Scottish Power Energy Networks Holdings Limited Audit & Compliance Committee

29 January 2020

2019 ANNUAL ACTIVITY REPORT





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Report for the year 2019 presented at the Scottish Power Energy Networks Holdings Limited Audit & Compliance Committee ("the Committee") meeting of 29 January 2020 for noting by the Committee and thereafter submitted to the Board of Directors of Scottish Power Energy Networks Holdings Limited on 29 January 2020 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:

Member	Title	Position
Wendy Barnes	Independent, Non- Executive Member (Chairperson)	Independent Non-Executive Director – Scottish Power Energy Networks Holdings Limited
Sr José Izaguirre Nazar	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
Alison McGregor	Independent, Non- Executive Member	Independent Non-Executive Director – Scottish Power Energy Networks Holdings Limited

Throughout 2019, Andrew Black, Solicitor, SP Energy Networks, acted as Secretary to the Committee.



II. AUDIT AND COMPLIANCE COMMITTEE MEETINGS 2019

a) **COMMITTEE HIGHLIGHTS**

	2019
Number of meetings	5
Number of written resolutions	3
Reports, Proposals and Updates to the Company's Board of Directors	20
Presentations from Senior Management	38
Presentations from the External Auditor	2



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

Title	Date
Proposed Calendar of Sessions and Agendas 2019	30 January 2019
2. 2018 Committee Annual Activity Report	
3. SPEN ACC Report – 2018 Year End Financial Information	
4. 2019 Internal Audit Budget	
5. SPEN ACC Risk Report – Enterprise Risk Management	
SPEN ACC Report on SPEN's 2019 (to date) Financial Information	19 March 2019
7. SPEN ACC Risk Report – Enterprise Risk Management	
SPEN ACC Report in relation to the proposed appointment of Professor Dame Lesley Anne Glover as a Sufficiently Independent Director of various SPEN Companies	24 June 2019
SPEN ACC Report on SPEN's H1 2019 Financial Information	03 July 2019
 SPEN ACC Report on the Terms of Engagement – 2019/20 Regulatory Audit 	
 SPEN ACC Report – External Auditor Independence (2018/19 Regulatory Accounts) 	
12. SPEN ACC Risk Report – Enterprise Risk Management	
 SPEN ACC Report on SPEN's 2018/19 Regulatory Submissions 	
SPEN ACC Report – Special Purpose Vehicles or entities domiciled in tax havens	
15. SPEN ACC Report on SPEN's 2019 Q3 Financial Information	25 September 2019
16. SPEN ACC Risk Report – Enterprise Risk Management	
17. 2020 Internal Audit Plan	26 November 2019
18. SPEN ACC Report – Audit Related Assurance Services	
19. SPEN ACC Risk Report – Enterprise Risk Management	
20. Data Protection Officer Update	



ii) Senior Management Presentations

Date	Senior Manager	Presentation
30 January 2019	Finance Director	2018 Year End Financial Performance Review
	Head of Internal Audit	Internal Audit Report on Year End Financial Information & Certification Process
		2019 Internal Audit Budget
		2018 Internal Audit Annual Activity Report
		Internal Audit Activities Update
	Legal Director & Business Compliance Officer and Chief Compliance Officer	Compliance Update
	Network Planning & Regulation Director	SPEN Risk Report
19 March 2019	Finance Director	Q1 2019 Financial Performance Review
	Head of Internal Audit	Internal Audit Report on Q1 2019 Financial Information
		Internal Audit Activities Update
	Legal Director & Business Compliance Officer and Chief Compliance Officer	2019 Compliance Report and Activity Plan
	Network Planning & Regulation Director	SPEN Approach to Risk Reporting SPEN Risk Report
03 July 2019	Finance Director	2019 to date Financial Performance Review
	Head of Internal Audit	Internal Audit Report on H1 2019 Financial Information
		2019 Internal Audit Activities Update
	Legal Director & Business Compliance Officer and Chief Compliance Officer	2019 Compliance Report and Activity Plan Update



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

Network Planning and Regulation Report on SPEN's 2018/19 Regulatory Submissions

25 September 2019 Finance Director

2019 Q3 Financial Performance Review

Head of Internal Audit

Internal Audit Report on 2019 Q3 Financial

Information

2019 Internal Audit Activities Update

Legal Director and **Business Compliance**

Officer

Compliance Division Report

Network Planning & Regulation Director

SPEN Risk Report

Network Planning & Regulation Director and Director of Process & Technology

Update on Operational Telecommunications Risk

Network Planning & Regulation Director, Head of Internal Audit, and Licence and Assurance Manager

Overview of SPEN Assurance Framework

26 November 2019 Finance Director

October 2019 Financial Performance Review

Head of Internal Audit

2019 Internal Audit Activities Update

Chief Compliance

Officer

Overview of SPEN Assurance Framework

2019 Compliance Update

Head of Data Privacy and Protection and **Customer Services**

Director

Data Protection Officer Update

Legal Director

Legal Claims and Regulatory Investigations

Report





Network Planning & Regulation Director

SPEN Risk Report



External Auditor Presentations

Subject	Date
External Audit Update	30 January 2019
External Audit Update on Regulatory Accounts	03 July 2019



b) MEETING AGENDAS

In 2019, the Committee held five meetings. The following tables show the business transacted at each of these meetings:

Session 1 - 30 January 2019

Legal Update

- Proposed Calendar of Sessions & Agendas 2019
- 2018 Committee Annual Activity Report

Financial Information Review

- External Audit Update
- 2018 Year End Financial Performance Review
- Internal Audit Report on Year End Financial Information and Certification Process
- SPEN ACC Report on 2018 Year End Financial Information

Internal Audit Update

- > 2019 Internal Audit Budget
- 2018 Internal Audit Annual Activity Report
- > Internal Audit Activities Update

Risk Update

- ➤ SPEN Risk Report
- > SPEN ACC Risk Report Enterprise Risk Management

Compliance Division Update

Compliance Update

Session 2 – 19 March 2019

Financial Information Review

- Q1 2019 Financial Performance Review
- Internal Audit Report on Q1 2019 Financial Information
- SPEN ACC Report on SPEN's 2019 (to date) Financial Information

Internal Audit Update

> Internal Audit Activities Update

Risk Update

- > SPEN Approach to Risk Reporting
- SPEN Risk Report
- SPEN ACC Risk Report Enterprise Risk Management

Compliance Division Update

2019 Compliance Report and Activity Plan

Session 3 - 03 July 2019



Financial Information Review

- External Audit Update on Regulatory Accounts
- 2019 to date Financial Performance Review
- ➤ Internal Audit Report on H1 2019 Financial Information
- > SPEN ACC Report on SPEN's H1 2019 Financial Information

Internal Audit Update

- 2019 Internal Audit Activities Update
- ➤ SPEN ACC Report on the Terms of Engagement 2019/20 Regulatory Audit
- ➤ SPEN ACC Report External Auditor Independence (2018/19 Regulatory Accounts)

Risk Update

- SPEN Risk Report
- > SPEN ACC Risk Report Enterprise Risk Management

2019 Regulatory Submissions

- Draft Certification of Availability of Resources
- Draft Certificate of Compliance
- Draft Intervention Plan
- Draft Certification of Unbundling
- Draft Ultimate Controller Undertaking
- Network Planning and Regulation Report on SPEN's 2018/19 Regulatory Submissions
- SPEN ACC Report on SPEN's 2018/19 Regulatory Submissions

Compliance Division Update

> 2019 Compliance Report and Activity Plan Update

Special Purpose Entities and Tax Haven Companies

> SPEN ACC Report - Special Purpose Vehicles or entities domiciled in tax havens

Session 4 - 25 September 2019

Financial Information Review

- > 2019 Q3 Financial Performance Review
- > Internal Audit Report on 2019 Q3 Financial Information
- > SPEN ACC Report on SPEN's 2019 Q3 Financial Information

Internal Audit Update

2019 Internal Audit Activities Update

Risk Update

- ➤ SPEN Risk Report
- SPEN ACC Risk Report Enterprise Risk Management
- Update on Operational Telecommunications Risk

SPEN Assurance Framework

Overview of SPEN Assurance Framework

Compliance Division Update

Compliance Division Report



Session 5 - 26 November 2019

Financial Information Review

October 2019 Financial Performance Review

Internal Audit Update

- 2019 Internal Audit Activities Update
- 2020 Internal Audit Plan
- > SPEN ACC Report Audit Related Assurance Services

Risk Update

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

Compliance Division Update

- Overview of SPEN Assurance Framework
- > 2019 Compliance Update

Data Protection Officer Update

Data Protection Officer Report

Legal Claims and Regulatory Investigations

Legal Claims and Regulatory Investigations Report

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 three written resolutions during 2019 as follows:

- ▶ 17 June 2019: General Risk Control and Management Policy, Corporate Risk Policies, Risk Policy for the Company and the Company Group, Risk Limit Guidelines and Business Specific Risk Limit Guidelines;
- 24 June 2019: Report on the proposed appointment of Professor Dame Lesley Anne Glover as a Sufficiently Independent Director of the Board of Directors of SP Transmission plc, SP Distribution plc and SP Manweb plc; and
- 23 July 2019: Compliance Officer Report on Business Separation and the SPEN Report describing the measures taken by SP Transmission plc, SP Distribution plc and SP Manweb plc to meet their respective business separation requirements.



III. MAIN ACTIVITIES

In 2019, 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

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."

The Head of Internal Audit presented a report to the Committee at its meeting on 30 January 2019, summarising the main activities and achievements of the Internal Audit department in 2018.

On 30 January 2019, the Committee proposed the 2018 Internal Audit Annual Budget for approval by the Company's Board

At every meeting in 2019 the Head of Internal Audit presented a report to the Committee to update on Internal Audit activities.

On 26 November 2019, the Committee approved the 2020 Internal Audit Annual Activity Plan.

b) Internal Monitoring and Risk Management Systems

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."

The Network Planning & Regulation Director presented papers to the Committee on 30 January 2019, 19 March 2019, 03 July 2019, 25 September 2019 and 26 November 2019 providing an update on the performance against defined key limits and indicators, and the main risks facing the Company.

On 19 March 2019 the Network Planning & Regulation Director presented an update to the Committee on the Company's approach to Risk Reporting

On 17 June 2019, the Committee noted the General Risk Control and Management Policy, Corporate Risk Policies, Risk Policy for the Company and the Company Group, Risk Limit Guidelines and Business Specific Risk Limit Guidelines.



On 25 September the Company's Director of Process & Technology presented an update to the Committee on the Operational Telecommunications Risk.

c) Audited Accounts

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".

On 03 July 2019, 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 letter sent to the Scottish Power Audit and Compliance Committee dated 3 July 2019; (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) all audit related assurance services were pre-approved by the Scottish Power Audit & Compliance Committee and the value of these services are not material.

On 03 July 2019 the Head of Internal Audit presented a report to the Committee on the appointment and conditions of the engagement of the external auditor (KPMG) for the 2019/20 regulatory audit.

On 26 November 2019 the Committee considered and approved the audit related assurance services to be provided by the external auditor (KPMG) for the financial year to December 2019 and the Company's regulatory year to March 2020.

As part of the supervision of the auditing of the financial statements by the Committee, the external auditor appeared before the Committee to present the External Audit Update on the December 2018 Statutory and 2018/19 Regulatory Accounts.

d) Economic and Financial Information

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."

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 December 2018 on 30 January 2019;
- > Results to 31 March 2019 on 19 March 2019;



- Results to 30 June 2019 on 03 July 2019; and
- > Results to 30 September 2019 on 25 September 2019.

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 2018 consolidated annual accounts of the Iberdrola Group; comments and observations about the significant issues of the period; and potential risks and sources of uncertainty in the accounting policies and practices adopted with potentially significant impact in the 2019 consolidated annual accounts.

At each meeting of the Committee during 2019, 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 December 2018 Statutory and 2018/19 Regulatory Accounts.

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

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."

On 30 January 2019, 19 March 2019 and 03 July 2019 the Legal Director and Business Compliance Officer and ScottishPower's Chief Compliance Officer presented an update to the Committee on the Compliance Division activities.

On 25 September the Legal Director and Business Compliance Officer presented an update to the Committee on the Compliance Division activities.

On 26 November ScottishPower's Chief Compliance Officer presented an update to the Committee on the Compliance Division activities.

f) Irregular and Improper Financial Conduct

The Terms of Reference indicates that the role of the Committee is "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...To undertake the necessary investigations regarding claims by third parties against the Company or regarding irregular or anomalous conduct."

On 26 November 2019, the Legal Director presented a report of the Company's 2019 Legal Claims and Regulatory Investigations. The aim of this report is to provide the Committee with an



update on the status of major legal claims and regulatory investigations and potential legal risks affecting the Company.

g) Special Purpose Vehicles and Tax Haven Companies

The Terms of Reference indicates that the role of the Committee is "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...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...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

On 03 July 2019, the Committee Secretary provided a report for the Committee in relation to special purpose vehicles or entities domiciled in tax havens within the Company's group of companies ("SPENH Group"). The report confirmed that there are no special purpose vehicles or in entities domiciled in countries or territories which are considered tax havens within the SPENH Group.

h) 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 23 July 2019 the Compliance Officer Report on Business Separation and the Company's Report describing the measures taken by SP Transmission plc, SP Distribution plc and SP Manweb plc to meet their respective business separation requirements.

On 24 June 2019 the Committee considered the suitability of a proposed director appointment to the UK regulated business subsidiaries of the Company and informed the Board of Directors accordingly.



IV. 2020 Outlook

At its meeting on 29 January 2020 the Committee will consider a proposed Calendar of Sessions for 2020. 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 2020 are set out in the table below:

Audit Committee Function	Proposed Activities
Internal Audit	 Presentations by the Head of Internal Audit: 2019 Internal Audit Annual Activity Report 2020 Internal Audit Budget Monitoring of 2020 Internal Audit Activities 2021 Internal Audit Plan
Internal Monitoring and Risk Management Systems	 Presentations by Network Planning & Regulation Director: Risk Monitoring and Management Update Key Risk Review
External Audit	 Presentations by the External Auditor: External Audit Updates on Regulatory Accounts Presentation by the Head of Internal Audit: Terms of Engagement for 2019/20 Regulatory audit Independence Report for 2019/20 regulatory audit Audit Related Assurance Services
Economic and Financial Information	 Presentations by the Company's Finance Director: Quarterly Business Performance Closing Forecast 2020 Presentations by the Head of Internal Audit: Quarterly Financial Reviews
Compliance and Good Governance	 Presentations by the Business Compliance Officer and SP Chief Compliance Officer: Monitoring of 2020 Compliance Division Activities 2020 Annual Activity Plan and Budget Presentation by the Secretary of the Committee Scottish Power Energy Networks ACC Annual Report of Activities. Presentation by the UK Tax Director Compliance with Corporate Tax Policy
Irregular and Improper Financial Conduct	 Presentations by the Company's Legal Director Legal Claims and Regulatory Investigations





Special Purpose Vehicles and Tax Haven Companies	 Presentations by the Company's Legal Director Liquidations and Special Purpose Entities Report
Business Separation of Activities Compliance	 Presentations by the Compliance Officer Compliance Officer Report – Business Separation

Other potential areas which may require committee attention (depending on activities in 2020) 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

<u>Implementation of the new business and governance structure of the Iberdrola Group</u>

Approved by the Scottish Power Energy Networks Holdings Limited Board on 31st January 2018



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

Article 1.- Nature and purpose

- 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, 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

 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 fulfil 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 *SPLCommittee* 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:

- 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

- 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

- 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

- 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.
- 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

 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
 - 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.