

Scottish and Southern Energy Power Distribution Limited

**Report of Compliance Officer
for the year to 31 March 2014**

ID271336



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Duties of Compliance Officer



1 Introduction

Condition 42 of the electricity distribution licences of Southern Electric Power Distribution plc (“SEPD”) and Scottish Hydro Electric Power Distribution plc (“SHEPD”) and Special Conditions 2B and 2I of the electricity transmission licence of Scottish Hydro Electric Transmission plc (“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. SEPD, SHEPD and SHETL collectively trade as Scottish and Southern Energy Power Distribution Limited “SSEPD”.

SSEPD have agreed with The Gas and Electricity Markets Authority (“the Authority”) and published their Statement of Compliance which sets out how SSEPD 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 SSEPD 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 plc.

Henderson Loggie, Chartered Accountants, are the Compliance Officer appointed by SSEPD. On behalf of Henderson Loggie, the Compliance Officer role is led by George Hay (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 the Authority 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 in 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 the Authority 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 42 & 43 and Special Conditions C, D & E together with SSEPD’s Statement of Compliance as agreed by the Authority.

Our main contacts throughout the year at SSE have been the SSEPD Board and senior managers, in particular Steven Kennedy, Aileen McLeod, Malcolm Burns and Andrew Wright. We consider it important to visit a selection of key sites of the distribution and transmission businesses in Scotland and England where we have undertaken interviews and reviews. During the year we have visited sites in Perth, Arbroath, Aberdeen, Inverness, Oxford and West London.

Wherever appropriate we have utilised SSE resource, both Internal Audit and Regulation departments, as part of our review, 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 review was undertaken directly by us. In particular we communicate 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 focuses on the Statement of Compliance issued by SSEPD and the objectives set out in the relevant licence conditions. We visit key SSEPD operational sites in Scotland and England and look 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 we should specifically consider in the current year.

In particular this year, we considered the risks associated with the continuing significant growth in transmission, as well as new connections (in distribution and transmission), HR, physical access, cross subsidies, staff transfers and the interaction with Scotia Gas Networks plc. Progress on SMART metering was monitored and the appointment of sufficiently independent directors was noted. In addition the interaction with SSE’s generation business in Shetland was discussed with Regulation and considered.

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

Our report is structured in line with SSEPD’s Statement of Compliance. It sets out the results of our review and our assessment of SSEPD’s compliance with the terms of that Statement and accordingly the relevant licence conditions.



3 Managerial and operational independence of SSEPD

We consider there are several distinct facets which are essential to achieving managerial and operational separation as required by the Licence and Ofgem. These include legal and physical separation, autonomous boards with autonomous decision making processes, appropriate contractual and service level agreements, data confidentiality and branding of the separated businesses.

The practical aspects such as the creation of separate legal entities, 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. Our work has again confirmed that the culture throughout the organisation relating to separation remains robust.

We monitor the effectiveness of strategic data confidentiality, autonomy of decision making of the distribution and transmission businesses and corporate governance issues. This involved reviewing relevant board minutes and considering the operation of the decision making process with directors and officers. The make up of the board of SSEPD 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 to complement the SSE plc directors and SSE Management Board members.

In addition, the board's terms of reference and the capital authorisation corporate policy are regularly reviewed to maintain the independence of SSEPD and reinforce the corporate governance procedures.

Whilst absolute separation would 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 is undertaken, 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.

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. 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. There have been no disciplinary proceedings during the year under separation, confidentiality or competition conditions of employment.

There have been no staff transfers in the year where it was necessary to consider any separation implications. The procedures in place whereby any such transfers would be discussed with us in advance are still effective.



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.

In addition, the cross subsidy report and Regulatory accounts audited by KPMG LLP have not raised any material concerns from Ofgem.

This would imply the SLAs and operating structure are not anti competitive.

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 SSEPD’s approach was in line with their stated and accepted philosophy. This year our audit work included:

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

We confirmed the internal audit function continues to allocate significant resource to this area, each year undertaking a specific review of business separation access controls and with a standing remit to consider separation issues as part of all internal audit assignments.

This year their work identified a continuing and increased incidence of various minor administrative breaches relating to the storage of files and in particular inappropriate access authority for staff and some physical access issues. Whilst such breaches increase the risk of non-compliance, we do not consider they gave rise to any actual problems and all the points raised are being acted upon timeously. As a result of the recurring nature of these breaches the new internal compliance function is planning to monitor these issues on a regular basis and quarterly meetings involving relevant personnel, Compliance, Internal Audit and ourselves have been set up for the coming year to monitor progress.

A programme of enhanced business separation training is continuing to be provided to all SSEPD staff and in particular senior management, distribution and transmission personnel and facilities managers reinforcing the key separation messages and refreshing awareness of prescribed processes and procedures. New transmission personnel all receive appropriate business separation training on induction which is particularly important as many are joining from outwith the sector and have not previously worked in regulated businesses. There is scope for the controls over ongoing training of personnel to be strengthened.

SSEPD has procedures in place to ensure access to information specifically designated as confidential is restricted at all times. From our work we are satisfied that SSEPD continues to generally comply with its stated policy and to implement and enforce rigorously procedures and controls commensurate with that policy.



6 Branding

SSEPD's stated policy is to maintain a separate identity from other parts of SSE plc. Branding continues to be effective and is reinforced in the market place through vehicle, site, adverts and stationery brands.

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

7 Responsibility

Separate legal entities for the operating subsidiaries create an appropriate structure for separation to be effective. The formal procedure of regular SSEPD board meetings underpins this and we consider these to be fundamental to achieving effective separation. The composition of the board was previously strengthened to reflect in particular, the growth in transmission and comprises 5 executive directors together with a non executive chairman recognising the importance of SSEPD board responsibilities.

This board has clearly defined terms of reference 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 SSEPD 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 SSEPD from the group's capital expenditure approval procedure to ensure confidential information is not made available to inappropriate executives or staff.

The appointment of sufficiently independent directors with effect from 1 April 2014 should further strengthen the overall control environment.

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 Regulation Team whereby any complaints received relating to separation will be immediately advised to us with a covering letter setting out the investigation work to be undertaken by SSE. We will review details of SSE's response to the complainant and any remedial action taken or proposed and we will consider if we should undertake our own investigation. Whilst there can be no guarantee that every relevant complaint would be dealt with by Regulation, we are satisfied all those with substance would be notified to Regulation.

We have not been advised of any complaints relating to separation this 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 SSEPD directors allow relevant issues to be aired and addressed on a timely basis.



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 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

The appropriate practices, procedures and systems in SSEPD’s Statement of Compliance have been fully implemented for many years. Accordingly, our ongoing role continues to be to monitor compliance in association with internal audit, compliance and regulation teams, with the relevant systems and procedures in light of the licence conditions, independently assess SSEPD’s compliance taking account of any developments in the group’s business and to advise on any relevant issues which arise.

Henderson Loggie
5 June 2014



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.