

Protecting consumers, promoting value, safeguarding the future

Ofwat's approach to enforcement

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About this document

This document sets out Ofwat's (the Water Services Regulation Authority) approach to enforcement.

Our approach has been informed by the principles of better regulation – transparency, accountability, proportionality, consistency and targeting. We have also considered the Macrory principles in arriving at the framework set out in this document.

In developing our approach, we have taken into account the enforcement action that we have already taken using our powers set out in the Water Industry Act 1991 (WIA91).

The aims of our approach to enforcement are to secure companies' compliance and to change their behaviour. This is so that consumers' interests are protected. We want companies to understand what our expectations are and what the outcome will be if they fail their customers.

We have adopted a stepped approach to enforcement. And while we will deal with each contravention or failure on an individual basis, we will make sure that the issues of each case are analysed and investigated thoroughly, escalating any actions as necessary. The actions we will take will depend on the nature, seriousness and impact of any contravention. Our actions will be proportionate, and we will act in the best interests of a company's customers.

We will review our approach in 2011-12.

Contents

1.	Introduction	3
2.	Our aims	5
3.	The process we will follow	8
4.	The legal framework	12
5.	Keeping our approach under review	14
6.	Contacts within Ofwat	15

1. Introduction

1. In April 2008, we published '[Ofwat's strategy: taking a forward look](#)'. This set out our priorities and the approach that we are taking to regulate the water and sewerage sectors in England and Wales. We said that we will enforce standards and compliance using a transparent enforcement policy and that we will use our judgement about whether, and how far, to take specific cases.
2. Our expectation is that each company will comply with its obligations. Where this does not happen, we will take appropriate action to secure that companies comply with their obligations. We will take action with the express aim of incentivising compliance. The protection of consumers' interests is paramount.
3. We want companies, customers and other stakeholders to understand our approach and the circumstances that might lead us to use our Water Industry Act 1991 (WIA91) powers. We also want them to understand the expectations we have of the companies. The framework outlined in this paper sets out the approach that we will take to using sanctions. In pursuing sanctions, our aims are to secure compliance and change behaviour so that consumers' interests are protected. This includes providing consumers with recompense where their interests have been damaged.
4. Better regulation principles have informed our approach. These are that regulatory activities should be transparent, accountable, proportionate, consistent and targeted. We have also considered the approaches that other regulators take.
5. We have considered the principles identified by Macrory – '[Regulatory justice: Making sanctions effective](#)' – that regulators should have regard to when designing appropriate sanctioning regimes.
6. Our enforcement policy is focused on and framed around our statutory powers in WIA91. Ofwat has concurrent powers to the Office of Fair Trading under the Competition Act 1998 and Articles 81 and 82 of the EC treaty (further to section 31 WIA91), but this paper does not cover the use of these powers.

7. Formal enforcement action is likely only to be required to deal with the more serious and/or persistent breaches. We will continue to take a stepped approach where we have concerns that a company is contravening its obligations, or may do so in the future. If appropriate, we will escalate the action that we take in order to secure compliance. We will continue to pursue informal regulatory action with companies where that is the most appropriate means of making sure that they meet their obligations. However, there are some contraventions that are sufficiently serious to lead us to proceed straight to formal enforcement action.
8. The enforcement action that we have already taken has informed the development of our approach. We have secured formal undertakings (under section 19 WIA91) at a number of companies. Since April 2005, we have had the power under WIA91 to impose financial penalties. Since then, we have imposed eight financial penalties in total on five different companies. In these cases, we considered that imposing financial penalties was the most appropriate course of action to recognise the seriousness and impact of the contraventions found.
9. This document sets out our aims when we engage in enforcement action and in broad terms the process we will follow. The way in which we deal with specific contraventions and the sanctions that we apply will be guided by the particular circumstances of the case. In line with Macrory, we will pursue sanctions that are proportionate to the nature and seriousness of the incident and its impact.

2. Our aims

10. In considering and pursuing enforcement action our aims are to secure compliance and change behaviour, so that consumers' interests are protected. This applies both to the company or companies directly affected and to the water and sewerage sectors as a whole.
11. At present, we regulate a largely monopoly industry using comparative competition. We use comparisons to encourage each company to meet the standards of the best performers. In our strategy we set out our intention to introduce competition progressively where it benefits consumers and to maintain effective regulation where it does not. In May 2008, we published '[Ofwat's review of competition in the water and sewerage industries: part II](#)', which described the approach we intend to take. We have made it clear that as markets open we will look for opportunities to withdraw from regulation as competitive pressures provide sufficient protection for consumers. However, we will continue to have a role in protecting consumers' interests and to take enforcement action where breaches occur.
12. The areas where we need to pursue formal enforcement action may change over time and we will need to apply our enforcement tools within that context. We will continue to have a role that requires us to protect consumers and that may include pursuing enforcement action so that consumers are able to exercise choice.

2.1 Securing compliance

13. Our expectation is that companies will comply with their statutory and licence obligations. If this does not happen, we will take appropriate action to secure and incentivise compliance. We have made this expectation clear in our strategy and in the penalty notices relating to the action we have already pursued. These messages help the companies to understand what our expectations are and we will continue to ensure that our expectations are made clear.
14. In a largely monopoly industry, companies that fail to meet their obligations are failing their customers, most of whom cannot choose to switch to a different supplier.

15. Any failure by a company to meet its obligations undermines the confidence of consumers and other stakeholders in that company and in our ability to operate an effective regulatory regime. It can also affect our power to intervene to protect consumers' interests. The value of information we publish can also be diminished.
16. Securing compliance allows us to protect consumers and effect changes in behaviour.

2.2 Changing behaviour

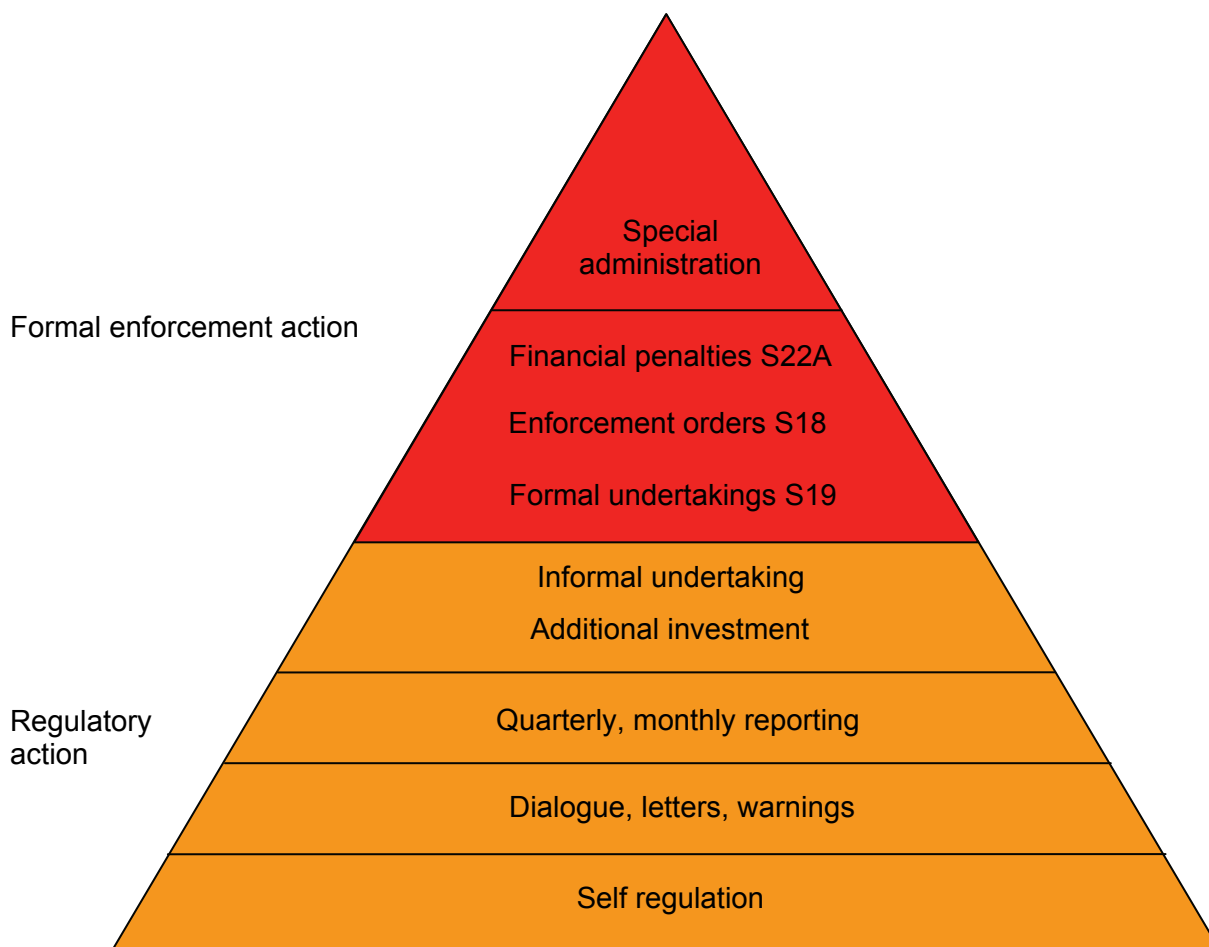
17. When we consider pursuing formal enforcement action we consider the effects of the action both on the company in question, and on the water and sewerage sectors as a whole. We expect the enforcement action we take will act as an incentive on the company in question to change its behaviour so that it becomes compliant. It also makes clear the regard with which the regulator views particular contraventions.
18. Enforcement action can directly change behaviour. For example, imposing a section 18 enforcement order or the volunteering of a section 19 undertaking should effect immediate changes to a company's behaviour.
19. Use of these enforcement tools and transparency about their use may also incentivise other companies to change their behaviour. Imposing either a financial penalty or an enforcement order indicates to the company in question and others in the water and sewerage sectors that certain behaviours are not acceptable and are sufficiently serious to attract a formal sanction. This will incentivise changes in behaviour and deter other companies from acting in a similar way.
20. In determining the sanctions that we take in response to contraventions we will consider the approach that is best suited to securing a change in behaviour and incentivising compliance.
21. Some contraventions are so serious that they will always require a financial penalty. For example, we have dealt with cases where information has been deliberately misreported to us, which causes harm to customers and other market participants. It also prejudices the regulatory regime and our ability to protect consumers. Where this has occurred, we have pursued a financial penalty. Part of the rationale for doing this has been to incentivise future compliance.
22. We expect the penalties we have imposed to act as a deterrent to the other companies.

2.3 Protecting consumers

23. When we consider the appropriate action to take, we will consider the effect of the contravention or failure on the customers of the company, consumers in general and the regulatory regime. We will also consider whether the company has wrongfully benefited from the incident. This may include financial benefits, reputational benefits or benefits arising from access to or provision of information or services. Companies may have benefited financially through price limits or through incentive mechanisms, such as the overall performance assessment (OPA). If this occurs, we expect companies to provide full redress to their customers.
24. While a direct financial benefit can be quantified, there are other ways in which a company may benefit from a failure or contravention. For example, other benefits can include the avoided costs associated with establishing adequate systems and processes of control and governance. In addition, by reporting a more favourable position than was the case, a company may have benefited from an enhanced reputation. With the emergence of competition, enhanced reputation may attract more consumers and increase revenue.
25. If breaches are identified, we will make an assessment of the position the company would have been in had the failure or contravention not occurred, and of the benefit it has gained. We will review this and take it into account, along with any action the company has taken to provide redress and/or compensation, when pursuing enforcement action. As part of any sanction we will aim to restore the harm that regulatory non-compliance has caused.
26. If customers have suffered, we expect the company to provide redress as soon as possible to restore customers to the position they would have been in. In some circumstances, we would expect companies to provide compensation to their customers to reflect the harm and inconvenience they have suffered. In addition, we expect companies to act swiftly to put right the contravention or failure and to make sure that it does not happen again. We expect companies to provide us with an informal undertaking to secure this.

3. The process we will follow

27. This chapter is necessarily described in broad terms. Each case is different and we could not always follow a rigidly defined process.
28. There are a number of ways in which possible breaches or failures by companies to meet their obligations may come to our attention. Contraventions have come to our attention through several avenues; for example:
- a company self-reporting – if a company finds a possible contravention or fails to meet statutory standards, we expect it to advise us immediately it becomes aware of any potential problem;
 - a complaint from a third party;
 - a concern raised by a whistleblower (a current or ex-employee of a company);
 - a referral from the Consumer Council for Water; or
 - as a result of our monitoring or investigations.
29. We are developing a strategic framework for keeping companies accountable (as set out in our [‘Forward programme 2009-10 to 2011-12’](#)). As we develop this strategic framework, we anticipate carrying out proactive checks on specific aspects of company data to ensure compliance. We may discover a contravention or failure as a result of our proactive and more targeted checks on company data.
30. If an area of concern comes to light, generally we will adopt a stepped approach to the analysis, investigation and escalation of the issue. Some contraventions may require us to move straight to formal enforcement action.
31. There are a number of actions we can take if a breach is identified or the potential for a company to breach its obligations is identified. These range from a letter to the company reminding it of its obligations to applying for a special administration order.
32. We have set out in the pyramid below the enforcement tools that we have available to us.



33. The pyramid is based on the powers described in chapter 4.

34. The action that we take will depend on the nature, seriousness and impact of any contravention. In determining the seriousness of any breach, we will consider the damage that has arisen as a result of the breach and the extent to which it was within the control of a prudent management. In determining the impact of the breach, we will consider the materiality of the breach and the impact it has on customers of the company as a whole, other market participants, the regulatory regime, the environment and others. We will also consider the balance between the seriousness of the breach and its impact. In considering the seriousness and impact, we will also consider the potential damage that could be caused to customers and the seriousness of the risk of that damage.

35. We will consider whether action under the Competition Act 1998 (CA98) or Articles 81 and 82 of the EC treaty would be a more appropriate way of proceeding rather than using the WIA91 statutory powers. We will do this based on the individual facts of the case.

36. Our powers under WIA91 are described in more detail in chapter 4.
37. Before taking any enforcement action our first step will be to gather information to determine whether a contravention has occurred, is occurring or is likely to occur, and the nature of the contravention. We will expect companies to provide us with all of the information that we require.
38. A notice under section 203 WIA91 requires the company to produce specific documents or information where it may be contravening or have contravened its licence or a statutory or other requirement. Issuing a section 203 notice is not necessarily an indicator that we intend to pursue formal enforcement action. However, it does indicate that we consider a contravention may be or may have been occurring. In some circumstances, we may also seek third party checks or additional information as appropriate in addition to the section 203 response.
39. In some circumstances we may require an independent investigation so that we have complete information before we decide whether to take enforcement action and the nature of that action.
40. Our aim is to make sure that any enforcement action we take is proportionate in the circumstances of the contravention or failure.
41. If we find that a contravention has occurred, we will consider what the appropriate sanction to deal with the contravention is. Our decisions on appropriate sanctions will be informed by the Macrory principles.
- A sanction should aim to change the behaviour of the offender.
 - A sanction should aim to eliminate any financial gain or benefit from non-compliance.
 - A sanction should be responsive and consider what is appropriate for the particular offender and the regulatory issue.
 - A sanction should be proportionate to the nature of the offence and the harm caused.
 - A sanction should aim to restore the harm caused by regulatory non-compliance where appropriate.
 - A sanction should aim to deter future non-compliance.
42. If we are considering enforcement action, we will alert the company involved to the action that we consider is most appropriate to deal with the specific breach. We encourage companies to come forward if they consider a breach is occurring and to take action to remedy the damage that the breach has caused.

43. We aim to act consistently in similar circumstances to achieve similar results. While this does not mean that we will adopt a uniform approach, it does mean that our expectations will be made clear. This will incentivise companies to ensure compliance.

44. We will also make our decisions public to ensure that our aims and expectations are transparent and that we are accountable for our decisions. We will publish information regularly on where we have undertaken investigations and any action we have taken. In addition, as required by the WIA91, where we take any formal enforcement action we will publicise this so that we secure our aims. There is a statutory requirement on us to publish:

- a formal notice whenever we propose a final enforcement order under section 18 WIA91 and any final or provisional enforcement orders we impose;
- any undertakings accepted under section 19 WIA91; and
- a formal notice whenever we propose, vary, or impose a financial penalty under section 22A WIA91.

We would also expect to publish any non-confidential representations received in response to any of our proposals.

45. We will examine a number of issues, including prioritisation, when we consider specific contraventions and the action we will take. The list below is not exhaustive and has been guided by the Office of Fair Trading's approach to prioritisation. Considerations include:

- the direct effect on consumers;
- the indirect effects of the action, for example if the practice, is new and could be repeated elsewhere;
- the likelihood of a successful outcome;
- the relative administrative burden of different types of action;
- a consideration of the level of intent and past behaviour and performance; and
- whether the resource requirements of particular courses of action are proportionate.

46. In pursuing enforcement action we will prioritise our interventions to ensure our resources are used to maximum effectiveness so that we secure our aims.

4. The legal framework

47. We summarise below the enforcement provisions we have under WIA91.

48. Section 6(2) of WIA91 states that a company holding a licence to be a water and sewerage undertaker is under an obligation to comply with the conditions of its appointment, and to comply with statutory and other obligations placed on the company by virtue of the relevant legislation. Companies holding a water supply licence are also expected to comply with the conditions of their licence and to comply with the relevant statutory and other obligations.

49. If a company does not comply with its obligations, we may have powers to take action against the company. These powers are summarised below.

4.1 Enforcement orders – section 18

50. If we are satisfied that a company is contravening or is likely to contravene any condition of its appointment or licence or any statutory or other requirement that we can enforce under section 18 WIA91, we are under a duty to impose an enforcement order.

51. This is subject to certain exceptions set out in section 19 WIA91. For example, we are not required to impose an enforcement order if the contravention is of a trivial nature; or the company has given and is complying with an undertaking under section 19.

4.2 Undertakings – section 19

52. Section 19 provides exceptions to the duty to enforce under section 18. One exception is where the company has given, and is complying with an undertaking to take all appropriate steps to ensure compliance. If the company fails to comply with the undertaking, we are under a duty to pursue an enforcement order, subject to the exceptions set out in section 19.

4.3 Financial penalties – section 22A

53. If we are satisfied that a company has contravened or is contravening a condition of its appointment or licence or any statutory or other requirement that we can enforce under section 18 WIA91 or has failed to achieve certain prescribed standards, we can impose a financial penalty of up to 10% of the company's turnover (as defined in the Water Industry (Determination of Turnover for Penalties) Order 2005, [SI 2005 No. 477](#)) on the company.

4.4 Special administration orders – sections 23-25

54. With the consent of the Secretary of State or, if appropriate, of Welsh Ministers, we can in some cases apply to the High Court for a special administration order. The High Court can only make a special administration order in certain circumstances, including where it is satisfied that:

- (a) there has been or is likely to be a contravention of a principal duty or an enforcement order that is serious enough to make it inappropriate for the company to continue to hold its appointment or licence; or
- (b) the company is or is likely to be unable to pay its debts.

55. While the special administration order is in force, the affairs, business and property of the company will be managed by a person appointed by the High Court pending the transfer of the relevant parts of the company's undertaking to another company or companies.

5. Keeping our approach under review

56. Our forward programme commits us to reviewing the approach in 2011-12. In 2011-12, as well as evaluating the content, we will examine the formal enforcement actions we have taken and seek to evaluate their effect and the learning points. We will also review the effectiveness of our enforcement powers. We will publish our proposals if it is necessary to revise our approach.

6. Contacts within Ofwat

6.1 Enforcement Policy team contacts

Ingrid Olsen, Head of Enforcement Policy
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Phone: 0121 625 1325

Sally Birse, Enforcement Policy Manager
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Phone: 0121 625 1395

6.2 Whistleblower contact

If you are a water company employee or have worked for a company and consider that a company may be breaching its obligations, we can be contacted on each of the numbers above or by email (whistle@ofwat.gsi.gov.uk).



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