



**Southern Electric Power Distribution plc
Scottish Hydro Electric Power Distribution plc
Scottish Hydro Electric Transmission Ltd**

Compliance Annual Report 2010/11

Restriction on use of certain information and independence of the Distribution and
Transmission Businesses

Compliance Report 2010/11

Introduction

This report is for the year to March 2011, as required by Condition 43 of the standard distribution licences of:

Southern Electric Power Distribution plc (SEPD), and
Scottish Hydro Electric Power Distribution plc (SHEPD)

and by Special Condition E of the Transmission Licence of:

Scottish Hydro Electric Transmission Ltd (SHETL).

as to compliance with the licence requirements on the restriction on use of certain information and independence of the distribution and transmission businesses ("Compliance").

SSE Power Distribution is a trading name of SEPD, SHEPD and SHETL, part of the Scottish and Southern Energy plc (SSE) group of companies.

Henderson Loggie continued to be appointed as Compliance Officer for 2010/11 and have been re-appointed for 2011/12.

Legal separation and governance

SSE Power Distribution has published a Statement of Compliance, as required by the distribution and transmission licences. This can be found on the SSE Power Distribution website:

www.ssepd.co.uk.

SSE Power Distribution has a separate Board of Directors. Corporate governance procedures, which have been advised on by the Compliance Officer, continue in place between the SSE Power Distribution Board and the SSE Board. Two of the SSE Power Distribution Directors are also SSE Directors, which reinforces the decision-making authority of the SSE Power Distribution Board and maintains appropriate corporate governance.

SSE Power Distribution has its own management structure. SSE energy systems staff are employed by SSE Power Distribution.

Responsibility and monitoring

The SSE Power Distribution Board has overall responsibility for Compliance.

It is the responsibility of managers to ensure Compliance within their own business areas, in accordance with SSE policy. Business processes are designed to ensure Compliance by staff in the normal course of their duties. Monitoring of these processes is carried out internally by the SSE Internal Audit department, in liaison with the Head of Regulation, Networks.

During the year SSE Power Distribution has worked closely with the Compliance Officer, appointed in accordance with the requirements of the licences. The Compliance Officer's work during the year was to monitor the ongoing effectiveness of procedures and systems with regard to Compliance, and Internal Audit is utilised in carrying out this role.

The Compliance Officer has full and open access to all staff and documentation. There have been regular visits and meetings with the Compliance Officer during the year to monitor ongoing Compliance. The Compliance Officer's report to the Directors of SSE Power Distribution, as required by the Licences, is attached to this report.

New or modified systems

There have been no new, or modifications to, IT systems where there has been any need to take into account Compliance considerations.

Staff training and movements

Staff transfers from SSE Power Distribution to the supply and generation businesses, where there is a Compliance implication, are discussed with the Compliance Officer.

During 2010/11, a senior staff member within the transmission business was offered a role within the SSE renewable generation development business. This transfer proposal was reviewed by the SSE Power Distribution Board and it was subsequently decided that the transfer was not in line with the principles of separation. As a result, the SSE Power Distribution Board opted to block the transfer and the staff member remained in the transmission business.

Transmission

SSE jointly manages and operates its transmission and distribution businesses.

Complaints or representations on compliance

There were no complaints regarding SSE Power Distribution received during the year.

Further information

Queries on this report should be addressed to:

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Scottish & Southern Energy plc
Report of Compliance Officer
for the year to 31 March 2011

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1 Introduction

Condition 42 of the Distribution licences of Southern Electric Power Distribution plc ("SEPD") and Scottish Hydro Electric Power Distribution plc ("SHEPD") and Special Conditions C and E of the Transmission licence of Scottish Hydro Electric Transmission Limited ("SHETL") require that distribution and transmission are managed in such a way that they do not restrict, prevent or distort competition elsewhere in the energy industry and the absolute confidentiality of related, commercially sensitive information. Other conditions of the Licences prohibit cross subsidisation between separate businesses and discrimination between suppliers by the distribution business, in addition to a financial ring fence.

SSE have agreed with Ofgem and published their Statement of Compliance which sets out how SEPD, SHEPD and SHETL (who collectively trade as SSE Power Distribution) comply with the licence requirements specifically on the restriction on use of certain information and independence of the distribution and transmission businesses.

Condition 43 of SEPD's and SHEPD's licences and Special Condition E of SHETL's licence require SSE to appoint a Compliance Officer to facilitate compliance with the licence restrictions on use of certain information and the independence of the distribution business within SSE.

Henderson Loggie, Chartered Accountants, are the the Compliance Officer appointed by SSE. On behalf of Henderson Loggie, the Compliance Officer's role is carried out by George Hay (partner) supported by Terry Allison (partner). The Licence requires we report annually to the Directors on our activities over the year to 31 March, and that the Licensee reports thereafter to Ofgem on the Compliance Officer's activities and other relevant issues.

The specific duties of the Compliance Officer are attached but principally we are responsible for supporting SSE with its compliance with the separation licence conditions. This includes providing advice to SSE on complying with the confidentiality and separation obligations placed on the distribution and transmission businesses, monitoring the effectiveness of the practices, procedures and systems adopted by SSE, investigating complaints and reporting annually to the Board. We are also required to liaise with Ofgem on all of these matters as appropriate.



2 Overall approach

During our period of appointment as Compliance Officer, we have developed a Compliance Audit Programme ("CAP") which details the monitoring and testing we consider necessary to ensure systems, procedures and controls are dealing efficiently and effectively with separation as required by Conditions 41 & 42 and Special Conditions C, D & E together with SSE Power Distribution's Statement of Compliance as agreed by Ofgem.

Our role continues to be the monitoring of systems and procedures established by SSE to ensure their ongoing effective operation in light of the latest requirements and guidelines. Our main contacts throughout the year at SSE have been the SSE Power Distribution Board and senior managers, in particular Rob McDonald, Steven Kennedy, Aileen McLeod (Regulation) and Malcolm Thomas (Internal Audit). We also consider it important to visit some of the key administration sites of the distribution and transmission businesses in Scotland and England where we have undertaken interviews and audit work as appropriate.

Wherever appropriate we have used SSE staff, both Internal Audit and Regulation departments, to assist us with the testing, with our role in such circumstances being to review the work undertaken, the results and conclusions reached and any remedial action taken. All other monitoring and testing was undertaken directly by ourselves and in particular we communicated with operational and administration managers and staff to discuss issues arising from separation, focusing on critical areas such as staff induction, training, branding, physical separation and access, IT, data confidentiality and managerial separation.

Our approach continues to build on the detailed work undertaken in previous years and focuses primarily on the Statement of Compliance issued by SSE Power Distribution and agreed with Ofgem. In addition, we visited key SSE Power Distribution operational sites in Scotland and England and looked at the scope and results of the work undertaken by Internal Audit. We also hold discussions with SSE Regulation department and review Ofgem website to identify particular areas of risk or other areas where we should specifically consider in the current year. Areas specifically addressed this year included new connections, distribution connections and transmission connections outage planning, HR, physical access, cross subsidies, staff transfers and the interaction with Scotia Gas Networks plc.

During the year Scottish Hydro Electric Power Distribution (SHEPD – a subsidiary of SSEPD) was fined by Ofgem for failing to fully comply with its Distribution licence conditions 12 (provision of connection quote within 90 days) and 30 (system and process sufficient to monitor provision of connections service). SSEPD has since made a significant investment in new systems, processes and controls to ensure ongoing compliance with these licence conditions. These new systems have been audited by Ofgem.

Our work has again confirmed that the culture throughout the organisation toward separation remains robust.

Whilst absolute separation could not be consistent with SSE's shareholder and stewardship responsibilities, systems, procedures and structures have been implemented and continue to operate to ensure the key objectives of separation have been met. In particular, the group structure has allowed effective managerial and operational independence within the group's strategic plan. Underpinning this is a philosophy whereby access to information and data is prevented where separation requires it and we consider its implementation has been robust and thorough. Where systems enhancement or development allows, separation issues will be considered. Where staff may have access to certain ancillary information not necessary for the performance of their duties, the staff involved are not in a position to realistically use the information/knowledge to effect anti-competitive practices. Where confidential strategic information, which is recognised as a genuine risk to the planned benefits of separation, is involved, we found effective procedures and systems to be in place.

SSE places particular emphasis on confidentiality clauses in staff appointment letters and regularly reinforces the importance of confidentiality and clearly sets out the disciplinary process which would follow any breach.

We have not been required to meet with Ofgem this year.

Our report this year is structured in line with SSE Power Distribution's Statement of Compliance and sets out the results of our testing and assessment of SSE Power Distribution's compliance with the terms of the statement and hence the relevant licence conditions.

3 Managerial and operational independence of SSE Power Distribution

We identified several distinct facets all of which are essential to achieving managerial and operational separation as required by the Licence and Ofgem. These include legal and physical separation, establishment of autonomous boards and decision making processes, establishment of contractual and service level agreements, data confidentiality (including new connections) and branding of the separated businesses.

The more obvious, practical aspects such as the creation of separate legal entities, statutory transfer schemes, physical access restrictions and branding have been specifically verified. We also spoke with staff and managers across the group to confirm processes and procedures were being followed and reinforced.

We monitor the effectiveness of strategic data confidentiality, autonomy of decision making of the distribution business and corporate governance issues. This involved reviewing relevant board minutes and discussing the actual operation of the decision making process with directors and officers. The make up of the board of SSE Power Distribution and the regular board meetings help ensure appropriate governance is maintained and reinforce SSE's recognition of separation. The board composition has been reviewed and strengthened over recent years with the appointment of senior distribution and regulation personnel as directors.

In addition, this year the board's terms of reference and the capital authorisation corporate policy have been refreshed to further strengthen the independence of SSEPD and reinforce the corporate governance procedures.

The ongoing training of staff on confidentiality and the seriousness with which SSE would regard any breaches continues to ensure the underlying philosophy and approach adopted by SSE in this area is maintained. There have been no disciplinary proceedings under separation, confidentiality or competition conditions of employment.

During the year a senior staff member within the Transmission Business was offered a role within the SSE onshore renewable generation development business. This proposed staff transfer was identified and reviewed by the SSEPD Board who decided it was not in line with the principles of separation. As a result the staff transfer was blocked and the manager was retained within the Transmission Business.

4 Common services

We have considered the service level agreements ("SLAs") in place and discussed their operation in practice with no issues being identified. There have been no external complaints in this regard which implies the practices are not anti competitive.

In addition, the report on cross subsidies presented by SSE and audited by KPMG LLP did not raise any material concerns from Ofgem.

The position with regard to Scotia Gas Networks plc is discussed at section 10.

5 Customer system and confidential information

In each year of our appointment, we have given particular focus to the integrated Customer Services ("CS") system and the related staff induction and training programmes and concluded that SSE's approach was in line with their stated and accepted philosophy. This year we again focussed on:

- confirming systems, processes and procedures are still appropriate;
- review of internal audit work on the IT security profiles and access controls and resultant follow up action plans.

Each year, the internal audit function allocates significant resource to this area. Their work identified minor administrative matters relating to access for staff following transfers and the storage of files but none which gave rise to any separation risk. All the points raised have been acted upon and resolved swiftly. From our work we are satisfied that SSE continues to comply with its stated policy and to implement and enforce rigorously procedures and controls commensurate with that policy.

SSE Power Distribution has procedures in place to ensure access to information specifically designated as confidential is restricted at all times.

6 Branding

Following SSE Power Distribution's stated policy, branding continues to be effective and is reinforced in the market place through vehicle, site, advertising and stationary brands.

We are satisfied that branding is in keeping with the group policy and consistent with the need to separately brand the power distribution business within the market place.

7 Responsibility

Separate legal entities for the operating subsidiaries creates an appropriate structure for separation to be effective. The formal procedure of regular SSE Power Distribution board meetings underpins this and we consider these to be fundamental to achieving effective separation. At least 6 board meetings are held each year.

This board has clearly defined terms of reference which have been refreshed in the current year and a remit which allows SSE group to continue to meet its corporate objectives whilst satisfying the Licence requirements. In addition, the corporate governance policy has been approved by the PLC board which recognises the role of the SSE Power Distribution board and empowers it with prime responsibility for protecting the independence and confidentiality of commercially sensitive information. In this regard, we note that the Capital Authorisation Corporate Policy continues to partially exempt SSE Power Distribution from the group's capital expenditure approval procedure to ensure confidential information is not made available to inappropriate executives or staff.

As an independent, external compliance officer, our approach brings an objective review of the practices, procedures and systems in place or planned to help ensure the conditions of the Licences and the Statement of Compliance are being achieved.

8 Complaints

We have established a procedure with SSE's Director of Regulation whereby any complaints received relating to separation will be immediately forwarded to us with a covering letter setting out the investigation work to be undertaken by SSE. Thereafter we will receive details of SSE's response to the complainant and any remedial action taken or proposed. We would then decide whether or not we considered it necessary to undertake our own investigation. Whilst there can be no guarantee that every relevant complaint would be dealt with by Regulation, we are satisfied that all those with substance would be notified to Regulation and thereafter the above procedure would be applied.

We have not been advised of any complaints relating to separation during the year.

9 Advisory role

Our remit as Compliance Officer includes providing input on separation issues to help ensure policies and procedures are consistent with the Statement of Compliance and meet the expectations of Ofgem where practicable.

Meetings with Regulation staff and SSE Power Distribution directors allowed such issues to be aired and addressed as they arise.

10 Scotia Gas Networks plc ("SGN")

SSE has a joint venture agreement with 2 Canadian Pension Schemes to own and run two gas distribution networks previously owned by National Grid Transco plc. The joint venture company is Scotia Gas Networks plc and SSE owns 50%.

SGN use SSE managerial staff under a Managed Services Agreement which has been approved by Ofgem. SGN has its own finance systems and all SSE staff working for SGN have to use separate access authorities controlled by SGN. Internal audit have reviewed access of SSE staff to SGN systems and are satisfied appropriate controls exist. We have considered physical access and have not identified any separation issues.

We have also considered the strategic interaction and staff transfers/secondments under the MSA and are satisfied that no separation issues exist for SSE. We have reviewed the Managed Services Agreement and are satisfied it does not give rise to cross subsidies or distort competition.

SSE has a gas supply business and a gas connections business. We have considered the implications of owning 50% of SGN and the Managed Services Agreement in terms of operation and management but are satisfied that SSE's procedures and controls are appropriate to guard against access to or use of confidential information and to prevent any anti-competitive practices.

11 The year ahead

Separation has now been fully achieved, the appropriate practices, procedures and systems bedded in and SSE's Statement of Compliance fully implemented. Accordingly, our ongoing role will be to monitor the operation of the relevant systems and procedures in light of the licence conditions, independently assess SSE's compliance and to advise on any relevant issues which arise.

Henderson Loggie
30 June 2011

Attachment I Duties of Compliance Officer

- 1.1 The duties and tasks assigned to the Compliance Officer shall include:
- a) providing relevant advice and information to the Licensee for the purpose of ensuring its compliance with the Relevant Duties;
 - b) monitoring the effectiveness of the practices, procedures and systems adopted by the Licensee in accordance with the statement referred to in Condition 42 of the Distribution Licences and Special Condition E of the Transmission licence;
 - c) advising whether, to the extent that the implementation of such practices, procedures and systems requires the co-operation of any other person, they are designed so as reasonably to admit the required co-operation;
 - d) investigating any complaint or representation made available to him;
 - e) recommending and advising upon the remedial action which any such investigation has demonstrated to be necessary or desirable;
 - f) providing relevant advice and information to the Licensee for the purpose of ensuring its effective implementation of:
 - i) the practices, procedures and systems adopted in accordance with the statement referred to above; and
 - ii) any remedial action recommended in accordance with sub-paragraph (d); and
 - g) reporting annually to the directors of the Licensee – in respect of the year ending 31 March 2003 and of each subsequent year – as to his activities during the period covered by the report, including the fulfilment of the other duties and tasks assigned to him by the Licensee.
- 1.2 As soon as is reasonably practicable following each annual report of the Compliance Officer, the Licensee shall produce a report:
- a) as to its compliance during the relevant year with the Relevant Duties; and
 - b) as to its implementation of the practices, procedures and systems adopted in accordance with the statement referred to above.

- 1.3 The report produced in accordance with paragraph 1.2 shall in particular:
- a) detail the activities of the Compliance Officer during the relevant year;
 - b) refer to such other matters as are or may be appropriate in relation to the implementation of the practices, procedures and systems adopted in accordance with the statement referred to above; and
 - c) set out the details of any investigations conducted by the Compliance Officer, including:
 - i) the number, type and source of the complaints or representations on which such investigations were based;
 - ii) the outcome of such investigations; and
 - iii) any remedial action taken by the Licensee following such investigations.