

FINAL TRANSCRIPT

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NGG - Preliminary 2006 National Grid Earnings Conference Call

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PRESENTATION

Sir John Parker - *National Grid - Chairman*

Well, a very good morning, ladies and gentlemen, and welcome to National Grid's preliminary results. With me to make today's presentation is, of course, Steve Holliday, who stepped up to become Chief Executive on January 1 this year, and Steve Lucas, our Finance Director. In the audience we also have Nick Winsler, Edward Astle, Mark Fairbairn and Mark was appointed to the Board in January of this year, and Cheryl LaFleur, the lady in pink from the United States.

We are conducting a very thorough search process for an Executive Director to lead the Electricity Distribution business, and we're aiming to fill the post prior to completion of the KeySpan acquisition. But meanwhile the Electricity Distribution business is being well managed under Cheryl's capable leadership.

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Now we continue to have confidence in National Grid's ability to deliver good results and sustain growth, and this is reflected in our announcement today of a 10% increase in our full year dividend. And once again, this exceeds our stated policy of 7% growth.

In a moment, Steve Holliday will update you on excellent progress in delivering against our strategy which he outlined last November, but first I'm going to invite Steve Lucas to take us through the financial results. Steve.

Steve Lucas - National Grid - Finance Director

Thanks, John, and good morning. Before I start, please note that there are a few technical details at the front of the appendix. All through the presentation, I will express operating profit at constant exchange rate, and all the numbers I quote are in pounds sterling unless otherwise stated. As I'll be making forward-looking statements, I'll refer you to the cautionary statement included at the front of the presentation.

Today, our results are reported on the new lines of business, and they're shown here. In the appendix, we've provided financial information which will allow you to reconcile the numbers to the old reporting segments. And we've also given you the usual step diagrams. Wireless and Basslink are now discontinued businesses, and are not included in these results. Finally, we've also excluded US stranded costs from the continuing businesses part of this presentation.

Now the headlines. Once again, good results. We've increased our operating profit to GBP2,031 million, up GBP84 million. Profit before tax was up 9%, and earnings per share up 9%. We've increased the full year dividend by 10%, once again, ahead of our 7% target.

I will now take you through the results in more detail.

Excluding US stranded costs, operating profit was up 5%. This was driven by a strong performance from Transmission in the UK, and Electricity Distribution in the US. Transmission performed well. Operating profit was GBP1,054 million, up GBP91 million on last year. In UK Electricity Transmission, a 9% increase in revenue generated GBP103 million increase in profit. Additionally, a lower depreciation charge in the UK following last year's one-off changes, led to an increase of GBP27 million. These favorable items were partially offset by an under-recovery of gas and electricity income of GBP22 million, following an over-recovery last year of GBP42 million. This is a timing impact, but it resulted in an overall decrease of GBP64 million. Other items increased operating profit by GBP25 million, and mainly relate to one-off items in the previous year.

Now on to Gas Distribution. Operating profit in this segment was GBP480 million, a decrease of GBP47 million. The price rises in October increased formula income by GBP73 million, however, this was more than offset by lower volumes which were down 8%, and that cost us GBP69 million. This was due to two main factors. The first was weather, with the second warmest UK winter since 1914. The second factor was the negative impact of high gas prices on consumer demand. This led to an under-recovery of income of GBP42 million this year which, combined with a GBP10 million under-recovery in 2005/06, meant that the net drop year-on-year was GBP32 million.

It should be noted that for 2007/08, under the mini review proposals, these risks have been removed, and there will be no volume drivers impacting our allowed revenues in the UK. This year's under-recovery of GBP42 million should be recovered next year.

In August, we completed the acquisition of the Rhode Island assets of New England gas; this made a GBP17 million contribution to operating profit. The planned increase in RepEx investment led to high depreciation charges, further reducing operating profit by GBP8 million.

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As we indicated in November, controllable costs in the UK are increasing, and for the full year they rose by GBP16 million. This was mainly workload related, including maintenance work and service cut-offs. Non-controllable costs were GBP23 million higher year-on-year, mainly due to business rates in the UK which, as a pass-through cost, will be recovered next year.

Electricity Distribution had a good result. Operating profit was GBP364 million, up GBP67 million on last year. Revenues, excluding pass-through commodity costs, increased by GBP91 million over last year. This was mainly driven by the commencement of recoveries from the New York deferral account which boosted profit by GBP72 million. We will also recover around \$150 million next year. Additionally, the timing on pass-through items, mainly relating to an over-recovery of commodity costs in Rhode Island, led to a GBP23 million increase. Controllable costs were up GBP19 million, due to our reliability enhancement program, and an increase in bad debts, which was caused by the high commodity prices.

At the interims, I told you about the very severe snow storm which hit western New York in October. This was followed by a bad storm in Albany in January. Together, these storms cost us GBP43 million, and we expect most of these costs to be recovered through the deferral account in future periods. Depreciation charges were GBP9 million higher, and other items mainly relate to pensions, and resulted in a net improvement of GBP24 million.

Now on to our non-regulated segment. Operating profit here was GBP133 million, down GBP17 million. Metering profit was up 6% at GBP103 million. Growth in our competitive metering business, OnStream, continues to more than offset a decline in regulated metering revenue, with over 800,000 meters installed this year. Our LNG import terminal at the Isle of Grain made its first full contribution of GBP9 million. Property was slightly down, delivering GBP86 million of operating profit. As anticipated, our connections business was down GBP9 million, as contracts with the independent gas network owners expired. Finally, corporate and other costs were up GBP15 million. The vast majority of these were one-off items.

That covers the breakdown of operating profit. As usual, we've converted last year's operating profit at this year's exchange rate. The weaker dollar then brings last year's operating profit down by GBP63 million, and the net impact on earnings was GBP29 million. You'll find further details on all this in the appendix.

Our US stranded cost recoveries delivered GBP423 million of profit. As announced last year, we are returning a post-tax cash flow relating to the stranded assets to shareholders via our share buyback program. This year, we repurchased 22 million of our shares at an average price of 754p, returning a total of GBP169 million. The buyback excludes contract settlements, which largely relate to legacy power purchase arrangements, and are cash neutral. These contract payments will be largely complete by March 2008. Next year, we anticipate the stranded asset buyback will amount to around \$300 million.

Now to interest, tax, earnings, and dividend. Net finance costs were GBP547 million, a GBP55 million decrease from last year at actual exchange rates. This was mainly due to the impact of favorable short term cash investments, and an increased pension credit for the UK Gas scheme. We had an effective underlying interest rate on net debt of 5.95% for the year. This year, we had the benefit from cash investments, which reduced this by around 35 basis points to an effective rate of around 5.6%. Our effective tax rate has risen slightly to 32% for the year, including US stranded costs.

Earnings per share, excluding US stranded costs, were 38.3p, a 9% increase on last year. The full year dividend per share is 28.7p, a 10% increase, and exceeding our 7% target for the fourth year running. The full year dividend paid to our ADR holders will be \$2.79 per ADR.

Now on to capital investment. In a moment, Steve will talk you through our future investment plans, so I'll just give you the headlines.

Capital investment in our continuing businesses was GBP2.3 billion, up 23%. And this slide shows the breakdown by our lines of business. The majority of the step up is coming from Transmission of which, of course, the biggest project is Milford Haven.

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I'll now turn to cash flow and net debt. Opening net debt was GBP10.9 billion. Operating cash flow was GBP3.1 billion after exceptional spending of GBP86 million. Cash interest was GBP642 million, and tax paid was GBP310 million. Cash CapEx was GBP2.5 billion, which includes the acquisition of Rhode Island Gas. Dividends account for GBP730 million, and the share buyback for GBP169 million. Together, these led to a GBP1.1 billion increase in net debt. There were other cash flow items of GBP61 million, primarily relating to our discontinued businesses. Finally, there were non-cash movements of GBP181 million. These included IFRS fair value, and dollar exchange impact. All in all, this gives a closing net debt for the period of GBP11.8 billion.

Now I'd like to talk about our returns. This is the first time we've provided individual business returns, and going forward, we will provide annual updates. As you are aware, National Grid has a clear, focused and low risk business model, and we said in November that we wanted the market to be able to judge our performance based likewise on clear and transparent metrics. We're delivering on that promise by providing two main return measures against which you can judge our performance. These measures are, our performance against regulatory contracts in the UK and US, and a Group return on equity.

A lot of the information on our returns is in the appendix, and I think that will answer most of your questions. And of course, the IR team will be happy to talk through the detail.

The first set of return metrics compares our UK businesses' operating performance against their regulatory contract. We'll provide this information for Electricity Transmission, Gas Transmission, and Gas Distribution. We've used an operational measure, which is comparable on an apples to apples basis with the so-called vanilla return used by Ofgem to determine our allowed revenues. We are currently allowed a 5.05% return for Transmission, based on a pre-tax cost of debt, and a post-tax cost of equity, with a 60% gearing assumption. This leads to the 4.4% post-tax real return allowed by OFGEN.

In simple terms, the numerator is operating profit less cash tax, and adjusted for regulatory depreciation and treatment of RepEx and the interest charge based on assumed gearing of 60%. This numerator is then divided by the regulatory asset base.

Now for the results, turning first to Electricity Transmission in the UK. In UK Electricity Transmission, our return over the last three years was 4.8%. The returns in 2006 and '07 were mainly suppressed by our increased investment program prior to the price control review outcome. Going forward, we expect these returns to pick up.

Turning to Gas. We presented Transmission and Distribution together for 2005 and 2006 in line with our reported accounts. For 2007, we've reported these two businesses separately, and will continue to do so going forward. The average return for Transmission and Distribution over the last three years was 6.1%, well above our allowed return. This year, Gas Transmission has delivered a 7.8% return. The drivers of this performance were lower operating costs, and outperformance on CapEx. On the other hand, Gas Distribution delivered a 4.4% return this year. Its performance was substantially affected by the profile of its regulated revenues, weather, and volumes, higher pensions and higher shrinkage gas costs. Of these, warm weather and lower volumes have had the biggest influence. By way of illustration this year, if weather and volumes had been normal our return would have been around our regulatory benchmark.

Going forward of course, issues like the impact of weather, higher pension and shrinkage costs, together with the capital over-spend have been addressed in the mini review. So we would expect returns to be materially higher.

Let's now look at our US returns. In the US our performance will be measured against our base regulatory returns for our three main businesses. Our Upstate New York business, Niagara Mohawk, is allowed a 10.6% base return on equity. For Massachusetts Distribution there's not an allowed regulatory return as such, instead it has a revenue allowance which is indexed to the average electricity distribution rates in the north east. New England Power is allowed a 10.9% base return on equity. It also gets around an 11% return its stranded assets. These returns are based on US GAAP and are in accordance with our regulatory filings, including the regulatory assumptions for capital structure. The calculation is straightforward; net income divided by the equity rate base.

The pie chart on this slide shows the relative sizes of our main rate bases, with our Upstate New York business accounting for around two thirds of our total US businesses. Over the last three years Niagara Mohawk has delivered an average return of

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10.4%, Massachusetts Distribution achieved an average return of 11.8%, and New England Power yielded an 11.6% return. As you can see, overall we performed well against our US rate plans, though this year has seen a drop off in returns in our distribution businesses. This is due to increased bad debts driven by high commodity costs, adverse weather, higher CapEx and higher reliability expenditure.

Now as I said previously, we have two return measures, and the second metric is a Group return on equity. The equity base we use for this calculation is our total invested capital minus net debt. So we're not using a book value as we believe this is a more realistic method of measuring our performance. The numerator used is an adjusted net income. The main adjustments are to take accounting depreciation out and replace it with regulatory depreciation and to adjust the regulatory CapEx mainly relating to RepEx. This gives a fairer measure of our underlying regulatory drivers. There is an adjustment for UK RAV indexation. This addresses the issue of having nominal returns in the US, but real returns in the UK. It therefore allows us to report a nominal return on equity. And of course, we exclude US stranded costs.

The invested capital is made up of our UK regulatory asset base, plus what we've invested in the US including goodwill, and our unregulated businesses net asset value. This metric therefore captures the total financing and operational performance of the Group. As you can see, we've averaged 12.4% return on equity over the last three years. The year-to-year fluctuations are principally due to the impact of RPI indexation in our UK regulated businesses, indeed, inflation of 4.4% this year, helped drive returns to 14.1%. In addition, the return in 2006 was suppressed by the proceeds from the network sales, which temporarily pushed the gearing down. For these reasons you can see why we prefer to focus on a three year rolling average return.

So in summary, a good year on the results front. We've had good growth in EPS, up 9%, and we've increased the full year dividend by 10%. Importantly for the future, investment in continuing businesses is up 23%, and finally, as I've just told you, we've delivered an average 12.4% return on equity over the past three years. And with that, I'll now hand you on to Steve.

Steve Holliday - *National Grid - CEO*

Good morning everyone, and thank you Steve. When we announced our results last November, I took the opportunity to set out then my thoughts about our business and our plans for the future of National Grid. I talked about our strategy. I talked about growth, and I talked about how we would drive our performance. That strategy in November, described how we would become even more focused. It talked about how we would run our business in a more integrated way, and that we would increase the discipline and rigor in the way in which we operate and in the way in which we finance our business. Those three actions are absolutely driving and increasing the long-term returns the National Grid will deliver. And I'm going to update you this morning on the progress we've made against those plans.

We have a very clear business model. It's focused on our principal growth markets, Electricity and Gas, UK and US. And given that focus we announced in November the intention to exit both our Wireless businesses and Basslink. The original intention you'll recall, was to de-merge the Wireless business, however, in the months after that announcement it became increasingly clear that more value was going to be created through a sale. And in April we were delighted to announce the completion of the sale to Macquarie. And today we're announcing the final part of that, which is the agreement to sell our much smaller US Wireless business for \$290 million.

Together those two sales have generated proceeds of GBP2.7 billion, over GBP1 billion higher than the consensus of the market valuation prior to that announcement in November, and doubling our investment in two and half years. Extraordinary result. The sale of Basslink, our interconnector in Australia, is progressing well. We're now in a competitive process. We've got over 30 interested parties and expect to complete that sale later this summer.

Our determination to run our business in an integrated way is a key advantage for us, and the restructuring of our business around the new lines of business is complete, and today Steve's reported our results on that basis. But don't be fooled, that is not the end. We've made good progress in implementing our new operating model. We now have a global IS organization, and

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in the UK we have one shared service organization. In the US we've appointed 85 leaders for the new structure, providing a solid base for the swift integration of KeySpan, but more on KeySpan in a moment.

But this increasing our discipline is not just about operations, it also means moving to another level of rigor in the management of our balance sheet. As I promised in November, and as Steve has told you, we've already returned last year's cash flows from the US stranded assets. And there's a further \$1.7 billion to come over the next five years.

Following the sale of our Wireless business we're now returning GBP1.8 billion by a share buyback over the next 18 months, and as you've already heard, for the fourth consecutive year, we've delivered dividend growth ahead of our 7% target with today's 10% announcement.

But let me move on to the opportunities that we see for investment, investment that will drive organic growth. In November we outlined our capital plans for the five year period through to 2011, so things have changed since then. Firstly we've accepted Ofgem's final for the transmission networks in the UK, proposals to underpin the returns that we will make from this investment over the next five years.

And today we've announced additional investment in a third phase expansion of our L&G terminal at the Isle of Grain. This phase of GBP310 million will add an eighth tank and a second unloading jetty, and the returns for that are underpinned by 19 year contracts with Eon, Ebidrola and Centrica. It'll increase the annual L&G capacity that we have for 15 million tonnes and has the capacity to deliver almost 20% of the UK's gas through that facility.

We're also close to finalizing negotiations on BritNed. This is a joint venture with TenneT, to build an electricity interconnector between the UK and the Netherlands. And subject to getting the required exemptions from our regulators, we jointly plan to construct what will be 160 mile subsea cable, each investing approximately GBP200 million. Those developments, together with the sale of our Wireless business are now reflected in today's update to our capital plans, bringing our total projected investment in our existing businesses to GBP14 billion to March 2012. And you've already heard from Steve, we delivered last year exactly to plan GBP2.3 billion of investment in Electricity and Gas infrastructure.

So in round numbers, we're projecting investments of GBP7 billion in Transmission, GBP4 billion in Gas Distribution, GBP1.5 billion in Electric Distribution and GBP1.8 billion in non-regulated activity. But let me look at it another way. If you split GBP9.9 billion in our UK regulated activities, GBP2.7 billion in our US regulated activities and the balance in the non-regulated. In the UK we're working with Ofgem on the price control for our Gas Distribution business for the five year period through to March 2013. And assuming we reach a satisfactory conclusion by the end of this year, all of the returns for the GBP9.9 billion will be underpinned by regulatory contract. On our projections that will grow our UK regulated asset base by 35%.

As you can see, there are clear differences between the level of investment in the UK and the US, yet the size, the scale and indeed the age of the networks are broadly the same on both sides of the Atlantic. And the drivers, the new generation, particularly that of renewable energy are almost the same. So as we look ahead, there is clearly a need for investment in our US networks, both our New England distribution business and our New York rate plans assume a flat level of investment. So as Steve mentioned, anything about this level (inaudible) short-term returns. But this recognition, this crucial recognition of the need to increase investment, is a key area of our discussions and of our regulatory focus in the US over the next period.

And KeySpan, of course, will provide more opportunity for attractive, organic capital expenditure. Our initial projections for that business would add another GBP1.5 billion to this plan through to March 2012, taking the total to almost GBP16 billion. But first we need to complete the deal. Over the last year, we've made significant progress; in November, we had five of the required clearances. Since then we've agreed in principle with the Long Island Power Authority for the renewal of three contracts, in particular the contract that manages the Electricity Transmission and Distribution assets on the Island through to 2013. In the past month, we've reached agreement with the staff of the New Hampshire Public Utilities Commission and other parties on their approval of this merger. Both of those agreements now only await a formal sign off from the relevant parties.

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We've always anticipated that the final step, the final milestone will be the approval in New York from the New York Public Service Commission. We always knew it would take time. Since March we've been in confidential discussions with the Commission staff and the other interested parties. These discussions are on both the standalone rate plans for KeySpan's Gas business in New York City and on Long Island and the merger plan. And last week significant progress was made by KeySpan in achieving an agreement, in principle, on the standalone revenue increases. That agreement now requires formalizing and approval by the Commission.

But the KeySpan agreements resolve many very important issues that will form a basis of the merger plan. In fact, only yesterday we received a proposed new timetable for the administrative law judge that allows the rate agreements for KeySpan and the merger plan to proceed on parallel paths. And very importantly, actually provides a backstop date in the autumn of 2007.

I am very confident the PSC will approve this merger. Why? It's quite simple; this transaction brings a wealth of benefits to customers in New York State. In July we filed proposals that were designed to deliver almost \$800 million of benefits over ten years to the consumers of New York. Those are savings that are expected to flow and will flow directly from this merger. \$351 million of those savings will be allocated to our existing Upstate customers in New York, in the old Niagara Mohawk territory. All of ours, and all of KeySpan's labor unions are totally in support of this merger.

So in short, we're offering a package with huge benefits for all our consumers, KeySpan's and National Grid's, and importantly, one that has to make sense for our investors. And clearly it's incumbent upon us and the staff of the PSC to get this resolved and get on with delivering those savings. Those savings are the reason why I'm so confident this transaction will close.

Our value drivers are very clear. Regulatory skills and regulatory relationships are crucial for our business. A major part of our value creation is predetermined by having the right regulatory arrangements. Hence no surprise in our huge focus over the past year in the Transmission review and currently in the Gas Distribution review here in the UK. And the criticality of the importance of those rate plans for the merger in the United States.

And today, Steve's given you a small [teach in] on our new metric. Measures to be intended to allow investors to clearly see how we are performing against these regulatory contracts and to hold us to account.

Financing these businesses in the most efficient way is a huge determinant of value, and that's one of the elements that we will capture through the overall return on equity metric. Driving returns is also about operating efficiently and maximizing the synergies in our business. And I know we have a huge opportunity to create further value from the rigorous application of standardizing the way we do things in the best way. We've now conducted a thorough review across our businesses to identify what is the best practice and where we have opportunities to create common systems and processes.

Now I do not want to sound like a consultant or fall into consultant speak this morning, but this chart illustrates over 100 such opportunities for improvement that we've so far identified. Clearly our focus are on those opportunities in the top-right hand quadrant; the ones that are relatively easy to implement and offer the largest prize. And we've already started to implement some of these.

Let me show you just one from that box. This is an initiative that allows us to make stepped change in the way in which we repair gas leaks on our gas mains. For the very first time, we are bringing together technology from both the UK and the US businesses. The so-called keyhole technology has actually been used in the US for a number of years, yet we've never exploited it in the UK. So at the start of this year, we brought over two trucks from the States with their crews to see if we could apply it in the United Kingdom. In simple terms, the technology consists of a coring machine and a vacuum unit, which very quickly expose a gas main to be repaired, excavating a hole 18 inches in diameter. That's at least four times smaller than anything we would normally do in the UK.

We then employ a repair technology, a UK technology developed here called Ecoséal. It's a state of the art, flexible sealant material, which ensures the integrity of the pipe. But Ecoséal here is being applied using long reach tools that were developed

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in the United States. When the repairs are complete, we use a compaction device to ensure that the road reinstatement is correct, and as you can see here, the end result is very impressive. We've done over 50 trials. The combination of these practices halves the normal time for the total job. We've ordered five trucks that will arrive in the UK in the autumn and training in the application of EcoSeal is underway in the US. Using EcoSeal in the US will allow them to use those trucks significantly more than they currently can, a real example of one plus one equaling three.

And we're not going to rest until we've applied that kind of mindset, that kind of approach to standardizing our best practice across all of our businesses. This is just the start; it's a good start. But as well as driving performance in today's business, we're setting ourselves up, we're setting up a framework here that prescribes the platform that we will use for the day one integration of KeySpan. And believe me, we are ready to go.

Our work to confirm in detail resources of the \$200 million of annual savings is now complete. Almost half those savings come from shared services and corporate functions, a significant amount of the remainder from IS. We've run a very thorough process to make sure we've got absolutely the best people running our US operations and as I mentioned, we've made 85 appointments for that leadership team. At the very top level, we will have four from National Grid in the US, two from National Grid in the UK and seven from KeySpan, a real quality combination. Within the past month, we've secured new labor agreements for our Electric businesses in the US. Those agreements provide an important platform for improving the performance and efficiency of our operations. Post-merger budgets are now confirmed and importantly, allocated to each of the leaders I'm talking about, and they now have responsibility for the first 100 days of execution.

We've delivered a lot over the past year, but as always, there's much to do. Looking ahead, UK regulatory focus we're off on the arrangements for Gas Distribution to be a key area. We'll complete the sale of Basslink, and we'll work to complete the acquisition of KeySpan. And through this framework of improvement, we'll pursue the opportunities that deliver firstly the highest impact on customer service and on our returns. We'll commence the return of the GBP1.8 billion from the sales proceeds of our Wireless businesses. And remember, that is in addition to the return of the cash flows from our US stranded assets. And before the end of this financial year, we will update our dividend policy to take us beyond March 2008.

This is another good set of results. We have created extraordinary value through the sale of our Wireless business, but importantly for the future, we've really sharpened up our strategy. We've stepped up our investment program, we are improving the transparency of the new return on equity measure, and we're making huge progress on really integrating our businesses across the UK and the US. And we're ready to hit the ground running as soon as KeySpan completes.

So we're delivering on all the fronts we talked about in November and that's going to continue because all of these actions are at the very, very heart of driving more value for our shareholders. Thank you.

Sir John Parker - National Grid - Chairman

Thank you very much Steve and ladies and gentlemen. We will now take your questions, but I want to personally apologize to you advance that I will have to leave very shortly in order to chair the monthly court meeting of the Bank of England at 10.15. But Steve and the management team will, of course, remain available to you.

But let's take the first question.

QUESTIONS AND ANSWERS

Unidentified Audience Member

No questions about interest rates for you John (inaudible)

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Sir John Parker - *National Grid - Chairman*

Yes, we (inaudible) here.

Richard Alderman - *Merrill Lynch - Analyst*

Morning, it's Richard [Alderman] from Merrill Lynch. A question for Steve, just looking at your diagram with 100 controllable cost initiatives; slightly more than 50% of them are in the easy side of the diagram. Could you give us some indication in the plan as to how long the first half of the costs initiatives will take?

And I think you mentioned a GBP1.5 billion overall Group controllable cost number back in the November results. What sort of impact on that number would the first half of the initiatives take?

Steve Holliday - *National Grid - CEO*

Well on the timing basis, a lot of this work, as I said, has been understanding and planning it. Those plans are now complete, particularly for the top 20, so those will be in place by the end of this financial year.

But a number of those things are going to go over a period of years, Richard, actually. We said back in November, GBP1.5 billion is indeed the controllable cost base of this business. We're not going to hang ourselves, I think, on saying it's 10%, it's 5% etc.

The great thing about these new return measures, I think, is you can clearly see what cost efficiency actually does. It flows straight down to those return measures. And where we have some capacity in our rate plans, if they're capped, we're under-earning, we can clearly drive those returns harder than they are today.

Sir John Parker - *National Grid - Chairman*

Next question? Back row.

Colin Pollock - *Credit Suisse - Analyst*

Morning, it's Colin Pollock at Credit Suisse. I have a few questions if I may? First of all, I just wondered if you could explain the rationale for not returning all of the cash from the disposal of the Wireless business? I think in total it's 2.7.

And in terms of the KeySpan deal, I wonder if you could just give us a quick update on where you've got on discussions on ROE and things like first disposals, which I think people were talking about potential for that to be a part of the settlement?

I wonder if you could indicate if you're going to give us any visibility on these cash savings which you alluded to in terms of the indication with the business?

And finally, if I may, just trying to understand the impact of the buyback following Wireless on your DPS target growth for next year. Thanks. Sorry if that's too much.

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Steve Holliday - *National Grid - CEO*

It's fine Colin, I've got a pen in my hand here. Let Steve add a bit (inaudible). But let's be clear, we said in November that we'd be disciplined about our balance sheet. We said that you will hold us to account. We judge at the moment the right level of return from the Wireless was GBP1.8 billion.

There's clearly a lot going on. We've got the sale of Basslink, we've got the Gas review going on in the UK and of course, we've got the closure on KeySpan. When we're through that, we will come back and look at the balance sheet and make sure it's positioned where it needs to be and we'll look at the dividend going forward. That's a commitment we've made and you'll hold us to account on that.

In terms of the negotiated detail on KeySpan; these discussions are confidential and so there's only so much I can say. I can only say the things that you've picked up because those are things that are in the public domain. And they were to do with the statements that were made back in February and March by both the Commission and ourselves in terms of putting in a litigated position.

The Commission have some concerns, that have nothing to do with this merger frankly, they are [base case] concerns about the potential of dominance that Ravenswood has in the New York capacity market. That's number one. And we laid out our stall in terms of how savings would be shared etc., and that's how you get to this great number of \$800 million of savings for customers in New York. But it's factored off, obviously, on ROE and you can find very publicly the sort of ROE that are being negotiated around transactions at the moment and they're in the upper nines as you know. But all that stuff is confidential.

What we've done on Ravenswood is, we have made a serious of proposals to address the issues that the Commission have and are very confident that those proposals will find a position that they're happy with and we can get on with delivering these benefits for the customers in New York. And those benefits will springboard of the \$200 million a year of savings that we're confirming. Obviously, that's a number we'll acknowledge as we go forward and will come back and again; you'll hold us to account on that number.

Steve do you want to pick on the DPS going forward?

Steve Lucas - *National Grid - Finance Director*

Yes, I mean we do quote our dividend in a per share way. We obviously increased that by 10% per share. Clearly with the return of GBP1.8 billion, you notice that there was a difference between what we're receiving and that number. I just underline that there's no question that Wireless did support an element of National Grid's debt, so we clearly had to address that, and that explains most of the difference.

By the time we have completed KeySpan, we will have added over \$11 billion of debt to National Grid's numbers. And just underlining the point that Steve made, is that's there a lot of moving parts here, so bringing the debt, at the point that we complete KeySpan, to around GBP18 billion. Obviously, we're quite capable of doing the calculations, but I think we judge it right now wise that we wait until we've got more clarity on KeySpan, more clarity on Gas Distribution, some of the moving parts are stopped moving and then we can freeze our calculations and then determine the longer term dividend policy, and that's what we will do.

Colin Pollock - *Credit Suisse - Analyst*

Okay. Thank you very much.

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Andrew Wright - UBS - Analyst

Good morning. Andrew Wright from UBS. You mentioned the need for additional CapEx in your US -- your existing US businesses, and I wondered if you perceived any danger that you will be required to make additional investments there to ensure that reliability standards are maintained? Or whether this is still very much in the optional level that's something that you can negotiate with the regulators without any pressure coming through from the operational performance in those businesses?

Steve Holliday - National Grid - CEO

Well, this is the real world, Andrew, isn't it? We are, already, actually investing money on reliability in New York, in particular, and in Massachusetts. We've talked in the States of \$1.4 billion going in over the next period of time, which is a number actually some of which is CapEx and some of which is OpEx. And Cheryl can give you, in a moment, just a flavor of some of the things we've done this year.

You know, it's the things in the UK here, we need to reach an agreement, clearly, that that investment are required, because ultimately the ratepayers are going to pay for that investment. But we're also not going to let things deteriorate beyond a certain condition in the short term. There's a lot spoken about in New York about our reliability, actually. We are average in New York State. We are absolutely bang on in terms of saving (inaudible) statistics, we are average of all the New York utilities. That disappoints me, frankly, because that's not National Grid. We are not an average business, at all. That's why we're talking about this, we really think we do need to increase the expenditure there, but it's going to be subject to the discussions we're going to be having over the next few years.

Cheryl, do you want to just give people a flavor for what we've done in the year just gone by?

Cheryl LaFleur - National Grid - SVP USA

Yes, we've over the past year we've been running (inaudible) replacing tens of thousands of our older switches, and our poles to really allow to consistently meet the service standards that our regulators set. I think we're well ahead of any mandatory spending, but really, trying to put ourselves in the best position in terms of (inaudible) we're in now, we'll be able to get this existing CapEx recognized and raised and (inaudible) sustainable (inaudible) going forward.

Steve Holliday - National Grid - CEO

Thanks, Cheryl.

Bobby?

Bobby Chada - Morgan Stanley - Analyst

Thanks, it's Bobby Chada from Morgan Stanley. I just have a couple of questions. I think previously KeySpan in their standalone rate proposal had put forward something like a double-digit rate increase, which was significantly higher than your initial merger plan. In the -- can you talk about what they have agreed or got to in this new standalone proposal that's been concluded?

That was the first point, and then secondly, am I right in thinking that the US returns that you've quoted do not include the deferred revenues that you're receiving in New York, and therefore if those were wrapped in, the number would be higher? Thanks very much.

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Steve Holliday - National Grid - CEO

I'll let Steve do the second part. The beginning of the first part is very easy, unfortunately, Bobby. I can't tell you the answer to that. You're quite right in what you inferred though. When the filings were made, which was October last year. October last year was when the Commission actually asked, asked for the filings, for the standalone rate cases, which in many ways we were quite pleased about, because it does show what would happen without the merger, as well as the benefits from the merger. They have reached an agreement. It is confidential until the Commission actually agree and put it in the public domain.

Steve Lucas - National Grid - Finance Director

It's a very good question, Bobby. We have not included in the US return calculations the impact of deferral account recoveries, which as you know added \$150 million to our numbers in the year we've just reported add another \$150 million in the year ahead. And indeed, because there's an accumulation of costs building up, we'll continue to add to our revenues and indeed our returns. And that's because under US GAAP they are stripped out, but there's no question that that would add materially to the return numbers that we've reported today.

Steve Holliday - National Grid - CEO

Someone down here now.

Andrew Moulder - CreditSights - Analyst

Yes, hi, it's Andrew Moulder at CreditSights. I was a bit disappointed you didn't actually give any balance sheet ratios, or areas there in which can also judge your performance. I appreciate there are a lot of moving parts, but you have talked a lot about balance sheet efficiency. Is it possible, at this time, to give us some indication of what you actually mean by that? What that might mean for the rating of Nat Grid, and whether you're still committed to an A range rating at the UK opcos? Thank you.

Steve Lucas - National Grid - Finance Director

We are still committed to an A range rating for our UK operating companies, make that very clear. Within that commitment, we will absolutely have a very sharp pencil in ensuring that we are not retaining excessive capacity or excessive flexibility. And it was demonstrably evident, buying KeySpan for cash, that we had retained capacity, and we certainly wouldn't retain excess capacity for as long going forward. There are an awful lot of details that I could have referred to in the presentation. Obviously, I devoted a huge amount to the returns, which we felt were very important.

The very important metric that we use -- that the rating agencies use, as you know, for judging ratings and other things, is the cash cover ratio in terms of the interest bill, and in these numbers it was 4.6%. That's a good, comfortable margin for the rating that we've got. We, as you know, maintain a very active dialog with the rating agencies, particularly going into any transaction. We'd like to have total visibility, not just for the equity investors, but also debt investors, so that as you've seen over the years, within hours of announcements being made, the rating agencies also come out with their confirmation of the ratings. And we'll continue to do that going forward.

Steve Holliday - National Grid - CEO

But, if I can just add to that. What's behind your question, I agree with. We talk about that discipline around the balance sheet. We talk about the discipline around the way we run our business; we're putting the return metrics out there today. When we come back at the end of the year, and we talk about the balance sheet, we do need to, I think, get a metric you can hold us to account on.

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Edmund Reid - *Cazenove - Analyst*

Hi, Edmund Reid from Cazenove. I just had a quick question on the metering business, and Ofgem recently put out something regarding their investigation into the metering business. I think this has been ongoing for the past year and a bit, now, and I was just wondering where you'd got to on that?

And then secondly, also on the metering business, the way you see the opportunities in terms of maybe smart metering; I think you've talking about that a lot recently.

Steve Lucas - *National Grid - Finance Director*

Well, I know that Edward is chomping at the bit to talk about the first part of that question, but let me just handle the second part first. We are doing a lot of work in the UK and the US on smart metering, actually, and we see huge opportunities for us, both in the UK and in the US. Don't forget, in the US we own all the electric meters, it's part of the network. The position in the US in particular has dramatically changed in the past 18 months, with the new elected governors in Massachusetts and in New York, the energy efficiency agenda and climate change agenda is now top. So we're doing a lot of work in helping people think through, what are the right answers over there?

We're doing a lot of work over here with some of the trials, and I, and I know Edward and the team, are also very concerned about the use of the expression smart meters, because it covers a multitude of different interpretations, actually, from things that are frankly quite dumb, to things that are extraordinarily smart. And we're trying to make sure that before people over-commit, that we actually think about what is a sensible longer-term solution, because you don't take a meter in and out every 12 months, obviously.

We'll let Edward come back and just tell you about where we are vis- -vis the first part of your question, Ed.

Edward Astle - *National Grid - Group Director*

Thank you for that. Just to finish off on smart, Steve, I think it's worth saying that we see it as a great investment opportunity. We are in electric as well as gas metering through our OnStream business in the UK, and we've done a lot already practically with trials, with new products for the industrial and commercial consumers, and with a very clear proposition, which we're discussing now with our customers, and indeed with a lot of the interested parties at government level too. So big opportunity there for us.

Where are we with the competition [active] investigation from Ofgem. It's actually nearly two years since Ofgem instigated this investigation. We have a very robust rebuttal, both in writing and verbally, which Steve led last August and September. We were surprised and disappointed that they came back with a supplementary statement of objections. Our initial assessment suggests to us that we are as confident now as we were last summer, that we are not in breach of the Competition Act, and we're working very, very hard to try and help Ofgem bring this to a very swift conclusion.

Edmund Reid - *Cazenove - Analyst*

(inaudible) is there anything that defines, in terms of --

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Edward Astle - National Grid - Group Director

Through the process, yes. There's a defined period now of eight weeks from the original arrival of this supplementary statement of objections. That then is the time when we give our written permission back, and then there'll be an oral hearing in the summer. The uncertainty then is how long it will take Ofgem to make up their minds based on our submission.

Steve Holliday - National Grid - CEO

New entrants in competition in this market has developed almost as fast as any market been opened. Which is a very interesting fact, I think.

Jonathan, was that you with your hand up?

Jonathan Mirrlees-Black - Exane BNP Paribas - Analyst

Thank you. Jonathan Mirrlees-Black Exane BNP Paribas. Quick question on the asset base on which you're using to measure returns in the UK. Just to clarify, it looks like the asset base you're using, it doesn't include the CapEx which isn't in the RAV that would be added within five years under the incentive arrangements. And if that's the case, could you say what the figure is that would be added, and the returns that would be if you included that? And perhaps you could also indicate the volume of spend that you expect on that kind of CapEx within the plan period?

And a second question, if I may? Steve's been making comments recently about climate change, and possible changes to incentives on utilities, and I think it might apply both in the US and the UK. I'll be quite interested to hear what your thoughts are and perhaps to set them out in a bit more detail, and what impact you think that might have on discussions you're having with regulators. Thank you.

Steve Lucas - National Grid - Finance Director

It's actually our calculation of RAV, and underpinning that is our confidence that actually the investment we're making actually will go into RAV. So those returns are calculated on what we've invested, including everything. So there's nothing more to add in that respect.

We're not going to give you ROE estimates or predictions going forward. I have told you, I think that they will go up, actually pretty much across the board in Transmissions will go up because of all the things that were fixed in the Transmission price control, and indeed all of the things that are going to be fixed in the Distribution price control will also cause those returns to materially increase. And the detail is in the appendix. There's 15 pages of details, which I think will answer you absolutely specifically on the detailed numbers.

Jonathan Mirrlees-Black - Exane BNP Paribas - Analyst

Can I just ask, does that include the investment that Ofgem haven't yet included, that will be included?

Steve Lucas - National Grid - Finance Director

Yes, it's in there.

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Steve Holliday - National Grid - CEO

These are actual investment, yes. All the IR team here, and there are going to be a lot of questions about the detail, and I suspect we should take those offline, when you've had a chance to read the 15 pages which is a bit unfair on you. And I don't want to go into the second part too deeply this morning. Suffice it to say, I think we feel very strongly that we've done a lot in our business over the last few years to make sure that we are using as little energy as we can, and we're producing as little greenhouse gas as we can. And the biggest solution to the carbon issue is to stop using energy in the first place. That's the cheapest way of saving carbon.

And there are a lot of things that we believe can be done. We have great experience in the US in particular, where through our rate plans we have invested to help consumers use less energy. This financial year will we spend I think it's \$168 million, from memory, across our territory recovered through the rates to help people consume less energy. Sometimes on buildings, we're reducing energy use about 40%. There's a huge prize there that we're not actually getting at.

Some of the statements that I've been making, some of the things that we are doing, are turning it on its head and saying, you can talk about this until you're blue in the face, but if you make money out of selling units of energy, you're going to sell units of energy. We can certainly, in our business, turn our rate plans into fixed revenue plans and provide incentives for us to invest and help people consume less energy. So we're motivated to make money out of that, and at the same time we're reducing energy consumption. Those are the sort of discussions that we've started, particularly in the US, where it fits the business model we have. I just think that's where we've got to go now. Otherwise, people will continue to want to sell more units of energy.

Jonathan Mirrlees-Black - Exane BNP Paribas - Analyst

And the timescale you think that agreements on that sort of rate plan might be achieved?

Steve Holliday - National Grid - CEO

Do you know, if I had a crystal ball, I wouldn't do this job, I can assure you. I'm being facetious; I don't know. The discussions are getting quite deep and interesting. I certainly would hope something in the next two years or so, but please don't hold me to that as a target at this stage.

Peter?

Peter Anderson - Citigroup - Analyst

[Peter Anderson] of Citigroup. A couple of easy ones. Firstly on the property profits, can you just give us a feel actually how you generate GBP80 million odd of property profits, and just us a feel how sustainable that is going forward?

And then perhaps just a follow-on on [Wrighty's] question on the US. Can you give us a feel for this regularity lag on the CapEx, that's [getting into the] rate base? What is the average time length we should be calculating, and is the cost of that lag recoverable, when it goes into the rate base, do they add a bit on for the costs you've incurred?

Steve Holliday - National Grid - CEO

Alright. Let me do the second one first, and don't get this out of proportion here. We are not spending massive amounts of CapEx over and above the flat line in the rate plan. We are running slightly ahead on those plans. And some of it is OpEx as well, actually, which we're investing, because some of the work that Cheryl described actually is operating expenditure. You do not get a recovery when it gets into the rate base. So it's very important, therefore, that we constrain that and negotiate it, make

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sure that we get the CapEx that we believe these businesses require. Clearly in the next few years, there are some opportunities for us to do that.

Edward, do you want to pick up the dissertation on property?

Edward Astle - *National Grid - Group Director*

On property, very briefly, these are proceeds from selling on property that has been operational within National Grid, old gas held sites, for example, many of which are in urban centers, after we've cleaned them up. So we are simply focused on our portfolio of sites, cleaning it up, selling it on. And we're selling it into almost all property sectors, some housing, some retail, some commercial.

Peter Anderson - *Citigroup - Analyst*

Sorry, (inaudible) the salability of this sort of (inaudible) rate?

Edward Astle - *National Grid - Group Director*

Well, clearly property portfolio is a finite resource, so over the long run, I think you have to imagine we will actually end up completing sale of the sellable properties. What we have found over time, partly because of the buoyancy of the property market, partly because of the success we have in remediating ever more complex sites, because of improving technology. We're stretching that out, and I think we've already exceeded some of the forecasts that we had before. So we're good for a while yet, but over the long term, we have to assume that we will have completed the task.

Steve Holliday - *National Grid - CEO*

We'll still be talking about that here, though, in a good few years' time. Because they still have a rump to go yet.

Andrew Wright - *UBS - Analyst*

Hi, this is Andrew Wright again. Question on the Netherlands interconnector, or the interconnectors in general. Could you just let us know what the megawatts you expect that interconnector to be, and when you expect it to be commissioned, if it does go ahead? And are there other plans for interconnectors with continental Europe that you know about or are involved with? And in particular, is the Norway interconnector still alive?

Steve Holliday - *National Grid - CEO*

Well, it's a gigawatt, is the answer to the first part, 1,000 megawatts. I think 2010 is the start-up date for that. We will continue to pursue other interconnectors where they make sense. Norway, as you know, has come and gone; it's still there, we haven't dropped it. It's not economic at this stage, but we'll keep looking at it. Things that are electric and gas and associated with the UK and the US, we will continue to pursue. And interconnectors are very much a part of that.

Andrew Wright - *UBS - Analyst*

Do you know if there are any further proposals for an expansion of an interconnector with France, for example?

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Steve Holliday - *National Grid - CEO*

No, there aren't at the moment. Behind you (inaudible) that's fine.

Fraser McLaren - *ING - Analyst*

[Fraser McLaren] from ING. I have a few questions, if I may? First on New York, I understand that there's been some noise around the expense of land remediation. Is this related to merger approval, and is there any risk here?

Next, you've worked hard to reduce US bad debts in the past, but experience reversed last year. Would you outline the reasons, please?

And last one for Steve, two Steves, I'm sorry --

Steve Holliday - *National Grid - CEO*

It just flies between the two of us, it's fantastic.

Fraser McLaren - *ING - Analyst*

Could you confirm that the net debt guidance of GBP18 billion includes the receipt, but not the return of the cash from the Basslink deal?

Steve Holliday - *National Grid - CEO*

Okay, let me do the first two actually there. Land remediation, it's back to Edward's story just is now, actually. There are a number of old gas sites on Long Island that are contracted, essentially, to be remediated by KeySpan. They have been for a long time. We've remediated a lot of sites upstate, actually, and done a very good job. So one of the things that we said in this transaction is, one of the benefits that will happen, actually, is the expertise that we have in both the US and particularly Edward's team here in the UK. It absolutely is, I can say this without being arrogant, world-class. People from all over the world come to learn the techniques that we've applied here. But we can apply those techniques to those sites, and more efficiently and effectively remediate those sites.

Now, I don't think we started it, but by discussing it, everyone's going ah, yes, those sites, right, let's go back to those sites. Now how quickly were you going to remediate them, and when? And so there's a little bit of noise around that actually. And, of course, people would like the sites to be remediated faster, but the remediation costs money, and it gets recovered through the rate. So there is an agreed pace at which that will be done in New York. What we will do is bring some extra expertise to the table there to help with that.

Bad debts last year are commodity-price related. There's huge hike, about a doubling, year-on-year, on commodity prices, which is not surprising, then flows straight through into the bad debts. Of course, they're coming back off again, now, so we would expect to see an improvement in this fiscal year.

Steve Lucas - *National Grid - Finance Director*

We've already seen an improvement, actually, partly because of the effect of prices dropping, but partly people have accelerated their payment of the bills. I think the important thing is that the proportion of the amounts outstanding of the amount that was being paid was actually broadly similar to prior periods. So the underlying performance on bad debts had not deteriorated,

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we just simply had a multiplier effect with the prices. But you're right, it is an area where we focus, and it is an area where we continue to believe we will get benefits. And actually, it's one of the benefits that will come out of the KeySpan merger, because KeySpan have made themselves big inroads into bad debt, and we'd like to tap into some of that experience.

Yes, I gave a broad GBP18 billion guidance on net debt by the time we complete KeySpan. It includes proceeds from the sale of Basslink. It does not make any assumption about where those proceeds will go, but to absolutely come back to the point Steve made, we know whose money that is. If we haven't a short-term need for it, it goes back to shareholders.

Steve Holliday - *National Grid - CEO*

Ed?

Fraser McLaren - *ING - Analyst*

Thank you.

Edmund Reid - *Cazenove - Analyst*

I have a specific question on the ROE calculation in New York. You mentioned before that you weren't including the deferral recovery. I just wondered why not, because in certain years you're under-recovering, so surely if you're doing a sort of average, rolling average, you should include it?

Steve Lucas - *National Grid - Finance Director*

Yes, of course, we're also not including the expense to which the deferral account relates. So let me explain. US GAAP basically says for certain sorts of costs, we won't run them through the P&L, we'll put them in an account to be recovered later. IFRS, we hit our profits with those expenses, but we then get the benefit in future years from recovering those costs. We think actually, the way we'd expressed it is the fairest way, essentially, ignore the costs which are going to be recovered under deferral arrangements, but also ignore the receipts. What that does is evens out the time. I was merely pointing out that in the short term, in the next two years, we would expect to actually have returns measured effectively under IFRS; it would be materially higher. So you'd see that flowing through into the Group ROE much more than the individual performance against the New York rate plan.

Steve Holliday - *National Grid - CEO*

And of course, the key thing is that the regulatory arrangements are fixed under US GAAP, essentially, and are published, so we've got to go back to US GAAP there. If you put them under IFRS it would be meaningless. They'd be very, very high, but they'd be meaningless as well.

Edmund Reid - *Cazenove - Analyst*

Okay.

Steve Holliday - *National Grid - CEO*

Ian?

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Unidentified Audience Member

Could I just ask about Basslink? You say you've had lots of interest. I suppose the question is, why haven't you sold it already, if you have so much interest, given that in Australia, the home of the infrastructure fund?

Steve Holliday - National Grid - CEO

You just can't win. We've done so much for six months and you here -- I think we said back in -- I'm sure I said, back in November, actually, that having announced the sale of Basslink, the first thing we had to do is talk to Hydro Tasmania, who were the contracted party as part of the contract, and make sure that all the change of control elements of that contract were resolved and sorted out. So that took a little period to get that all sorted, which is done. And then we have to put an information memo together, which is now complete. That went out to the parties, and the auction process is now underway. There's nothing hidden here at all. It'll take as long as it takes, but late summer we should have it complete.

Any final questions? Okay, if not, thank you very much for joining us this morning. We are going to be around, so if anyone would like to pick us up, then please do so. Thank you.

Steve Lucas - National Grid - Finance Director

Cheers.

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