

# Consultation on compliance codes guidance

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## About this consultation

This consultation sets out our draft condition R compliance codes guidance. It provides guidance to water undertakers on the issues that need to be covered in their compliance codes. It is not, however, a substitute for condition R and should be read alongside that condition.

Paragraph 7(4)(a) of water undertakers' appointment condition R requires water undertakers to have in place a compliance code which complies with compliance guidance issued by us. Water undertakers will need to have arrangements (details of which should be contained in their compliance codes) in place in order to:

- establish that they are complying with the confidentiality obligations under appointment condition R;
- protect commercially sensitive information received from or in relation to licensed water suppliers (licensees);
- ensure that transactions between themselves and any associate licensee are at arm's length;
- provide clear information to staff on their individual obligations; and
- give confidence that they are carrying out their functions under the water supply licensing (WSL) regime in a fair manner and that there is no discriminatory behaviour against customers or licensees.

Once we have considered responses to this consultation and issued our final guidance, we will allow water undertakers sufficient time to produce and publish their compliance codes. We welcome your views on the proposals outlined in this document. We have also identified some specific questions in each chapter of the document and welcome your views on these.

The consultation is structured as follows.

- **Chapter 1** briefly explains the obligations on water undertakers under appointment condition R.
- **Chapter 2** examines the relevant duties on water undertakers under appointment condition R and provides guidance on the issues that need to be covered in their compliance codes.
- **Chapter 3** examines other general areas that are relevant to the compliance issues raised in chapter 2.

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## Responding to this consultation

We invite your views on the questions and processes that are set out in this paper.

Please send responses to this consultation to Hayley Purcell by **6 June 2008**.

You can e-mail your responses to **hayley.purcell@ofwat.gsi.gov.uk**

or post them to:

Hayley Purcell  
Competition Policy Team  
Ofwat  
Centre City Tower  
7 Hill Street  
Birmingham B5 4UA.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory ‘Code of Practice’ with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

## 1. Background to appointment condition R

This condition supports the duties placed on water undertakers by sections 66A-66C WIA91 with regard to the provision of access to licensees on reasonable terms.

Condition R ensures that each water undertaker:

- produces, publishes and updates as necessary a code for access (including prices) in compliance with the access codes guidance;
- does not unfairly discriminate between licensees (or their customers) and their other customers;
- does not obtain an unfair commercial advantage because of their activities under this condition (this also applies to any associates of a water undertaker); and
- produces, publishes and updates a compliance code which follows our guidance.

Condition R also requires that water undertakers do not show undue preference to, or undue discrimination against, actual or potential customers or any actual or potential licensees. This will prevent unwarranted distinctions between:

- a water undertaker's retail activities and licensees;
- different licensees (or their customers); or
- customers connected to the water undertaker's network, whether or not they are supplied by a licensee or the water undertaker. A water undertaker cannot treat a licensee's customer any differently from its own customers (unless specifically agreed as part of the access agreement). For example, if there is a drought order or a hosepipe ban, the water undertaker cannot require the licensee's customers to limit their water use in precedence or preference to limiting water use by its own customers.

## 2. Obligations under appointment condition R

This chapter outlines the duties on water undertakers under condition R which fall within the scope of this document. It also provides guidance on the issues that each water undertaker will need to cover in its compliance code, including the types of procedures to prevent any breach of its obligations under this condition. The points set out in this chapter are intended to be examples and form a non-exhaustive list.

Paragraph 7(4) of condition R defines compliance guidance as guidance in relation to a water undertaker's compliance with its obligations under paragraph 7 (obligations about information) and 5(1)(b) (arm's length trading) of this condition; and generally in relation to any obligation of confidentiality on a water undertaker in relation to information provided to or by it under or for the purposes of this condition or condition S (customer transfer protocol), and its compliance with those obligations.

In addition, paragraph 7(4)(c) of condition R requires each water undertaker to review its compliance code once a year (by no later than the anniversary of the date that we first issued compliance guidance). Water undertakers should also update their compliance codes whenever we issue any revised guidance (after we have consulted on this) and notify us once they have done so. They should follow our timetables when doing this.

### 2.1 Arm's length trading

Under paragraph 5(1)(b) of appointment condition R, a water undertaker that is related a licensee must make sure that transactions between the two are carried out at arm's length. An associate licensee may call on the skills and experience of staff and other resources of the water undertaker only where the service provided by those staff or using those resources is properly charged and accounted for. For example, a licensee may use staff that the regulated business employs (including during the application stages of the licensing process) or buildings, equipment and other resources.

Any service to a licensee should be clearly illustrated in the financial records of the licensee and the water undertaker and needs to comply with Regulatory Accounting Guideline 5 (RAG5), licensees' standard licence condition 7 (area of operation and arm's length transactions) and paragraph 5 of condition R (anti-competitive behaviour).

We do not stop any individual from being a director of both a water undertaker and an associate licensee. We do, however, consider that directors must be aware of their companies' duties under condition R. For example, if a director receives information when negotiating an access agreement in their capacity as director of a licensee, they may not use it in their capacity as director of a water undertaker, unless this is allowed for in standard licence condition 2.

Water undertakers' compliance codes should include details of any related licensees. They should also clearly set out the procedures staff are required to follow when handling transactions with licensees. This should include details on how staff should account and charge for services provided to a licensee, including any related licensees.

A standard set of procedures applying to all licensees would help to remove the risk of discriminatory behaviour towards individual licensees. A water undertaker would need to justify instances where it has taken steps that are inconsistent with the procedures set out in its compliance code, if it was found to be in breach of the relevant obligations under condition R.

**Q1: Is the guidance set out above regarding arm's length trading clear?**

**Q2: Are there any other areas that could be covered above?**

## **2.2 Obligations about information**

Each water undertaker must make sure that neither it, nor any related company, obtains any unfair commercial advantage from any exchange of information specified under paragraph 7 of condition R. For example, a water undertaker may have access to confidential information relating to a licensee's activities which it might be able to use to gain an unfair commercial advantage.

In the course of providing access under sections 66A-66C WIA91, water undertakers will need to obtain information from licensees. This may include details of:

- customers that the licensee supplies;
- its water sources;
- water quality; volume and timing of water to be supplied;
- the security of supply associated with the licensees' water sources; and

- meter reading details.

Under paragraph 9 of condition R a water undertaker cannot request from a licensee or from a person supplied or seeking to be supplied by a licensee more information than it reasonably requires:

- (i) in order to carry out its functions;
- (ii) to ascertain whether the licensee has sufficient product and public liability insurance;
- (iii) to comply with any condition of its appointment;
- (iv) in relation to national security or civil emergencies; or
- (v) to comply with any reasonable request for information made by the Environment Agency.

Water undertakers may only use the information a licensee provides (or that relates to a licensee) in relation to the WSL regime for the purpose for which it was supplied. Each water undertaker must also take appropriate steps to protect any information it receives from misuse within the company itself. The purpose of paragraph 7 of condition R is not only to prevent “inappropriate disclosure” of information to third parties (such as those outside the water undertaker) but also to prevent “inappropriate disclosure” of information within the water undertaker (such as to other employees or agents of the water undertaker itself). Licensees and water undertakers must agree a pre-contract confidentiality agreement at the start of their negotiations (paragraph 7(1) of condition R). This is so that both parties can be sure that neither may disclose without consent or misuse information received as part of the access negotiation process.

Compliance codes should set out how such information received from or in relation to licensees will be handled and should provide details of the person or team responsible for this information. It is essential that information a water undertaker receives from or relating to a licensee in such circumstances is not used to gain an unfair commercial advantage in any way and that it is not misused in any way. Compliance codes should therefore set out the procedures in place to prevent this.

In addition, compliance codes should set out procedures for sending out information to licensees. For example under paragraph 8 of condition R, a water undertaker should provide a licensee with such information as the licensee reasonably requires to:

- enable the licensee to apply for, negotiate and conclude an agreement under section 66D;

- comply with any condition of its water supply licence, or any statutory requirement imposed in consequence of its water supply licence; or
- comply with any reasonable request for information made by the Environment Agency.

Water undertakers may decide to go further than just having a confidentiality agreement in place and ensure that all dealings with licensees are handled separately from dealings with customers. This would reduce the possibility of information being used inappropriately and remove any perception that a water undertaker could be trying to persuade a customer not to switch supplier. Examples of the steps taken by some water undertakers to protect information received from or in relation to a licensee include:

- assigning different team members to deal with requests from licensees and customers.
- changing security settings on confidential computer folders.
- using separate rooms to discuss licensee issues and customer issues.
- having different e-mail addresses to handle correspondence from customers and licensees separately; and
- using a different building to any related licensee.

Compliance codes should contain a list of actions in relation to obligations about information so that employees can clearly see what actions will result in a breach of condition R.

**Q3: Is the guidance set out above regarding obligations about information clear?**

**Q4: Are there any other areas that could be covered above?**

### **3. General areas**

Water undertakers' compliance codes should provide enough information to demonstrate that they are complying with the relevant obligations under condition R. It is important that compliance codes are clear enough to allow us and licensees to assess whether the policies in place are sufficient to give confidence that each water undertaker is carrying out its functions under the WSL regime in a fair manner and that there is no discriminatory behaviour against customers or licensees.

#### **3.1 Staff training**

Compliance codes should include details of the training available to staff in relation to the areas of compliance highlighted in chapter 2. Raising awareness of the compliance code will need to be spread among all relevant employees if it is to be effective. Training will be an important part of an effective compliance code and is essential for all employees who have dealings with licensees and customers. The type of training would need to be tailored to each water undertaker's particular requirements.

#### **3.2 Compliance statement**

We would expect each water undertaker's compliance code to include a clear statement of the company's approach to compliance. This could take the form of a personal message to staff from the most senior individual in the organisation stating their commitment to the compliance code or a general statement made on behalf of the organisation including evidence of how this message is repeated throughout the company. This statement should also make it clear to employees of the water undertaker why compliance with the obligations under condition R is important to the company.

#### **3.3 Monitoring process**

Evaluating the compliance code regularly will be essential not only as a means of making sure that the code is working properly but also to enable areas of risk to be identified and addressed. It may be useful for each water undertaker to keep a log of all breaches (whether suspected, alleged or actual) as part of its monitoring process. Details of the process for monitoring how effective the compliance code is should be

included within the compliance code itself. Evaluating the code could include the following elements:

- testing individual employee's knowledge of the code including policy and procedures; or
- auditing correspondence files processes to check for actual or potential breaches.

### **3.4 Disciplinary process**

It will be important for each water undertaker's compliance code to include details of the disciplinary procedures in place for breaches of condition R. This will be essential in making the relevant employees aware of the consequences of any breaches of this condition.

Where we are satisfied that information is being, or is likely to be, misused in breach of condition R, we can use our enforcement powers to secure compliance. Since April 2005 we have also had the power to impose financial penalties of up to 10% of turnover where a company contravenes its appointment conditions.

**Q5: Are there any other general areas that need to be included here?**







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