

**Scottish Power Energy Networks Holdings Limited**  
**Audit & Compliance Committee**  
30 January 2019

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**2018 ANNUAL ACTIVITY  
REPORT**

## **2018 ANNUAL ACTIVITY REPORT**

Report for the fiscal year 2018 presented at the Scottish Power Energy Networks Holdings Limited Audit & Compliance Committee ("the Committee") meeting of 30 January 2019 for noting by the Committee and thereafter submitted to the Board of Directors of Scottish Power Energy Networks Holdings Limited on 30 January 2019 for approval, pursuant to article 5 of the Terms of Reference of the Committee.

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## I. INTRODUCTION

In accordance with the provisions of the Articles of Association of Scottish Power Energy Networks Holdings Limited (“the Company”), the board of Directors established the Committee on 31 January 2018. The Committee is a permanent internal body and has an informative and consultative role. The Committee does not have an executive function. It has powers to gather information, carry out assessments and present proposals to the Board of Directors within the scope of its activities.

The Committee provides an additional assurance that the Board of Directors supervises the significant risks of the Business with the utmost transparency, self-discipline and rigour. In assessing the effectiveness of the Internal Control System, where relevant to the Company, the Committee contributes to the attainment of the strategic objectives of the Company. While an effective Internal Control System does not, in and of itself, guarantee the achievement of such goals, it does provide an assurance that the Management of the Company makes its decisions within the framework of the guidelines and standards issued by the Board of Directors.

The Committee’s Terms of Reference set out the authority and responsibilities of the Committee together with its method of operation. The Terms of Reference have been prepared taking into account the fact that the ultimate parent company of the Company is a listed company, is the parent company of the Iberdrola Group and also has an Audit and Risk Supervision Committee within its governance structure.

The Committee exercises its functions with full autonomy, notwithstanding the establishment of a framework for collaborating with and reporting on the development of its functions with the Iberdrola Audit and Risk Supervision Committee and the Internal Audit function as defined in the Regulations of the Audit and Risk Supervision Committee of Iberdrola S.A.

The Committee consists of the following members:

<b>Member</b>	<b>Title</b>	<b>Position</b>
<b>Wendy Barnes*</b>	Independent, Non-Executive Member <b>(Chairperson)</b>	Independent Non-Executive Director – Scottish Power Energy Networks Holdings Limited
<b>Sr José Izaguirre Nazar</b>	Non-Independent Non-Executive Member	Administration and Control Director – Iberdrola S.A. and Non-Independent and Non-Executive Director – Scottish Power Energy Networks Holdings Limited
<b>Alison McGregor**</b>	Independent, Non-Executive Member	Independent Non-Executive Director – Scottish Power Energy Networks Holdings Limited

\*On 15 November 2018, Wendy Barnes was appointed as Chair of the Committee following the resignation of Sue Fox. Until 15 November 2018, Ms Fox was Chair of the Committee.

\*\*On 15 November 2018, Alison McGregor was appointed as a member of the Committee following the resignation of Sue Fox.

Throughout 2018, Andrew Black, Solicitor, SP Energy Networks, acted as Secretary to the Committee.

## **II. AUDIT AND COMPLIANCE COMMITTEE MEETINGS 2018**

### **a) COMMITTEE HIGHLIGHTS**

	<b>2018</b>
Number of meetings	4
Number of written resolutions	4
Reports, Proposals and Updates to the Company's Board of Directors	12
Presentations from Senior Management	30
Presentations from the External Auditor	1

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**i) Reports, Proposals and Updates to the Scottish Power Energy Networks Holdings Limited Board of Directors**

<b>Title</b>	<b>Date</b>
1. SPEN ACC Report on SPEN's 2018 (to date) Financial Information	<b>21 March 2018</b>
2. SPEN ACC Report – External Auditor Independence	
3. SPEN ACC Risk Report – Enterprise Risk Management	
4. SPEN ACC Report on SPEN's H1 2018 Financial Information	<b>20 June 2018</b>
5. SPEN ACC Risk Report – Enterprise Risk Management	
6. SPEN ACC Report on SPEN's 2017/18 Regulatory Submissions	
7. SPEN ACC Report in relation to the proposed appointment of Craig Arthur as a Non-Independent Executive Director of the Board of Directors of SP Distribution plc	<b>13 September 2018</b>
8. SPEN ACC Report on SPEN's 2018 Q3 Financial Information	<b>26 September 2018</b>
9. SPEN ACC Risk Report – Enterprise Risk Management	
10. SPEN ACC Report in relation to the proposed appointment of Alison McGregor as a Sufficient Independent Director of Various SPEN Companies	<b>9 November 2018</b>
11. SPEN ACC Report in relation to Audit Related Assurance Services	<b>15 November 2018</b>
12. SPEN ACC Risk Report – Enterprise Risk Management	

## ii) Senior Management Presentations

<b>Date</b>	<b>Senior Manager</b>	<b>Presentation</b>
<b>21 March 2018</b>	Finance Director	2018 to date Financial Performance Review Changes to the Reporting Requirements for Statutory Accounts
	Head of Internal Audit	Internal Audit Report on 2018 (to date) Financial Information and Certification Process 2018 Internal Audit Activity Plan External Auditors Independence Report
	Legal Director and Business Compliance Officer	2018 Compliance Report and Activity Plan Update
	Network Planning & Regulation Director	SPEN Risk Report
<b>20 June 2018</b>	Finance Director	2018 to date Financial Performance Review
	Head of Internal Audit	Internal Audit Report on H1 2018 Financial Information 2018 Internal Audit Activities Update Terms of Engagement – 2018 Audit
	Legal Director and Business Compliance Officer	2018 Compliance Report and Activity Plan Update
	Chief Compliance Officer	Draft Compliance Officer Report
	Network Planning & Regulation Director	SPEN Risk Report Draft Certification of Availability of Resources Draft Certificate of Compliance Draft Intervention Plan Draft Certification of Unbundling Draft Ultimate Controller Undertaking Draft Business Separation Report Network Planning and Regulation Report on SPEN's 2017/18 Regulatory Submissions
<b>26 September 2018</b>	Finance Director	2018 Q3 Financial Performance Review

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	Head of Internal Audit	Internal Audit Report on Q3 2018 Financial Information 2018 Internal Audit Activities Update
	Legal Director and Business Compliance Officer	2018 Compliance Report and Activity Plan Update
	Network Planning & Regulation Director	SPEN Risk Report

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<b>15 November 2018</b>	Finance Director	October 2018 Financial Performance Review
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	Head of Internal Audit	2018 Internal Audit Activities Update and 2019 draft Internal Audit Plan
	Legal Director and Business Compliance Officer, Chief Compliance Officer	2018 Compliance Update
	Network Planning & Regulation Director	SPEN Risk Report

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**iii) External Auditor Presentations**

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<b>Subject</b>	<b>Date</b>
External Audit Update on Statutory and Regulatory Accounts	20 June 2018

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## b) MEETING AGENDAS

In 2018, the Committee held four meetings. The following tables show the business transacted at each of these meetings:

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### Session 1 – 21 March 2018

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#### **Financial Information Review**

- 2018 to date Financial Performance Review
- Changes to the Reporting Requirements for Statutory Accounts
- Internal Audit Report on 2018 (to date) Financial Information and Certification Process
- SPEN ACC Report on SPEN's 2018 (to date) Financial Information

#### **Internal Audit Update**

- 2018 Internal Audit Activity Plan
- External Auditor Independence Report
- SPEN ACC Report – External Auditor Independence

#### **Risk Update**

- SPEN Risk Report
- SPEN ACC Risk Report – Enterprise Risk Management

#### **Compliance Division Update**

- 2018 Compliance Report and Activity Plan Update
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### Session 2 – 20 June 2018

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#### **Financial Information Review**

- External Audit Update on Statutory and Regulatory Accounts
- 2018 to date Financial Performance Review
- Internal Audit Report on H1 2018 Financial Information
- SPEN ACC Report on SPEN's H1 2018 Financial Information

#### **Internal Audit Update**

- 2018 Internal Audit Activities Update
- Terms of Engagement – 2018 Audit

#### **Risk Update**

- SPEN Risk Report
- SPEN ACC Risk Report – Enterprise Risk Management

#### **2018 Regulatory Submissions**

- Draft Certification of Availability of Resources
- Draft Certificate of Compliance
- Draft Intervention Plan
- Draft Certification of Unbundling
- Draft Ultimate Controller Undertaking
- Draft Business Separation Report
- Network Planning and Regulation Report on SPEN's 2017/18 Regulatory Submissions
- SPEN ACC Report on SPEN's 2017/18 Regulatory Submissions

#### **Compliance Division Update**

- 2018 Compliance Report and Activity Plan Update
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- Draft Compliance Officer Report
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### **Session 3 – 26 September 2018**

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#### **Financial Information Review**

- 2018 Q3 Financial Performance Review
- Internal Audit Report on 2018 Q3 Financial Information
- SPEN ACC Report on SPEN's 2018 Q3 Financial Information

#### **Internal Audit Update**

- 2018 Internal Audit Activities Update

#### **Risk Update**

- SPEN Risk Report
- SPEN ACC Risk Report – Enterprise Risk Management

#### **Compliance Division Update**

- 2018 Compliance Report and Activity Plan Update
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### **Session 4 – 15 November 2018**

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#### **1. Financial Information Review**

- October 2018 Financial Performance Review

#### **2. Internal Audit Update**

- 2018 Internal Audit Activities Update and 2019 draft Internal Audit Plan
- SPEN ACC Report in relation to Audit Related Assurance Services

#### **3. Risk Update**

- SPEN Risk Report
- SPEN ACC Risk Report – Enterprise Risk Management

#### **4. Compliance Division Update**

- 2018 Compliance Update
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Article 10 of the Company's Articles of Association makes provision for the use of the electronic written resolution process which can be used in relation to the proceedings of any Board committees. The Committee passed four written resolutions during 2018 as follows:

- 7 June 2018: Risk Limits and Indicators for the Company and Guidelines for Risk Limits and Realising the Application of the Risk Policy for Iberdrola's Network Businesses in ScottishPower;
- 12 September 2018: Report on the proposed appointment of Craig Arthur as a Non-Independent Executive Director of the Board of Directors of SP Distribution plc;
- 9 November 2018: Report on the proposed appointment of Alison McGregor as a Sufficiently Independent Director of the Board of Directors of SP Distribution plc, SP Transmission plc and SP Manweb plc; and
- 7 December 2018: Approval of the Company's 2019 Internal Audit Plan.

### **III. MAIN ACTIVITIES**

In 2018, the Committee carried out a number of planned activities in order to effectively discharge the duties entrusted to it by the Board of Directors of the Company.

#### **a) Internal Audit**

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The Terms of Reference indicate that the role of the Committee is “*To oversee the independence and efficiency of the Internal Audit Department... To approve the guidelines and annual action plans established by the head of the Internal Audit Department... To propose the budget of the Internal Audit Department for its approval by the Board of Directors... To propose to the Board of Directors the appointment, re-election or cessation of the head of the Internal Audit Department... To oversee the head of the Internal Audit Department... To receive regular information on the activities carried out by the Internal Audit Department... To ensure that the managers of the Company take into account the conclusions and recommendations in the reports of the Internal Audit Department.*”

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At three meetings in 2018 the Head of Internal Audit presented a report to the Committee to update on Internal Audit activities.

On 7 December 2018, the Committee approved the 2019 Internal Audit Annual Activity Plan.

#### **b) Internal Monitoring and Risk Management Systems**

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The Terms of Reference indicate that the role of the Committee is “*To be aware of and keep under review the Company’s internal financial information process and internal risk monitoring and management systems... To ensure... that the main risks of the Company and those of any of the Company’s subsidiaries are identified, managed and adequately reported... The Committee shall ensure the establishment of measures necessary to mitigate the impact of any risks identified and introduce information and internal monitoring systems which monitor and manage such risks, including contingent liabilities or off balance-sheet risks... Maintain appropriate relationships with the Company Risk Division... To make, at least every six months, a report of the risks of the Company for the Board of Directors.*”

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The Network Planning & Regulation Director presented papers to the Committee on 21 March, 20 June, 26 September and 15 November providing an update on the performance against defined key limits and indicators, and the main risks facing the Company.

On 7 June 2018, the Risk Limits and Indicators for the Company and Guidelines for Risk Limits and Realising the Application of the Risk Policy for Iberdrola’s Network Businesses in ScottishPower were noted by the Committee

#### **c) Audited Accounts**

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The Terms of Reference indicate that the role of the Committee is “*To propose to the Board of Directors the appointment, and the terms of engagement of the Company’s auditors, in accordance with the policy as established by the parent company of the Iberdrola Group... To ensure the independence of the Company’s auditors... Issue on an annual basis and prior to the issuance of the Company’s auditors’ report, a report setting forth an opinion on the independence of the auditors... Analyse together with the auditors, any significant weakness detected in the internal control system... To serve as a communication channel between the Board of Directors and the auditors.*”

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On 21 March 2018, the Head of Internal Audit presented a report to the Committee on the independence of the appointed external auditor (KPMG). The Committee noted that: (i) the external auditor has confirmed their independence in the letters sent to the Scottish Power Audit and Compliance Committee dated 3 January 2018 and 13 February 2018; (ii) the external auditor has confirmed that as part of their internal procedures and rules, they have in place adequate processes to consider any threats to their independence and relevant safeguards and mitigations; and (iii) there were no non-audit services provided by the external auditor for the period ended 31 December 2017; and (iv) all audit related assurance services were pre-approved by the Scottish Power Audit & Compliance Committee and the value of these services are not material (£0.175m of which £0.13m relates to the Company).

On 20 June 2018 the Head of Internal Audit provided an update to the Committee on the appointment and conditions of the engagement of KPMG for the 2018 audit. On 15 November 2018 the Committee considered and approved the audit related assurance services to be provided by the external auditor.

As part of the supervision of the auditing of the financial statements by the Committee, the external auditor appeared before the Committee to present External Audit Update on the 2017 Statutory and 2017/18 Regulatory Accounts.

#### **d) Economic and Financial Information**

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*The Terms of Reference indicate that the role of the Committee is “To oversee the process for the preparation of and the integrity of the financial economic information of the Company (including half year information), advising on any proposals for changes to the accounting practices and policies with the general accounting practices and policies of the parent company of the Iberdrola Group. The Committee will elaborate a report for the Board of Directors on the annual, interim semi-annual and quarterly financial statements... To oversee compliance with the legal requirements and the correct application of the national and international accounting and financial information principles and practices...To inform the Board of Directors of the principles on which transactions carried out between the Company and any of the other companies forming part of the Iberdrola Group, and any of the Company’s subsidiaries, must respect in order to protect the interests of the Company.”*

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One of the most significant activities of the Committee is the periodic submission to the Board of Directors of its reports on the approval of the year end and interim economic and financial information of the Company. Through the support of the Head of Internal Audit, the Committee approved the reports for the Company’s Board of Directors, specifically:-

- Results to 31 March 2018 on 21 March 2018;
- Results to 30 June 2018 on 20 June 2018; and
- Results to 30 September 2018 on 26 September 2018.

The reports of the Committee provide an opinion to the Board of Directors on the following: Changes in accounting policies and practices from those adopted in the 2017 consolidated annual accounts of the Iberdrola Group; and potential risks and sources of uncertainty in the accounting policies and practices adopted with potentially significant impact in the 2017 consolidated annual accounts.

At each meeting of the Committee during 2018, the Finance Director presented an update about the financial performance of the Company. In addition, the external auditors, KPMG, also presented an update on the 2017 Statutory and 2017/18 Regulatory Accounts.

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**e) Compliance, Good Governance and Prevention and Correction of Fraudulent and Illegal Behaviours**

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*The Terms of Reference indicate that the role of the Committee is to “receive information from the Compliance Division in connection with any matter relating to regulatory compliance and the prevention and correction of illegal or fraudulent conduct. Review, through the Compliance Division, the internal policies and procedures of the Company to verify the effectiveness thereof to prevent inappropriate conduct and identify any policies or procedures that are more effective at promoting the highest ethical standards...report to the Board of the Directors on the amendments of the Compliance Division Regulations. Review and ratify the annual operating budget of the Compliance Division, for submission to the Board of Directors, and ensure that the Compliance Division has the necessary human and material resources to perform its duties, also ensuring its independence and effectiveness. Approve the annual activity plan for the Compliance Division. Report the proposals of the appointments for the Energy Networks Compliance Director. Review the status of compliance with laws, regulations and internal procedures and the scope and status of systems designed to promote Company compliance with laws, regulations and internal procedures.”*

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On 21 March 2018, 20 June 2018, 26 September 2018 and 15 November 2018, the Legal Director and Business Compliance Officer presented a report to the Committee to update on the Compliance Division activities.

On 21 March 2018, the Legal Director and Business Compliance Officer presented an evaluation of the 2017 Compliance Programme and an overview of the 2018 Compliance Activity Plan.

On 20 June 2018, the Legal Director and Business Compliance Officer and the Chief Compliance Officer presented an overview of the work to embed compliance and ethics within the Company, the First Line of Defence Activities being undertaken by the Compliance Division and an overview of the Company's 2017 and 2018 Claims, Allegations and Enquiries.

On 26 September 2018, the Legal Director and Business Compliance Officer provided an update on developments within the Compliance Division including an update on the SP Chief Compliance Officer, Business Separation, Employee Training and Vendor Screening together with an overview of the Company's 2018 (to date) Claims, Allegations and Enquiries.

On 15 November 2018, the Legal Director and Business Compliance Officer and the Chief Compliance Officer provided an update on the New SP Chief Compliance Officer, One ScottishPower, the initial results of the Cultural Ethics Survey and an update in relation to the Vendor Screening Tool.

**f) Business Separation of Activities Compliance**

*The Terms of Reference indicate that the role of the Committee is “To give its opinion and note on an annual basis the Compliance Officer Report on Business Separation, submitted to the Committee by the Compliance Officer to provide an update on compliance with the separation of activities focusing on the effectiveness of the practices, procedures, and systems adopted in accordance with applicable regulatory requirements of the Company and its subsidiaries. To overview any regulated activities business separation report of the Company and its subsidiaries. To inform to the Board of Directors in advance of any changes to the business separation regulatory requirements applicable to the Company and its subsidiaries”.*

The Distribution and Transmission licence conditions include a number of requirements relating to separation between electricity network businesses and competitive energy activities. They also require the appointment of a Compliance Officer with specific tasks and duties including the

preparation and submission of an Annual Report to the Licensee. On 20 June 2018, the Committee noted the Compliance Officer's draft report on Business Separation. On 12<sup>th</sup> September and 9<sup>th</sup> November 2018 the Committee considered the suitability of various proposed director appointments to the UK regulated business subsidiaries of the Company and informed the Board of Directors accordingly.

#### IV. 2019 Outlook

At its meeting on 30 January 2019 the Committee will consider a proposed Calendar of Sessions for 2019. This will ensure that the Committee fulfils its duties and responsibilities as defined in Article 3 of the Terms of Reference. Subject to approval by the Committee, the proposed activities to be covered in the sessions of 2019 are set out in the table below:

<b>Audit Committee Function</b>	<b>Proposed Activities</b>
Internal Audit	<ul style="list-style-type: none"> <li>➤ Presentations by the Head of Internal Audit:               <ul style="list-style-type: none"> <li>○ 2018 Internal Audit Annual Activity Report</li> <li>○ Monitoring of 2019 Internal Audit Activities</li> <li>○ 2020 Internal Audit Plan and Budget</li> </ul> </li> </ul>
Internal Monitoring and Risk Management Systems	<ul style="list-style-type: none"> <li>➤ Presentations by Network Planning &amp; Regulation Director:               <ul style="list-style-type: none"> <li>○ Risk Monitoring and Management Systems Update</li> </ul> </li> </ul>
External Audit	<ul style="list-style-type: none"> <li>➤ Presentations by the External Auditor:               <ul style="list-style-type: none"> <li>○ External Audit Updates on Statutory and Regulatory Accounts</li> </ul> </li> <li>➤ Presentation by the Head of Internal Audit:               <ul style="list-style-type: none"> <li>○ Independence Report for 2018 statutory audit</li> <li>○ Audit Related Assurance Services</li> </ul> </li> </ul>
Economic and Financial Information	<ul style="list-style-type: none"> <li>➤ Presentations by the Company's Finance Director:               <ul style="list-style-type: none"> <li>○ Quarterly Business Performance</li> <li>○ Closing Forecast 2019</li> </ul> </li> <li>➤ Presentations by the Head of Internal Audit:               <ul style="list-style-type: none"> <li>○ Quarterly Financial Reviews</li> </ul> </li> </ul>
Compliance and Good Governance	<ul style="list-style-type: none"> <li>➤ Presentations by the Business Compliance Officer and SP Chief Compliance Officer:               <ul style="list-style-type: none"> <li>○ Monitoring of 2019 Compliance Division Activities</li> <li>○ 2019 Annual Activity Plan and Budget</li> </ul> </li> <li>➤ Presentation by the Secretary of the Committee               <ul style="list-style-type: none"> <li>○ Scottish Power Energy Networks ACC Annual Report of Activities.</li> </ul> </li> </ul>
Business Separation of Activities Compliance	<ul style="list-style-type: none"> <li>➤ Presentations by the Compliance Officer               <ul style="list-style-type: none"> <li>○ Compliance Officer Report – Business Separation</li> </ul> </li> </ul>

**Other potential areas which may require committee attention (depending on activities in 2019) are:**

- Creation of Special Purpose Vehicles (SPV) or companies domiciled in Tax Havens; and
- Consultancy Engagements with the external auditor.



V. APPENDIX

**Terms of Reference of the Scottish Power  
Energy Networks Holdings Limited Audit  
and Compliance Committee**

**Implementation of the new business and governance structure of the  
Iberdrola Group**

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**Approved by the Scottish Power Energy Networks Holdings Limited Board on 31<sup>st</sup>  
January 2018**

## CHAPTER I.- NATURE, PURPOSE AND APPROVAL OF THE TERMS OF REFERENCE

### Article 1.- Nature and purpose

1. In accordance with the provisions of the Articles of Association of Scottish Power Energy Networks Holdings Limited (the “**Company**”), the board of directors of the *Company* (the “**Board of Directors**”, a director thereof being a “**Director**”) have established the Energy Networks Audit and Compliance Committee (the “**Committee**”), a permanent internal body, having an informative and consultative role, without executive functions, with powers of information, assessment and presentation of proposals to the *Board of Directors* within its scope of action, which shall be governed by the Memorandum and Articles of Association of the *Company* and this Terms of Reference.
2. These Terms of Reference set out the principles of action and the internal operational regime of the *Committee* within the UK Energy Networks Business. They have been prepared taking into account that:
  - (i) the ultimate parent of the *Company* is a listed company as well as the parent company of the Iberdrola Group, which also has an Audit and Risk Supervision Committee and a Corporate Social Responsibility Committee within its governance structure; and
  - (ii) the unlisted country sub holding company of the Iberdrola Group in the United Kingdom, Scottish Power Limited has an Audit and Compliance Committee (the “**SPL Committee**”) within its governance structure.

### Article 2.- Approval, amendment and priority

1. These Terms of Reference must be approved by a resolution of a majority of the members of the *Committee* and be ratified by a resolution of the *Board of Directors* of the *Company*.
2. Any amendment of these Terms of Reference must be approved by resolution of the *Board of Directors* on the initiative of the *Board of Directors*, the chairman of the *Board of Directors*, the *Chairman* of the *Committee*, the majority of the members of the *Committee*, or of one third of the *Directors*.
3. These Terms of Reference further develop and supplement the provisions of the Articles of Association of the *Company* and the Terms of Reference of the *Board of Directors* applicable to the *Committee*. The latter provisions shall prevail in the event of conflict with the former.

## CHAPTER II.- FUNCTIONS OF THE COMMITTEE

### Article 3.- Functions

1. The *Committee*, as well as the ScottishPower internal audit department (the “**Internal Audit Department**”) and the ScottishPower Energy Networks Compliance Division (the “**Compliance Division**”), shall exercise their functions with full autonomy, but without

prejudice to the establishment of an adequate framework for collaborating with and reporting on the development of their functions to the *SPL Committee* and to the Scottish Power Limited Compliance Division. The *Committee* shall cooperate with the *SPL Committee* in accordance with the General Framework of Relations of Coordination and Information Among the Audit Committees of Iberdrola S.A. and its Group (“**General Framework**”)

2. The *Committee* shall have the following functions to the extent applicable to the UK Energy Networks Business:

a) **Internal Audit:**

- (i) To oversee the independence and efficiency of the *Internal Audit Department*, ensuring that such department has sufficient resources and the professional qualifications necessary to carry out its functions optimally, and ensuring that the Basic Internal Auditing Regulations of the Iberdrola Group are complied with.
- (ii) To approve the guidelines and the annual action plans established by the head of the *Internal Audit Department*, in accordance with the guidelines and general plans established by the head of the *Iberdrola Internal Audit Department*, but focused in the *Company* risks.
- (iii) To propose the budget of the *Internal Audit Department*, for its approval by the *Board of Directors*.
- (iv) The head of the *Internal Audit Department* will prepare the information required for the meetings of the *Committee* that he/she will attend. The head of the *Internal Audit Department* is, furthermore, required to inform the *Committee* of any incidents which may occur in the development of the annual work plan, presenting it at the end of each year with an activity report. This internal audit activity report will also be presented to the head of the *Scottish Power Internal Audit Department*.
- (v) To receive regular information on the activities carried out by the *Internal Audit Department*.
- (vi) To ensure that the managers of the *Company* take into account the conclusions and recommendations in the reports of the *Internal Audit Department*. The Head of the *Internal Audit Department* shall be the usual point of contact between the *Committee* and the rest of the *Company* except for risk or compliance matters. The Head of the *Internal Audit Department* will prepare the relevant documents for the *Committee* meetings within the scope of his/her responsibilities. The *Committee* may gather information and request the collaboration of any manager of the *Company* or of any of the *Company's* subsidiaries. Any such gathering of information and/or requests for collaboration shall also be notified to the chairman of the *Board of Directors* and to the Chief Executive Officer, if there is one, but in any case without prejudice to the provisions of Article 13.5 below.

b) **Internal Monitoring and Risk Management Systems:**

- (i) To be aware of and keep under review the *Company's* internal financial information process and internal risk monitoring and management systems and those of any of the *Company's* subsidiaries, ensuring that these are adequately adapted to the processes and general systems established by the parent company of the Iberdrola Group.
  - (ii) To ensure, in accordance with the general monitoring and risk management policy established by the parent company of the Iberdrola Group, that the main risks of the *Company* and those of any of the *Company's* subsidiaries are identified, managed and adequately reported, identifying, on this basis: the different types of risks which may face the *Company*, including financial or economics risks, contingent liabilities and other off balance-sheet risks; the level of risk of that the *Company* deems acceptable; the measures necessary to mitigate the impact of any risks, should any of them materialise; and the information and internal monitoring systems which will be used to monitor and manage the aforementioned risks, including the contingent liabilities or off balance-sheet risks.
  - (iii) The *Committee* shall ensure the establishment of measures necessary to mitigate the impact of any risks identified and introduce information and internal monitoring systems which monitor and manage such risks, including contingent liabilities or off balance-sheet risks.
  - (iv) Maintain appropriate relationships with the Company Risk and Compliance Divisions. The Company Risk and Compliance Divisions shall be the normal bodies for communication with the *Committee* and the rest of the *Company's* organisation on specific matters of risk and compliance respectively, as it is responsible for preparing the information required on these issues at meetings, with the Director of the Company Risk Division and the Energy Networks Compliance Director attending them if the *Committee* so deems appropriate, but in any case without prejudice to the provisions of Article 13.5 and 13.6 below.
  - (v) To make, at least every six months, a report of the risks of the *Company* for the *Board of Directors* that the *Chairman* of the *Committee* will make available to the chairman of the *SPL Committee*, in accordance with the *General Framework* in order to allow the *SPL Committee* to fulfill its duties relating to the internal control of the Group as well as its risk management systems.
- c) **Audited Accounts:**
- (i) To propose to the *Board of Directors* the appointment, and terms of engagement, of the *Company's* auditors, in accordance with the policy as established by the parent company of the Iberdrola Group. The *Chairman* of the *Committee* shall make such proposal available to the chairman of the *SPL Committee* in accordance with the *General Framework*.

For the avoidance of doubt, the *Company's* auditors referred to in these Terms of Reference are the auditors which have been formally appointed in accordance with the relevant applicable law.

- (ii) To ensure the independence of the *Company's* auditors, receiving from them information on those issues related to the audit process which may put their independence at risk, and in general, information on any other issues which may be provided for in applicable legislation and/or the relevant audit practices in force from time to time. In any event, it shall receive from the *Company's* auditors, on an annual basis, a written confirmation of their independence in respect of the *Company* or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the said auditors or by persons or entities related thereto, pursuant to the legislation governing the audit of financial statements.
  - (iii) Issue, and provide to the *Board of Directors*, on an annual basis and prior to the issuance of the *Company's* auditors' report, a report setting forth an opinion on the independence of the auditors. This report shall, in all cases, include the provision of the additional services referred to in the preceding paragraph. The *Chairman* of the *Committee* shall make this report available to the chairman of the *SPL Committee* in accordance with the *General Framework*.
  - (iv) Analyse, together with the auditors, any significant weaknesses detected in the internal control system during the conduct of the audit and to review the contents of the Auditors Reports before they are issued, in order to avoid qualifications in their preparation and assess the results of each audit, overseeing the reply of the management of the *Company* to their recommendations.
  - (v) To serve as a communication channel between the *Board of Directors* and the auditors, relaying to the *Board of Directors* the regular information updates on the audit process and results received from the auditors.
- d) **Economic and Financial Information:**
- (i) To oversee the process for the preparation of and the integrity of the financial economic information of the *Company* (including half year information), advising on any proposals for changes to the accounting practices and policies with the general accounting practices and policies of the parent company of the Iberdrola Group. The *Committee* will elaborate a report for the *Board of Directors* on the annual, interim semi-annual and quarterly financial statements. The *Chairman* of the *Committee* will make these reports available to the chairman of the *SPL Committee* in accordance with the *General Framework* in order to allow the *SPL Committee* to supervise the process of preparation and submission and the integrity of the economic and financial information related to the Group.
  - (ii) To oversee compliance with the legal requirements and the correct application of the national and international accounting and financial information principles and

practices which may be applicable in relation to the Annual Report and Accounts and the Director's Report of the *Company*.

- (iii) To inform the *Board of Directors* of the principles on which the transactions carried out between the *Company* and any of the other companies forming part of the Iberdrola Group, and any of the *Company's* subsidiaries, must respect in order to protect the interests of the *Company*.

e) **Compliance, Good Governance and Prevention and Correction of Fraudulent and Illegal Behaviours:**

- (i) Receive information from the *Compliance Division* in connection with any matter relating to regulatory compliance and the prevention and correction of illegal or fraudulent conduct.
- (ii) Review, through the *Compliance Division*, the internal policies and procedures of the *Company* to verify the effectiveness thereof to prevent inappropriate conduct and identify any policies or procedures that are more effective at promoting the highest ethical standards, for submission to the *Board of Directors*. In particular the *Compliance Division* will report to the *Board of the Directors* on the amendments of the *Compliance Division* Regulations.
- (iii) Review and ratify the annual operating budget of the *Compliance Division*, for submission to the *Board of Directors*, and ensure that the *Compliance Division* has the necessary human and material resources to perform its duties, also ensuring its independence and effectiveness.
- (iv) Approve the annual activity plan for the *Compliance Division*.
- (v) Report the proposals of the appointments for the Energy Networks Compliance Director.
- (vi) Review the status of compliance with laws, regulations and internal procedures and the scope and status of systems designed to promote *Company* compliance with laws, regulations and internal procedures, through review of reports from management, legal counsel and third parties as determined by the *Committee*.

(f) **Irregular and Improper Financial Conduct:**

- (i) To establish and supervise, in coordination with the mechanisms established by the parent company of the Iberdrola Group, the channels which permit employees of the *Company* to communicate, confidentially and, if it is deemed appropriate, anonymously, any potentially significant irregularities, especially those which are financial or accounting in nature which they may have witnessed at the *Company*. In doing so, the *Committee* shall respect applicable regulations regarding the protection of personal information and the fundamental rights of the parties involved.

- (ii) To undertake the necessary investigations regarding claims by third parties against the *Company* or regarding irregular or anomalous conduct, in accordance with the provisions of the above paragraph.
- (g) **Special Purpose Vehicles and Tax Haven Companies:**
  - (i) To inform the *Board of Directors*, prior to adoption of any decision on the creation or acquisition of holdings in special purpose vehicles or in entities domiciled in countries or territories which are considered tax havens, and produce for the *Board of Directors* a report on any such proposals. The *Chairman* of the *Committee* shall make this report available to the chairman of the *SPL Committee* in accordance with the General Framework.
  - (ii) To produce, for the *Board of Directors*, a report on the monitoring of special purpose vehicles or in entities domiciled in countries or territories which are considered tax havens. The *Chairman* of the *Committee* shall make this available to the chairman of the *SPL Committee* in accordance with the *General Framework*.
  - (iii) To inform the *Board of Directors* of any other transactions or operations of a similar nature which, due to their complexity, could undermine the transparency of the Iberdrola Group.
- h) **Business Separation of Activities Compliance**
  - (i) To give its opinion and note on an annual basis the Compliance Director Report on Business Separation, submitted to the *Committee* by the Compliance Director to provide an update on compliance with the separation of activities focusing on the effectiveness of the practices, procedures, and systems adopted in accordance with applicable regulatory requirements of the *Company* and its subsidiaries.
  - (ii) To overview any regulated activities business separation report of the *Company* and its subsidiaries.
  - (iii) To inform to the *Board of Directors* in advance of any changes to the business separation regulatory requirements applicable to the *Company* and its subsidiaries.
- 3. The *Committee* shall similarly assume any other functions which, as the case may be, the Articles of Association of the *Company* or the *Board of Directors* attribute to it within the UK Energy Networks Business.

#### **Article 4.- Scope of functions. Information to the Board of Directors**

1. The functions indicated in the above Article shall extend to the *Company* and any and all of the *Company's* subsidiaries within the UK Energy Networks Business
2. At the first meeting of the *Board of Directors* subsequent to any meeting(s) of the *Committee* the *Chairman* shall inform the *Board of Directors* of the resolutions and significant events which occurred at the meeting(s) of the *Committee*.

#### **Article 5.- Annual Report**

The *Committee* shall submit to the *Board of Directors* for its approval an Annual Report of its activities, an evaluation of the adequacy of the *Committee's* Terms of Reference and an evaluation of the *Committee's* performance during the previous year, within the three months subsequent to the end of the year. This Annual Report shall subsequently be made available to the chairman of the *SPL Committee* in accordance with the *General Framework*.

#### **Article 6.- Specialist Services**

1. In order to carry out its functions, the *Committee* may engage or employ, permanently or occasionally, legal advisors, accountants, financiers or other specialists, who, subject to the provisions of Article 13.6, may attend the meetings of the *Committee*, as well as the meetings of the *Board of Directors* when required, and who may speak at the meetings but may not vote.
2. Employment of such specialists shall be made in accordance with the Articles of Association.

### **CHAPTER III.- FORMATION, APPOINTMENT AND CESSATION OF MEMBERS**

#### **Article 7.- Formation**

1. The *Committee* shall be formed of three (3) Directors, from among which at least two (2) of them shall be independent Directors.
2. The *Committee* shall have a chairman (the "**Chairman**") and a secretary, who, in the event of absence, shall be substituted respectively by the two members who have the most seniority on the Board by length of service, on the one hand, and, on the other hand, the least seniority on the Board by length of service. In the event of equal seniority, the independent non-executive director(s) on the *Board of Directors* shall decide.
3. The *Chairman* of the *Committee* must be appointed from among the independent Directors forming part thereof.

#### **Article 8.- Appointment**

1. The members of the *Committee*, as well as the *Chairman*, shall be appointed by the *Board of Directors*.
2. The *Board of Directors* shall attempt to ensure that the members of the *Committee* have the necessary experience and knowledge of accounts, audit or risk management, which is adequate for the functions they are asked to provide. It shall not be necessary for them to be experts in these areas.

#### **Article 9.- Duration**

1. The Directors sitting on the *Committee* shall exercise this office while their appointment as Directors of the *Company* continues in force, unless the *Board of Directors* agrees otherwise.



2. The Directors which make up the *Committee*, and which are re-elected as Directors of the *Company* in accordance with the Articles of Association, shall continue to carry out their positions on the *Committee* without the need for a new election, unless the *Board of Directors* agree otherwise.

#### **Article 10.- Cessation**

The members of the *Committee* shall cease in their positions:

- (a) if/when they cease to be Directors of the *Company*, or
- (b) by resolution of the *Board of Directors*.

#### **CHAPTER IV.- MEETINGS OF THE COMMITTEE**

#### **Article 11.- Sessions**

1. The *Committee* shall meet as many times as is considered necessary in the opinion of the *Chairman* to comply with their undertakings, and at least four (4) times a year, or when two (2) of its members so request it.
2. The chairman of the *Board of Directors* and, if it exists, the Chief Executive Officer, may request informative meetings with the *Committee*, on an exceptional basis.

#### **Article 12.- Meeting Calls**

1. The *Chairman*, or the secretary of the *Committee* at the request of the former, may call a meeting of the *Committee* by means of a letter, email or any other means, addressed to each of its members, indicating the place, date and time of the meeting, as well as the agenda to be followed.
2. The calling of a meeting must be made with a minimum notice period of 48 hours, unless there is a need for an urgent meeting.
3. It shall not be necessary to call meetings of the *Committee* in advance when all the members of the *Committee* are present and unanimously accept holding the meeting and debating the points on the agenda.
4. A meeting of the *Committee* may be held in several places provided that they are connected to each other by a system that permits the recognition and identification of the attendees, and discussion among them.

#### **Article 13.- Quorum, Attendance and Adoption of Resolutions**

1. The *Committee* shall be quorate when a majority of its members are present or duly represented.

Any member of the *Committee* may delegate its representation to another member of the *Committee* by means of a letter, email or other communication, which includes specific instructions regarding how to cast his vote, addressed to the secretary of the *Committee*.

2. Meetings of the *Committee* shall be presided over by the *Chairman*, which will be assisted by the secretary.
3. Resolutions shall be adopted by a majority of votes of the members of the *Committee* present or duly represented at the meeting. In the event of a tie, the *Chairman* will have a casting vote.
4. If none of the members of the *Committee* make any opposition, votes may be made in writing and without a *Committee* meeting as permitted by the Articles of Association of the *Company*.
5. At the request of the *Chairman*, addressed for such purpose to the Chairman of the *Board of Directors*, any Director may be requested to attend a meeting of the *Committee*. The *Chairman* may also request, through the Secretary of the *Board of Directors*, the attendance of any director, manager or employee of the *Company* as well as of any member of the management decision-making bodies of the companies in which the *Company* has an interest provided that there is no legal impediment thereto.
6. Persons who are not members of the *Committee* may not attend meetings when the matters dealt with are outside of the scope of the powers or duties of such persons.
7. The *Committee* may request the presence at its meetings of both the *Company's* auditor as well as the auditor of any entity within the *Company*, provided that there is no legal impediment thereto.
8. The secretary of the *Committee* shall:
  - a) draw up the minutes of each meeting, which shall be approved at the end of the same meeting or at the start of the immediately subsequent meeting; and
  - b) make, maintain and circulate to the members of the *Committee* records of resolutions passed in writing.

## **CHAPTER V.- COMPLIANCE, INTERPRETATION AND INTEGRATION OF THE REGULATIONS**

### **Article 14.- Compliance**

1. The members of the *Committee*, as well as the other Directors affected, have the obligation to be aware of and comply with these Terms of Reference, for which purpose the secretary of the *Board of Directors* shall provide all of them with a copy.
2. Additionally, the *Committee*, in particular the *Chairman*, shall have the obligation to oversee compliance with these Terms of Reference, adopting any measures necessary for such purpose.
3. Without prejudice to their duties as *Directors* under UK law (as applicable), *Committee* members must act with independence of judgement and action with respect to the rest of the organisation and perform their work with the utmost diligence and professional competence.

**Article 15.- Interpretation and Integration of the Regulation**

1. Any doubts or discrepancies as regards the interpretation of these Terms of Reference shall be resolved by a majority of the votes of the members of the *Committee*, and in the absence of such majority, by the *Chairman*, to be assisted by any persons the *Board of Directors* may appoint for this purpose. The interpretation and resolution of any doubts or discrepancies which may arise must be reported to the *Board of Directors*.
2. In the absence of any specific regulations, the provisions of the Articles of Association of the *Company* relating to the operation of the *Board of Directors*, provided they are not incompatible with its nature and function, shall be applicable to the *Committee*.
3. In these Terms of Reference the term “Group” shall mean a group as defined in section 1261 of the Companies Act 2006.