



How we do our job

A code of practice governing the discharge of Ofwat's functions

September 2003

1. The Director General of Water Services (the Director) supported by the Office of Water Services (Ofwat) is the economic regulator of the water and sewerage industry in England and Wales. This code of practice sets out an overall approach, and a framework of general principles, which we will follow in the discharge of our functions. We want stakeholders to understand how they can expect us to exercise our powers and functions. This is important to companies in terms of regulatory certainty, and to customers who rely on us to protect their interests.
2. We expect the Water Bill which is currently before Parliament to place a duty on the Water Services Regulatory Authority to publish a code of practice on the discharge of its functions. This code governs the conduct of Ofwat as currently constituted. This code of practice will be updated once the Water Bill is implemented and will reflect the new duties and requirements in the Bill.
3. The code does not set out in prescriptive form a detailed set of procedures to follow. In a number of areas the Water Industry Act 1991 (the Act) lays down clear procedural steps to be followed. In other areas Ofwat produces dedicated documents. Current examples are the approach and timetable for the periodic review in 2004, and the process for approving companies' charging schemes. Also, the code needs to be sufficiently flexible to allow us to respond to the needs of customers and of the industry. For these reasons the purpose of the code is to set out the overall approach and a framework of principles which govern how we discharge our functions. It reflects our approach so far, and best practice elsewhere.
4. The code is supported by a number of publications providing more detail about how we operate, and these are referred to in the text.

Our functions

5. A list of our regulatory functions is included at annex A. These are grouped into three broad categories:
 - **decision-making** which covers the key activities in regulating licensed water and sewerage companies;
 - **advice and information** which covers advice to the Secretary of State for Environment, Food and Rural Affairs, the Welsh Assembly Government and to other government bodies, and the provision of information to customers and others; and
 - **administration** which covers the statutory requirements covering the way in which we operate and report on our work.
6. The code is primarily directed at the first two categories since it is the decisions we take, and the way we take those decisions, that matter most to our

stakeholders. On the third, we aim to be a professional organisation that delivers value for money and does not impose unreasonable costs on the companies that we regulate.

Overall approach

7. Our overall approach to the discharge of our functions is set out in a statement of aims, which we publish, annually in the forward programme. This is reproduced in annex B. The statement of aims covers our core functions and, importantly, what we hope to achieve, reflecting the purpose of economic regulation as set out in our statutory duties in sections 2 and 3 of the Act.

Framework of principles

8. Underpinning our overall approach is a framework of principles which are described below. We are fully committed to these and cannot currently envisage circumstances in which we would depart from them, but should such exceptional circumstances arise we could be obliged to do so. In such circumstances we would explain our actions.

Acting in accordance with our statutory duties

9. In the exercise of most of our key functions we are required, by section 2 of the Act, to act in a way that we judge will enable water and sewerage companies:
 - properly to carry out their functions; and
 - to finance their functions, in particular by securing a reasonable rate of return on their capital.

And, subject to the above, to:

- protect customers' interests as regards price and quality of service;
- promote economy and efficiency on the part of the companies; and
- facilitate the development of competition.

We also take due account of our general environmental and recreational duties under the Act.

10. Compliance with these duties is, and must be, central to much of what we do, and is reflected in our aims.
11. The Water Bill will, once enacted, add to our duties. This code will require amendment both to take account of these changes and of other proposals, including the reconstitution of Ofwat as a Water Services Regulatory Authority (the Authority), and the separation of WaterVoice as the Consumer Council for Water. We expect the broad principles that underlie this code of practice to be

adopted by the Authority once established, but that will be a matter for the new Authority.

12. In addition to the duties imposed by the Act, the Environment Act 1995, the Competition Act 1998, the Enterprise Act 2002 and the Fair Trading Act 1973 impose obligations which are specific to the regulation of water and sewerage companies. We must comply with these.
13. More generally, we discharge our functions in a way which meets the general obligations that apply to Ofwat as a public body. These include applying the laws of natural justice and respect for human rights. These are of particular importance in the exercise of functions that have a quasi-judicial element such as the use of enforcement powers and the determination of a dispute or complaint between a customer and a company.

Independence

14. Ofwat is a non-ministerial government department. The Director is appointed by the Secretary of State for Environment, Food and Rural Affairs (Secretary of State), and Ofwat's staff are civil servants and abide by the values set out in 'The Civil Service Code'. The Secretary of State and the Welsh Assembly Government have specific roles in relation to some of our functions. In particular, they may give us guidance on matters relating to the approval of companies' charges schemes, to which we must have regard. It is important, therefore, that we act in close consultation with government.
15. The statutory duties placed on us, however, are for us alone to discharge. In acting independently we are, and will be, open to the views of stakeholders. Subject to that we reach our own judgements and it is important for effective regulation that we do so.
16. Acting independently does not mean, however, that we are not accountable. We are accountable to Parliament and take this very seriously. We report on our activities annually to Parliament and the National Assembly for Wales. We are subject to scrutiny by the National Audit Office (NAO) and appear before the Public Accounts Committee following publication of the NAO's reports. We appear before other Parliamentary Select Committees and Assembly Committees. We respond to individual MPs and Assembly Members on constituency issues as, more generally, we welcome opportunities to account publicly for the discharge of our functions.
17. Our decisions are subject to judicial review. Also, companies can refer our decisions about price limits and about changes to Licence Conditions to the Competition Commission. Some other decisions can be appealed against through the courts. Our decisions under the Competition Act 1998 can be appealed to the Competition Appeals Tribunal. We examine all decisions and

judgements made by these bodies about us, change our actions as appropriate and explain how we have done this.

Acting in accordance with good regulatory practice

18. The publications 'Principles of Good Regulation' (1998) and 'Economic Regulators' (2001) by the Better Regulation Task Force (Cabinet Office) set down general regulatory principles: transparency, accountability, consistency, proportionality and targeting. These principles apply to us. We expect the Water Bill to place a statutory duty on the Authority to have regard to them. Our approach to consistency, proportionality and targeting is set out below. Transparency and accountability are covered elsewhere in this code (see paragraphs 16, 17 and 23).
19. Our intention is to make decisions on a 'no surprises' basis, and we aim to expose our thinking on issues before arriving at decisions. Where appropriate, decisions we take in the future should be consistent with past decisions; and decisions should be consistent as between companies and as between customers. This does not preclude changes to policies and methodologies which can be justified by experience or by changed circumstances. We will maintain an open mind.
20. Linked to consistency is the avoidance of retrospection. This is important for investor confidence and reducing regulatory risks and costs. Subject to compliance with our statutory duties, our decisions will not normally have retrospective effects.
21. When exercising our powers we aim to address specific problems. We do not intervene unnecessarily. Our intervention should be timely which includes anticipating issues as well as avoiding delay in responding to unforeseen problems.
22. We use Regulatory Impact Assessments (RIAs) where we expect a new policy, or a change in policy, to directly affect the water and sewerage companies and/or other stakeholders. 'How we use Regulatory Impact Assessments' sets out the criteria that we use to decide whether RIAs are appropriate.

Acting in a transparent manner

23. There are three elements to acting transparently:

- Consultation: In our code of practice on written consultations, 'Having Your Say', we commit to consulting stakeholders where our decisions affect the industry and its customers. The way we consult is set out in that code of practice. As well as seeking written responses to published consultations,

where appropriate we use workshops, seminars and the media to ensure that all stakeholders have an opportunity to state their views.

- **Information:** We aim to ensure that stakeholders have ready access to the information available to us to help them in representing their views to us, and to understand the basis for our decisions. Our policy is to publish as much information as we can in a clear and concise way to properly inform stakeholders. This includes publication of our annual reports on aspects of company performance, and companies' annual returns to us on all aspects of their businesses. The Ofwat publication scheme under the Freedom of Information Act 2000 sets out our policy in detail. We are bound, however, to have regard to issues of confidentiality. We can also provide versions of our documents in different formats in response to requests.
- **Reasoned decisions:** We give reasoned explanations for all our decisions. This includes decisions made following consultation as well as decisions taken on issues affecting individual customers (for example dispute determinations) or affecting individual companies.

Certain decisions, such as setting price limits, involve complex calculations. In order to explain a decision, we will provide details of these calculations to stakeholders so that they can see how we have arrived at our conclusions. The degree of detail will be appropriate to the stakeholder.

Applying good governance and decision-making structures

24. We have established a Board, comprising the Director General (the Director), four executive directors and four non-executive advisory directors. Currently the statutory powers are vested in the person of the Director. The Board, therefore, advises the Director. With this in mind its terms of reference are to:

- ensure the strategic decisions made by Ofwat are
 - subject to high level internal critical review,
 - well informed and innovative, and
 - will deliver effective outcomes for customers and the industry;
- monitor the performance of the office against its planned objectives as set out annually in the forward programme; and
- oversee corporate governance and take action as required to ensure central guidance and best practice are followed.

25. Necessarily some day-to-day decisions are delegated to staff. Where these are formal decisions under the Act, there is a written delegation to the executive director concerned.
26. Complaints and disputes are handled in accordance with the 'Ofwat complaints procedure'. The ten WaterVoice Committees handle most complaints about the water companies. Decisions are open to review, depending on circumstances, through our internal review procedure. The Parliamentary Commissioner for Administration (the Parliamentary Ombudsman) can investigate complaints against Ofwat about injustice caused by its maladministration.
27. Each year we publish, after consultation with our stakeholders, a forward programme setting out the work we will do in the year ahead, and what we expect to achieve. We report what we have done in our Annual Report to the Secretary of State for Environment, Food and Rural Affairs and the First Minister for the Welsh Assembly Government.

Establishing a factual basis for our decisions and advice

28. The quality of decisions depends on the information on which they are based. We aim to ensure that our decisions are based on the relevant information available to us – and we use our information gathering powers to that end. We identify the issues on which decisions need to be made and involve other relevant bodies, as appropriate, in arriving at our decisions.
29. We make every effort to make our decisions in a timely fashion and set out the timeframes within which we will make them. However, there may be some cases where the complexity of the issues may mean that it is not possible to arrive at a decision quickly.

Co-ordinating our activities with other regulatory bodies

30. We are one of a number of bodies with regulatory responsibilities for water and sewerage services. These include the Drinking Water Inspectorate, the Environment Agency, English Nature, the Countryside Council for Wales, the Health and Safety Executive, and the Office of Fair Trading (OFT). Where relevant we take all reasonable steps to co-operate productively with these bodies, within the framework of regulatory independence.
31. Central to achieving this aim are Memoranda of Understanding. We have agreed a Memorandum of Understanding with the Health and Safety Executive, and are in the process of doing so with the Drinking Water Inspectorate. We will also be establishing a Memorandum of Understanding with the Environment Agency. We will publish each of these on our web-site, once agreed. We expect them to cover such areas as how we will co-operate with one another, what information

we will exchange with one another and how we manage matters that involve both parties.

Customer representation

32. The Act requires the Director to establish and maintain up to ten Customer Service Committees (now known as WaterVoice Committees). The Committees have statutory functions and they report to the Director annually on their activities. The Committees represent customers' interests, deal with complaints about water companies and monitor the services companies provide. The Chairmen and members are appointed in accordance with the Code of Practice of the Commissioner for Public Appointments. Subject to proper accountability the WaterVoice Council (a non-statutory body comprising the Chairmen of the Committees) and the Committees speak independently of Ofwat in representing the interests of customers. WaterVoice publishes its forward programme setting out its priorities each year. The separate roles and working relationship between Ofwat and WaterVoice are set out in a Memorandum of Understanding.
33. The Competition Act 1998 is applied concurrently by the OFT and sector regulators. Ofwat complies with the OFT's guidelines on concurrent working which were agreed with the sector regulators.
34. We undertake joint work with other utility economic regulators on cross-cutting issues. Examples include our approaches to setting the cost of capital and the way in which companies present their regulatory accounts.

Achieving value for money

35. We are funded by customers. We therefore aim to operate cost-effectively both in terms of our own activities, and the impact our decisions have on the companies that we regulate.
36. We manage our resources prudently, working to deliver increasing outputs effectively and efficiently. Our Audit Committee under the chairmanship of one of our non-executive advisory directors will regularly review our performance on this.
37. The information that we request from companies places a burden on them, and therefore customers, in terms of collection and analysis and systems to assist in this process. We consult companies on our information requirements so that the volume we collect is kept to essentials, can be gathered efficiently and is regularly reviewed.
38. The use of RIAs enables us to consider the costs and benefits of the policy initiatives that we make.

Customers' views

39. We regularly conduct research across England and Wales in order to understand customers' satisfaction with the services they receive. Along with others we seek to understand customers' expectations about the future level of bills and their priorities for investment.
40. Stakeholders are also asked for their views on the way in which we carry out our duties and following price reviews. Where faults in our process are identified we make improvements.

Review of the code

41. The new Authority will review this code when the new Water Act is implemented, and we suggest that they do so every three years thereafter.

Ofwat's functions

Decision-making

- Setting price limits (Licence Condition B)
- Interim adjustments to price limits (Licence Condition B)
- Making inset appointments, and terminations and variations of appointments (section 7¹)
- Modification of a company's licence (section 13)
- Special administration orders (section 23)
- Enforcement action against companies for breach of enforceable statutory duties and Licence Conditions (section 18)
- Determination of individual disputes between customers and companies (section 30A and other sections)²
- Making of bulk supply orders and varying bulk supply agreements (section 40)
- Determination of interest rates (sections 42, 48, 99, 100 and 185)
- Imposing requirements on companies as to promoting the efficient use of water (section 93B)
- Approving companies' complaints procedures (section 86A and 116A)
- Approval of companies' charges schemes (section 143)
- Approving companies' codes of practice (Licence Conditions G, H and I)
- Making a Water Resale order (section 150)
- Acting under the Competition Act 1998 to prevent anti-competitive behaviour (section 31).

Advice and information

- Advice to Office of Fair Trading on mergers and acquisitions
- Recommendations to the Secretary of State on setting of overall standards of performance and standards to be achieved in individual cases (Guaranteed Standards Scheme) (sections 38 and 95)
- Publication of information (section 201)
- Publication of information about company performance (sections 38A, 93D and 95A).

¹ Section numbers refer to the Water Industry Act 1991

² For a full list of disputes that Ofwat can decide see Ofwat's complaint procedure.

Administration

- Establishment of Customer Service Committees (WaterVoice)
- Annual reports to the Secretary of State on Ofwat's activities (section 193)
- Maintenance of the Director's register (section 195)
- Operation of Licence Condition N on licence fees payable by companies to the Secretary of State.

Statement of aims

Our vision

A water industry that delivers a world-class service, representing best value to customers now and in the future.

Our mission

To regulate in a way that provides incentives and encourages the companies to achieve a world-class service in terms of quality and value for customers in England and Wales.

How do we do it?

By:

- Setting price limits at levels which:
 - Enable well managed companies to finance the delivery of services in line with relevant standards and requirements.
 - Provide incentives for companies to improve efficiency and service delivery.
 - Share the benefits between customers and investors.
- Ensuring that we are aware of stakeholders' views and priorities by consulting with customers' groups, the industry and others, and undertaking customer surveys.
- Facilitating the development of competition to promote further efficiency gains and, where practicable, further choice for customers.
- Working with the quality regulators to ensure that Ministers have the information they need to set the quality improvement programme within a long-term framework.
- Ensuring that customers' tariffs are fair and do not unduly discriminate or show preference to any class of customers.
- Handling disputes and complaints involving the companies economically, effectively and fairly.
- Monitoring the companies' performance and taking action, where necessary, to protect the interests of customers and other stakeholders.
- Openly and transparently publishing information, which allows customers and other stakeholders to have their say in regulatory decisions.
- Making sure that Ofwat delivers best value in its regulatory role and by valuing and encouraging the development of its entire staff.
- Assessing company performance by making appropriate comparisons between the regulated companies, drawing on relevant information from other sectors from international comparisons where available.

Relevant documents

Customer charter - Our standards of service

Freedom of Information Act 2000 - Our publication scheme

Having your say - Ofwat's code of practice on consultations

How to make a complaint – A guide to complaining to Ofwat under the Competition Act 1998

How we use Regulatory Impact Assessments

Memorandum of Understanding between Ofwat and the Health and Safety Executive (March 2003)

Memorandum of Understanding between Ofwat and WaterVoice, January 2002 (updated March 2003)

Ofwat complaints procedure – How we can help if you have a complaint about a water company

Ofwat Forward Programme 2003-04 to 2005-06

WaterVoice Programme 2003-04 to 2004-05

Each of these documents, and others, are available from our Library on 0121 625 1373 or from our website at www.ofwat.gov.uk