

SCOTTISH WATER'S COMPLIANCE OFFICER'S REPORT

COMPLIANCE OFFICER'S ACTIVITIES

ANNUAL REPORT ON BUSINESS SEPARATION 2023/24

1 Introduction

This report fulfils the reporting requirements of the Water Services (Intra-Group Regulation) Directions 2006, as amended (the "Intra-Group Directions") in relation to 2023/24. 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 ("LP") 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 2024/25.

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 2023/24 there were 34 enquiries including on specific issues such as the status of a historic free water agreement, provision of market sensitive information, the status of Business Stream as a subsidiary of Scottish Water, a request from a LP to film marketing material on a Scottish Water asset and resolution of a customer issue relating to their inability to switch LP.

Compliance training was provided to all new starts within the key market-facing teams.

2.2 Compliance with the Intra-Group Directions

Scottish Water is required to manage its systems and processes so that no LP is able to access Scottish Water's confidential information. In 2023/24, no LP had access to any of Scottish Water's premises, equipment or facilities. Scottish Water's systems were only accessible to people working for or on behalf of Scottish Water, and subject to password and profile-controlled access. LPs 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 2024/25, further "self-service" functionality will be rolled out, particularly in relation to smart metering.

Intra-group contracts

At the end of 2023/24, there were four intra-group contracts between Scottish Water and Business Stream, each of which had been approved in advance by the Water Industry Commission for Scotland (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; and
- Scottish Water provided two services to Business Stream: Internal Audit services; and Insurance and Taxation Advice.

In order to allow Scottish Water Internal Audit employees to carry out audits on Business Stream activities, one individual has time-limited password-controlled access to a secure portal for the sharing of sensitive documents.

The escrow agreement between Scottish Water and Business Stream in relation to the Wholesale Charges Deferral Scheme came to an end in early 2023/24.

There were no contracts between Scottish Water and any other LP. Two LPs 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 LP in 2023/24 asking them to ensure the confidentiality of the market information held by the affiliated PFI contractor.

Investigations

The Compliance team identified and investigated four compliance concerns in 2023/34. These related to the use by a LP of marketing material which referred to Scottish Water; a proposed change of trading name by a LP; the provision of Digital collateral to a LP; and a concern raised by an LP about data protection of end-customer personal information.

In addition, there was an internal audit of the management of Schedule 3 agreements, which had a significant Compliance input.

There were no formal complaints from LPs or the Commission in 2023/24.

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 2023/24, 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 2023, 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 2023/24. 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 LP 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. There was no evidence of preferential treatment to any LP, either in terms of pass/fail KPI performance or the time taken to resolve KPIs (outperformance of KPI).

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 LP was offered a senior-level meeting with an appropriate staff within Scottish Water. The Business Stream and Scottish Water Chief Executives met eight times in 2023/24 and the Compliance Manager attended each of these meetings.
- Scottish Water continued to develop its policy on Section 29E departures through the “Partner Ecosystem” approach. This will be reviewed in the light of potential changes to water industry legislation.

3 Conclusion

In the 2023/24 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.

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