

# **DRAFT**

**Section 22A Water Industry Act 1991**

**Statement of policy with respect**

**to financial penalties**

**[2005]**

**[Ofwat, Department for Environment, Food and Rural Affairs  
and Welsh Assembly (Government) ]**

# Statement of policy with respect to financial penalties pursuant to section 22A of the Water Industry Act 1991

## 1. Background

**1.1** The Water Industry Act 1991 (the Act), as amended by the Water Act 2003, provides that in certain circumstances an enforcement authority may impose a financial penalty on providers of water and sewerage services<sup>1</sup>. The powers apply to the statutory undertakers appointed under Chapter 1 of Part 2 of the Water Industry Act 1991, that is the existing water and sewerage companies. They also apply to any company holding a licence under Chapter 1A of the Water Industry Act. The relevant enforcement authorities are the water regulator (Ofwat), the Secretary of State and the National Assembly for Wales.

**1.2** Any financial penalty is not returned to customers but is paid into the Treasury's consolidated fund.

**1.3** The Act requires the enforcement authority, having undertaken appropriate consultation, to prepare and publish a statement of policy with respect to the imposition of a penalty, and to its amount<sup>2</sup>. This statement has been prepared in accordance with those requirements.

**1.4** The enforcement authority may not impose a penalty where it is satisfied that the most appropriate way of proceeding is under the Competition Act 1998<sup>3</sup>. We will take this into account throughout our procedures and deliberations.

**1.5** The Act lays out procedures for notifying and consulting affected parties. In imposing any penalty, the enforcement authority will follow the procedural requirements set out in the Act<sup>4</sup>. We will also consult other enforcing authorities and regulators as necessary and consider the views of WaterVoice.

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<sup>1</sup> Section 22A (1) and (2) of the Water Industry Act 1991

<sup>2</sup> Section 22B

<sup>3</sup> Section 22A (13)

<sup>4</sup> Section 22A (4) , (5), (6)

## 2. General approach

- 2.1** The primary purpose of the financial penalty system should be to give companies an incentive to comply with statutory and regulatory requirements now and in the future. Penalties must be reasonable in all the circumstances of the case but must also be such as to adequately incentivise both the company in question and other companies.
- 2.2** In deciding whether to impose a penalty, the enforcement authority will take account of the particular facts and circumstances of the case under consideration, including the extent to which the circumstances from which the contravention or failure arose, were or were not outside the control of the undertaker or licence holder. The enforcement authority will also take account of any representations made by interested parties in response to public notice of its proposals.
- 2.3** One enforcement authority will take lead responsibility for each aspect of performance. Decisions on any particular case will not be reopened or revisited by another enforcement authority. This does not preclude early notification and consultation between enforcement authorities when any case is being considered, indeed this will be normal practice.
- 2.4** When setting price limits at a price review, Ofwat will exclude any direct costs associated with financial penalties imposed under section 22A ie investors in the company will bear the full cost of the penalty.
- 2.5** Where a penalty has been imposed this will be considered when price adjustments are made in relation to any other service related incentive mechanism such as Ofwat's overall performance assessment.
- 2.6** In considering any case in which a financial penalty might be imposed, the enforcement authority will need to address three key questions :
- Is it satisfied that:
    - i) the undertaker or licence holder has contravened or is contravening any relevant condition of its appointment or licence; or
    - ii) the undertaker or licence holder has contravened or is contravening any statutory or other requirement which is enforceable under section 18 of the Act; or
    - iii) the undertaker or licence holder has contributed or is contributing to a contravention; or
    - iv) the undertaker has failed to achieve any standard of performance prescribed under section 38(2) or 95(2) of the Act.
  - If so, is it appropriate to impose a financial penalty?
  - If so, what amount is reasonable in all the circumstances of the case?

### **3. Is a penalty appropriate and, if so, at what level?**

**3.1** Once satisfied that a contravention or failure of service has occurred or is occurring, the enforcement authority will have to decide whether a financial penalty should be imposed and at what level.

**3.2** When considering whether to impose a penalty, imposition of a financial penalty is more likely where:

- the contravention or failure has damaged the interests of customers or other market participants or damaged the environment;
- to do so would be likely to create an incentive to compliance and deter future breaches.

**3.3** A financial penalty will be less likely to be imposed where:

- the contravention or failure was or is of a trivial nature, the breach or possibility of a breach would not have been apparent to a diligent undertaker or licence holder;
- the undertaker or licence holder is open to prosecution in respect of the failure or contravention. Although a penalty might be appropriate in respect of different consequences of such a contravention or failure (eg for inadequate arrangements for communicating with customers in the event of an environmental or drinking water incident ) .

**3.4** Once it has been decided that a penalty should be imposed the enforcement authority must consider the appropriate level. Any penalty must be reasonable in all the circumstances of the case. Factors relevant to decisions on the broad level of a penalty will include:

- the seriousness and duration of the contravention or failure;
- the degree of nuisance, harm or increased cost incurred by customers, other market participants or the environment;
- any gain (financial or otherwise) made by the undertaker or licence holder as a result of the contravention or failure;
- precedents set under equivalent provisions for other utilities and public services.

**3.5** Having considered the broad level of penalty, other factors may be taken into consideration. Aggravating factors tending to lead to a higher penalty than otherwise may include, but would not necessarily be limited to :

- repeated contravention or failure;

- continuation of contravention or failure after either becoming aware of the contravention or failure or becoming aware of the start of the enforcement authority's investigation;
- the involvement of senior management in any contravention or failure;
- the absence of any evidence of internal mechanisms or procedures intended to prevent contravention or failure; and
- the extent of any attempt to conceal the contravention or failure from the enforcement authority.

**3.6** Mitigating factors tending to decrease the level of any penalty would include, but would not necessarily be limited to :

- the extent to which the undertaker or licence holder had taken steps to secure compliance, either specifically or by maintaining an appropriate compliance policy, with suitable management supervision;
- appropriate action to remedy the contravention or failure;
- evidence that the contravention or failure was genuinely accidental or inadvertent or outside management control;
- the extent to which the undertaker or licence holder had compensated those affected;
- proactive reporting of the contravention or failure to the enforcement authority; and
- co-operation with any investigation.

**3.7** Having considered, to the extent appropriate, the factors listed above and the circumstances of the case under consideration, the enforcement authority will determine the appropriate level of financial penalty. In doing so it will ensure that the amount it determines is not more than ten percent of the turnover of the undertaker or licence holder as required by the Act. The definition and relevant period of turnover will be that set in regulations by the Secretary of State after consulting the National Assembly for Wales.<sup>5</sup>

**3.8** We envisage that the maximum penalty would be applied only in the most severe cases.

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<sup>5</sup> Section 22A (11).

## **4. Revision of the Statement of Policy**

- 4.1** This statement was approved by [the Secretary of State, the National Assembly for Wales and Ofwat] on [ INSERT DATE]. It may, from time to time, be revised, in accordance with the Act<sup>6</sup>. Any revised statement will be consulted on and published.

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<sup>6</sup> Section 22B (3) Water Industry.

## **Annex 1**

### **List of statutory and other requirements enforceable under section 18 of the Water Industry Act 1991**

#### **Requirements where Ofwat has delegated responsibilities and will lead as the enforcing authority**

- Sections 37 and 94 – the general water supply and sewerage duties, pursuant to an authorisation from the Secretary of State.
- Section 59 – duty to supply water for ‘other public purposes’ (eg highway cleaning, local authority purposes or the cleaning of sewers and drains).
- Section 65 – duty to maintain constant supplies at prescribed pressure (the ‘topmost story’ test).
- Section 181– duty to comply with requirement to make a payment to a complainant about exercise of pipelaying powers in private land.
- Section 191 – maintenance of register of trade effluent consents, agreements and notices.
- Licence conditions.

#### **Requirements where DEFRA or Welsh Assembly retain role as lead enforcing authority**

- Drinking water quality requirements (enforced by the Drinking Water Inspectorate on behalf of the Secretary of State and the Welsh Assembly).