337) |
| Scrip dividend related share issue ² | 4 | (5) | | | (1) | | (1) |
| Purchase of treasury shares | | | (267) | | (267) | | (267) |
| Issue of treasury shares | | | 16 | | 16 | | 16 |
| Purchase of own shares | | | (6) | | (6) | | (6) |
| Other movements in non-controlling interests | | | | | | (5) | (5) |
| Share-based payment | | | 22 | | 22 | | 22 |
| Tax on share-based payment | | | 2 | | 2 | | 2 |
| At 31 March 2016 | 447 | 1,326 | 16,305 | (4,523) | 13,555 | 10 | 13,565 |

1. For further details of other equity reserves, see note 25.

2. Included within share premium account are costs associated with scrip dividends.

Unaudited commentary on consolidated statement of changes in equity

The consolidated statement of changes in equity shows additions and reductions to equity. For us, the main items are profit earned and dividends paid in the year.

Dividends

The Directors are proposing a final dividend of 28.34p, bringing the total dividend for the year to 43.34p, a 1.1% increase on 2014/15.

The Directors intend to continue the policy of increasing the annual dividend by at least the rate of RPI inflation for the foreseeable future.

Table of Contents**Consolidated statement of financial position**

as at 31 March

| | Notes | 2016 £m | 2015 £m |
|--|-------|----------------|------------|
| Non-current assets | | | |
| Goodwill | 9 | 5,315 | 5,145 |
| Other intangible assets | 10 | 887 | 802 |
| Property, plant and equipment | 11 | 43,364 | 40,723 |
| Other non-current assets | 12 | 82 | 80 |
| Pension assets | 22 | 410 | 121 |
| Financial and other investments | 13 | 482 | 330 |
| Investments in joint ventures and associates | 14 | 397 | 318 |
| Derivative financial assets | 15 | 1,685 | 1,539 |
| Total non-current assets | | 52,622 | 49,058 |
| Current assets | | | |
| Inventories and current intangible assets | 16 | 437 | 340 |
| Trade and other receivables | 17 | 2,472 | 2,836 |
| Financial and other investments | 13 | 2,998 | 2,559 |
| Derivative financial assets | 15 | 278 | 177 |
| Cash and cash equivalents | 18 | 127 | 119 |
| Total current assets | | 6,312 | 6,031 |
| Total assets | | 58,934 | 55,089 |
| Current liabilities | | | |
| Borrowings | 19 | (3,611) | (3,028) |
| Derivative financial liabilities | 15 | (337) | (635) |
| Trade and other payables | 20 | (3,285) | (3,292) |
| Current tax liabilities | | (252) | (184) |
| Provisions | 23 | (236) | (235) |
| Total current liabilities | | (7,721) | (7,374) |
| Non-current liabilities | | | |
| Borrowings | 19 | (24,733) | (22,882) |

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| | | | |
|--|----|-----------------|----------|
| Derivative financial liabilities | 15 | (1,732) | (1,764) |
| Other non-current liabilities | 21 | (2,071) | (1,919) |
| Deferred tax liabilities | 6 | (4,634) | (4,297) |
| Pensions and other post-retirement benefit obligations | 22 | (2,995) | (3,379) |
| Provisions | 23 | (1,483) | (1,500) |
| Total non-current liabilities | | (37,648) | (35,741) |
| Total liabilities | | (45,369) | (43,115) |
| Net assets | | 13,565 | 11,974 |
| Equity | | | |
| Share capital | 24 | 447 | 443 |
| Share premium account | | 1,326 | 1,331 |
| Retained earnings | | 16,305 | 14,870 |
| Other equity reserves | 25 | (4,523) | (4,682) |
| Shareholders equity | | 13,555 | 11,962 |
| Non-controlling interests | | 10 | 12 |
| Total equity | | 13,565 | 11,974 |

The consolidated financial statements set out on pages 94 to 167 were approved by the Board of Directors on 18 May 2016 and were signed on its behalf by:

Sir Peter Gershon Chairman

Andrew Bonfield Finance Director

National Grid plc

Registered number: 4031152

Table of Contents**Financial Statements****Unaudited commentary on consolidated statement of financial position**

The consolidated statement of financial position shows all of the Group's assets and liabilities at the year end. As a capital-intensive business, we have significant amounts of physical assets and corresponding borrowings.

Goodwill and other intangible assets

Goodwill and intangibles increased by £255m to £6,202m as at 31 March 2016. This increase primarily relates to foreign exchange movements of £184m and software additions of £220m, partially offset by software amortisation of £147m.

Property, plant and equipment

Property, plant and equipment increased by £2,641m to £43,364m as at 31 March 2016. This was principally due to capital expenditure of £3,673m on the renewal and extension of our regulated networks and foreign exchange movements of £543m, offset by depreciation of £1,468m in the year. See page 24 for further details of our capital expenditure.

Investments and other non-current assets

Investments in joint ventures and associates, financial and other investments and other non-current assets have increased by £233m to £961m. This is primarily due to an increase in investments in joint ventures of £79m, together with an increase in available-for-sale investments of £152m.

Inventories and current intangible assets, and trade and other receivables

Inventories and current intangible assets, and trade and other receivables have decreased by £267m to £2,909m as at 31 March 2016. This is due to an increase in inventories and current intangible assets of £97m, more than offset by a net decrease in trade and other receivables of £364m. The £364m decrease consists of a foreign exchange impact of £57m due to the stronger US dollar against sterling offset by a decrease in the underlying balances of £421m, reflecting collection of high 2015 winter billings, coupled with the impact of the recent mild winter.

Trade and other payables

Trade and other payables have decreased by £7m to £3,285m, primarily due to a foreign exchange impact of £48m more than offset by movements in the US related to warmer weather and energy billing settlements.

Current tax balances

Net current tax balances have increased by £51m to £175m as at 31 March 2016, which includes a £77m current tax asset in trade and other receivables (£60m current tax asset in 2014/15). This is primarily due to the tax payments made in 2015/16 being only partially offset by a smaller current year tax charge.

Deferred tax balances

Deferred tax balances have increased by £337m to £4,634m as at 31 March 2016. This was primarily due to the impact of the £125m deferred tax charge on actuarial gains in reserves (£299m tax credit in 2014/15) and foreign exchange movements being offset by the impact of the reduction in the UK statutory tax rate.

Provisions and other non-current liabilities

Provisions (both current and non-current) and other non-current liabilities increased by £136m to £3,790m as at 31 March 2016.

Total provisions decreased by £16m in the year. The underlying movements include additions of £63m, primarily relating to an increase to the provision for the estimated environmental restoration and remediation costs for a number of sites and other provision increases of £33m, together with foreign exchange movements of £42m, offset by utilisation of £200m in relation to all classes of provisions.

Net debt

Net debt is the aggregate of cash and cash equivalents, current financial and other investments, borrowings, and derivative financial assets and liabilities. See further analysis with the consolidated cash flow statement on page 100.

Net pension and other post-retirement obligations

A summary of the total UK and US assets and liabilities and the overall net IAS 19 (revised) accounting deficit is shown below:

| | UK | US | Total |
|---------------------------|-------|---------|---------|
| | £m | £m | £m |
| Net plan liability | | | |
| As at 1 April 2015 | (672) | (2,586) | (3,258) |
| Exchange movements | | (81) | (81) |
| Current service cost | (74) | (147) | (221) |
| Net interest cost | (18) | (94) | (112) |
| Curtailments and other | (24) | (15) | (39) |
| Actuarial (losses)/gains | | | |
| on plan assets | (18) | (320) | (338) |
| on plan liabilities | 552 | 325 | 877 |

| | | | |
|----------------------------|-------------|----------------|----------------|
| Employer contributions | 239 | 348 | 587 |
| As at 31 March 2016 | (15) | (2,570) | (2,585) |
| Represented by: | | | |
| Plan assets | 19,401 | 7,033 | 26,434 |
| Plan liabilities | (19,416) | (9,603) | (29,019) |
| | (15) | (2,570) | (2,585) |

The principal movements in net obligations during the year include net actuarial gains of £539m and employer contributions of £587m. Net actuarial gains include actuarial gains on plan liabilities of £877m arising as a consequence of decreases in the nominal discount rate in the US and experience gains reflecting liability experience throughout the year including the impact of pension increases being lower than assumed and some updates to the way a section of plan liabilities is estimated. This is partially offset by actuarial losses of £338m arising on plan assets resulting from actual asset returns being less than assumed returns which is based upon the discount rate at the start of the year.

Further information on our pension and other post-retirement obligations can be found in notes 22 and 29 to the consolidated financial statements.

Off balance sheet items

There were no significant off balance sheet items other than the contractual obligations shown in note 30(b) to the consolidated financial statements, and the commitments and contingencies discussed in note 27.

Through the ordinary course of our operations, we are party to various litigation, claims and investigations. We do not expect the ultimate resolution of any of these proceedings to have a material adverse effect on our results of operations, cash flows or financial position.

Table of Contents**Consolidated cash flow statement**

for the years ended 31 March

| | Notes | 2016 £m | 2015 £m | 2014 £m |
|---|-------|----------------|----------------|----------------|
| Cash flows from operating activities | | | | |
| Total operating profit | 2(b) | 4,085 | 3,780 | 3,735 |
| Adjustments for: | | | | |
| Exceptional items and remeasurements | 4 | 11 | 83 | (71) |
| Depreciation, amortisation and impairment | | 1,614 | 1,494 | 1,417 |
| Share-based payment charge | | 22 | 20 | 20 |
| Gain on exchange of associate for available-for-sale investment | | (49) | | |
| Changes in working capital | | 456 | 301 | (59) |
| Changes in provisions | | (90) | (41) | (150) |
| Changes in pensions and other post-retirement benefit obligations | | (327) | (270) | (323) |
| Cash flows relating to exceptional items | | (62) | (17) | (150) |
| Cash generated from operations | | 5,660 | 5,350 | 4,419 |
| Tax paid | | (292) | (343) | (400) |
| Net cash inflow from operating activities | | 5,368 | 5,007 | 4,019 |
| Cash flows from investing activities | | | | |
| Acquisition of investments | | (116) | | (4) |
| Purchases of intangible assets | | (220) | (207) | (179) |
| Purchases of property, plant and equipment | | (3,408) | (3,076) | (2,944) |
| Disposals of property, plant and equipment | | 4 | 9 | 4 |
| Dividends received from joint ventures | | 72 | 79 | 38 |
| Interest received | | 23 | 37 | 35 |
| Net movements in short-term financial investments | | (391) | 1,157 | 1,720 |
| Net cash flow used in investing activities | | (4,036) | (2,001) | (1,330) |
| Cash flows from financing activities | | | | |
| Purchase of treasury shares | | (267) | (338) | |
| Proceeds from issue of treasury shares | | 16 | 23 | 14 |
| Purchase of own shares | | (6) | (7) | (5) |
| Proceeds received from loans | | 2,726 | 1,534 | 1,134 |
| Repayment of loans | | (896) | (2,839) | (2,192) |
| Net movements in short-term borrowings and derivatives | | (730) | 623 | 37 |
| Interest paid | | (834) | (826) | (901) |
| Exceptional finance costs on the redemption of debt | | | (152) | |
| Dividends paid to shareholders | | (1,337) | (1,271) | (1,059) |
| Net cash flow used in financing activities | | (1,328) | (3,253) | (2,972) |

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| | | | | |
|---|-------|------------|-------|-------|
| Net increase/(decrease) in cash and cash equivalents | 26(a) | 4 | (247) | (283) |
| Exchange movements | | 4 | 24 | (26) |
| Net cash and cash equivalents at start of year | | 116 | 339 | 648 |
| Net cash and cash equivalents at end of year¹ | 18 | 124 | 116 | 339 |

1. Net of bank overdrafts of £3m (2015: £3m; 2014: £15m).

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[Unaudited commentary on the consolidated cash flow statement](#)

The consolidated cash flow statement shows how the cash balance has moved during the year. Cash inflows and outflows are presented to allow users to understand how they relate to the day-to-day operations of the business (Operating activities); the money that has been spent or earned on assets in the year, including acquisitions of physical assets or other businesses (Investing activities); and the cash raised from debt, share issues or share buybacks and other loan borrowings or repayments (Financing activities).

Reconciliation of cash flow to net debt

| | 2016 | 2015 |
|--|-----------------|----------|
| | £m | £m |
| Cash generated from operations | 5,660 | 5,350 |
| Net capital expenditure | (3,740) | (3,274) |
| Business net cash flow | 1,920 | 2,076 |
| Net interest paid (including exceptional interest) | (811) | (941) |
| Tax paid | (292) | (343) |
| Dividends paid | (1,337) | (1,271) |
| Other cash movements | (185) | (243) |
| Non-cash movements | (705) | (2,003) |
| Increase in net debt | (1,410) | (2,725) |
| Opening net debt | (23,915) | (21,190) |
| Closing net debt | (25,325) | (23,915) |
| Cash generated from operations | | |

Cash generated from operations (£m)

Cash flows from our operations are largely stable when viewed over the longer term. Our electricity and gas transmission and distribution operations in the UK are subject to multi-year rate agreements with regulators. In the UK, we have largely stable cash flows. However, in the US our short-term cash flows are dependent on the price of gas and electricity and the timing of customer payments. The regulatory mechanisms for recovering costs from customers can result in significant cash flow swings from year to year. Changes in volumes in the US, for example as a consequence of abnormally mild or extreme weather can affect revenues and hence, cash flows, particularly in the winter months.

For the year ended 31 March 2016, cash flow from operations increased by £310m to £5,660m.

Changes in working capital improved by £155m over the prior year, principally in the US due to the collection of winter 2015 billings and lower closing balances due to milder weather.

Net capital expenditure

Net capital expenditure in the year of £3,740m was £466m higher than the prior year. This was a result of higher spend in our US and UK regulated businesses. Further details of our capital expenditure can be seen on page 24.

Net interest paid

Net interest paid and exceptional finance costs in 2015/16 were £811m, £130m lower than 2014/15 primarily due to prior year debt redemption cash outflows.

Tax paid

Tax paid in the year to 31 March 2016 was £292m, £51m lower than the prior year. This reflected the reduction in the UK corporation tax rate from 21% to 20%, partially offset by repayments received in the US in the prior year.

Dividends paid

Dividends paid in the year ended 31 March 2016 amounted to £1,337m. This was £66m higher than 2014/15, reflecting the increase in the final dividend for the year ended 31 March 2015 paid in August 2015, together with a lower average scrip dividend take-up in the year.

Other cash movements

Other cash flows principally arise from dividends from joint ventures and movements in treasury shares, including the cost of repurchasing shares as part of the share buyback programme

(£267m, £71m lower than the prior year).

Non-cash movements

The non-cash movements are predominantly due to the strengthening of the US dollar against sterling, resulting in movements in foreign exchange arising on net debt held in US dollars. In the year, the dollar strengthened from \$1.49 at 31 March 2015 to \$1.44 at

31 March 2016.

Other non-cash movements are from changes in fair values of financial assets and liabilities and interest accretions and accruals.

Net debt

Net debt at 31 March (£m)

| | | |
|---|-----------------------------|-----|
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|---|-----------------------------|-----|

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Notes to the consolidated financial statements

analysis of items in the primary statements

1. Basis of preparation and recent accounting developments

Accounting policies describe our approach to recognising and measuring transactions and balances in the year. Accounting policies applicable across the financial statements are shown below. Accounting policies that are specific to a component of the financial statements have been incorporated into the relevant note.

This section also shows areas of judgement and key sources of estimation uncertainty in these financial statements. In addition, we summarise new EU endorsed accounting standards, amendments and interpretations and whether these are effective in 2016 or later years, explaining how significant changes are expected to affect our reported results.

National Grid's principal activities involve the transmission and distribution of electricity and gas in Great Britain and northeastern US. The Company is a public limited liability company incorporated and domiciled in England and Wales, with its registered office at 1-3 Strand, London WC2N 5EH.

The Company has its primary listing on the London Stock Exchange and is also quoted on the New York Stock Exchange.

These consolidated financial statements were approved for issue by the Board on 18 May 2016.

These consolidated financial statements have been prepared in accordance with International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) and related interpretations as issued by the IASB and IFRS as adopted by the EU. They are prepared on the basis of all IFRS accounting standards and interpretations that are mandatory for periods ended 31 March 2016 and in accordance with the Companies Act 2006 applicable to companies reporting under IFRS and Article 4 of the EU IAS Regulation. The 2015 and 2014 comparative financial information has also been prepared on this basis.

The consolidated financial statements have been prepared on an historical cost basis, except for the recording of pension assets and liabilities, the revaluation of derivative financial instruments and certain commodity contracts and investments classified as available-for-sale.

These consolidated financial statements are presented in pounds sterling, which is also 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 (see accounting policy D).

A. Going concern

The Directors considered it appropriate to prepare the financial statements on a going concern basis. The going concern basis presumes that the Group has adequate resources to remain in operation, and that the Directors intend it to do so, for at least one year from the date the financial statements are signed.

B. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries, together with a share of the results, assets and liabilities of jointly controlled entities (joint ventures) and associates using the equity method of accounting, where the investment is carried at cost plus post-acquisition changes in the share of net assets of the joint venture or associate, less any provision for impairment.

A subsidiary is defined as an entity controlled by the Company. Control is achieved where the Company has the power to affect the returns of an entity to which it is exposed or to which it has rights.

Losses in excess of the consolidated interest in joint ventures and associates are not recognised, except where the Company or its subsidiaries have made a commitment to make good those losses.

Where necessary, adjustments are made to bring the accounting policies used in the individual financial statements of the Company, subsidiaries, joint ventures and associates into line with those used by the Company in its consolidated financial statements under IFRS. Intercompany transactions are eliminated.

The results of subsidiaries, joint ventures and associates acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate.

Acquisitions are accounted for using the acquisition method, where the purchase price is allocated to the identifiable assets acquired and liabilities assumed on a fair value basis and the remainder recognised as goodwill.

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Financial Statements

1. Basis of preparation and recent accounting developments continued

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 reporting date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at closing exchange rates. Non-monetary assets are not retranslated unless they are carried at fair value.

Gains and losses arising on the retranslation of monetary assets and liabilities are included in the income statement, except where the adoption of hedge accounting requires inclusion in other comprehensive income – note 15.

On consolidation, the assets and liabilities of operations that have a functional currency different from the Company's functional currency of pounds sterling, principally our US operations that have a functional currency of US dollars, are translated at exchange rates prevailing at the reporting date. Income and expense items are translated at the average exchange rates for the period where these do not differ materially from rates at the date of the transaction. Exchange differences arising are classified as equity and transferred to the consolidated translation reserve.

D. 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 estimations is contained in 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 are as follows:

the categorisation of certain items as exceptional items and the definition of adjusted earnings notes 4 and 7; energy purchase contracts as being for normal purchase, sale or usage note 27; and the recognition of surpluses in respect of defined benefit pension schemes notes 22 and 29. IFRS provides certain options available within accounting standards. Choices we have made, and continue to make, include the following:

Presentational formats: we use the nature of expense method for our income statement and aggregate our statement of financial position 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 separately on the face of the income statement.

Customer contributions: contributions received prior to 1 July 2009 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.

For net investment hedges, we have chosen to use the spot rate method, rather than the alternative forward rate method.

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

review of residual lives, carrying values and impairment charges for other intangible assets and property, plant and equipment notes 10 and 11;

estimation of liabilities for pensions and other post-retirement benefits notes 22 and 29;

valuation of financial instruments and derivatives notes 15 and 30;

revenue recognition and assessment of unbilled revenue note 2; and

environmental and decommissioning provisions note 23.

In order to illustrate the impact that changes in assumptions could have on our results and financial position, we have included sensitivity analysis in note 33.

New IFRS accounting standards and interpretations adopted in 2015/16

The following standards, interpretations and amendments, issued by the IASB and by the IFRS Interpretations Committee (IFRIC), are effective for the year ended 31 March 2016. None of the pronouncements has had a material impact on the Company's consolidated results or assets and liabilities for the year ended 31 March 2016.

Amendment to IAS 19 Defined Benefit Plans: Employee Contributions ;
Annual Improvements to IFRSs 2010-2012 Cycle; and
Annual Improvements to IFRSs 2011-2013 Cycle.

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Notes to the consolidated financial statements

analysis of items in the primary statements continued

1. Basis of preparation and recent accounting developments continued

New IFRS accounting standards and interpretations not yet adopted

The Company enters into a significant number of transactions that fall within the scope of IFRS 9 Financial Instruments and IFRS 16 Leases, effective for periods beginning on or after 1 January 2018 and 1 January 2019 respectively, subject to EU endorsement. We are assessing the likely impact of these standards on the Company's financial statements.

IFRS 15 Revenue from Contracts with Customers was issued by the IASB in May 2014. Subject to EU endorsement, it is effective for accounting periods beginning on or after 1 January 2018. The new standard provides enhanced detail on the principle of recognising revenue to reflect the transfer of goods and services to customers at a value which the Company expects to be entitled to receive.

The Group has completed an initial impact assessment of the new standard by completing a survey of all businesses identifying the likely impact of IFRS 15. This was a tailored questionnaire based on the known impacts of the new standard on power and utility companies. Whilst no material differences were identified as part of the questionnaire process, further follow-up work will be required to determine the impact, if any, on certain revenue items including, but not limited to, variable consideration contracts, take or pay arrangements and performance obligations where multiple goods or services are provided in individual contracts.

Other standards and interpretations or amendments thereto which have been issued, but are not yet effective, are not expected to have a material impact on the Company's consolidated financial statements.

2. Segmental analysis

This note sets out the financial performance for the year split into the different parts of the business (operating segments). We monitor and manage the performance of these operating segments on a day-to-day basis.

Our strategy in action

We own a portfolio of businesses that range from businesses with high levels of investment and growth (such as UK Electricity Transmission) to cash generative developed assets with minimal investment requirements (such as National Grid Metering, included within Other activities).

We generate the majority of our revenue from our regulated operating segments in the UK and US. We work with our regulators to obtain agreements that balance the risks we face with the opportunity to deliver reasonable returns for our investors. When investing in Other activities we aim to leverage our core capabilities to deliver higher returns for investors.

Our regulated businesses earn revenue for the transmission, distribution and generation services they have provided during the year. In any one year, the revenue recognised may differ from that allowed under our regulatory agreements and any such timing differences are adjusted through future prices. Our Other activities earn revenue in line with their contractual terms.

Revenue primarily represents the sales value derived from the generation, transmission and distribution of energy, together with the sales value derived from the provision of other services to customers. It excludes value added (sales) tax and intra-group sales.

Revenue includes an assessment of unbilled energy and transportation services supplied to customers between the date of the last meter reading and the year-end. This is estimated based on historical consumption and weather patterns.

Where revenue exceeds the maximum amount permitted by a regulatory agreement, adjustments will be made to future prices to reflect this over-recovery. No liability is recognised, as such an adjustment relates to the provision of future services. Similarly no asset is recognised where a regulatory agreement permits adjustments to be made to future prices in respect of an under-recovery. As part of our regulatory agreements we are entitled to recover certain costs directly from customers (pass through costs). These amounts are included in the overall calculation of revenue as stipulated by regulatory agreements and explained further on pages 176 to 182.

We present revenue and the results of the business analysed by operating segment, based on the information the Board of Directors uses internally for the purposes of evaluating the performance of operating segments and determining resource allocation between operating segments. The Board of Directors is National Grid's chief operating decision-making body (as defined by IFRS 8 Operating Segments) and assesses the performance of operations principally on the basis of operating profit before exceptional items and remeasurements (see note 4).

There have been no changes to our reporting structure for the year ended 31 March 2016.

Table of Contents**Financial Statements****2. Segmental analysis continued**

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

| | |
|-----------------------------|--|
| UK Electricity Transmission | High voltage electricity transmission networks in Great Britain. |
| UK Gas Transmission | The gas transmission network in Great Britain and UK LNG storage activities. |
| UK Gas Distribution | Four of the eight regional networks of Great Britain's gas distribution system. |
| US Regulated | Gas distribution networks, electricity distribution networks and high voltage electricity transmission networks in New York and New England and electricity generation facilities in New York. |

Other activities primarily relate to non-regulated businesses and other commercial operations not included within the above segments, including: UK gas metering activities; the Great Britain-France Interconnector; UK property management; a UK LNG import terminal (National Grid Grain LNG Limited); US LNG operations; US unregulated transmission pipelines; together with corporate activities.

Sales between operating segments are priced considering the regulatory and legal requirements to which the businesses are subject. The analysis of revenue by geographical area is on the basis of destination. There are no material sales between the UK and US geographical areas.

(a) Revenue

| 2016 | | 2015 | | 2014 | |
|--------------|--------------|-------|-------|-------|-------|
| Sales | Sales | Sales | Sales | Sales | Sales |

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| | Total between sales segments | | to third parties | Total between sales segments | | to third parties | Total between sales segments | | to third parties |
|---------------------|------------------------------|--------------|------------------|------------------------------|-------|------------------|------------------------------|-------|------------------|
| | £m | £m | £m | £m | £m | £m | £m | £m | £m |
| Operating segments: | | | | | | | | | |
| UK Electricity | | | | | | | | | |
| Transmission | 3,977 | (20) | 3,957 | 3,754 | (12) | 3,742 | 3,387 | (14) | 3,373 |
| UK Gas Transmission | 1,047 | (109) | 938 | 1,022 | (107) | 915 | 941 | (104) | 837 |
| UK Gas Distribution | 1,918 | (36) | 1,882 | 1,867 | (43) | 1,824 | 1,898 | (49) | 1,849 |
| US Regulated | 7,493 | | 7,493 | 7,986 | | 7,986 | 8,040 | | 8,040 |
| Other activities | 876 | (31) | 845 | 762 | (28) | 734 | 736 | (26) | 710 |
| | 15,311 | (196) | 15,115 | 15,391 | (190) | 15,201 | 15,002 | (193) | 14,809 |
| Geographical areas: | | | | | | | | | |
| UK | | | 7,522 | | | 7,191 | | | 6,759 |
| US | | | 7,593 | | | 8,010 | | | 8,050 |
| | | | 15,115 | | | 15,201 | | | 14,809 |

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analysis of items in the primary statements continued

2. Segmental analysis continued**(b) Operating profit**

A reconciliation of the operating segments' measure of profit to total profit before tax is provided below. Further details of the exceptional items and remeasurements are provided in note 4.

| | Before exceptional items and remeasurements | | | After exceptional items and remeasurements | | |
|---------------------|--|------------|------------|---|------------|------------|
| | 2016 £m | 2015 £m | 2014 £m | 2016 £m | 2015 £m | 2014 £m |
| Operating segments: | | | | | | |
| UK | | | | | | |
| Electricity | | | | | | |
| Transmission | 1,173 | 1,237 | 1,087 | 1,173 | 1,237 | 1,027 |
| UK Gas | | | | | | |
| Transmission | 486 | 437 | 417 | 486 | 437 | 406 |
| UK Gas | | | | | | |
| Distribution | 878 | 826 | 904 | 878 | 826 | 780 |
| US Regulated | 1,185 | 1,164 | 1,125 | 1,196 | 1,081 | 1,388 |
| Other | | | | | | |
| activities | 374 | 199 | 131 | 352 | 199 | 134 |
| | 4,096 | 3,863 | 3,664 | 4,085 | 3,780 | 3,735 |
| Geographical areas: | | | | | | |
| UK | 2,889 | 2,820 | 2,723 | 2,867 | 2,820 | 2,531 |
| US | 1,207 | 1,043 | 941 | 1,218 | 960 | 1,204 |
| | 4,096 | 3,863 | 3,664 | 4,085 | 3,780 | 3,735 |

| | | | | | | |
|--|----------------|---------|---------|----------------|---------|---------|
| Reconciliation to profit before tax: | | | | | | |
| Operating profit | 4,096 | 3,863 | 3,664 | 4,085 | 3,780 | 3,735 |
| Finance income | 22 | 36 | 36 | 22 | 36 | 36 |
| Finance costs | (1,035) | (1,069) | (1,144) | (1,134) | (1,234) | (1,051) |
| Share of post-tax results of joint ventures and associates | 59 | 46 | 28 | 59 | 46 | 28 |
| Profit before tax | 3,142 | 2,876 | 2,584 | 3,032 | 2,628 | 2,748 |

(c) Capital expenditure

| | Net book value of property, plant and equipment and other intangible assets | | | Capital expenditure | | | Depreciation and amortisation | | |
|-------------------------------|---|------------|------------|---------------------|------------|------------|-------------------------------|------------|------------|
| | 2016 £m | 2015 £m | 2014 £m | 2016 £m | 2015 £m | 2014 £m | 2016 £m | 2015 £m | 2014 £m |
| Operating segments: | | | | | | | | | |
| UK | | | | | | | | | |
| Electricity | | | | | | | | | |
| Transmission | 11,907 | 11,276 | 10,635 | 1,084 | 1,074 | 1,381 | (390) | (376) | (343) |
| UK Gas | | | | | | | | | |
| Transmission | 4,140 | 4,132 | 4,120 | 186 | 184 | 181 | (178) | (172) | (172) |
| UK Gas | | | | | | | | | |
| Distribution | 8,378 | 8,130 | 7,921 | 549 | 498 | 480 | (298) | (286) | (271) |
| US Regulated | 17,490 | 15,664 | 12,948 | 1,856 | 1,501 | 1,219 | (535) | (452) | (419) |
| Other | | | | | | | | | |
| activities | 2,336 | 2,323 | 2,224 | 218 | 213 | 180 | (213) | (196) | (211) |
| | 44,251 | 41,525 | 37,848 | 3,893 | 3,470 | 3,441 | (1,614) | (1,482) | (1,416) |
| Geographical areas: | | | | | | | | | |
| UK | 25,914 | 25,073 | 24,285 | 1,952 | 1,864 | 2,155 | (1,018) | (983) | (938) |
| US | 18,337 | 16,452 | 13,563 | 1,941 | 1,606 | 1,286 | (596) | (499) | (478) |
| | 44,251 | 41,525 | 37,848 | 3,893 | 3,470 | 3,441 | (1,614) | (1,482) | (1,416) |
| By asset type: | | | | | | | | | |
| Property, plant and equipment | 43,364 | 40,723 | 37,179 | 3,673 | 3,263 | 3,262 | (1,467) | (1,361) | (1,289) |
| Non-current intangible assets | 887 | 802 | 669 | 220 | 207 | 179 | (147) | (121) | (127) |
| | 44,251 | 41,525 | 37,848 | 3,893 | 3,470 | 3,441 | (1,614) | (1,482) | (1,416) |

Total non-current assets other than financial instruments and pension assets located in the UK and US were £26,261m and £23,784m respectively as at 31 March 2016 (31 March 2015: UK £25,278m, US £21,790m; 31 March 2014: UK £24,531m, US £18,349m).

| | | |
|-----|---|-----------------------------|
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Unaudited commentary on the results of our principal operations by segment

As a business, we have three measures of operating profit that are used on a regular basis and disclosed in this Annual Report.

Statutory operating profit: This is operating profit as calculated under International Financial Reporting Standards (IFRS). Statutory operating profit by segment is shown in note 2 on page 106.

Adjusted operating profit: Adjusted operating profit (business performance) excludes items that if included could distort understanding of our performance for the year and the comparability between periods. Further details of items that are excluded in adjusted operating profit are shown in note 4 on page 111.

Regulated financial performance: This is particularly relevant for our UK operations and is a measure of operating profit that reflects the impact of the businesses' regulatory arrangements when presenting financial performance.

Reconciliations between statutory and adjusted operating profit can be found on page 196. Reconciliations between adjusted operating profit and regulated financial performance for UK Electricity Transmission, UK Gas Transmission and UK Gas Distribution can be found on page 108.

Commentary on segmental adjusted operating profit results

We have summarised the results of our principal operating segments here by segment to provide direct reference to the results as disclosed in note 2. This analysis has been prepared based on adjusted operating profit (operating profit before exceptional items and remeasurements) as set out in note 2(b).

UK Electricity Transmission

For the year ended 31 March 2016, revenue in the UK Electricity Transmission segment increased by £223m to £3,977m, and adjusted operating profit decreased by £64m to £1,173m.

The revenue growth of £223m was principally due to the recovery of higher pass-through costs such as payments to other UK network owners and system balancing costs, and under-recoveries of allowed revenues in the prior year. This was partly offset by reductions in allowed revenues this year and a legal settlement received in 2014/15 that did not repeat this year. Net revenue (after deducting pass-through costs) was £14m higher. Regulated controllable costs were £28m higher due to inflation and salary growth, together with legal cost recoveries in the prior year, higher tower maintenance costs and transformation costs associated with our System Operator business. Depreciation and amortisation was £14m higher reflecting the continued capital investment programme. Other costs were £36m higher than prior year due to additional asset impairments this year and lower scrap and disposal proceeds.

Capital investment remained around the same level as last year at £1,084m.

UK Gas Transmission

Revenue in the UK Gas Transmission segment increased by £25m in 2015/16 to £1,047m and adjusted operating profit increased by £49m to £486m.

Revenue was £25m higher, principally due to over-recoveries of allowed revenues in the year. Regulated controllable costs were £10m higher than last year, mainly as a result of inflation, higher gas system service charges and organisational change costs. Depreciation costs were £6m higher due to ongoing investment (investment in the year was £186m, similar to last year). Other operating costs were £19m lower than last year, mostly reflecting additional costs in 2014/15 relating to the closure of LNG facilities.

UK Gas Distribution

UK Gas Distribution revenue increased by £51m in the year to £1,918m, and adjusted operating profit increased by £52m to £878m.

Revenue was £51m higher, principally reflecting increased regulatory allowances. In part, these allowances were increased to compensate for expected increases in taxation costs reflecting a change to the tax treatment of replacement expenditure. Regulated controllable costs were £21m higher due to inflation, recruitment, property costs and higher charges from our strategic partners to cover connections and winter resourcing. Depreciation and amortisation was £12m higher reflecting the continued mains replacement programme (investment in the year was £51m higher at £549m). Pass-through costs charged to customers were £11m lower this year, and other costs were £23m lower than prior year, which included provisions for additional asset protection costs.

US Regulated

Revenue in our US Regulated businesses was £493m lower at £7,493m, while adjusted operating profit increased by £21m to £1,185m.

The stronger US dollar increased operating profit in the year by £81m. Excluding the impact of foreign exchange rate movements, revenue decreased by £1,051m, principally as a result of lower commodity costs passed on to customers and unfavourable timing of recoveries year over year, partly offset by higher revenue allowances under the Niagara Mohawk three year rate plan and the benefit of capex trackers. The reduction in revenue was mostly offset by a £1,027m reduction in pass-through costs incurred (excluding the impact of foreign exchange). Regulated controllable costs reduced by £71m at constant currency, partly as a result of lower gas leak and compliance work this year and additional costs incurred last year to improve data quality and bring regulatory filings up to date. Depreciation and amortisation costs were £51m higher this year at constant currency as a result of ongoing investment in our networks.

Pension costs were £15m higher at constant currency due to changes in actuarial discount rates, while other operating costs were £41m higher at constant currency including higher asset removal costs.

Our capital investment programme continues in the US, with a further £1,856m invested in 2015/16, including spend on gas mains replacement, gas customer growth and electric system reinforcement.

Other activities

Revenue in Other activities increased by £114m to £876m in the year ended 31 March 2016. Adjusted operating profit was £175m higher at £374m.

In the US, adjusted operating profit was £143m higher, reflecting lower spend on upgrades to our finance systems which completed last year. In addition, we benefited from a £49m gain on disposal of our investment in the Iroquois pipeline, and the deconsolidation of our investment in Clean Line. In the UK, adjusted operating profit was £32m higher as a result of strong auction revenues at the French interconnector and higher property sales. Capital investment in our Other activities was at a similar level to last year at £218m.

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Notes to the consolidated financial statements

analysis of items in the primary statements continued

[Unaudited commentary on the results of our principal operations by segment continued](#)

Commentary on UK regulated financial performance

The regulated financial performance calculation provides a measure of the performance of the regulated operations before the impacts of interest and taxation. It adjusts reported operating profit under IFRS to reflect the impact of the businesses' regulatory arrangements when presenting financial performance.

Adjustments in calculating regulatory financial performance

The principal adjustments from reported operating profit to UK regulated financial performance are:

Movement in regulatory IOUs : Revenue related to performance in one year may be recovered in later years. Revenue may be recovered in one year but be required to be returned to customers in future years. IFRS recognises these revenues when they flow through invoices to customers and not in the period to which they relate.

Performance RAV: UK performance efficiencies are in part remunerated by the creation of additional RAV which is expected to result in future earnings under regulatory arrangements.

Pension adjustment: Cash payments against pension deficits in the UK are recoverable under regulatory contracts.

3% RAV indexation: Future UK revenue allowances are expected to be set using an asset base adjusted for inflation. These will be billed in future periods and recognised under IFRS at that time. A 3% RPI inflation assumption is used, reflecting the long-run expectation.

Deferred taxation adjustment: Future UK revenues are expected to recover cash taxation costs, including the unwinding of deferred taxation balances created in the current year.

Regulatory depreciation: UK regulated revenues include an allowance for a return of regulatory capital in accordance with regulatory assumed asset lives. This return does not form part of regulatory profit.

Fast/slow money adjustment: The regulatory remuneration of costs incurred is split between in year revenue allowances and the creation of additional RAV. This does not align with the classification of costs as operating costs and fixed asset additions under IFRS accounting principles.

UK Electricity Transmission

Regulated financial performance for UK Electricity Transmission decreased to £1,195m from £1,232m, down 3%. The slight year-on-year decrease is principally a result of a one-off legal settlement of £56m included in last year's results. Electricity Transmission underlying performance and operational return on equity were broadly similar this year.

| Reconciliation of regulated financial performance to operating profit | 2016 | 2015 | % |
|--|--------------|-------|---------------|
| | £m | £m | change |
| Reported operating profit | 1,173 | 1,237 | (5) |
| Movement in regulatory IOUs | (147) | (130) | |
| Deferred taxation adjustment | 80 | 88 | |
| RAV indexation (average 3% long-run inflation) | 339 | 326 | |
| Regulatory vs IFRS depreciation difference | (368) | (352) | |
| Fast/slow money adjustment | 92 | 34 | |
| Pensions | (54) | (48) | |
| Performance RAV created | 80 | 77 | |
| Regulated financial performance | 1,195 | 1,232 | (3) |

UK Gas Transmission

Regulated financial performance for UK Gas Transmission decreased to £535m from £648m, down 17%. This reflected a lower operational return on equity, mainly as a result of the expiration of the gas permit incentive scheme.

| Reconciliation of regulated financial performance to operating profit | 2016 | 2015 | % |
|--|-------------|------|---------------|
| | £m | £m | change |
| Reported operating profit | 486 | 437 | 11 |
| Movement in regulatory IOUs | (80) | (16) | |
| Deferred taxation adjustment | 45 | 85 | |
| RAV indexation (average 3% long-run inflation) | 166 | 166 | |
| Regulatory vs IFRS depreciation difference | (18) | (22) | |
| Fast/slow money adjustment | 18 | 54 | |
| Pensions | (77) | (49) | |
| Performance RAV created | (5) | (7) | |
| Regulated financial performance | 535 | 648 | (17) |

UK Gas Distribution

Regulated financial performance for UK Gas Distribution was unchanged at £819m. This reflects similar achieved operational return on equity year-on-year, with the benefit of a higher asset base being offset by lower allowed cost of debt.

| Reconciliation of regulated financial performance to operating profit | 2016 | 2015 | % |
|--|--------------|-------|---------------|
| | £m | £m | change |
| Reported operating profit | 878 | 826 | 6 |
| Movement in regulatory IOUs | (35) | (28) | |
| Deferred taxation adjustment | (34) | 60 | |
| RAV indexation (average 3% long-run inflation) | 255 | 255 | |
| Regulatory vs IFRS depreciation difference | (104) | (148) | |
| Fast/slow money adjustment | (168) | (182) | |
| Pensions | (13) | (5) | |
| Performance RAV created | 40 | 41 | |
| Regulated financial performance | 819 | 819 | |

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Financial Statements

3. Operating costs

Below we have presented separately certain items included in our operating costs. These include a breakdown of payroll costs (including disclosure of amounts paid to key management personnel) and fees paid to our auditors.

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

| | Before exceptional items and remeasurements | | | Exceptional items and remeasurements | | | Total | | |
|-------------------------------------|--|------------|------------|---|------------|------------|------------|------------|------------|
| | 2016 £m | 2015 £m | 2014 £m | 2016 £m | 2015 £m | 2014 £m | 2016 £m | 2015 £m | 2014 £m |
| Depreciation and amortisation | 1,614 | 1,482 | 1,416 | | | | 1,614 | 1,482 | 1,416 |
| Payroll costs | 1,506 | 1,459 | 1,373 | | | (155) | 1,506 | 1,459 | 1,218 |
| Purchases of electricity | 1,304 | 1,615 | 1,513 | 8 | 70 | (49) | 1,312 | 1,685 | 1,464 |
| Purchases of gas | 1,003 | 1,403 | 1,722 | (19) | 13 | 33 | 984 | 1,416 | 1,755 |
| Rates and property taxes | 1,050 | 1,004 | 963 | | | | 1,050 | 1,004 | 963 |
| Balancing Services | | | | | | | | | |
| Incentive Scheme | 907 | 874 | 872 | | | | 907 | 874 | 872 |
| Payments to other UK network owners | 971 | 801 | 630 | | | | 971 | 801 | 630 |
| Other | 2,664 | 2,700 | 2,656 | 22 | | 100 | 2,686 | 2,700 | 2,756 |
| | 11,019 | 11,338 | 11,145 | 11 | 83 | (71) | 11,030 | 11,421 | 11,074 |

| | | | |
|--------------------------------------|------------|-----|-----|
| Operating costs include: | | | |
| Inventory consumed | 303 | 365 | 422 |
| Operating leases | 99 | 98 | 115 |
| Research and development expenditure | 29 | 23 | 12 |

(a) Payroll costs

| | 2016 | 2015 | 2014 ¹ |
|---|--------------|-------|-------------------|
| | £m | £m | £m |
| Wages and salaries ¹ | 1,720 | 1,598 | 1,377 |
| Social security costs | 137 | 129 | 126 |
| Other pension costs (note 22) | 238 | 224 | 229 |
| Share-based payment | 22 | 20 | 20 |
| Severance costs (excluding pension costs) | 5 | 4 | 30 |
| | 2,122 | 1,975 | 1,782 |
| Less: payroll costs capitalised | (616) | (516) | (564) |
| | 1,506 | 1,459 | |