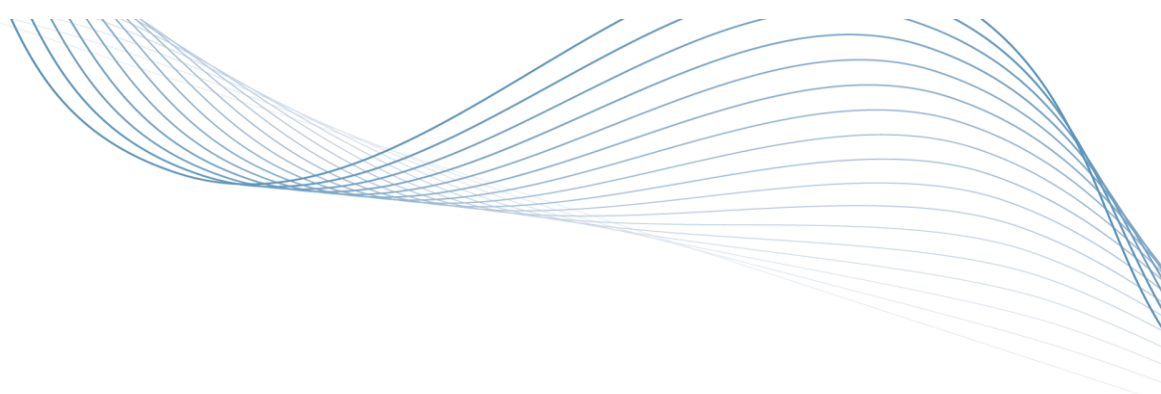




CONSULTATION ON MEASURES IN SUPPORT OF THE RETAIL MARKET

1 November 2024



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Consultation on measures in support of the retail market

The non-household retail market in Scotland has now been operating effectively for over sixteen years. During this time, WICS has regularly kept the regulatory framework under review to ensure that the market arrangements continue to work well and serve the interests of customers and market participants.

This document consults on measures to support the implementation of a Code of Practice and seeks views on the current level playing field arrangements.

As part of the implementation of a Code of Practice, WICS is also consulting on a draft licence condition, pursuant to Paragraph 2(6) of Schedule 2 to the Water Services etc. (Scotland) Act 2005.

WICS is now seeking views from stakeholders. Any responses should be provided by 6 December 2024 to CompetitionTeam@watercommission.co.uk

This document has been sent to:

- All licensed providers;
- Scottish Water;
- The Central Market Agency Limited;
- Scottish Government;
- Scottish Public Services Ombudsman; and
- Consumer Scotland.

This consultation document is also available on the WICS website: <https://wics.scot/consultations/retail-market-consultations>



1. Context

1.1. Background

The non-household retail market in Scotland has now been operating effectively for over sixteen years. During this time, WICS has regularly kept the regulatory framework under review to ensure that the market arrangements continue to work well for market participants and deliver benefits to customers.

WICS now considers it is appropriate to consult on measures to support the implementation of a Code of Practice (**CoP**) and launch a targeted review of the level playing field arrangements. Each key area will be addressed in Section 2 and Section 3 respectively.

1.2. Duties of WICS

WICS has the general function under Section 1(2) of the Water Industry (Scotland) Act 2002 (the 2002 Act) of promoting the interest of (current and future) customers (the Customer Function). Section 11 of the Water Services etc. (Scotland) Act 2005 (the **2005 Act**) provides that WICS has the duty to exercise its functions relating to retail services licences for the purpose of securing the participation by licensed providers in a) an orderly manner and b) in a manner that is not detrimental to the exercise of Scottish Waters' core functions (the Participation Duty).

As the regulator of the market, WICS also has responsibility for the administration of the retail licensing framework (and its associated codes and documents) and to monitor and enforce licensees' compliance with their licence obligations. Against that background, WICS periodically monitors the effectiveness of the retail licensing framework to ensure it is consistent with its duties, including the Participation Duty. Whilst a key part of this is to ensure a level playfield field across all market participants, WICS does not have an active remit to promote competition nor does it have any concurrent competition powers.



2. Measures in support of a Code of Practice

2.1. Background

2.1.1. EARLY CONSULTATIONS

2.1.1.1. Benefits from the opening of a retail market

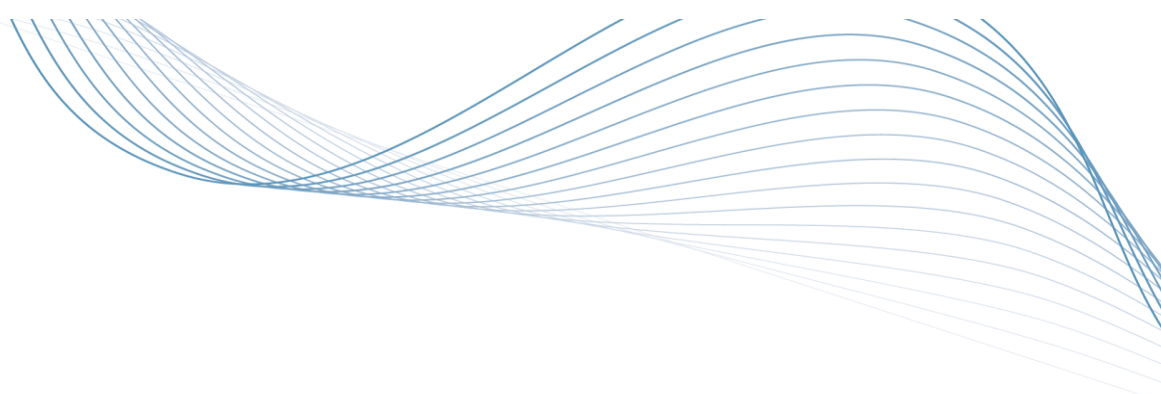
Since market opening in April 2008, customers have enjoyed greater choice and tailored services. Especially in the early years of the market, licensed providers developed enhanced services to meet the expectations of their customers, for example by offering a more responsive customer service, new methods of payment, automatic meter readers and advice on how to improve water efficiency or reduce discharges.

WICS wants to ensure that the market continues to deliver a similarly wide range of benefits to consumers and that customers can make informed choices on the service offerings from licensed providers. WICS is also mindful that licensed providers have developed different value propositions. Ensuring that customers can access (and have confidence in) clear and transparent information about licensed providers' service commitments is critical to support and retain customers' trust and confidence in the market.

2.1.1.2. The need for a Market Health Check

In 2018, WICS launched a root and branch review of the retail market to ensure that the market continues to work well for customers, licensed providers and Scottish Water. As part of this review, WICS [consulted](#) on the introduction of a market-wide process that would encourage market participants to demonstrate high standards of conduct. At the time, WICS set out a process that would form a key underpinning to the implementation of [Ethical Business Practice \(EBP\)](#) and improve customer outcomes by providing a mechanism to validate the service offerings from licensed providers who are seeking to go above and beyond the minimum default service. In May 2021, WICS confirmed this by publishing a [decision](#) to introduce the Market Health Check (MHC).

In April 2023, WICS published a [letter](#) setting out the foundations for an effective MHC, the steps that would help establish the governance and operational arrangements of the MHC, including the need for a CoP that would provide a baseline of the commitments made by licensed providers to their customers for the MHC.



2.1.1.3. The need for a Code of Practice

In August 2023, WICS, Consumer Scotland, the Central Market Agency (**CMA**) and Scottish Water signed a quadri-partite cooperation agreement that established a joint Steering Group (**SG**). The SG provided oversight and guidance to licensed providers working jointly with the Senior Stakeholder Group (**SSG**)¹ around the development of the MHC and the CoP.

In line with the principles of Ethical Business Regulation (**EBR**) and EBP, WICS invited market participants to work collaboratively on the development of the CoP with the leadership and guidance of the SSG.

The SG worked in close collaboration with the SSG in providing support for the development of the CoP. This also included involvement from other licensed providers (that do not otherwise form part of the SSG) in the development of these arrangements.

2.1.2. MORE RECENT DEVELOPMENTS

In July 2024, WICS published a [letter](#) to all market participants, setting out a deadline on the development of the CoP by 4 October, including its expectations on receiving written commitments from market participants by the same date.

The letter also outlined that if WICS received written commitments from licensed providers to a common version of the CoP, it would plan to undertake a public consultation to implement the CoP and consult on the overall process for the MHC.

In September 2024, the Commission also held a [market wide roundtable](#) to outline some of its initial thinking surrounding the operational implementation of the MHC process and provide further clarity by addressing questions from licensed providers.

Following the agreed deadline, eighteen licensed providers have formally outlined their support and commitment to the CoP and the associated MHC process. This represents circa 99.9% (on a Supply Point basis) of the market share. WICS is pleased to see such a significant level of ownership and commitment.

The table below sets out the responses received:

¹ The Senior Stakeholder Group was formed to focus on strategic issues and provide leadership to the industry in engaging with WICS. It brings together representatives from licensed providers, Consumer Scotland and Scottish Water.

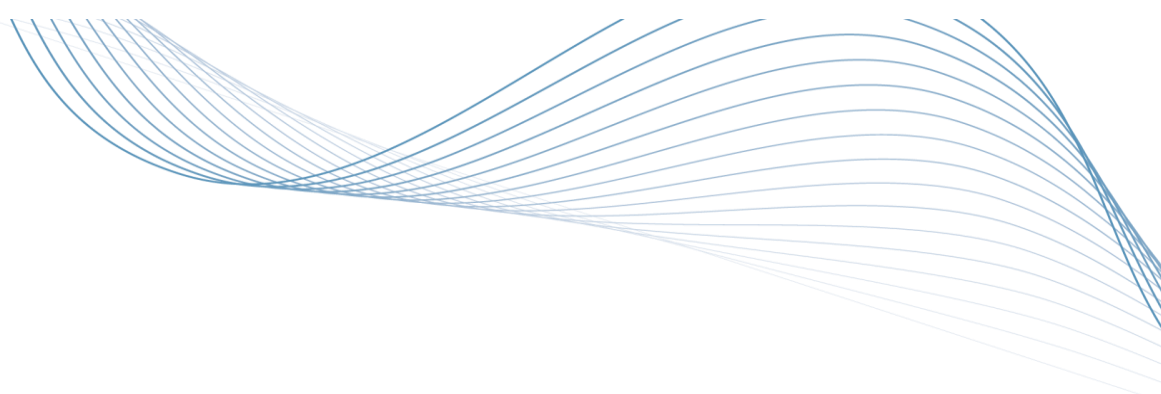


Table 1: Responses received from licensed providers

Licensed Providers	Responses received
Advanced Demand Side Management	Committed to the CoP and MHC process
Anglian Water Business (Wave)	Committed to the CoP and MHC process
Blue Business Water	Committed to the CoP and MHC process
Brightwater Services	Committed to the CoP and MHC process
Business Stream	Committed to the CoP and MHC process
Castle Water	Committed to the CoP and MHC process
Clear Business Water	Committed to the CoP and MHC process
Commercial Water Solutions	Committed to the CoP and MHC process
Everflow	Committed to the CoP and MHC process
Intelligent Business Water	Committed to the CoP and MHC process
Pennon Water Services	Committed to the CoP and MHC process
Pure (CGV)	Committed to the CoP and MHC process
Sutton and East Surrey Water Services	Committed to the CoP and MHC process
The Water Retail Company	Committed to the CoP and MHC process
Veolia Water Projects	Committed to the CoP and MHC process
Water Plus	Committed to the CoP and MHC process
Water 2 Business	Committed to the CoP and MHC process
Waterscan	Committed to the CoP and MHC process
Real Water (Edinburgh)	No response received
Smarta Water	No response received



2.2. Implementing the Code of Practice

2.2.1. COMMITMENTS FROM LICENSED PROVIDERS

On 9 September, the SSG sent to WICS a final version of the CoP which can be found in Annex 5.1 to this document. WICS has been encouraged to see the level of collaboration from market participants in developing and agreeing a final version of the CoP. WICS thanks all market participants (including Scottish Water, Consumer Scotland and the CMA) for their efforts. This represents an important milestone in the implementation of the CoP.

The CoP sets out commitments from licensed providers on:

- Sales and marketing activities;
- Billing, debt recovery and contract expiry;
- Complaints and dispute resolution; and
- Transfers.

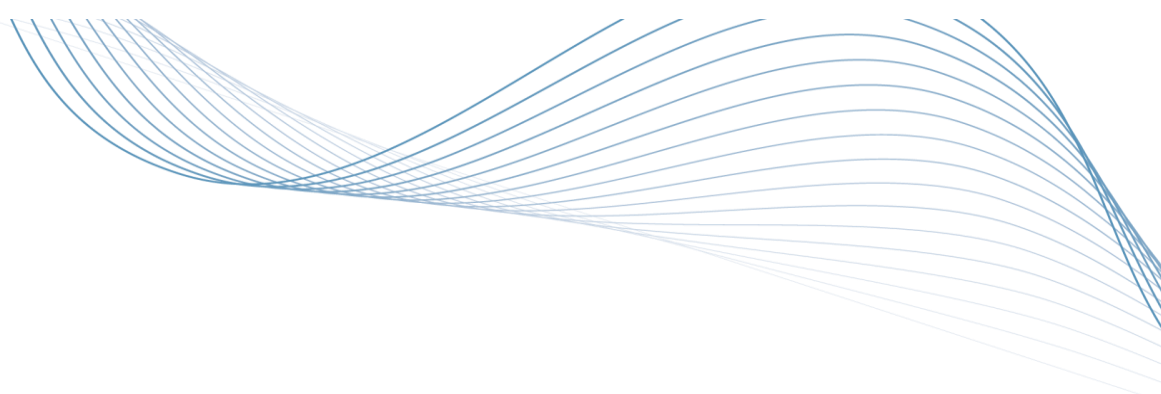
WICS has made limited amendments to the CoP (contained as part of Annex 5.1) to address a small number of incorrect references and editorial matters. At this stage, however, WICS is not proposing to make any changes to the content of the CoP shared by the SSG. WICS believes that whilst there will be opportunities to further review and refine the CoP, at this stage, the focus should be on providing certainty and clarity on the implementation. Any changes to the CoP as a result of customer research could be considered for example as part of the governance process outlined within the CoP itself.

One area of the CoP that WICS believes could be further strengthened is around the use of Third Party Intermediaries (**TPIs**). WICS plans to work with licensed providers in 2025 to review options on strengthening the requirements around the use of TPIs to ensure that customers are appropriately protected and receive complete and accurate information around quotes. This may be developed as part of a change to the existing market code or as part of a future change to the CoP.

2.2.2. IMPLEMENTATION OF THE CODE OF PRACTICE

2.2.2.1. Changes to the licence conditions

In terms of implementation, WICS is proposing to introduce a new voluntary standard licence condition (**SLC**) that would apply to all licensed providers who have opted in the CoP and MHC process. This approach ensures a structured and formalised approach and is consistent with the recent [implementation](#) of SLC B4 on Financial Resilience.



2.2.2.2. Statutory consultation on draft licence condition to implement the CoP

Pursuant to Paragraph 2(6) of Schedule 2 to the 2005 Act, and for the reasons set out above, WICS now invites stakeholders to make any representations on the proposed SLC for the implementation of the CoP policy. A copy of the proposed new SLC is set out as part of Annex 5.2.

2.2.2.3. Implementation and implications for licensed providers

To ensure that licensed providers have sufficient time to prepare for implementation, WICS proposes that the CoP goes live from **30 April 2025** as part of the new voluntary SLC.

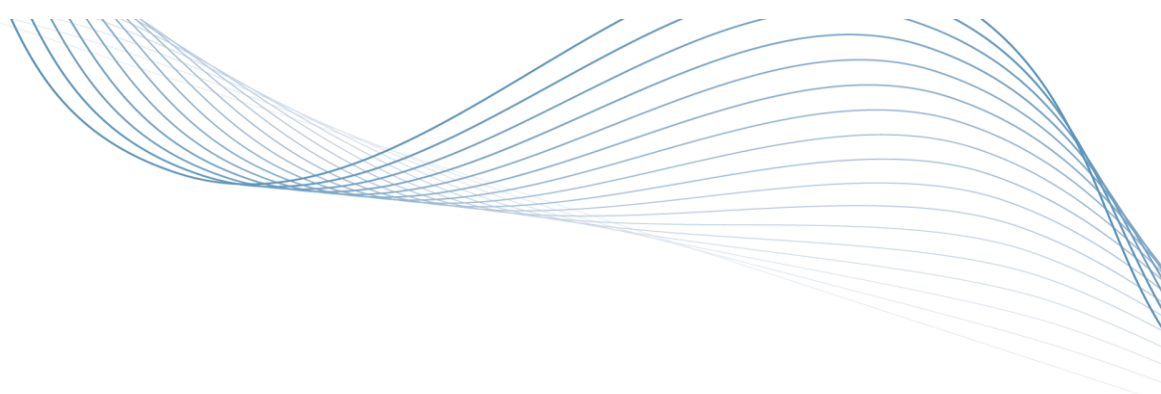
As previously outlined, WICS is also proposing to comment favourably both on its website and on the Scotland on Tap website about the licensed providers who have committed to the CoP. We are also proposing to disclose the list of licensed providers who have not opted in the CoP or fail to successfully complete the MHC. All licensed providers who sign up to the CoP can use this to promote their reputation and as part of their marketing approach.

Consistent with the current published [Financial Resilience Statement](#), Scottish Water will account as part of its financial assessment whether a licensed provider has committed to the CoP and completed the MHC and as a consequence, the level of wholesale prepayments may be affected by this. WICS will provide regular updates to Scottish Water regarding the participation and completion of the MHC process of licensed providers to allow Scottish Water to take this into account as part of their financial assessment.

Licensed providers that do not sign up to the new voluntary SLC implementing the CoP or fail thereafter to complete the MHC process, will be subject to a WICS audit to verify compliance with their SLCs.

Table 2: CoP implementation timeline

Events	Time
WICS issues final decision and new licence conditions	February 2025
WICS informs Scottish Water of licensed providers who have opted in/out	February 2025
WICS publishes list of licensed providers who have opted in/out	February 2025
Scottish Water informs licensed providers of changes to prepayments	March 2025



New licence condition and CoP come into effect	April 2025
Changes to level of prepayments takes effect	April 2025
WICS undertakes a compliance audit for licensed providers who opted out	June 2025

2.3. Implementing the Market Health Check

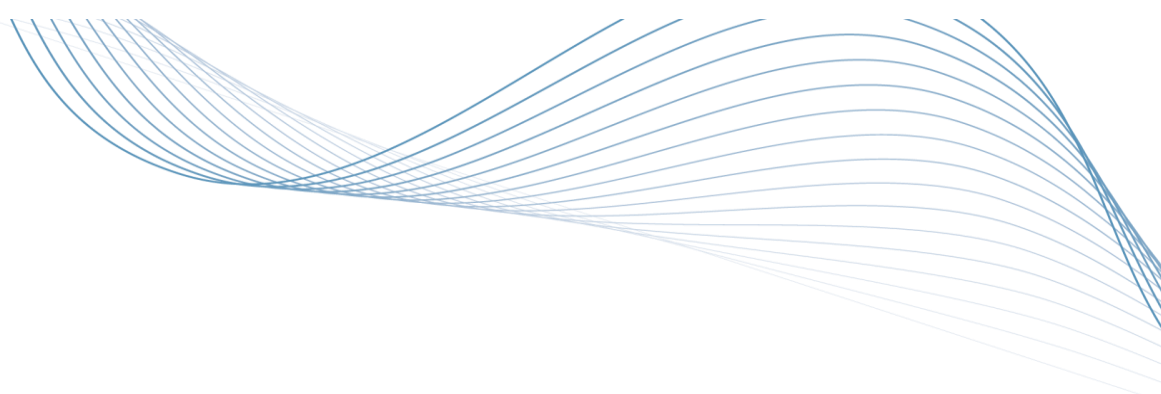
2.3.1. DESIGN AND GOVERNANCE OF THE MARKET HEALTH CHECK

2.3.1.1. Objectives of the Market Health Check

The CoP sets out a clear commitment to customers that licensed providers will undertake regular independent validation of the customer promises that are set out in the CoP. To this end, the MHC involves undertaking an independent and robust validation of licensed providers' behaviours against the commitments and standards contained in the CoP and an audit of licensed providers compliance with their SLCs. This will ultimately help build and retain confidence that the market continues to work effectively.

The MHC would provide licensed providers with a mechanism to check compliance and take corrective actions where issues are identified. At the end of the MHC, licensed providers who successfully complete this process would receive a certification. In terms of objectives, the MHC is aimed at:

- Providing transparency on the service offerings available to customers;
- Building greater confidence amongst customers on what they can expect to receive from their licensed provider;
- Supporting licensed providers in demonstrating an enhanced level of service above and beyond the minimum default service;
- Helping build confidence that licensed providers are upholding the service standards set out in the CoP;
- Providing licensed providers with opportunities for improvement where material issues are identified and corrective actions are needed.
- Allowing for greater service differentiation as licensed providers would be able to market their additional offerings above and beyond what is set out in the CoP.



2.3.1.2. Principles and governance

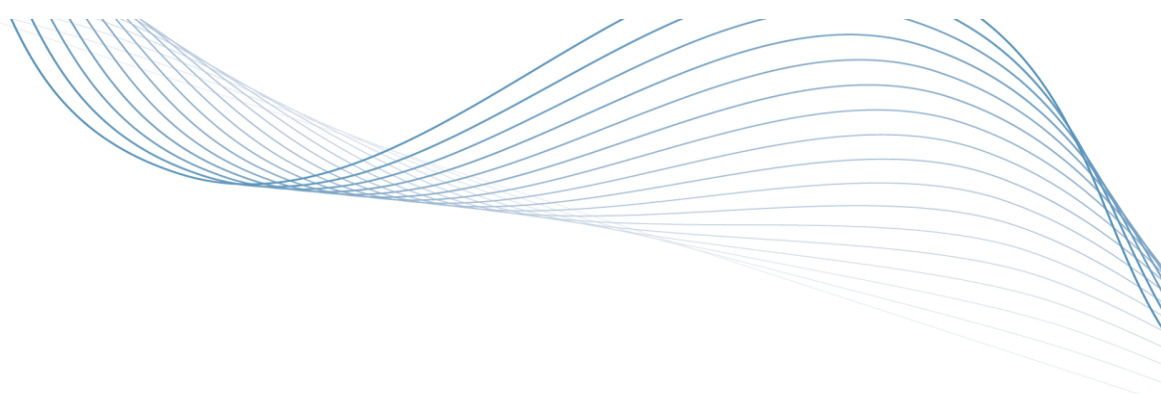
WICS is proposing to develop a MHC consistently with the following operating principles:

Table 3: Operating principles

Principles	Consideration
Customer confidence	The MHC provides an additional assurance that licensed providers are upholding their commitments. If there are shortfalls, WICS can investigate the matter and ensure corrective actions are taken.
Transparency	The MHC process is evidence based, replicable and standardised.
Proportionality	The scope and funding of the MHC should take account of the size of licensed providers, focusing on the material areas of the CoP.
Cost-effectiveness	The MHC should be designed and undertaken in a cost-effective manner.
Learning	The MHC should allow licensed providers to monitor their performance against their commitments and give them the opportunity to correct material issues and improve their operations before formal enforcement action is taken.
Collaboration	The MHC process and governance will be developed in collaboration with market participants and key stakeholders through public consultation.

In line with these principles WICS is proposing to:

1. Take responsibility for implementing and undertaking the MHC. This is likely to be the most cost-effective approach to implementation. This is further discussed in Section 2.3.1.5 of this consultation document.
2. Provide licensed providers with an opportunity to address material issues of non-compliance before these are escalated and enforcement action is considered as part of the MHC process.
3. Set out a process with clear timescales (Section 2.3.1.3) and prioritise the scope of the MHC on areas of high risk and high impact to ensure proportionality and standardisation (Section 2.3.1.4).
4. Recover the costs incurred as part of carrying out MHC activities through the ordinary licence fees levied on licensed providers. This is further discussed in Section 2.3.1.5 of this consultation document.



WICS has a general function to promote the interest of customer and facilitate an ordinary participation to the retail non-household market. In light of this and to ensure cost effectiveness and clarity around implementation, WICS is proposing to take responsibility for issuing certifications for the licensed providers who complete successfully the MHC. WICS would establish a MHC team that would undertake the process in line with the approach set out in this consultation document in collaboration with key stakeholders.

WICS recognises that the MHC process will need to be reviewed and refined over time and is therefore proposing to undertake a review of the process at the end of the first MHC. This will be done in close collaboration with the SG and the SSG and will seek to draw some lessons for improvement that will be shared with the SSG and all participants to the MHC.

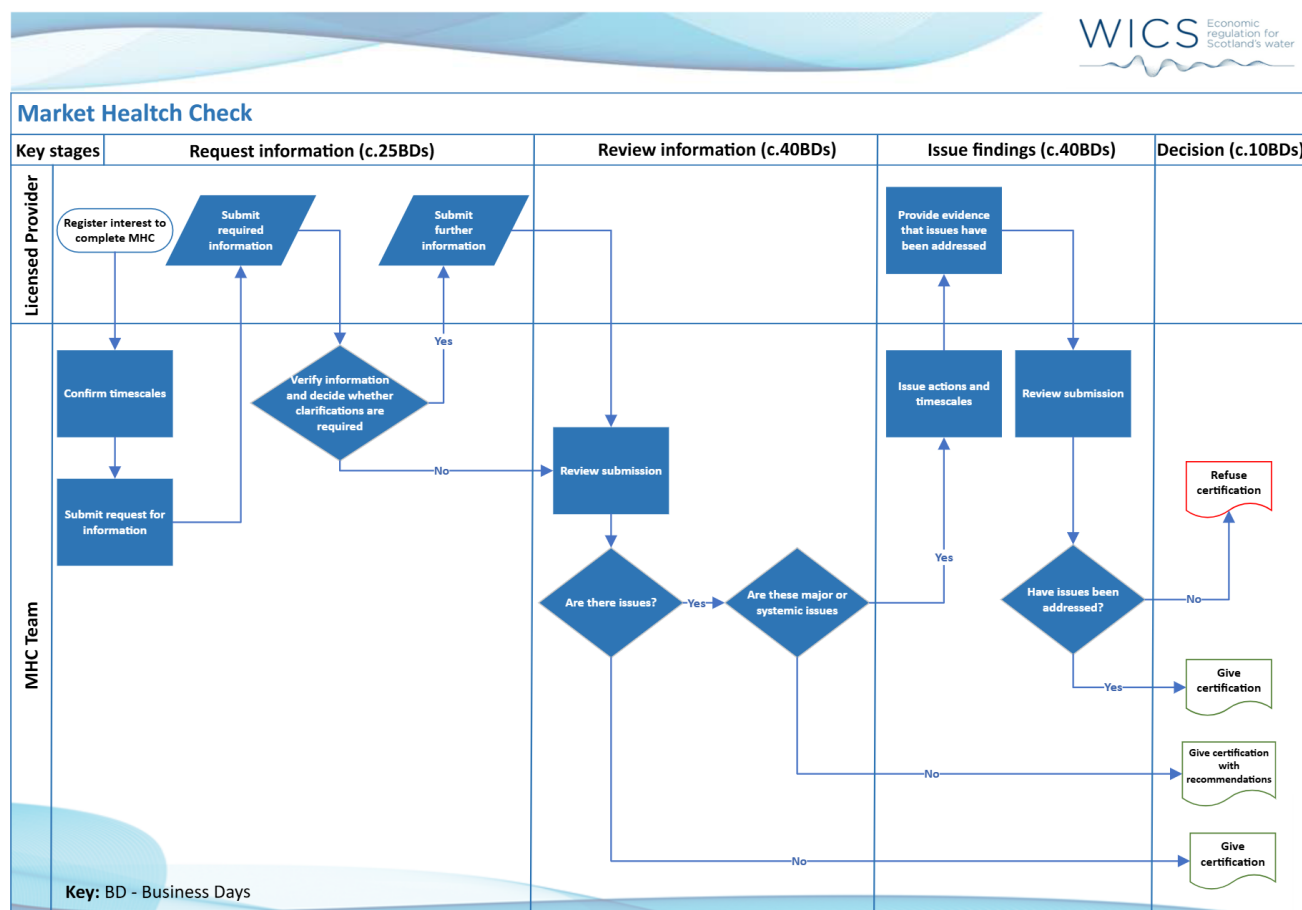
2.3.1.3. Process

Consistent with the key operating principles, WICS wants to ensure that the MHC process is standardised and transparent. This requires setting out a clear process for how the information will be required from licensed providers and reviewed with intermediate steps and timescales. At a high level the MHC process involves four key stages:

1. Request information from a licensed provider;
2. Review information by the MHC team;
3. Findings are issued by the MHC team to the licensed provider (including any plan for addressing material and systemic issue that have been identified); and
4. Final decision on whether to issue a certification or not. The certification would simply confirm that the relevant licensed provider has successfully completed the MHC process.

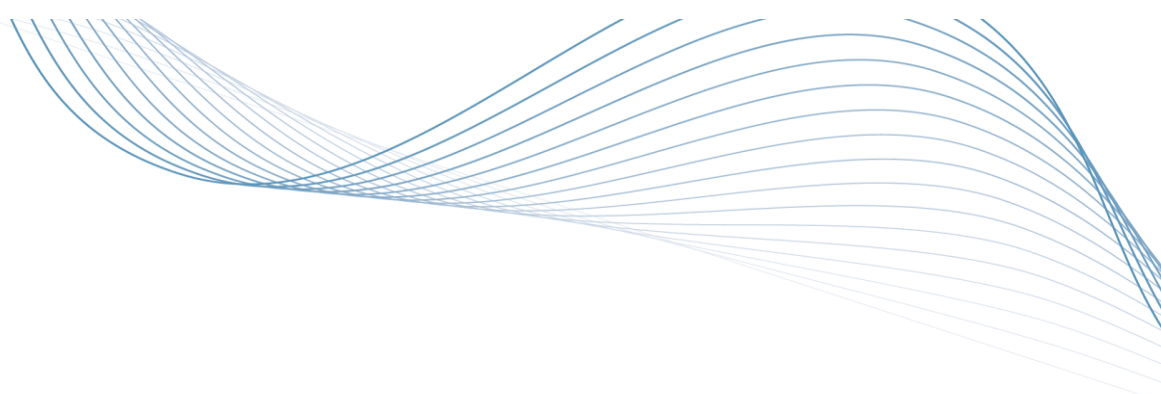
The diagram below outlines in more detail the different stages of the process with proposed timescales:

Figure 1: MHC process



Consistent with the transparency principle, in the first information gathering phase, depending on the scope and specific requirement being tested, the MHC team may require from the licensed provider internal policies and procedures and/or a sample of written records of communications with customers. To ensure consistency, the MHC team would request the same type of information from all MHC participants. To ensure proportionality, the size of the sample, however, may change depending on the size of the licensed provider.

The WICS team would thereafter assess the information and evidence provided against the commitments set out in the CoP. Consistent with the key operating principles outlined previously, WICS wants to ensure that the process remains proportionate and cost-effective. To this end, we are proposing that the MHC primarily focuses on addressing systemic and material issues and providing an opportunity to licensed providers to address issues within clearly defined timescales.



Consistent with the principle on customer confidence, WICS wants to ensure that customers and market participants have trust in the robustness of the process. If the MHC team identifies material systemic issues, then it would set out recommended corrective actions to be implemented within reasonable timescales having regard of the nature of the specific issue. It will then also re-test compliance with those provisions after the deadline has elapsed.

If based on that further test, it appears that licensed providers have still failed to address the issues then the MHC team would not issue a final certification (or would withdraw the existing certification in the case of a subsequent MHC). Unresolved systemic issues would thereafter be passed on to WICS compliance team and treated in line with WICS' [Policy for Licence Contraventions](#) and [Policy for Monitoring, Enforcement and Penalties](#).

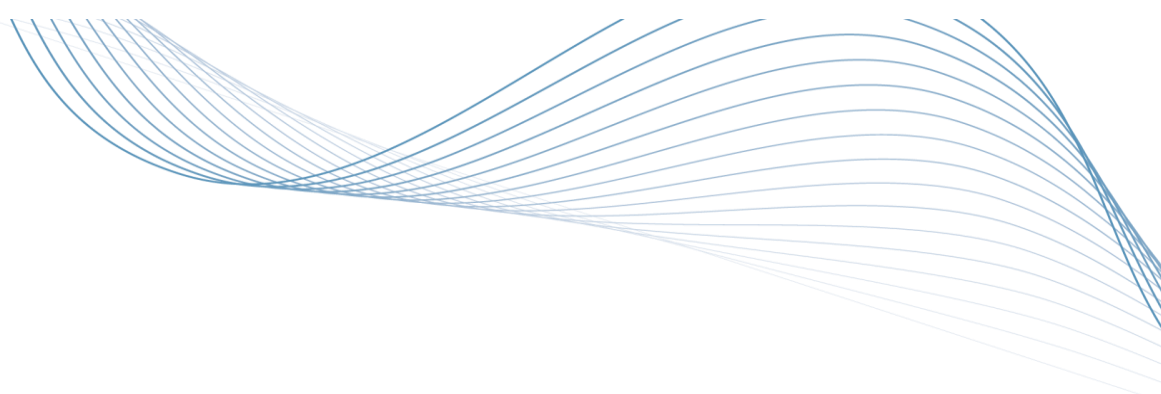
We also propose that non-binding recommendations are issued to licensed providers if minor issues are identified. These would not be disclosed publicly, and the licensed provider would take ownership and responsibility for implementing any suggested improvement and non-binding recommendations.

WICS is also proposing not to disclose any information as part of the MHC other than whether a licensed provider has obtained a certification or not. If major issues are identified and not addressed within indicated timescale, however, the relevant information would be passed on to the WICS enforcement team.

For ease of reference, all different outcomes are set out in the table below:

Table 4: Outcomes

Outcomes	Decision
No issues identified	WICS awards certification.
Minor issues identified	WICS awards certification, including one or more non-binding recommendations. The MHC team issues recommendations in cases where it identifies space for improvement. The relevant licensed provider will be expected to take ownership for implementing those recommendations.



Major issues identified but corrected	Award certification. Licensed provider has taken appropriate steps to address issues within the deadline set out by the MHC team. MHC re-tests the areas of concern and confirms issues have been addressed.
Major issues identified without corrective actions implemented	WICS does not award (or withdraws) certification. Unresolved issues that have been identified are not addressed within the timescales set out by the MHC team. Material and systemic issues are passed on the WICS compliance team.

➤ **QUESTIONS FOR CONSULTATION**

➤ **Do you agree with the proposed MHC process? What improvements consistent with the objectives and operating principles could be considered?**

2.3.1.4. Scope

The scope of the MHC will focus on the CoP and on the SLCs that all general licensed providers are required to comply with.

The assessment of a licensed provider’s compliance with the CoP (carried out as part of the MHC process) will be strictly limited to the content and requirements outlined as part of the CoP.

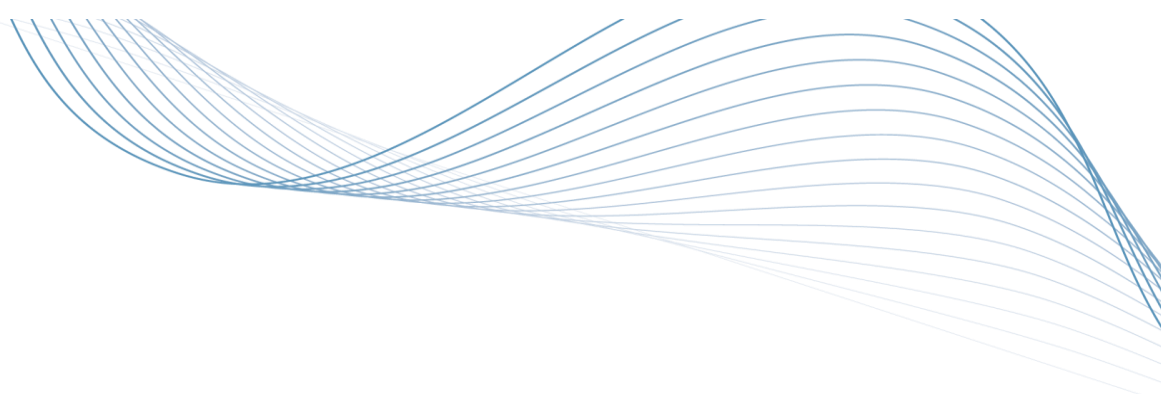
WICS is mindful that the MHC should be cost effective and proportionate. It therefore proposes to limit its assessment on high-impact and high-risk areas that are relevant to customers. Licensed providers will continue to be required to comply with all requirements of the CoP and of the SLCs regardless of whether these are tested as part of the MHC.

All licensed providers who commit to the CoP would be subject to a limited assessment of their compliance with their SLCs to avoid checking specific elements of the SLCs that are otherwise covered by the CoP. WICS will seek to avoid any duplication with the Central Market Agency’s regular audits.

➤ **QUESTIONS FOR CONSULTATION**

➤ **Which high risk, high impact areas do you think the MHC should prioritise in its first iteration in relation to the CoP?**

➤ **Which high risk / high impact areas do you think the MHC should prioritise in its first iteration in relation to the SLCs?**



2.3.1.5. Funding

Given that WICS proposes to take responsibility for undertaking the MHC process as part of a new voluntary SLC, the activities associated with the MHC would form part of WICS' ordinary workplan (similarly to the day-to-day management of the licencing regime or compliance monitoring). WICS is also mindful that the implementation of the CoP and the associated MHC process will bring market-wide benefits to all customers and licensed providers. Furthermore, to support the implementation of the MHC process, in 2023 WICS committed to forego the 3% nominal increase of all licensed providers' annual levy for the remainder of the current regulatory period, contributing c.£150k (between 2023-24 and 2026-27).

For all these reasons, WICS is proposing that all costs associated with the MHC process be shared and recovered proportionately through the ongoing levies collected by WICS from licensed providers (irrespective of whether a licensed provider has committed to the CoP or not). WICS is not proposing to levy any additional or separate fee for the participation in the MHC process but instead to cover this as part of its budget.

If there is a significant uptake in the MHC, we expect that a move to more proactive assurance approach may reduce the need for reactive enforcement action. This proposed approach appears to be the most proportionate and cost-effective way to implement the MHC process.

➤ QUESTIONS FOR CONSULTATION

- Do you agree with on the proposed funding approach for the MHC process?

2.3.2. NEXT STEPS

WICS has been pleased by the level of collaboration in drafting the CoP and the level of commitment to the CoP and the MHC demonstrated by licensed providers.

WICS plans to undertake a workshop with market participants in the following months on some of the detailed operational aspects of the MHC.

We also recognise the importance of providing clarity on the implementation timeline. This document therefore sets out a draft timeline for implementation below:

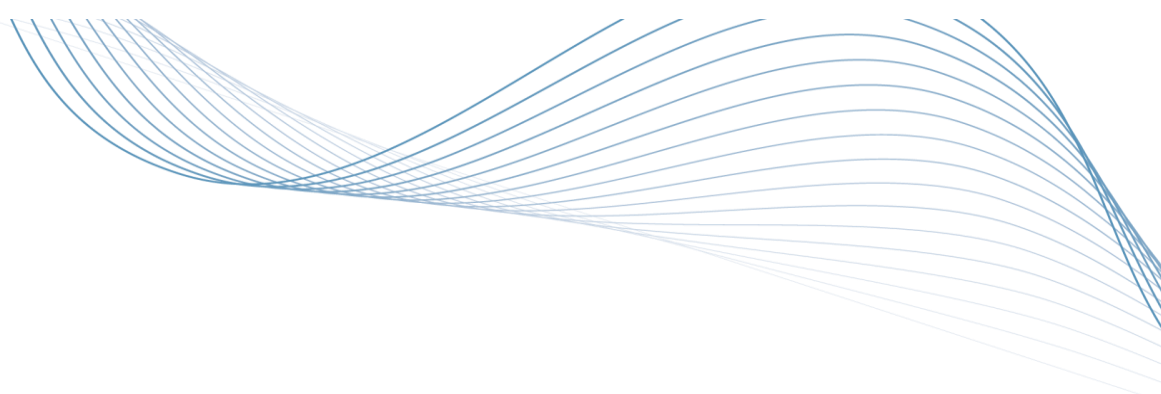


Table 5: MHC implementation timeline

Events	Date
Close of consultation	6 December
WICS publishes consultation response and final decision	February 2025
New licence condition and CoP come into effect	April 2025
MHC process starts	October 2025
MHC finishes	March 2026
WICS publishes list of LPs who obtain certifications	April 2026
WICS informs Scottish Water of licensed providers who do not obtain certifications	April 2026
Scottish Water informs licensed providers of changes to prepayments	May 2026
Changes to level of prepayments takes effect	June 2026
WICS undertakes a review of the MHC to identify lessons learnt	Summer 2026

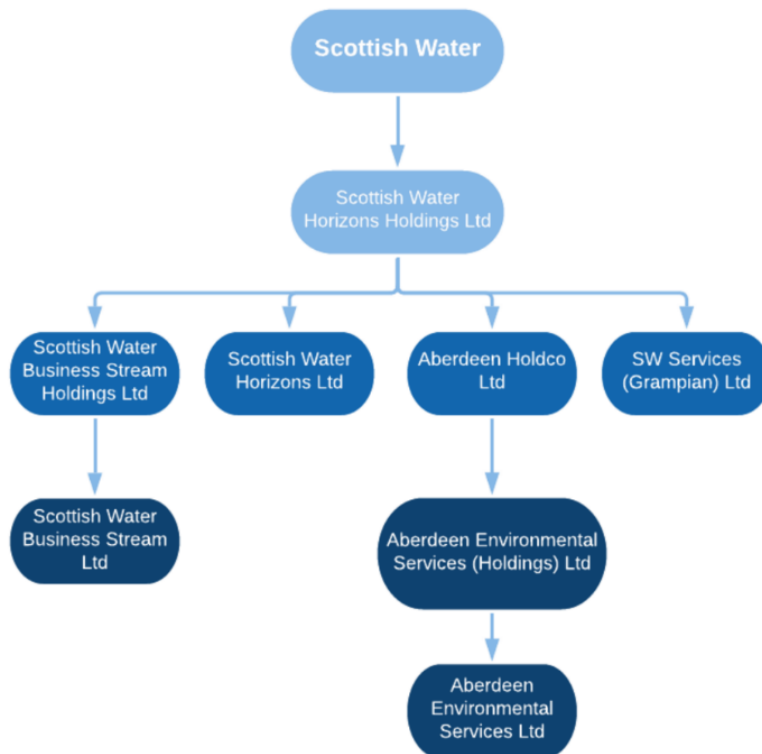
3. Level playing field

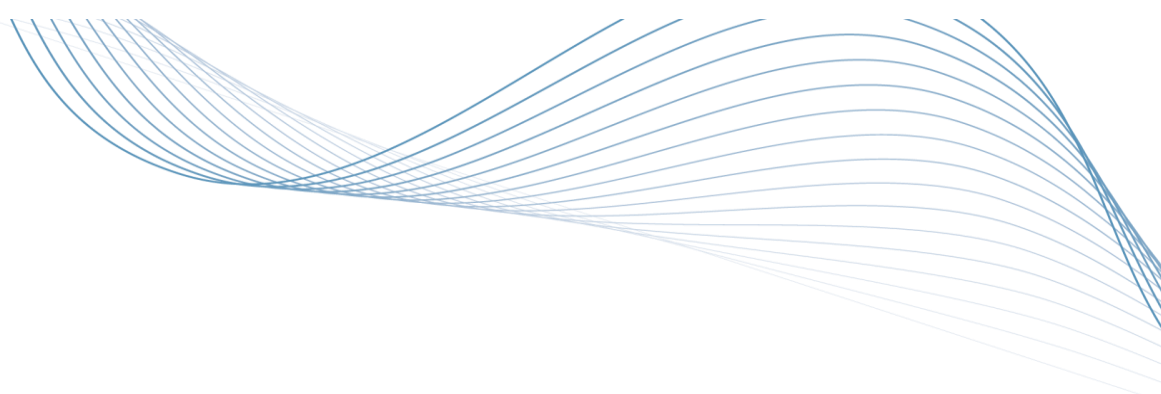
3.1. Measures in relation to Business Stream

3.1.1. BACKGROUND

Scottish Water is a statutory public corporation consisting of a group structure. Scottish Water, the core legal entity responsible for delivering the core functions set out in legislation (including its activities as wholesaler in the retail non-household market) sits at the top of the group and exercises its statutory and fiduciary interest in the performance of its subsidiaries. Consistent with this, Scottish Water established a holding company Scottish Water Business Stream Holdings (**SWBSH**) to take responsibility for its interest in Scottish Water Business Stream Limited (**SWBS**), a licensed provider owned by Scottish Water.

Figure 2 – Scottish Water’s structure





When the retail non-household market opened in 2008, SWBS served all non-household customers. In light of this and the ownership structure outlined as part of Figure 2, WICS issued directions² to Scottish Water, under Section 11(2) of the 2005 Act, to put in place measures to ensure business separation between SWBS and Scottish Water. These measures were aimed to support a level playing field in the retail market.

Scottish Water and SWBS are required, through direction under Section 11 of the 2005 Act and SWBS's licence conditions respectively, to comply with a Governance Code (the **Code**). The Code (outlined as part of Annex 5.3) requires:

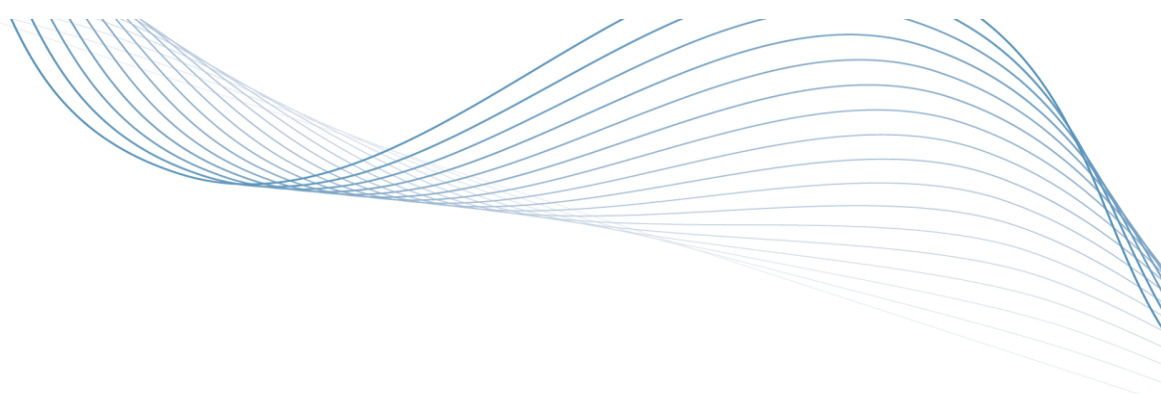
- SWBS to take all strategic and operational decisions independently of Scottish Water;
- transactions between Scottish Water and SWBS to be carried out at arms' length and on a normal commercial basis;
- information flows between Scottish Water and SWBS to be restricted to those set out explicitly in the Code so that competition occurs on a level playing field; and
- SWBS to have a robust financial structure – this involves:
 - no financial cross subsidy from Scottish Water;
 - evidence of SWBS's financial viability and compliance with covenants, namely that the ratio of EBITDA to net interest payable is no less than 3 and that net borrowing does not exceed 3.5 times EBITDA; and
 - an explicit requirement to earn a rate of return equivalent to that required by a stand-alone new entrant.

The Code states that SWBS' board has independence and does not seek any approval from Scottish Water, Scottish Water Horizons Holdings (**SWHHL**) or SWBSH apart from where a decision requires approval by Scottish Government, it relates to new financing of SWBS or is required by law. The Code sets out the composition of SWBSH' board comprising the Chief Executive of SWBS, the non-executive directors of Scottish Water, the Scottish Water Chairman and the Finance Director of Scottish Water.

The Code also sets out monitoring arrangements, including the appointment of compliance officers. The relationship between SWBS, SWBSH and Scottish Water, including their compliance with Directions and the Code is monitored by WICS³. These arrangements are of critical importance in demonstrating a level playing field in the retail market and building confidence amongst market

² Water Services (Intra-Group Regulation) Directions 2006.

³ Section 5 of the Code states that WICS can instruct advisors to audit parties' compliance with the Code.



participants that SWBS does not have an unfair advantage. The arrangements also play a key role in ensuring Scottish Water’s core customers are protected in light of the ownership structure of SWBS.

3.1.2. REVIEWING THE ARRANGEMENTS

3.1.2.1. The evolution of SWBS and recent events

While many of SWBS’ customers in Scotland have switch to other licensed providers since market opening, it still holds however an important share⁴ of the retail market. In light of this and the ownership structure discussed in the previous section, the Code continues to play an important role in building and maintaining confidence in a level playing field.

We are also mindful that SWBS’ activities have evolved, its original capital structure has changed, and the footprint of its operations has expanded significantly by entering the English non-household retail market, including through acquisitions. Changes made to the Code in 2013⁵ supported SWBS’ entry to the English non-household retail market. As a result of that, the activities that pertain to the English retail non-household market are referred to as “non-regulated” activities in the Code.

In light of all these changes, we believe it is timely to review the governance arrangements (including the Code) to ensure that it is up to date, that elements that are no longer relevant (e.g. the capital structure of SWBS at the time of market opening) are removed, and that it remains fit for purpose in light of 16 years of SWBS operating in the market.

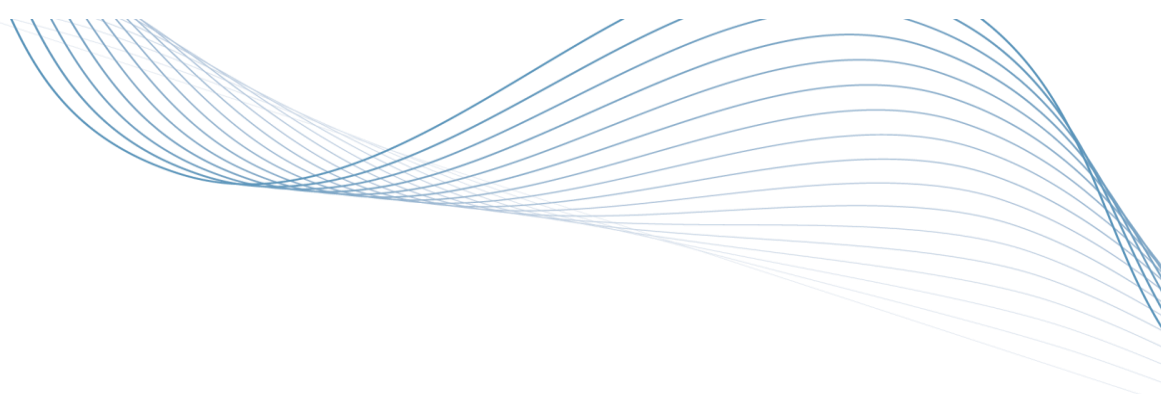
WICS is also committed to ensure that the lessons from recent economic shocks, such as the Covid-19 pandemic and the international energy crisis are appropriately considered. These events have shown the importance of ensuring that market participants remain in a financially resilient position to withstand external shocks. To this end, WICS introduced a voluntary licence condition on financial resilience⁶, SCL B4, which has been accepted by all market participants. Similarly, other regulators⁷ have also taken steps to boost the financial resilience of market operators.

⁴ This is around half of the Scottish market, depending on whether you look at number of supply points and or the proportion of wholesale charges.

⁵ [WICS](#), May 2013, “Amended Governance Code”.

⁶ [WICS](#), March 2023, “Decision on Wholesale Services Agreement and SCL B4 Financial Resilience”.

⁷ [Ofgem](#), 15 December 2021 “Raft of new measures to boost financial resilience in the energy sector”; [Ofgem](#), 25 November 2022 “Statutory Consultation - Strengthening Financial Resilience”.



From a level playing field perspective in relation to SWBS, retaining financial resilience is not only critical for the financial stability of the market but also a critical pre-requisite for SWBS to be able to comply with the Code and its financial covenants.

3.1.2.2. Principles underpinning a review

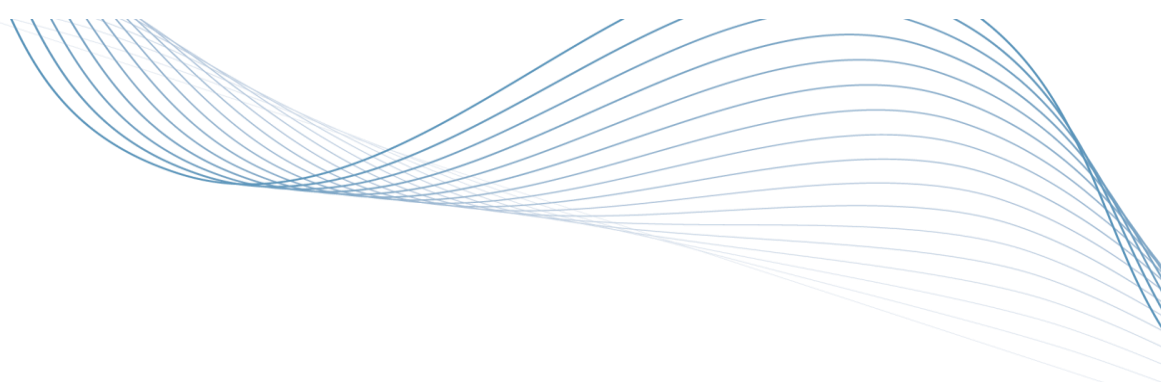
In reviewing the governance arrangements (including the Code), WICS wants to ensure that any potential change supports a level playing field and is consistent with the principles of:

1. Financial, operational and management independence between SWBS and Scottish Water;
2. Flexibility allowing SWBS to respond to market changes effectively whilst remaining financially resilient; and
3. Competition law and subsidy control.

WICS wants to ensure that future changes in the capital structure or material financing decisions (e.g. the level of debt of, or dividends paid by, SWBS) that can affect the current and future financial position of SWBS, do not undermine the key principle of independence underpinning the Code. To this end, we are consulting on the introduction of a principle (as part of the Code) on the long-term sustainability of SWBS' dividend policy. Whilst we recognise that the dividend policy is a matter for SWBSH, it is important that the dividend policy supports and builds confidence that SWBS can always comply with the Code. This approach is also consistent with some of the measures recently introduced by other regulators regarding scrutiny and intervention in dividend policy⁸.

We also note that the Code focuses predominantly on the regulated activities of SWBS (i.e. associated with the activities in the Scottish retail market). However, the same entity SWBS holds licences to operate in both the Scottish and English retail markets for the provision of water and sewerage services. Given that the Code clearly states that SWBS' Scottish regulated business must not be affected by the performance of the English regulated business, WICS is also seeking views on whether there should be greater reporting transparency and/or separation between the regulated and non-regulated business of SWBS. Requirements around business separation and governance have long been a feature in utilities regulation where there is a risk of conflict of interest between a network

⁸ [Decision](#) under section 13 and 12A of the Water Industry Act 1991 to modify the ring-fencing licence conditions of the largest undertakers, Ofwat, 20 March 2023. See also [Ofgem](#), 25 May 2023, where Ofgem wrote to all suppliers regarding expectations in relation to dividend policy and potential for further quantitative requirements relating to capital requirements being introduced in 2025.



companies and other interests in the same corporate group. In many cases this has included rules on the appointment of board directors in order to mitigate potential conflicts of interest.⁹

3.1.2.3. Questions for consultation

In light of all the issues outlined in the previous section, we are considering undertaking a review of governance arrangements (including the Code) to ensure that it remains effective and relevant. This approach is consistent with previous WICS consultations¹⁰. As part of this process, we are seeking stakeholders' views on the following questions:

1. How do we ensure that the Code arrangements can stand the test of time and that SWBS continues to operate in a financially independent way?
2. Are the financial covenants still effective and consistent with demonstrating financial viability whilst providing SWBS with the necessary flexibility to respond to market changes?
3. Are there any changes required to the information sharing controls between SWBS and Scottish Water?
4. Should there be any specificity on who should (or should not) hold Board level positions within SWBS?
5. What additional evidence could be required to demonstrate that the English regulated business is not adversely impacting the Scottish regulated business? Could a form of separation between the two elements be considered?
6. What other changes to the Code could reinforce confidence in a level playing field?

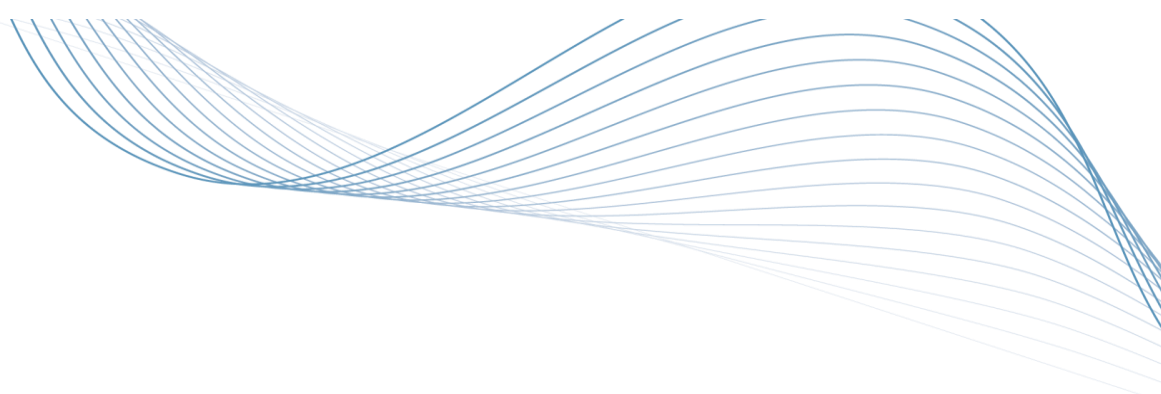
3.2. Measures in relation to other licensed providers

3.2.1. BACKGROUND

In Scotland there are five licensed providers (c.7% of market share) who are operating in both the Scottish and English market and are owned by holding companies of the undertakings in England. It is important to note that Ofwat took a different approach to assurance arrangements for the retail

⁹ See for instance the transmission / interconnection certification regime under Electricity Act 1989 and Gas Act 1986, [administered by Ofgem](#).

¹⁰ [Measures](#) to ensure the Scottish water and sewerage non-household retail market works well, WICS, May 2016. Scottish Water Business Stream requirement to publish tariffs (response published October 2007). Incorporation of standard licence conditions into SWBS provisional licences (response published August 2007).



incumbents in England at market opening.¹¹ Furthermore, there are some key regulatory design differences across the two markets, including the level of the gross retail margins available¹² to retailers.

Following consultation in 2016, WICS implemented changes to the licence conditions of all general licensed providers to restrict cross subsidisation between licensees in the market and related undertakings in the market in England. These measures were put in place to support a level playing field in the market.

WICS also required that all licensed providers make an annual declaration as to their compliance with UK Competition Law and rules on subsidies in the Scottish market.

3.2.2. QUESTIONS FOR CONSULTATION

In light of this consultation, we believe it is timely to also review these provisions for completeness and ask stakeholders the following questions:

- Are these annual declarations sufficient to ensure there is confidence in a level playing field?
- Should we require additional evidence to be provided to support the declaration? For example, can we be fully confident that any support to a licensee from a related undertaking is provided on an arm's length and commercial basis?
- What additional evidence could be required to demonstrate that the English regulated business is not adversely impacting the Scottish regulated business? Could a form of separation between the entities holding the two licences be considered?
- What other changes would support confidence in a level playing field in the market that WICS could consider given its statutory duties and powers?

At this stage WICS is not proposing specific measures but is looking for stakeholders' views on these questions and any specific licensing measures that it could consider implementing.

¹¹ This included compliance requirements in relation to [Market Readiness](#) ahead of market opening, which included requirements to demonstrate a level playing field.

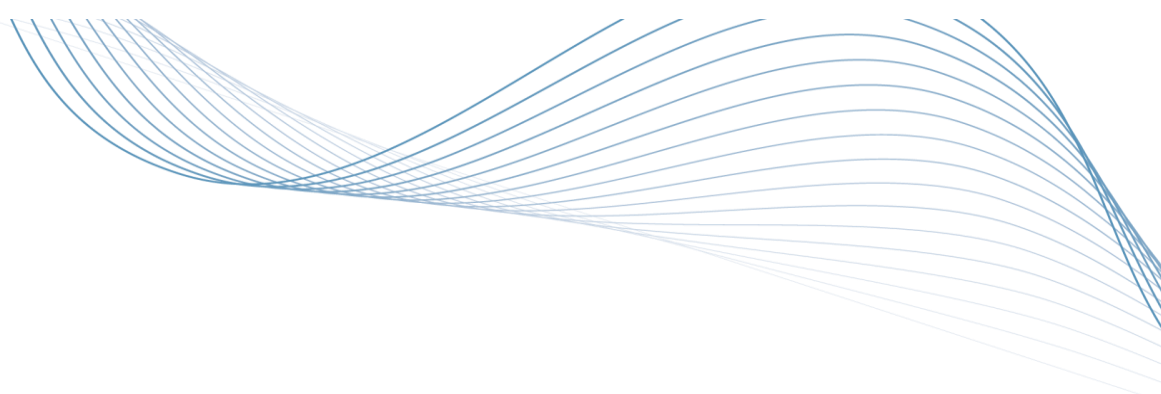
¹² [Ofwat](#), 15 December 2022, PN 42/22: Ofwat publishes decision on business retail price caps.



4. Next steps

WICS is seeking comments on the proposals, and draft licence condition, set out in this document which should be sent to CompetitionTeam@watercommission.co.uk by 06 December 2024. WICS plans to review the responses to this public consultation and issue a final decision in February 2025.

The Commission will continue to work closely with Scottish Water, the CMA, Consumer Scotland and licensed providers to help ensure that these proposals can be implemented effectively.



5. Annex

5.1. Code of Practice

Accessible separately

5.2. New Standard Licence Condition

Accessible separately

5.3. Governance Code

Accessible separately



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