

Undertakings for the purpose of section 19 of the Water Industry Act

1991

These undertakings are given by Southern Water Services Limited ("**SWS**") to the Water Services Regulation Authority ("**Ofwat**") pursuant to Section 19(1)(b) of the Water Industry Act 1991 ("**WIA91**").

Part 1: Contraventions to which the Undertakings relate

- (1) SWS is appointed as a water and wastewater undertaker under the WIA91 and operates pursuant to its instrument of appointment ("**Licence**").
- (2) As specified in a notice under Section 22A WIA91 to impose a penalty dated 25 June 2019, Ofwat has found that SWS has been, or is, in contravention of the following provisions of its Licence and the Act:
 - (i) Paragraph 9.2 of Condition B and/or paragraph 1 of Condition M of SWS' Licence, by deliberately misreporting information about SWS' Wastewater Treatment Works ("**WwTW**") performance for the period 2010-15;
 - (ii) Paragraph 1 of Condition M and/or the Regulatory Accounting Guidelines ("**RAGs**") (version 3.08)¹ issued under Condition F of SWS' Licence, by deliberately misreporting information about SWS' WwTW performance in its Annual Performance Report for the years 2015-16, 2016-17 and 2017-18;
 - (iii) Paragraph 13 of Condition I² of SWS' Licence in relation to the adequacy of its resources and systems of planning and internal

¹ https://www.ofwat.gov.uk/wp-content/uploads/2015/10/lic_lic_srn.pdf

² Prior to 1 March 2019, this was in paragraph 6A.1 of Condition F

control to enable it to properly carry out its regulated activities, particularly in relation to its obligations under section 94(1)(b) of the WIA91;

- (iv) Section 94(1)(b) of the WIA91 in relation to SWS' duty to make provision for dealing effectually, by means of sewage disposal works or otherwise, with the contents of the sewers in SWS' sewerage system.

(together, the "**Contraventions**").

- (3) SWS has already taken a number of steps, including those set out in Section 4 of the Penalty Notice, and has agreed to take the steps specified in Part 2 below (the "**Undertakings**") for the purpose of securing and facilitating compliance with its Licence and statutory duties in respect of those Contraventions.
- (4) Ofwat considers that, to the extent SWS complies with these Undertakings, it is not required to make an enforcement order under section 18 of the WIA91 in respect of the Contraventions.

Part 2: The Undertakings

- (5) SWS has committed to a range of financial and non-financial measures to address and resolve the Contraventions.

A. Customer redress measures

- (6) SWS will implement the following measures in relation to its wastewater customers:
 - i) Subject to paragraph 6) viii) below, wastewater customer bill rebates in respect of avoided Price Review penalties of £80m, and in respect

of compensatory measures of £31.7m, totalling £111.7m to be distributed in tranches over five years starting from financial year 2020/2021³.

- ii) An additional wastewater customer bill rebate of £11.2m in financial year 2020/2021 to reflect the late nature of the avoided Price Review penalties.
- iii) An explanation for these rebates will be clearly set out on wastewater customer bills and/or inserts for each of the five years that the rebates will apply, in wording approved by Ofwat.
- iv) These rebates shall apply to SWS's wholesale tariffs.
- v) By January 2020 SWS will liaise with and effectively communicate (including workshops where requested) with retailers and relevant water only companies to enable wastewater customers who are not directly billed by SWS to receive these rebates;
- vi) SWS will liaise with New Appointees in relation to how the rebates might affect their Discharge Agreements.
- vii) Wastewater customers who are still customers of SWS as at 2020/2021 billing date (1st April 2020) will receive their rebates in accordance with paragraphs i) and ii) above.
- viii) SWS will operate an appropriate and proportionate scheme to compensate those wastewater customers who should have had a reduction in their bills in each of the years from 2015/2016 to

³ It is intended that the tranches for the second and subsequent years will be broadly equal.

2019/2020, but who are no longer wastewater customers of SWS as at 1st April 2020. Such wastewater customers of SWS can apply to SWS via a dedicated SWS webpage for a compensation payment in a manner to be agreed between SWS and Ofwat. The amount paid by SWS under this paragraph will be deducted from the amounts paid to wastewater customers in the second and subsequent years of the five year period referred to in paragraph i) above.

- ix) For the avoidance of doubt, these rebates are funded entirely by SWS, and not customers.

B. Technical review of Wastewater Treatment Works

- (7) Having undertaken a technical review of environmental permit compliance across all numeric permitted⁴ WwTW, SWS will;
 - i) continue to carry out such inspections and audits on all relevant WwTW and embed such inspections and audits into a rolling programme; and
 - ii) continue providing a specific budget to identify and correct any permit compliance risks identified by the inspections and audits (to include the £26m of capex already provided for in relation to corrective actions identified to date).

⁴ Numeric permitted sites are those WwTW sites which have a permit which contains a specific numeric limit on the condition of the final effluent being discharged to the environment (e.g. the amount of ammonia).

C. Organisational compliance process measures

- (8) SWS has been through a period of significant change since 2017 and to ensure that there is a culture of compliance within SWS, SWS has introduced a number of organisational compliance process measures to the business. SWS will;
- (i) Implement a series of measures, as part of the Modern Compliance Framework (as defined in the Technical Annex referred to below), to support the management of compliance issues. This is to be supported by a risk-based programme of business assurance, including the development of a register of obligations, establishment of a new policy framework and the roll out of a programme of end-to-end process reviews to support regulatory reporting (as set out in the Technical Annex 7.2 to SWS' PR19 Business Plan submitted in September 2018)⁵.
 - (ii) Having introduced a programme of improvements in relation to the SWS final effluent sampling programme, ensure that the improvements continue to be embedded and supported by a programme of continuous improvement. Key improvements include:
 - a) Removing potential conflicts of interest in relation to the final effluent sampling programme, with a segregation of responsibilities for the operation of the sampling

⁵ <https://www.southernwater.co.uk/media/1902/ta-072-corporate-risks-ethical-business-practices-and-modern-compliance-framework.pdf>

programme between the Wholesale Wastewater Directorate and the Risk and Compliance Directorate.

- b) Strengthening the confidentiality of the sampling programme to minimise the likelihood of details of the programme being shared with front line operational teams.
- c) Annual checks by the Environmental Monitoring Team, the Environmental Permitting Team and the Risk and Control Team on the completeness of the sampling programme to ensure that the programme reflects the requirements of our regulatory obligations.
- d) Changes to reduce the predictability and representativeness of the sampling programme to ensure that front line operational staff cannot predict the future sampling programme.
- e) Changes in procedures to better control reasons for not sampling.
- f) The design and delivery of a programme to ensure sampler awareness and training in relation to the improved sampling programme and the Speak Up disclosure scheme⁶.
- g) A programme of annual site visits to check the status of sampling arrangements.

⁶ SWS's Speak Up disclosure scheme replaced its Whistleblowing policy and empowers employees to raise concerns about suspected misconduct through internal channels, and an external Speak Up service.

- h) Engagement sessions with front line WwTW operations staff in relation to compliance and the sampling programme.
 - i) Additional independent second line assurance on the sampling programme.
- (iii) Roll out and embed compliance training to all employees, to include programmes on public health, environmental compliance, information management and reporting processes, the extent of such training to be based upon a training needs analysis.

D. Organisational cultural change measures

- (9) To ensure that there is a change in the culture of the business, SWS has introduced a number of organisational cultural changes to the business. SWS is changing the performance and culture of the organisation which includes a commitment to deliver a step change in culture, mindset, skillsets, productivity, operational performance, ethical principles and practices, and employee engagement. In order to achieve these outcomes SWS will implement the following organisational cultural change measures:
- (i) Continue to roll out and embed the cultural change initiatives as part of SWS's wider transformation programme to include, but not limited to;
 - refreshing SWS's vision, purpose and values;

- improved levels of engagement and shifts in attitude to values and ethical principles by employees and the Senior Management Team as measured in SWS's annual Employee Engagement Survey; and
 - the programme of culture change initiatives being rolled out to the SWS line management community ('The Role of the Line Manager')
- (ii) Continue embedding Ethical Business Practice, including the Code of Ethics and Ethical Decision Making Framework (as set out in the Technical Annex 7.2 to SWS' PR19 Business Plan submitted in September 2018).
- (iii) Having refreshed and strengthened the Speak Up disclosure scheme for reporting potential compliance breaches by employees, carry out an annual review of the scheme. This to be reported as part of the annual review of culture change as committed in the Technical Annex 7.2 to SWS' PR19 Business Plan submitted in September 2018⁷.
- (iv) Carry out an annual review of incentive schemes for executives and senior management aimed at addressing behaviours linked to the Contraventions. The review will look at the degree to which incentives are focused on customer outcomes as reflected in the

⁷ <https://www.southernwater.co.uk/media/1902/ta-072-corporate-risks-ethical-business-practices-and-modern-compliance-framework.pdf>

'Putting the Sector in Balance; Ofwat position statement on PR19 Business Plans'⁸.

- (v) Ensure that no employee will be rewarded through the achievement of personal objectives where such personal objectives are linked to wastewater compliance unless SWS meets its relevant performance commitments. This will apply to any bonus or incentive scheme linked to a personal objective, whether standalone or otherwise including the bonus and incentive schemes operated by SWS as set out in its Annual Report.

E. Ensuring transparency

- (10) In order to ensure transparency and to rebuild the trust and confidence of customers, SWS will undertake the following activities;

(I) Within 6 months of these undertakings SWS will develop a website area on the main SWS website.

- a. (i) The new website area will, subject to paragraph (ii) below, contain relevant information on environmental performance, including but not limited to:

- pollution incidents;
- flow and spill reporting;

⁸ <https://www.ofwat.gov.uk/publication/putting-sector-back-balance-summary-ofwats-decision-issues-pr19-business-plans>

- wastewater treatment works final effluent compliance;
- regional bathing water compliance results;
- emissions; and
- river levels.

(ii) SWS will also work with the Environment Agency to publish pertinent Agency data and information on the website area.

- b. The new website area will include links to pertinent environmental information published by the Environment Agency and will provide updates on the work carried out by SWS.
- c. The company will continue to share spill discharge notifications with stakeholders for priority coastal locations on its 'Beachbuoy' webpage and will continuously improve the information available to be published, and the access to this information, via the new website pages.
- d. In addition, the website will provide updates on environment improvement activity carried out by SWS or in collaboration with others on improving the environment via investment programmes, catchment management and our partnership working programmes.
- e. This webpage will be tested with, and SWS will seek pertinent input from, its customers and stakeholders before its launch.

(II) To ensure that key elements of the delivery of the Undertakings are visible to SWS customer panel groups, the 6 monthly monitoring reports referred to in clause G below will also be provided to:

- a. the SWS Customer Challenge Group; and
- b. the SWS Customer Action Group.

(III) Further, a summary of the monitoring reports will be included in the SWS Annual Report and published on the SWS website.

F. Condition I certificate Assurance Undertaking

(11) SWS commits to the following in relation to the Condition I certificate:

(i) The Company will ensure that, in providing the certificate under Condition I of its licence, its Board of Directors will do so on the basis of its reasonable belief, formed on the basis of reasonable diligent enquiry. By way of evidence of that reasonable diligent enquiry, for a period of 5 years following the date of signature of these undertakings, the Board will provide Ofwat with a statement of the main factors it has taken into account in relation to the management and operation of its WwTW and the reporting of relevant information in connection with this, in providing the certificate, and procure a report from an external auditor on its ability to sign the certificate.

(ii) To facilitate this Report –

(a) An internal assurance team will produce an annual review of the processes, procedures and controls that relate to the principal

risks of the Company so far as they relate to the management and operation of its WwTW and the reporting of relevant information in connection with this, as identified to or by the Risk Committee and the Audit Committee (to include The Modern Compliance Framework and Enterprise Risk Management and all of the matters referred to in these undertakings) that the Board takes into account when considering its ability to approve and sign the Condition I certificate.

- (b) The external auditor will assure the key conclusions of the internal review carried out under paragraph (a) above and produce a 'Review and Recommend' Report addressed to the Board of the Company.

The Report will include the auditor's findings on;

- Whether the Company has appropriate and effective compliance and assurance policies in place, which are regularly reviewed by appropriate and qualified individuals within SWS, and updated where necessary;
- Whether these policies are implemented and adhered to;
- Details of how any compliance issues identified through any of these processes have been addressed;
- Whether the Company's Board is regularly informed of the operation of these policies and any material compliance issues;

- Whether the company should adopt any improvements to these processes.
- (c) The Directors will also provide Ofwat with an explanation of how they have addressed any adverse findings from the internal assurance team and/or external auditors.
- (d) Subject to the external auditor receiving a signed 'hold harmless letter' from Ofwat, the Company will share the report with Ofwat.

G. Reporting on compliance with the Undertakings

(12) SWS commits to the following in relation to the compliance with these Undertakings:

- (i) Provide written monitoring reports to Ofwat:
- (a) demonstrating the steps that it has taken in complying with the Undertakings, and
 - (b) providing assurance of its ongoing compliance with the Undertakings.

The first of these monitoring reports will be provided within 4 months of signature of these Undertakings and then on a six-monthly basis until the fifth anniversary of the date of signature of these Undertakings, or such earlier time as Ofwat agrees that this reporting can be reduced in frequency and/or content or that such reporting is no longer necessary;

- (ii) Designate a member of its Senior Management Team as the Undertakings' compliance officer, who will have a general responsibility for:
 - (a) ensuring compliance with the Undertakings;
 - (b) preparing the monitoring reports;
 - (c) providing the monitoring reports to the Company's Board so that the reports have the Board's assurance before their submission to Ofwat; and
 - (d) providing to Ofwat any supporting information and documents which Ofwat reasonably requests in relation to, or in connection with, the compliance with the Undertakings.
- (iii) Obtain independent, third party assurance of SWS's compliance with the Undertakings. This assurance will be reported to the SWS' Board and included in the monitoring reports provided to Ofwat. The assurance will be risk based and proportionate and the scope of the assurance will be agreed by SWS and Ofwat on an annual basis. Subject to the relevant professional duties, Ofwat will have direct, bilateral access to the independent, third party assurer.

The final report pursuant to clause 12(i) above will contain a description of SWS' status with regard to fulfilment of the organisational, cultural change and improved governance measures set out in these Undertakings. Following receipt of this final report, Ofwat shall in turn confirm that SWS has fulfilled these Undertakings and has no further obligations thereunder.

H. Other aspects of the Undertakings

- (13) For the avoidance of doubt, the Customer Bill Rebates referred to in Clause A above are at 2017/18 prices.

By signing these undertakings the Company agrees to be bound by them.

Signed on behalf of the Company by:

A handwritten signature in black ink, appearing to be 'John C. De G...', written in a cursive style.

Chief Executive Officer:

Southern Water Services Limited

Dated: 9.10.2019