

Notice, under and in accordance with section 22A(4) of the Water Industry Act 1991 (as amended), of the Water Services Regulation Authority's proposal to impose a penalty on Severn Trent Water Limited

This document constitutes a notice given under and in accordance with section 22A(4) of the Water Industry Act 1991 (as amended) (the "WIA91"). The background and context to this notice are set out in sections 1 to 8 below. This notice states that:

- (i) the Water Services Regulation Authority ("Ofwat") proposes to impose a penalty on Severn Trent Water Limited ("Severn Trent Water");
- (ii) Ofwat is satisfied that Severn Trent Water has failed to achieve standards of performance prescribed under sections 38(2) and 95(2) WIA91, namely the standards in the Water Supply and Sewerage Services (Customer Service Standards) Regulations 1989 (as amended) (the "GSS Regulations"). The reasons for this are set out at sections 4 and 5 below;
- (iii) the proposal to impose a penalty is in respect of Severn Trent Water's failure to achieve standards of performance prescribed under sections 38(2) and 95(2) WIA91, namely the GSS Regulations, at all material times between 9 June 2005 (the date twelve months prior to the date of this notice) and the date of this notice;
- (iv) the omissions which, in the opinion of Ofwat, constitute the failures in question and which justify the imposition of a penalty are set out in sections 4 to 7 below;
- (v) however, Ofwat requires Severn Trent Water to provide further information as to the extent of the failures to be able to quantify fully the amount of the proposed penalty;
- (vi) it is likely that Ofwat will vary the proposal stated in this notice once Severn Trent Water has provided information as to the full extent of the failures; if so, Ofwat will be required to give notice, as required by section 22A(5) WIA91, setting out the proposed variation and the reasons for it and allowing a period (not being less than twenty-one days from the date of publication of the notice) within which representations or objections with respect to the proposed variation may be made;
- (vii) Ofwat is also considering whether Severn Trent Water has or may have contravened conditions of its appointment by providing Ofwat with false information in relation to customer services and whether it would be appropriate to impose a separate penalty on Severn Trent Water in respect of those contraventions; this notice is without prejudice to any penalty Ofwat may impose or propose to impose, or any other action Ofwat may take, in respect of any such contraventions;

- (viii) representations or objections with respect to this proposed penalty may be made by 5pm on 31 October 2006; representations or objections should be made to Sue Cox, as set out below.

Sue Cox
Acting Head of Consumer Affairs
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Or by e-mail to sue.cox@ofwat.gsi.gov.uk

Representations and/or objections, which should be made in writing, should be clearly marked 'Severn Trent Water Proposed Penalty'.

Representations and/or objections will be placed in our library and made available to the public, unless you have clearly indicated that you do not wish this to happen. In general, we will honour this request, but there may be circumstances in which, under the Freedom of Information Act 2000, we would be obliged to disclose responses.

1. Regulatory and Legal Framework

On 1 April 2006, a body corporate known as the Water Services Regulation Authority replaced the officer known as the Director General of Water Services (the "Director") (section 34 of the Water Act 2003 (the "WA03") and article 4 of the Water Act 2003 (Commencement No 5, Transitional Provisions and Savings) Order 2005, SI 2005 No 2714). On the same day the functions of the Director were transferred to the Water Services Regulation Authority under section 36 WA03 and the Water Services Regulation Authority Transfer Scheme 2006.

Anything done by the Director for the purpose of or in connection with any of his functions and which is in effect immediately before the transfer is treated as if done by the Water Services Regulation Authority (Schedule 3, paragraph 6(1) WA03). The transfer of the functions does not affect the validity of anything done by the Director before the transfer takes place (Schedule 3, paragraph 6(2) WA03). The Water Services Regulation Authority is substituted for the Director in any document relating to anything transferred (Schedule 3, paragraph 8). In this notice, the term "Ofwat" is used to mean both the Water Services Regulation Authority from 1 April 2006 and the Director prior to 1 April 2006.

Ofwat is the economic regulator for the water and sewerage industry in England and Wales. Its primary duties are (so far as relevant):

- to further the consumer objective (namely to protect the interests of consumers, wherever appropriate by promoting effective competition between

persons engaged in, or in commercial activities connected with, the provision of water and sewerage services);

- to secure that the functions of a water undertaker¹ and of a sewerage undertaker are properly carried out as respects every area of England and Wales; and
- to secure that undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions.

2. Penalties

Under section 22A(1)(a) WIA91² Ofwat may impose on an undertaker a penalty of such amount as is reasonable in all the circumstances of the case where, amongst other things, it is satisfied that the undertaker:

- has contravened or is contravening any condition of its appointment;
- has failed or is failing to achieve any standard of performance prescribed under section 38(2) or 95(2) WIA91; or
- has contravened or is contravening any statutory or other requirement which is enforceable under section 18 WIA91 and in relation to which Ofwat is the enforcement authority.

By section 22A(10) WIA91, the power to impose a penalty under section 22A is not exercisable in respect of any contravention or failure before the commencement of section 22A, namely 1 April 2005³.

Ofwat may not impose a penalty in respect of a contravention or a failure later than twelve months from the time of the contravention or failure, unless before the end of that period notice under section 22A(4) WIA91 relating to the penalty is served on the undertaker under section 22A(8) WIA91.

A penalty may not exceed 10% of the company's turnover, determined in accordance with the Water Industry (Determination of Turnover for Penalties) Order 2005 (SI 2005 No. 477). That Order provides that the turnover of the company is the applicable turnover for the last business year preceding the date on which Ofwat

¹ Companies holding appointments as water only or water and sewerage undertakers under Chapter I of Part II of the WIA91.

² Sections 22A to 22F WIA91 were inserted by section 48(1) WA03. For present purposes, section 48(1) was brought into force on 1 April 2005 by the Water Act 2003 (Commencement No. 4, Transitional Provisions and Savings) Order 2005, SI 2005 No. 968, Article 2(i). Under Article 4 and Schedule 2, paragraph 4 of the Water Act 2003 (2003 (Commencement No. 4, Transitional Provisions and Savings) Order 2005, until the coming fully into force of section 36(1) WA03 (transfer to the Water Services Regulation Authority of functions, property etc) on 1 April 2006, any reference to the Water Services Regulation Authority in sections 22A to 22F WIA91 had effect as if it were a reference to the Director.

³ The Water Act 2003 (Commencement No. 4, Transitional Provisions and Savings) Order 2005, SI 2005 No. 968, Article 2(i).

gives notice under section 22A(4) WIA91 (i.e. the date of this notice). The applicable turnover is broadly the turnover derived from the company's regulated activities.

The 10% limit applies to each breach for which a penalty is imposed, rather than representing a cumulative limit for a financial year.

As required⁴, Ofwat has prepared and published jointly a Statement of Policy with the Secretary of State for the Environment, Food and Rural Affairs and the National Assembly for Wales with respect to the imposition of penalties and the determination of their amount (the "Statement of Policy")⁵. In deciding whether to impose a penalty, and in determining the amount of any penalty, Ofwat must have regard to the Statement of Policy most recently published at the time when the contravention or failure occurred.

Penalties are paid into the Consolidated Fund and are not returned to customers⁶.

Ofwat shall not impose a penalty under section 22A WIA91 where it is satisfied that the most appropriate way of proceeding is under the Competition Act 1998. The matters with respect to which Ofwat proposes to impose a penalty relate to failures to achieve standards of performance under the GSS Regulations. Consequently, Ofwat is satisfied that it would not be appropriate to proceed under the Competition Act 1998.

The behaviour in respect of which Ofwat proposes to impose a penalty is the failure to achieve standards of performance prescribed under section 38(2) or 95(2) WIA91. Under those provisions the Secretary of State has the power to prescribe, by regulations, such standards of performance in connection with the provision of supplies of water or sewerage services as, in his opinion, ought to be achieved in individual cases. The GSS Regulations are made under those powers.

The GSS Regulations provide that if an undertaker fails to provide certain customer services in the manner set out, the undertaker must make a payment to that customer. The standards of performance prescribed by the GSS Regulations relate to:

- Keeping of appointments – including giving notice of the appointment to the customer and offering a time slot for the appointment (Regulation 3);
- Responding within a certain timeframe with a substantive reply to queries about the correctness of an account and requests about changing payment arrangements (Regulation 4);

⁴ Section 22B WIA91, inserted by section 48 WA03. Section 22B WIA91 came into force on 1 October 2004: the Water Act 2003 (Commencement No 2, Transitional Provisions and Savings) Order 2004, SI 2004 No. 2528, Article 2(e)(ii).

⁵ "Statement of Policy with respect to financial penalties", 17 March 2005.

⁶ Section 22A(9) WIA91.

- Responding within a certain timeframe with a substantive reply to written complaints from customers in connection with the supply of water or the provision of sewerage services (Regulation 5);
- Interruptions to supply – including giving adequate notice of interruption and restoration of supplies (Regulation 6) and the length of time of an interruption to supply (Regulation 7);
- Maintaining adequate pressure (Regulation 7AA); and
- Flooding from sewers (Regulation 7B).

3. Background

On 7 April 2006, the Board of Severn Trent Plc (the parent company of Severn Trent Water) announced that it was providing Ofwat with an interim report into misreporting of customer relations data by Severn Trent Water to Ofwat. As a result of an ongoing review of Severn Trent Water by its managing director, Tony Wray, and his new management team, the Board of Severn Trent Plc believes there is prima facie evidence of customer relations data being misstated by Severn Trent Water in its submissions to Ofwat. The data concerns the handling of customer billing queries and telephone contacts over several years. This includes areas for which the GSS Regulations prescribe standards of performance.

As a result Ofwat and Severn Trent Water have jointly appointed Ernst & Young LLP to carry out an independent investigation into these irregularities. That investigation is ongoing.

In its announcement on 7 April, Severn Trent Plc gave an assurance that if customers had been disadvantaged they would be reimbursed. Ofwat has asked Severn Trent Water to provide a written undertaking that it will not benefit to the detriment of its customers from any irregularities found by the investigations. Consistent with this principle, the undertaking must state that Severn Trent Water will pay in full any amounts found by the investigation to be due to customers and that if Severn Trent Water benefited from the irregularities in terms of its price review, it will fully adjust future prices to its customers. Ofwat has also asked Severn Trent Water to undertake that, in due course, it will provide Ofwat with a written statement that the company has adequate systems of control and internal planning to fulfil its functions and meet its obligations as an undertaker.

Ofwat has received such an undertaking in these terms in another similar case but Severn Trent Water has yet to provide Ofwat with such an undertaking, in addition to the general assurance given by Severn Trent Plc.

Ofwat expects Severn Trent Water to work to identify customers who did not receive a payment as required by the GSS Regulations. Severn Trent Water has agreed to set out for Ofwat's agreement how it intends to approach this. Severn Trent Water is also taking action to improve its customer service performance and the accuracy of the information it reports to Ofwat.

4. The failures

Under the time limits imposed by section 22C WIA91 Ofwat may not impose a penalty in respect of a contravention or failure prior to twelve months before the date of this notice.

This notice therefore relates only to Severn Trent Water's failure to achieve standards of performance prescribed by the GSS Regulations for the period from 9 June 2005 to the date of this notice.

Separately, Ofwat is considering whether Severn Trent Water has or may have contravened conditions of its appointment by providing Ofwat with information which is not reliable, accurate and complete in relation to its customer services and whether it would be appropriate to impose, or to propose to impose, a separate penalty or penalties in respect of any such contraventions. This notice is without prejudice to any penalty Ofwat may impose or propose to impose, or any other action Ofwat may take, in respect of any such contraventions.

From the evidence and information that Ofwat has seen to date, it is satisfied that Severn Trent Water has failed to achieve standards of performance prescribed in the GSS Regulations during the relevant period.

Whilst the company has provided Ofwat with some information about its levels of performance and the extent of its failures to comply with standards of performance prescribed by the GSS Regulations, that information is not yet complete. As stated above, Severn Trent Water is undertaking work to provide further information.

5. Examples of failures to comply with standards of performance prescribed by the GSS Regulations⁷

5.1 Standard of performance prescribed by Regulation 4 of the GSS Regulations

Regulation 4 prescribes standards of performance in relation to account queries and requests about payment arrangements. It provides that, subject to certain exceptions:

- where a customer queries in writing the correctness of an account presented to him by an undertaker for the supply of water or sewerage services ("a query"), the undertaker must despatch a substantive reply to the customer within 10 working days from the date of receipt of the query; and
- where a customer asks in writing to change the arrangements by which he makes payments to the undertaker and that request cannot be met, the

⁷ Reference should be made to the GSS Regulations for the complete wording of the GSS Regulations, including the exceptions to the prescribed standards of performance.

undertaker must despatch a substantive reply to the customer within five working days from the date of the receipt of the request.

If an undertaker fails to meet a standard of performance prescribed under Regulation 4, it must pay to the customer (or credit to his account) the sum of £20.

Section 22A(4) WIA91 requires this notice to set out the omissions which, in the opinion of Ofwat, constitute the failure in question. The evidence and information provided to date show that Severn Trent Water has failed to achieve the standards of performance set out above on a significant number of occasions during the period from 9 June 2005 to the date of this notice.

5.2 Standard of performance prescribed by Regulation 5 of the GSS Regulations

Regulation 5 prescribes standards of performance in relation to handling complaints about water or sewerage services. It provides that, subject to certain exceptions, where a customer complains in writing to a water undertaker in connection with the supply of water or to a sewerage undertaker in connection with the provision of sewerage services, the undertaker must despatch a substantive reply to the customer within 10 working days from the date of the receipt of the complaint.

If the undertaker fails to meet a standard of performance prescribed by Regulation 5, it must pay to the customer (or credit to his account) the sum of £20.

Section 22A(4) WIA91 requires this notice to set out the omissions which, in the opinion of Ofwat, constitute the failure in question. The evidence and information provided to date show that Severn Trent Water has failed to achieve the standards of performance set out above on a significant number of occasions during the period from 9 June 2005 to the date of this notice.

6. Facts justifying the imposition of a penalty

In deciding whether to impose a penalty in respect of a failure, Ofwat shall have regard to its Statement of Policy. The Statement of Policy states that when considering whether to impose a penalty, Ofwat will take account of the particular facts and circumstances of the case under consideration. This will include the extent to which the circumstances under which the failure arose were, or were not, outside the control of the company. It also states that when considering whether to impose a penalty, a penalty is more likely where:

- the contravention or failure has damaged the interests of customers or other market participants or damaged the environment; or
- applying a penalty would be likely to create an incentive to comply and deter future contraventions or failures.

On the basis of such evidence and information as has been provided to Ofwat to date, it appears to Ofwat that the failures arose under circumstances which were

within the control of the company. Ofwat considers that customers' interests have been damaged, as the failures have meant that a significant number of Severn Trent Water's customers have not received the standards of performance in customer service prescribed by the GSS Regulations. Ofwat also considers that imposing a penalty would be likely to create an incentive to comply and deter future contraventions or failures on the part of Severn Trent Water and other undertakers.

The Statement of Policy states that a penalty will be less likely to be imposed where:

- the contravention or failure was or is of a trivial nature; or
- the contravention or possibility of a contravention would not have been apparent to a diligent company.

On the basis of such evidence and information as has been provided to Ofwat to date, it appears to Ofwat that the scale of the failures is not of a trivial nature and that the circumstances which lead to the failures should have been apparent to a diligent undertaker.

In the light of the above factors and on the basis that Ofwat is satisfied that Severn Trent Water has failed since 9 June 2005 to the date of this notice to achieve standards of performance prescribed in the GSS Regulations, Ofwat considers that it is appropriate to impose a penalty on Severn Trent Water in respect of its failure to achieve standards of performance under the GSS Regulations.

7. The amount of the penalty

Section 22B(2) WIA91 also states that in determining the amount of any penalty in respect of a failure Ofwat shall have regard to the Statement of Policy. The Statement of Policy sets out that any penalty must be reasonable in the circumstances of the case and that 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 company as a result of the contravention or failure;
- precedents set under equivalent provisions for other utilities and public services; and
- the level of any other penalty already or potentially imposed through other regulatory means in relation to the same contravention or failure.

On the basis of such evidence and information as has been provided to Ofwat to date, it appears to Ofwat that the failures are serious in nature. When Severn Trent

Water has provided Ofwat with further information about (among other things) its performance from 9 June 2005 to the date of this notice in relation to the standards of performance prescribed by the GSS Regulations, Ofwat will be in a position to consider the factors needed to determine the broad level of the penalty and the aggravating and mitigating factors as set out in the Statement of Policy.

As required by section 22A(4)(a) and (c) WIA91 this notice must state the amount of the penalty proposed to be imposed and the other facts, which in the opinion of Ofwat, justify the amount of the penalty imposed. For the purposes of this notice only, the amount of the penalty is the nominal amount of £1. Until the required information referred to in the above paragraph has been provided, Ofwat is unable to quantify the final amount of the penalty.

8. Variation of this notice

As stated above, Ofwat requires Severn Trent Water to provide further information on (among other things) its failures to achieve the standards of performance prescribed by the GSS Regulations. It is likely that Ofwat will vary the proposal stated in this notice once the further information has been provided.

Ofwat has decided to issue this notice now, in order to take into account as many failures to achieve the standards of performance prescribed by the GSS Regulations as possible. Under the time limits imposed by section 22C WIA91 Ofwat may not impose a penalty in respect of a contravention or failure prior to twelve months before the date of this notice. This notice therefore covers failures from 9 June 2005 to the date of this notice.

In the event that Ofwat wishes to vary this notice, in accordance with section 22A(5) WIA91, Ofwat will be required to give notice setting out the proposed variation and the reasons for it and to specify a period (of not less than twenty-one days) within which representations or objections with respect to the proposed variation may be made.

9. Representations or objections with respect to the proposed penalty

Under section 22A(4)(d) WIA91, Ofwat shall give notice specifying the period (of not less than twenty-one days from the date of publication of this notice) within which representations or objections with respect to the proposed penalty may be made. Accordingly, representations or objections with respect to the proposed penalty may be made by 5pm on 31 October 2006. Representations or objections should be made to Sue Cox, as set out below.

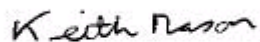
Sue Cox
Acting Head of Consumer Affairs
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Centre City Tower
7 Hill Street
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B5 4UA

Or by e-mail to sue.cox@ofwat.gsi.gov.uk

Any representations or objections, which should be made in writing, should be clearly marked 'Severn Trent Water Proposed Penalty'.

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Keith Mason
Director of Regulatory Finance and Competition
On behalf of the
Water Services Regulation Authority

With effect from 8 June 2006