

Water today, water tomorrow

**Section 22A Water Industry Act 1991  
Statement of policy with respect to  
financial penalties**

**Published jointly with the Department for  
Environment, Food and Rural Affairs and the  
Welsh Assembly Government**

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## About this document

This document sets out the revised joint statement of policy with respect to financial penalties pursuant to section 22A of the Water Industry Act 1991, as agreed by the enforcement authorities: Ofwat (The Water Services Regulation Authority), the Secretary of State and the Welsh Ministers (the enforcement authorities).

The enforcement authorities originally published a joint statement of policy on 17 March 2005. On 31 July 2009, Ofwat published a consultation paper setting out proposed revisions to the joint statement of policy. Alongside this document, Ofwat has published the responses to that consultation and a [summary of consultation responses](#).

This document supersedes all previous versions of the statement of policy and takes effect from 1 November 2010. Any future revisions will be subject to consultation and published in accordance with 22B(3) to (5) of the Water Industry Act 1991.

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

### **Background**

1. The Water Industry Act 1991 (WIA91), 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 (section 22A(1) and (2) of the WIA91 ). The penalties apply to the statutory undertakers appointed under Chapter 1 of Part 2 of the WIA91, that is the existing water and sewerage undertakers. They also apply to any company holding a licence under Chapter 1A of Part 2 of the WIA91 (licensees). The relevant enforcement authorities are Ofwat (The Water Services Regulation Authority), the Secretary of State and the Welsh Ministers (the enforcement authorities).
2. Any financial penalty collected is not returned to customers but is paid into the Consolidated Fund operated by the Treasury.
3. The WIA91 requires each enforcement authority, having undertaken appropriate consultation, to prepare and publish a statement of policy that it will have regard to in deciding whether to impose a penalty, and in determining its amount (section 22B of the WIA91). This statement has been prepared in accordance with those requirements. In addition, Ofwat published its approach to enforcement in July 2009.
4. The WIA91 lays out procedures for notifying and consulting affected parties. In imposing any penalty, each enforcement authority will follow the procedural requirements set out in section 22A(4) to (10) of the WIA91. The enforcement authorities will also consult each other and consider the views of interested parties, including the Consumer Council for Water.
5. An enforcement authority may not impose a penalty where it is satisfied that the most appropriate way of proceeding is under the Competition Act 1998 (section 22A(13) of the WIA91) Each enforcement authority will take this into account throughout its procedures and deliberations.

## General approach

6. The primary purpose of the financial penalty system is to give companies an incentive to comply with statutory and regulatory requirements now and in the future. Penalties must be reasonable in the circumstances of the case and should also provide an adequate incentive both to the company in question and to all companies to comply.
7. In deciding whether to impose a penalty, each enforcement authority 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 contravention or failure arose were, or were not, outside the control of the undertaker or licensee. The enforcement authority will also consider any representations made by interested parties in response to a public notice setting out its proposals.
8. One enforcement authority will take lead responsibility for each case where a penalty may be imposed. Decisions on any particular case will not be reopened or revisited by another enforcement authority. This does not preclude notification and consultation from an early stage between enforcement authorities when a case is being considered. This will be normal practice where concurrent powers exist.
9. Where concurrent powers exist between enforcement authorities, we will agree which authority should take the lead in any case as it arises. Where there are concurrent powers to impose a penalty, our expectation is that Ofwat will take the lead.
10. In setting price limits for undertakers at a price review, Ofwat will exclude any direct costs associated with financial penalties imposed under section 22A. Shareholders in the company, where they exist, will bear the full direct costs of the penalty. Customers should not bear the costs of any financial penalty that Ofwat imposes.
11. Licensees are not subject to price limits set by Ofwat. We expect licensees to bear the full direct costs of any financial penalty. There is an incentive for a licensee not to pass the cost of a financial penalty back to its customers, as this would make it less competitive. Customers might decide to switch supplier.

12. Where a penalty has been imposed on an undertaker, 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.
13. In considering any case in which a financial penalty might be imposed, the enforcement authority will need to address the following questions:
  - Is it satisfied that:
    - i) the undertaker or licensee has contravened or is contravening any relevant condition of its appointment or licence; or
    - ii) the undertaker or licensee has contravened or is contravening any statutory or other requirement which is enforceable under section 18 of the WIA91; or
    - iii) the undertaker or licensee has contributed or is contributing to a contravention by another; or
    - iv) the undertaker has failed or is failing to achieve any standard of performance prescribed under section 38(2) or 95(2) of the WIA91?
  - If so, is it appropriate to impose a financial penalty?
  - And, if so, what amount is reasonable in the circumstances of the case?

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

14. Once satisfied that a contravention or failure of service standard has occurred or is occurring, the enforcement authority will need to decide if a financial penalty should be imposed and the level of that penalty. Penalty notices will set out the enforcement authority's rationale for determining that a penalty should be imposed, and the factors that led it to the decision to impose a penalty. The notice will then go on to describe how the broad level of the penalty is arrived at.
15. When considering the appropriateness of a penalty and the broad level of any penalty, we will consider relevant factors. The following is a non-exhaustive list of factors we may consider:
  - the seriousness and duration of the contravention or failure;

- if the contravention or failure has damaged the interests of customers, the degree of harm caused and also any increased costs incurred by customers;
  - if the application of a penalty would be likely to create an incentive to comply and deter future contraventions or failures;
  - any gains made by the undertaker or licensee (financial or otherwise);
  - any damage to other market participants;
  - any damage caused to the environment;
  - whether the contravention or failure was or is of a trivial nature;
  - whether the contravention or possibility of a contravention would have been apparent to a diligent undertaker or licensee;
  - precedents set under equivalent provisions for other utilities.
16. The enforcement authority will also have regard to any potential prosecutions and will liaise with outside bodies to determine who should take enforcement action.
17. To avoid double jeopardy, a financial penalty will not be imposed when the undertaker or licensee is being or has been prosecuted in respect of that failure or contravention, although a penalty might be appropriate in respect of different consequences of such a contravention or failure (for example for inadequate arrangements for communicating with customers in the event of an environmental or drinking water incident).
18. In addition, the enforcement authority will take into account the various regulatory mechanisms already in place that give companies an incentive to comply with requirements.
19. Having considered and set out the broad level of penalty for the contravention, additional factors may be taken into consideration. Aggravating factors may lead to a higher penalty (the uplift to the broad level of the penalty will be identified) and mitigating factors may reduce the level of a penalty (any reduction will be identified). These may include, but would not necessarily be limited to:
- repeated contraventions or failures;
  - the continuation of a contravention or failure;
  - any involvement of senior management;
  - the level of co-operation with any investigation carried out;
  - any attempts to conceal the contravention or failure;

- the proactive reporting of the contravention or failure to the enforcement authority;
  - taking appropriate action to acknowledge and rectify the contravention or failure; and
  - activities to provide restitution and compensation.
20. Having considered the broad level of penalty and appropriate additional factors, the enforcement authority will determine the appropriate overall level of any financial penalty. In doing so, it will ensure that the amount it determines is not more than 10% of the turnover of the undertaker or licensee as required by section 22A(11) of the WIA91. The 10% limit applies to each breach for which a penalty is imposed, rather than representing a cumulative limit for a financial year.

### **Revision of the statement of policy**

21. This statement has been amended in accordance with sections 22B(3) to (5) of the WIA91. This statement supersedes all previous versions of the statement of policy and takes effect from 1 November 2010. Any future revisions will be subject to consultation and published in accordance with 22B(3) to (5) of the WIA91.

## Appendix to the statement of policy on penalties

### Ofwat's process for pursuing financial penalties under section 22A of the WIA91

1. If a contravention or failure has occurred or is occurring, and Ofwat considers the most appropriate action is to impose a financial penalty, we first need to take legal steps to preserve our ability to do so and to 'stop the clock' in terms of the time period that can be included in any penalty decision. In most circumstances that will be fulfilled by issuing a notice under section 203(2) of the WIA91.
2. When we have taken action to preserve our ability to impose a penalty and the clock has been stopped, the next stage is for us to inform the company of our intention to pursue a financial penalty. We do this by issuing a 'minded to' letter.
3. The 'minded to' stage is an informal procedure we have adopted in addition to the requirements of section 22(A) of the WIA91. The aim of this procedure is to give the company the opportunity to make written and oral representations and comment on the facts of any contravention or failure.
4. At this stage the executive will have considered the evidence of the case but the Ofwat Board will not yet have taken a decision to pursue action. The executive will always make the Board aware of the executive's intention to issue a 'minded to' letter. Any decision to impose a financial penalty is reserved for the Board.
5. The 'minded to' letter will give a broad indication of the recommendation the executive may make to the Board in terms of the broad range of a penalty. This does no more than give an internal indication of the range of the penalty the executive is considering recommending to the Board. The Board will determine the actual level of any penalty that it proposes to impose.
6. Following the informal 'minded to' stage, the executive will make recommendations to the Board. The Board will determine whether there has been a contravention or failure, whether a penalty is appropriate, and the appropriate level of any penalty, based on the evidence and relevant factors for consideration as explained in the statement of policy.
7. The next stage is to serve on the company a notice under section 22A(4) proposing to impose a penalty. At this stage, the process becomes public.

8. The company, the Consumer Council for Water and other interested parties can make written representations to us within the statutory consultation period (not less than 21 days). Following consideration of any representations received, the Board will then determine whether to withdraw, vary or confirm the penalty detailed in the section 22A(4) notice.
9. If the Board decides to vary the proposal in the section 22A(4) notice, this must be done using a formal notice of variation under section 22A(5). Invoking this process allows for a further period of consultation to allow the company, the Consumer Council for Water and other interested parties to make written representations on the varied proposal.
10. The final stage is for the Board to reconsider the case in the light of the representations. The Board will then decide whether there has been a contravention or failure, whether a penalty is appropriate and if so the appropriate level of the penalty. If the Board decides to do so, it will impose a financial penalty and issue a notice under section 22A(6) of the WIA91. Ofwat will issue an invoice with its section 22A(6) notice.
11. The company has 21 days following the imposition of a penalty in which to apply to the enforcement authority to specify a different date by which the penalty is to be paid.
12. Under section 22(E), the company has 42 days in which to appeal to the High Court. A company can appeal if it is aggrieved by:
  - a) the imposition of the penalty;
  - b) the amount of the penalty; or
  - c) the date by which the penalty is to be paid.
13. Once any penalty has been paid to Ofwat, Ofwat will pay it into the Consolidated Fund.



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