



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

Compliance Annual Report 2008

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

Compliance Report 2008

Introduction

This report is for the year to March 2008, as required by Condition 40 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 Energy Systems division of the Scottish and Southern Energy plc (SSE) group of companies.

Henderson Loggie continued to be appointed as Compliance Officer for 2007/08 and have been re-appointed for 2008/09.

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.ssepdc.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 Group Director of Regulation.

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 the year one member of staff moved from SHETL to SSE Generation. Interviews were held to remind the staff member of the relevant confidentiality responsibilities and the Compliance Officer was kept fully informed. There was not considered to be any specific business separation or confidentiality issues.

Transmission

SSE jointly manages and operates its transmission and distribution businesses.

Complaints or representations

There were no complaints received during the year. However, since the year end SSE has received a complaint regarding the activities of its Generation business. Whilst we do not believe that this complaint has any direct relevance to business separation we have kept the Compliance Officer apprised of the situation.

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 2008**

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Duties of Compliance Officer

1 Introduction

Condition 39 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 40 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, were appointed the Compliance Officer by SSE in August 2000 and this is our seventh report under the Licences. On behalf of Henderson Loggie, the Compliance Officer 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 39 & 40 and Special Conditions C,D & E together with SSE Power Distribution’s Statement of Compliance as agreed by Ofgem.

Our role this year has been to monitor the systems and procedures established to ensure their ongoing effective operation in light of the latest requirements and guidelines. Our main contacts at SSE have been the SSE Power Distribution Board, Rob McDonald, Malcolm Burns from Regulation, and Steven Kennedy, a SSE Power Distribution board director. We have met these people as relevant on a regular basis throughout the year. We also consider it important to visit 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 the previous years and focus 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 again looked at the scope and results of the work undertaken by Internal Audit. Other areas specifically addressed this year included separation issues between generation and transmission where we looked at connections, access to information by competitors and planning consent procedures, new connections in light of the new Distribution licence condition 4F, physical access, cross subsidies, staff transfers and the interaction with Scotia Gas Networks plc.

Our work has again confirmed that the culture throughout the organisation toward separation remains robust. Condition 4F has lead SSE to implement procedures to ensure full compliance across both North and South operations.

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 has also placed particular emphasis on confidentiality clauses in staff appointment letters and has taken every opportunity to reinforce the importance of confidentiality and to clearly set out the disciplinary process which would follow any breach. This year has seen every member of staff receive a letter detailing specific changes to the confidentiality clause in their contract of employment, as well as the usual competition act and regulation refreshers.

We have not been required to meet with Ofgem this year. However, during the year Ofgem raised issues with SSE regarding confidentiality within the offshore transmission project, related party transactions and the need for a separate Managing Director of Transmission report. All these have been dealt with satisfactorily and we have been kept informed of progress. Since the end of this reporting period, a complaint has been made resulting in an Ofgem enquiry under the Competition Act against the generation business. Although this has no direct separation licence implications, we are being kept fully abreast of developments, given the nature of the enquiry

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 our 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 were 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 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 regular board meetings of SSE Power Distribution help ensure appropriate governance is maintained and reinforce SSE's recognition of separation. The role of this board has been strengthened with the attendance of senior distribution personnel to report on specific matters. During this year, Mark Mathieson, Director of Distribution, joined the SSE Power Distribution board which is seen as a positive statement of the strong corporate governance employed by SSE Power Distribution to ensure effective and strong independence.

The ongoing reinforcement of confidentiality and training amongst staff 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.

We looked at generation / transmission and distribution / supply interaction including new connection procedures, the outcome of the internal audit work and discussed these areas with senior management. We were satisfied that the systems and procedures with regard to separation are robust.

We discussed the updating of the SSE corporate policy on separation and agreed the rationale and approach.

The SLAs have been reviewed and found to be appropriate and effective.

During the year a member of staff transferred from Transmission to Generation. Regulation identified this, and although there was no specific risk from a separation or competition perspective, interviews were held to specifically remind the staff member of relevant confidentiality responsibilities and we were fully informed. This demonstrates the robust and thorough approach adopted by SSE.

From 1 April 2008, SSE has proposed changes to its statement of compliance to allow members of the main board to be members of boards of generation or supply. This is for administrative reasons and we do not consider this weakens the managerial and operational independence of the SSE Power Distribution board. This proposal is currently with Ofgem for consideration.

4 Common services

We have considered the service level agreements (“SLAs”) in place and discussed their operation in practice with no issues being identified. An exercise undertaken during the year to review all existing SLAs and to consider if any new ones were required did not identify any major issues and reinforces SSEs commitment to detailed compliance. There have been no external complaints in this regard which implies the practices are not anti competitive.

The report on cross subsidies presented by SSE and audited by KPMG LLP did not raise any 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.

The testing this year did however identify that these minor administrative access breaches were continuing to arise following changes in managerial procedures. SSE view such instances very seriously and accordingly have further tightened the preventative control environment in this area. We are satisfied that these procedures are robust. This demonstrates the commitment of SSE to its rigorous compliance regime.

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 stationery 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. We discussed changes during the year which have subsequently been implemented with no adverse comment from Ofgem or competitors or the general public.

7 Responsibility

The formation of separate legal entities for the operating subsidiaries created 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. As noted above, during the year Mark Mathieson joined the board to further strengthen its independence. Board meetings are held every 2 months.

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, 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.

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.

Since the year end, a complaint has been received via Ofgem regarding the generation business. Although it has no direct separation relevance, we have been kept fully informed of developments.

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.

In the year, we have been consulted by SSE on branding, the Director of Transmission reporting, staff transfers and changes to their Compliance Statement.

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 has to use separate access authorities controlled by SGN. SSE 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, in light of the licences, will be to monitor the operation of the relevant systems and procedures, independently assess SSE's compliance and to advise on any relevant issues which arise.

Specifically, we will monitor the developments of the complaint raised since the year end against the generation business for any impact on our reporting responsibilities.

Henderson Loggie
May 2008

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 39 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.