

Scotia Gas Networks Limited

# Report of the Compliance Officer

For the year ended 31 March 2022



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# Introduction

Standard Special Condition A33 of the Gas Transporters Licences for Scotland Gas Networks plc and Southern Gas Networks plc 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 Scotland Gas Networks plc and Southern Gas Networks plc 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.

Henderson Loggie LLP, Chartered Accountants, have been appointed as Compliance Officer by SGN. On behalf of Henderson Loggie LLP, 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 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 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 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 Head of Audit, Risk & Compliance and the Senior Compliance Business Partner. 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 Futures, SGN Place and Biomethane projects within SGN Commercial Services, as well as increasing commercial developments and opportunities generally.

Wherever appropriate we use SGN departments, including Internal Audit, Legal & 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 over the years has been the relationship with and services provided by SSE and the resultant implications for SGN’s compliance with the licence conditions. SSE previously owned 33.3% of SGN and has provided a range of corporate and commercial services, although the extent of these was reducing consistently over time. SSE sold its equity stake in SGN during the year, and this received final regulatory approval in March 2022. The MSA has now been replaced by a Transitional Services Agreement (TSA) covering what services will continue to be provided by SSE in the short term. SSE is no longer related to SGN as defined by the licence conditions and therefore the potential business separation risk in this area has decreased.

There is a clear philosophy that access to information and data should be prevented where confidentiality requires it, specifically between the regulated and unregulated areas of SGN’s business. Relevant SGN 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 places 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.

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 have been in relation to its managerial and operational independence from SSE's supply and gas related businesses. This has included 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. As noted previously, the divestment by SSE of its equity stake in SGN in March 2022 reduces this potential area of concern going forward.

However, business areas within SGN such as metering and connections, together with the increasing level of unregulated commercial services business opportunities, add to the inherent risks for Compliance and reinforce the need for appropriate service level agreements (SLAs) and treasury management within SGN, and a strong awareness across the group of confidentiality and competition law.

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 as defined by the licence conditions. The fact that the Board is made up of representatives from each of the three shareholder 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. We have discussed the operation of the SSE MSA with the Director of Legal & Compliance and other relevant executives in previous years and are aware of the level of scrutiny of these arrangements applied by the Board. In recent years there has been a gradual reduction in reliance on services provided by SSE and this will come to a natural end as part of SSE's divestment. A TSA is now in place to manage the move fully away from SSE's corporate services.

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. Where SGN operates out of shared depots with SSE, there has always been clear physical separation controlled by PAC access. This is also being reviewed as part of SSE's divestment, with formal lease arrangements being put in place as part of the transition process.

Compliance with licence conditions is a specific risk recognised in the principal risks register managed by the Audit Committee. In addition, a formal business separation procedure is in place, owned by the Legal & 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 to it 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 up until March 2022 in terms of SGN's operation and management. The provision of resources by SSE has been governed by an MSA. We have reviewed this agreement in the past and discussed its operation in practice, and it was noted that only non-SSE board members were entitled to vote on MSA matters. Services provided under the MSA during the year included employer and public liability legal support, treasury, payroll, procurement and billing, some of which have now transferred in-house or been outsourced. As previously noted, a TSA is now in place to manage the move fully away from SSE's corporate services. SSE staff members who have been working on SGN business have formally transferred employment to SGN as part of the SSE divestment.

We have also considered other aspects such as physical access to premises, systems access and staff transfers/secondments under the MSA/TSA and are satisfied that no separation issues have arisen. 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. As part of the transition away from SSE's corporate services, an MSA is being put in place within SGN to govern corporate services provided internally, including provisions around pricing and service levels.

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/TSA with SSE provide a robust environment to control access to and the use of confidential information. Clear documentation and enforcement provide clarity and authority to this key area.

SGN has its own finance systems and all SSE staff working for SGN must use separate access authorities controlled by SGN. Where SGN operates out of shared depots with SSE, there has always been clear physical separation controlled by PAC access. This is also being reviewed as part of SSE's divestment, with formal lease arrangements being put in place as part of the transition process.

"Two-Hats" guidance is in place to give further support to SGN 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 a strong corporate identity and compliance culture and this is reinforced further through specific training on business separation being rolled out more widely across the business. The depth of the training is tailored to the role and related business separation risk as set out in the Compliance Training Strategy. Training has been rolled out to over 3,400 employees during 2021/22 through a mix of face to face learning, eLearning and videos, depending on the extent of business separation risk attaching to individual roles. All individuals in higher risk roles were provided with face to face training during the year and training is scheduled to be refreshed every two years in line with other compliance training on matters such as bribery and fraud.

## 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 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 principal risks 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 the Legal & Compliance, supported by Regulation.

A significant amount of work has been undertaken in recent years following an all-encompassing review and refresh of business separation processes and procedures. This project has resulted in improved training materials and 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.

The Business Separation Working Group guides and monitors SGN's annual compliance plan and directs 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 (regulated and unregulated) 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. The Ethics and Compliance Committee also supports the overall compliance framework of SGN, providing guidance on how to ensure regulatory compliance in a wide range of areas including business separation.



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 in connection with the regulated business 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 & Compliance Team, we are satisfied that all those with substance would be notified to Legal & 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 & 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.



Gavin Black  
Partner  
For and on behalf of Henderson Loggie LLP  
Chartered Accountants  
Dundee Office

23 June 2022



## Appendix – 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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