



Scotia Gas Networks

Report of the Compliance Officer

For the year ended 31 March 2020



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Introduction

Standard Special Condition A33 of the Gas Transporters Licences for Scotland Gas Networks plc and Southern Gas Networks plc (“Networks”) requires that gas transportation is managed to ensure it does not restrict, prevent or distort competition elsewhere in the energy industry and that there is absolute confidentiality of related, commercially sensitive information.

Scotia Gas Networks Limited (“SGN”) owns the Networks in its designated geographical areas and has published in its Statement of Compliance how it complies with the licence requirements, specifically the full managerial and operational independence of the transportation businesses.

Standard Special Condition A34 of the Gas Transporters Licence requires SGN to appoint a Compliance Officer to facilitate compliance with the licence restrictions on the use of certain information and the independence of the transportation business.

MHA Henderson Loggie, Chartered Accountants, have been appointed as Compliance Officer by SGN. On behalf of MHA Henderson Loggie, the Compliance Officer role is led by Gavin Black (Partner). The licences require us to report annually to the Directors on our activities over each year to 31 March, and the licensee to report thereafter to Ofgem on the Compliance Officer’s activities and other relevant issues.

The specific duties of the Compliance Officer are included in the appendix to this report but principally we are responsible for supporting SGN with its compliance with the relevant licence conditions. This includes providing advice to SGN on complying with the confidentiality and separation obligations placed on the transportation businesses, monitoring the effectiveness of the practices, procedures and systems adopted by SGN, investigating complaints and reporting annually to the SGN Audit Committee. We are also required to liaise with Ofgem on these matters as appropriate.

This report sets out the results of our testing and our assessment of SGN’s compliance with the terms of its Statement of Compliance and hence the relevant licence conditions.



Overall approach

We have developed a Compliance Review Programme (“CRP”) which sets out the monitoring and testing we consider necessary to ensure practices, procedures, systems and controls are dealing efficiently and effectively with the licence requirements on the restriction on use of certain information and independence of the transportation businesses (“Compliance”). The CRP is designed to recognise the business and the legislative environment SGN operates in with regard to achieving managerial and operational independence and the approach and philosophy adopted by SGN to comply with the licence conditions.

In previous years, we have considered the formalisation and communication of Compliance procedures throughout SGN and assessed how embedded the Compliance philosophy is in the organisation. We now monitor the systems and procedures established, including any changes in this area, to ensure their ongoing effective operation.

Our main contacts at SGN include the Director of Legal and Compliance, the Head of Compliance and the Head of Internal Audit and Risk. We discussed with key personnel their role, issues relevant to the licence conditions and gathered evidence relevant to our monitoring role. These discussions covered legal and compliance, regulation, finance, commercial activities, HR and internal audit, and were held with a range of corporate staff. Consideration was also given to any possible Compliance issues arising out of significant commercial business activity such as Murphy Utility Assets (SGN’s utility asset ownership joint venture with Murphy), SGN Place and SGN Smart, as well as increasing commercial developments and opportunities generally.

Wherever appropriate we use SGN departments, including Internal Audit, Legal and Compliance and Regulation, to assist with our testing, with our role being to understand their risk assessment processes, review the scope of their work, the results and conclusions reached and any remedial action taken. All other monitoring and testing is undertaken directly by ourselves and in particular has involved meeting with key individuals to discuss relevant issues and investigating critical areas such as governance, managerial separation, physical separation, IT and data confidentiality, the interaction and contracts with SSE plc (“SSE”), cross-subsidies, staff induction, training and branding.

One area of specific consideration is the relationship with and services provided by SSE and the resultant implications for SGN’s compliance with the licence conditions. SSE owns 33.3% of SGN and provides a range of corporate and commercial services, although the extent of these continues to reduce over time. There is a clear philosophy that access to information and data should be prevented where confidentiality requires it. Relevant SGN and SSE members of staff are aware of this and where commercially sensitive information which is recognised as a genuine risk to competition is involved, appropriate procedures and systems have been designed and implemented to restrict access to it.

SGN place particular emphasis on confidentiality clauses in staff contracts to reinforce the importance of confidentiality and to clearly set out the disciplinary process which would follow any breach. The Managed Services Agreement (MSA) with SSE also includes specific confidentiality clauses.

Since our appointment, we have not been required to meet with Ofgem.



Managerial and operational independence

We consider there are several distinct facets which are important to achieving ongoing managerial and operational independence as required by the licence and Ofgem. In particular, as SGN does not have a gas supply business, the key aspects relate to its managerial and operational independence from SSE's supply and gas related businesses. These include legal and physical separation, establishment of autonomous boards and decision-making processes, establishment of contractual service level agreements, data confidentiality and branding of the separated businesses. However, business areas within SGN such as metering and connections together with the growing provision of commercial services add to the inherent risks for Compliance and reinforce the need for appropriate treasury management and service level agreements (SLAs) within SGN and an awareness across the group of confidentiality and competition law.

In recent years, there have been changes in the corporate structure to reflect business developments. There is clear separation between the regulated business (including the two UK gas transportation licence holders) and the unregulated business, which includes commercial service offerings and a property sub-group. Governance is under continual review as the business changes and develops to ensure there is managerial separation between the regulated and unregulated business at Committee level, with appropriate reporting lines to the Group Executive Committee and the main Board of Directors.

The practical aspects such as the creation of separate legal entities with the appropriate split of directors and responsibilities, physical access restrictions and branding have been specifically reviewed to ensure the regulated business is independent of related supply and generation businesses. The fact that the Board is made up of representatives from each of the four owner groups as well as two sufficiently independent directors creates a strong framework for independent operation.

We monitor the effectiveness of strategic data confidentiality, autonomy of decision making and governance issues. This involves reviewing relevant board and audit committee minutes and discussing the managerial and strategic independence of SGN with directors and officers. It is clear from our work that SGN is run autonomously with commercial confidentiality and rigorous assessment of services provided by SSE, with value for money and quality continuing to be key to SGN. We have discussed the operation of the MSA with the Director of Legal and Compliance as well as with other relevant executives and are aware of the level of the scrutiny of these arrangements by the Board. In recent years there has been a gradual reduction in the reliance on services provided by SSE and this trend is expected to continue.

In terms of physical separation, we have confirmed over our years as Compliance Officer that physical access and security is in line with the Statement of Compliance, and that continual changes are being made to maintain this as the business grows and diversifies into more commercial activities.

Compliance with licence conditions is a specific risk recognised in the strategic risk register managed by the Audit Committee. In addition, a formal business separation procedure is in place, owned by the Legal and Compliance Team, to reinforce SGN's commitment to business separation. These, together with the operation of the Ethics and Compliance Committee and Business Separation Working Group reporting into the Group Executive Committee, provide a strong framework which runs through to the Board.

The ongoing reinforcement of confidentiality and training amongst staff, the importance attached by senior management and the seriousness with which SGN would regard any breaches continues to ensure the underlying philosophy and approach adopted by SGN in this area is maintained.



Common services

SSE has a gas supply business and an involvement in gas transportation. We have considered the implications of SSE owning 33.3% of SGN in terms of SGN's operation and management. The provision of resources by SSE is governed by an MSA. We have reviewed this agreement and discussed its operation in practice, and it is noted that only non-SSE board members are entitled to vote on MSA matters. Current services provided under the MSA include employer and public liability legal support, treasury, payroll, procurement and billing, with other corporate services having now transferred in-house.

SGN has its own finance systems and all SSE staff working for SGN use separate access authorities controlled by SGN. Internal audit has previously reviewed access by SSE staff to SGN systems and locations and are satisfied that appropriate controls exist. We have updated our understanding of physical access restrictions and have not identified any major separation issues which create significant risk.

We have also considered the strategic interaction and staff transfers/secondments under the MSA and are satisfied that no separation issues exist. In addition, the audit of the regulatory accounts includes specific agreed upon procedures reporting by the auditors on cross subsidies and no areas of concern have been identified.

In previous years, we have reviewed the SLAs in place between various companies within the SGN group and discussed their operation in practice, with no issues being identified. A master SLA template is in place to form the basis of new SLAs that are required from time to time and to ensure all SLAs are consistent and fit for purpose.

There have been no external complaints regarding common services or cross subsidies which suggests that the practices adopted are not anti-competitive.

We are satisfied that SGN's procedures and controls are appropriate to guard against access to or use of confidential information, to prevent any anti-competitive practices and to preserve the independence of the transportation businesses.



Systems and confidential information

Internal Audit has previously reviewed this area from a Compliance perspective and their work confirmed that access controls for finance and other key systems were operating as designed providing assurance that the licence conditions were being complied with.

System controls, physical access controls and the terms of the MSA with SSE provide a robust environment to control access to and use of confidential information. Clear documentation and enforcement provide clarity and authority to this key area.

As previously noted, SGN has its own finance systems and all SSE staff working for SGN must use separate access authorities controlled by SGN.

In addition, “Two-Hats” guidance has been developed to provide further support to corporate staff who provide services to both the regulated and unregulated businesses. This helps identify which role these individuals are fulfilling at any point in time and how to manage confidential information when working with other parties and also ensuring it is not used by these individuals in fulfilling their other roles.

SGN employee contracts and letters of appointment specifically address confidentiality and the disciplinary procedures that would apply to breaches in this area. A formal induction package is in place and a Compliance Communications Strategy has been developed to cascade key board messages and directives including confidentiality, data protection, business separation and whistleblowing to ensure all staff are aware of the key requirements.

SGN has identified that staff transferring between the regulated and unregulated businesses or between SGN and SSE could have regulatory implications. Accordingly, HR and Compliance have established formal procedures to assess all staff transfers to identify any such issues so appropriate steps can be taken if potential business separation issues exist.

SGN has created its own identity and compliance culture and this is being reinforced further through additional training on business separation being rolled out more widely across the business. This is scheduled to be refreshed every two years in line with other compliance training on matters such as bribery and fraud and systems automation improvements are being made to accurately monitor when training is due for renewal and to record the successful completion of it. The level of training is tailored to the role and related business separation risk as set out in the Compliance Training Strategy.



Branding

The effectiveness of branding is an important aspect of SGN's stated policy and is reinforced in the marketplace through vehicles, staff, PPE and publications. Separate brand identities have been developed for unregulated businesses created in recent years.

We are satisfied that branding is in keeping with the SGN policy and is consistent with the requirements of the marketplace and the licence conditions.



Responsibility and monitoring

The importance of Compliance as a key risk within the organisation is clearly recognised by the board and audit committee and is included on the strategic risk register. Systems, policies and procedures reinforce this and demonstrate group wide awareness.

Whilst ultimate responsibility rests with the board, it is a key requirement for executives and managers to ensure compliance with the SGN's business separation and related procedures and the relevant Licence conditions within their own business areas. Internal monitoring of Compliance is carried out by Internal Audit, in conjunction with the Legal and Compliance and Regulation teams.

A project was initiated in 2018/19 to undertake an all-encompassing review and refresh of business separation processes and procedures. The detailed discovery phase was undertaken 2018/19 and the implementation phase of the project is ongoing. This has resulted in a suite of new and updated policies and procedures on Compliance training and communications, management of confidential information and "Two-Hats" guidance for corporate staff who provide services across the regulated and unregulated businesses.

A Business Separation Working Group has been established to guide and monitor SGN's annual compliance plan and to direct SGN's approach to business separation requirements. Membership of this group includes senior personnel from areas including Legal and Compliance, Regulation, Internal Audit, Finance, HR, IT, Property and Operations to ensure that all key aspects of business separation are considered. Clear terms of reference are in place to define the purpose and measure the performance of this group.

As an independent external Compliance Officer, our approach brings an objective review of the practices and procedures in place or planned to help ensure the conditions of the licence and the Statement of Compliance are being met.



Complaints

We have agreed a procedure whereby any complaints received relating to business separation will be immediately forwarded to us setting out the investigation work to be undertaken by SGN. Thereafter we will receive details of SGN's response to the complainant and any remedial action taken or proposed. We would then decide whether it is necessary to undertake our own investigation. Whilst there can be no guarantee that every relevant complaint would be dealt with by the Legal and Compliance Team, we are satisfied that all those with substance would be notified to Legal and Compliance and thereafter the above procedure would be applied.

We have not been advised of any business separation or Compliance complaints during the period of our appointment.



Advisory role

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

Regular contact with the Legal and Compliance team allows such issues to be aired and addressed as they arise.

SGN systems and procedures are well established and are operating effectively. Accordingly, our ongoing role will be to continue to monitor the effectiveness of the Compliance systems and procedures established throughout the organisation.

Where appropriate, we will continue to provide assistance and an independent external view on Compliance matters and the development of the management and operational systems, procedures and controls.



Partner
For and on behalf of MHA Henderson Loggie
Chartered Accountants
Dundee office
29 May 2020

MHA Henderson Loggie is a trading name of Henderson Loggie LLP



Appendix A – Duties of the 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 at paragraph 4 of Standard Special Condition A33 (Restriction on use of Certain Information and Independence of the Transportation Business);
 - 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 in accordance with paragraph 4;
 - 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 (e); and
 - g) reporting annually to the directors of the licensee – in respect of the year ending 31 March 2007 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 above 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.

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