

SCOTTISH WATER'S COMPLIANCE OFFICER'S REPORT

COMPLIANCE OFFICER'S ACTIVITIES

ANNUAL REPORT ON BUSINESS SEPARATION 2022/23

1 Introduction

This report fulfils the reporting requirements set out in the Water Services (Intra-Group Regulation) Directions 2006, as amended (the “Intra-Group Directions”) in relation to 2022/23. It covers the duties of the Compliance Officer and implementation of practices, procedures and systems to ensure compliance with the Market Directions. The specific responsibilities of the Compliance Officer are:

- to provide advice to Scottish Water on compliance with the Market Directions;
- to ensure the ring-fencing of Business Stream so that its management and operations are independent from Scottish Water; and
- to ensure that each Licensed Provider is treated no more or less favourably than any other.

The associated Compliance Statement sets out the detailed arrangements by which Scottish Water will comply with its responsibilities in 2023/24.

2 Compliance with the Market Directions

2.1 Advice to Scottish Water

The Compliance team resolves enquiries from the organisation in relation to compliance with the Market Directions. In 2022/23, there were 57 enquiries, including on specific issues such as individuals taking up positions in Scottish Water who were previously employed by Licensed Providers, and on wider policy issues such as ensuring fair treatment of all Licensed Providers under the new policy and guidance relating to the design and implementation of the Water Services (Wholesale Charges Relief Schemes) Directions 2020.

Compliance training was provided by to (i) all new starts within the key market-facing teams; (ii) employees taking up market-facing roles within Financial Control; and (iii) individuals recruited by Scottish Water who had previously been employed by a Licensed Provider.

2.2 Compliance with the Intra-Group Directions

Scottish Water is required to manage its systems and processes so that no Licensed Provider is able to access Scottish Water's confidential information. In 2022/23, no Licensed Provider had access to any of Scottish Water's premises, equipment or facilities. Scottish Water's systems were subject to password and profile-controlled access. Licensed Providers had access to certain portals that allowed them to (i) submit requests for operational activities; (ii) view information about their customers; and (iii) view general information about ongoing operational activity. Over 2023/24, further “self-service” functionality will be rolled out, particularly in relation to smart metering.

Intra-group contracts

In 2022/23, there were four intra-group contracts between Scottish Water and Business Stream, each of which was approved in advance by the Commission:

- Business Stream's use of the Scottish Water marque was covered by a licensing agreement;
- Business Stream provided a meter reading service to Scottish Water in relation to non-market domestic properties managed by a third party to whom Scottish Water was a sub-contractor;
- Business Stream entered into an escrow agreement in 2021/22 in relation to the Wholesale Charges Deferral Scheme, which it is anticipated will come to an end in early 2023/24; and
- Scottish Water provided Internal Audit services, together with insurance and taxation advice, to Business Stream.

In order to allow Scottish Water Internal Audit employees to carry out audits on Business Stream activities, time-limited password-controlled access was granted to two individuals. Compliance training for internal audit staff will be refreshed in early 2023/24.

There were no contracts between Scottish Water and any other Licensed Provider. A small number of Licensed Providers have affiliates that own or operate Wastewater Treatment Works under PFI contracts with Scottish Water. In accordance with the annual process, Scottish Water wrote to each relevant Licensed Provider in 2022/23 asking them to ensure the confidentiality of the market information held by the affiliated PFI contractor. Following repayment of the external bank debt in relation to the North-East PFI scheme, which was operated by a company which had a Licensed Provider as an associated company in the same group, the Concession Agreement terminated with effect from 1 October 2022 and the North-East PFI operations have now been integrated within Scottish Water wastewater operations. From a compliance perspective, this removed a small risk in relation to confidential data.

Investigations

The Compliance team identified and investigated three compliance concerns in 2022/23:

- One concern related to the inadvertent misuse of the "pause" functionality in the customer management system, where, in a small number of cases, employees misinterpreted the policy, leading to some tasks being incorrectly recorded as passing the KPI. Training was provided to relevant employees and the KPI was adjusted to reflect the correct position.
- One concern related to the use of a particular method of backdating market information. On investigation, this behaviour was in line with established policy.
- One other concern related to a Licensed Provider making wholesale payments to a third-party, but it was established on investigation that this was caused by fraudulent activity by the third party.

There were no formal complaints from Licensed Providers or the Commission in 2022/23.

2.3 Compliance with the Governance Code Directions

Scottish Water is required to ensure that Business Stream has an independent management structure and independent operations. Throughout 2022/23, this was delivered in line with the requirements of the Governance Code through Scottish Water Horizons Holdings Limited

(SWHH), and Scottish Water Business Stream Holdings Limited (SWBSH), which exercise Scottish Water's ownership responsibilities in relation to Business Stream.

As required by its Standard Licence Condition A9 ("SLC A9"), Business Stream provided Scottish Water with the appropriate assurances that, during the period from 1 January to 31 December 2022, it (i) only received financial support on commercial, arm's length terms; (ii) had an appropriate financial structure; and (iii) ensured that its Scottish customers were not disadvantaged by its operations in England and Wales.

2.4 Compliance with the Codes and Services Directions

Scottish Water complied with the Codes and Services Directions in 2022/23. Operational Code performance is reported to the Board and out-performed the corporate target. Market Code metrics also out-performed the corporate target. These obligations were subject to external audit by the Central Market Agency ("CMA") with no significant negative findings. Both metrics compared favourably with the equivalent standards in the English and Welsh market.

The Compliance team monitored operational performance to ensure that each Licensed Provider was treated no more or less favourably in relation to compliance with the operational standards, and in terms of recovery in the rare instances of KPI failure.

2.5 Other market requirements

There are a number of other requirements within the Market Directions. The following activities were carried out to fulfil these obligations:

- The Compliance team kept records of all meetings between Scottish Water and Business Stream. These records were cross-referenced against the equivalent records held by Business Stream to ensure consistency.
- Each Licensed Provider was offered a senior-level meeting with an appropriate staff within Scottish Water. The Business Stream and Scottish Water Chief Executives met 8 times in 2022/23 – the Compliance Manager attended each of these meetings.
- Scottish Water continued to develop its policy on Section 29E departures through the "Partner Ecosystem" approach. The Operational Code was also amended to clarify the ability of Scottish Water to approach end-customers directly in certain circumstances.

3 Conclusion

In the 2022/23 financial year, Scottish Water continued to operate robust separation and market-facing structures. Systems and processes are in place to monitor the level of Scottish Water's performance and there continues to be effective identification and remediation of potential and actual issues. Going forward, Scottish Water is committed to ensuring that its separation and market obligations are achieved.

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