

9 January 2017

Trust in water

Ofwat's approach to enforcement

www.ofwat.gov.uk

The logo for Ofwat, featuring the letters 'o', 'f', 'w', 'a', and 't' in a bold, sans-serif font. The letter 'w' is enclosed within a dark blue circle.

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1. Introduction

1. Ofwat is a statutory body with responsibility for regulating water and waste water companies in England and Wales. One of its functions is to licence and regulate these companies ('undertakers') in a manner which it considers "best calculated" to secure the proper carrying out of their functions. Sections 18-22E of the Water Industry Act 1991 (WIA91) provide that Ofwat may take enforcement action against the companies it regulates where these companies either fail to comply with their statutory duties and licence obligations, or are likely to do so. In this document, the term water and waste water companies refers to all companies that we regulate, namely undertakers; retailers; and licensed infrastructure providers.¹ When we use the term 'water company' it refers to a water or waste water company and when we use the term 'water sector' we mean the water and waste water sector.
2. This document sets out our aims when we engage in enforcement action and, in broad terms, the process we will follow. We also demonstrate the different routes we have to secure compliance and achieve the best results for customers and wider society.
3. In January 2015, we launched our new strategy, '[Trust in water](#)', which set out our journey to become a regulator that is more:
 - **outcomes focused** – focusing on the things that really matter to customers, the environment and society now and in the future;
 - **relationships focused** – encouraging the sector to step up, take responsibility for its relationships, be open, honest, fair and transparent;
 - **proportionate and targeted** – focusing our regulatory intervention where it is needed most, stepping in where necessary (and only where necessary) to protect customers; and

¹ The term 'undertaker' is used in the legislation to refer to monopoly companies that are regulated by us to provide water only or water and waste water services to consumers in England and Wales. Undertakers are regulated under an instrument of appointment. The term 'retailers' is used for companies that operate under a licence issued by us and provide retail services to non-household customers. An infrastructure provider is regulated by us under a project licence.

- **willing and able to use all the tools in our regulatory tool kit** – using both our traditional tools, as well as broader tools to shine a light on issues and provoke debate.
4. The decisions on where to focus our actions and how we carry out our work are informed by an assessment of risks, creating more proportionate and targeted regulation.
 5. Our enforcement policy must be consistent with the statutory framework in the WIA91 and should also give effect to our strategy. We want companies, customers and other stakeholders to understand our approach to ensuring compliance in the sector and the circumstances that might lead us to use our formal enforcement powers.
 6. When considering our approach to enforcement, we have taken into account the principles of best regulatory practice, which are:
 - proportionality;
 - accountability;
 - consistency;
 - targeting only cases in which action is needed; and
 - transparency².
 7. We will take a stepped approach where we have concerns that a company is contravening its obligations, or may do so in the future. We will usually pursue informal regulatory action with companies first where that is the most appropriate means of making sure that they meet their obligations. If this does not achieve the desired result, we may take formal regulatory action, including enforcement. Our monitoring and assurance framework provides a way of enabling us to decide when we may need to step in to protect customers, and where applicable, where we may need to take enforcement action.
 8. As part of our risk-based approach to regulation, we will also consider settlement, where our powers allow us to do so. This will enable us to better prioritise cases and target our resources on those cases that pose the greatest harm or detriment to customers and wider society.
 9. Through our approach to enforcement, we want to promote trust and confidence in the water sector by making sure our decisions are consistent, and by being transparent about the decisions we have taken. The enforcement action that we have already taken has informed the development

² These principles are set out in section 2(4) of the WIA91.

of our approach. We will, and do already, publish information on any investigations and actions we take. Under section 195A of the WIA91, Ofwat is required to provide reasons for any formal enforcement action it takes.

2. Our aims

10. In considering and pursuing enforcement action our aims are to secure companies' compliance with their statutory and licence obligations, and change behaviour, so that customers' interests are protected. We can only take enforcement action against the companies we regulate, but we seek to ensure that the outcome of any enforcement action benefits the sector as a whole.
11. To deliver the most beneficial outcomes to customers, we focus on cases that:
 - reduce a significant occurrence of customer harm or detriment;
 - set a precedent that encourages beneficial changes in the sector; or
 - set a precedent that prevents similar cases occurring in the future by, for example, encouraging water companies to change how they treat customers.
12. Where information suggests that there is a significant risk that companies may fail in their obligations, we follow a risk-based approach and consider:
 - whether we are best placed to act, or whether it might be more effective or efficient for another party to take action;
 - what regulatory tool, including opening an enforcement case, could be used to address the issue; and
 - an assessment of the costs and benefits of our intervention.
13. As well as opening and investigating cases, we will also carry out work to try and resolve issues before they become cases. This includes challenging the sector to choose to act in the best interests of customers, rather than requiring them to do so through formal regulatory action.

2.1 Securing compliance

14. Companies must comply with their statutory and licence obligations. If a company fails to comply with its obligations, we will take appropriate action to incentivise and secure compliance.
15. Any failure by a company to meet its obligations undermines the confidence of customers and other stakeholders in that company and in our ability to

operate an effective regulatory framework. In some circumstances, it can also affect our power to intervene to protect customers' interests – particularly when it has an impact on the value of information we hold.

16. In our strategy and in the penalty notices relating to the action we have already taken, we have made it clear that we will take action if a company fails to comply with its obligations. These messages help companies understand our expectations. They also help build customers' trust and confidence that we will take appropriate action if there is non-compliance.
17. In line with our strategy, we will first explore options short of formal enforcement action to ensure the companies we regulate comply with their obligations. Our risk-based approach to regulation enables us to use enforcement tools more flexibly to deliver quicker, more beneficial outcomes for customers.
18. In light of this, we recognise that the sector and other stakeholders will benefit from further information on the tools available to secure compliance from companies. In cases where we consider a company may have breached its licence or a statutory obligation, we may consider not opening a formal enforcement case if that company satisfies us that the potential breach is not ongoing and it has taken steps to provide appropriate redress to its customers. We may also start formal proceedings against a company but agree to a reduced penalty if that company puts measures in place to provide customers with appropriate redress. We refer to these type of arrangements as 'settlement'.
19. An example of where we have used settlement as a tool to reach an effective early resolution was an investigation we conducted into a potential breach by an undertaker of its appointment conditions. In that case, although we did use our formal enforcement powers under the WIA91, we reduced the penalty we imposed because the company pledged to provide a package of measures for customers.
20. The decision on whether to enter in to a settlement agreement will depend on:
 - the facts of the case;
 - the legal context; and
 - whether we consider that a formal enforcement decision will establish an important and valuable precedent for the sector.

21. Where we are able to accept a settlement offer from early engagement with the company, this is likely to be the most effective way to ensure that customers are offered appropriate redress in the timeliest manner.

2.2 Changing behaviour

22. When we look at pursuing formal enforcement action, we consider the effects of the action both on the company in question, and on the water and waste water sector 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 to the sector the seriousness with which we view particular contraventions.
23. Enforcement action can directly change behaviour. For example, imposing an enforcement order under section 18 of the WIA91 or accepting an undertaking from a company pursuant to section 19 of the WIA91 should effect immediate changes to that company's behaviour.
24. Using these enforcement tools and being transparent 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 sector, 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.
25. 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.
26. Some contraventions are so serious that they are likely to always require formal enforcement action. For example, we have dealt with cases where companies have deliberately misreported information to us, causing harm to customers and other market participants. Deliberate misreporting also prejudices the regulatory framework and our ability to protect customers. Where this has occurred we have imposed substantial financial penalties. Part of the rationale for doing this has been to incentivise future compliance.

2.3 Protecting customers

27. When we consider the appropriate action to take, we will consider the effect of the contravention or failure on:
- the company's customers;
 - customers in general; and
 - the regulatory framework.
28. We also consider whether the company has wrongfully benefited from the incident. This may include financial or reputational benefits. Companies may have benefited financially through price limits or through incentive mechanisms. If this occurs, we expect them to provide full redress to their customers.
29. 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, an enhanced reputation may attract more customers and increase revenue.
30. 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 deciding whether to pursue enforcement action and the nature of that action. As part of any sanction we will aim to restore the harm that regulatory non-compliance has caused.
31. 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. We also expect companies to act swiftly to put right the contravention or failure and to make sure that it does not happen again.

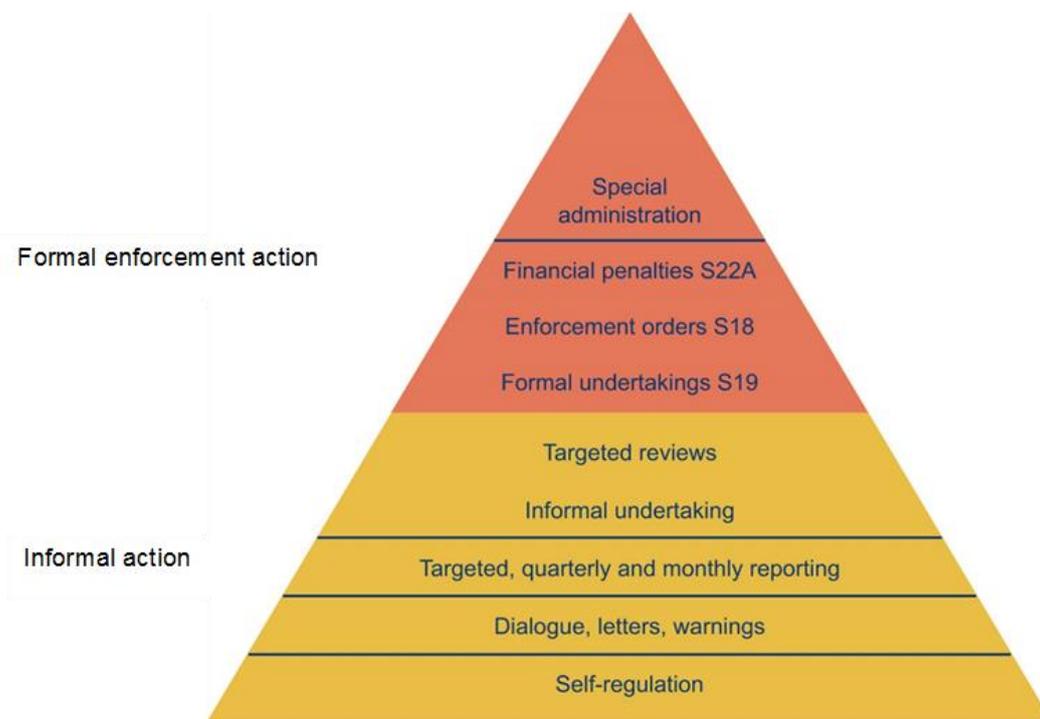
3. The process we will follow

32. This chapter is necessarily described in broad terms and we emphasise that each case is different and will be reviewed and determined on its own merits.
33. 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;
 - publically available information, including the information companies provide to their customers;
 - information from other stakeholders (including other regulators);
 - customer complaints and enquiries;
 - whistle-blowers;
 - market research; or
 - information received from investors.
34. Furthermore, our company monitoring framework helps us to keep companies accountable and from time to time we will carry 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.
35. Overall we expect companies to be accountable for managing the risks to trust and confidence in the provision of their services, including the risks to delivering the outcomes customers and society expect.
36. If an area of concern comes to light, we will generally adopt a stepped approach to the analysis, investigation and escalation of the issue. However, some contraventions may require us to move straight to formal enforcement action.
37. There are a number of actions we can take if a breach – 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.

38. As mentioned in section 2.1 above, we may consider settlement as a way to incentivise early resolution. Here, we must strike a balance between:

- recognising that formal decisions are likely to be more effective in establishing precedent within the sector and will demonstrate our willingness to take effective action; and
- balancing those effects against the potential for settlement to give better and more speedy outcomes for customers.

39. The diagram below sets out the enforcement tools that we have available to us³.



40. 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 prudent management. In determining the impact of the breach, we will consider the materiality of the breach and the impact it has on:

³ Targeted reviews provide extra visibility of the sector's approach to a particular topic. They allow us to challenge the sector to improve through gathering intelligence and assessing where companies have not identified or managed their risks. This is a proportionate response where, for example:

- There are significant concerns identified by stakeholders;
- There is a high risk to customers or other stakeholders; or
- There is an opportunity for major benefits for stakeholders.

- customers of the company as a whole;
 - other market participants;
 - the regulatory framework; and
 - the environment and wider society.
41. We will also consider the balance between the seriousness of the breach and its impact.
42. We will consider whether action under the Competition Act 1998 (CA98) or Articles 101 and 102 of the Treaty on the Functioning of the European Union would be a more appropriate way of proceeding rather than using our WIA91 statutory powers. We will do this based on the individual facts of the case. See section 4.6 below for more details.
43. We describe our powers under the WIA91 in more detail in chapter 4.
44. 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 expect companies to provide us with all of the information that we require.
45. A notice issued by us under section 203 of the WIA91 may require a company to produce specific documents or information where it may be contravening or may 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. But it does indicate that we consider a contravention may be or may have been occurring. In some circumstances, we may also seek additional information as appropriate (including from third parties).
46. Our aim is to make sure that any enforcement action we take is proportionate in the circumstances of the contravention or failure.
47. 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. Our [‘Statement of policy with regards to financial penalties’](#) sets out how financial penalties may be imposed. In imposing a penalty, we take account of any mitigating factors – including the proactive reporting of the contravention or failure.

48. 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 we will make our expectations clear. This will incentivise companies to ensure compliance.
49. 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 carried out 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 notice whenever we propose making a final enforcement order under section 18 of the WIA91 or confirming a provisional enforcement order;
 - a summary of any undertakings accepted under section 19 of the WIA91;
 - a notice whenever we propose imposing or varying a financial penalty under section 22A of the WIA91; and
 - a notice providing reasons for any formal enforcement action taken (section 195A of the WIA91).
50. We would also expect to publish any non-confidential representations received in response to any request by us in the course of an investigation.
51. In pursuing enforcement action, we will prioritise our interventions to ensure our resources are used to maximum effectiveness.
52. When we have received allegations from a complainant, we will endeavour to keep the complainant informed, in general terms, of any key progress, whether the complainant is a whistle blower or a third party complainant who has an interest in how we address their complaint. We will also always advise the complainant whether we have accepted the matter for investigation.
53. There are a number of factors we will take into account when deciding whether or not to review a matter referred to us by an individual complaint. Particularly in light of our experience in considering allegations from complainants in the past, at the outset we will usually need to review whether we have the legislative power to investigate the relevant allegation. Although we can seek information from companies in respect of relevant

allegations, it will always be helpful if complainants can provide robust evidence to support their allegations. Where we accept a matter for review, we will always advise the complainant, following our investigation and analysis, whether we have decided to take enforcement or other action.

54. In circumstances where we take enforcement action, we will make the details of our decision available publically, and we will draw the complainant's attention to the relevant publication. In circumstances where we do not take enforcement action, we will explain the basis for that decision to the complainant where appropriate. However, we cannot disclose confidential information to the complainant without lawful authority, and legal restrictions, including those set out in section 206 of the WIA91 (Restriction on disclosure of information), may well prevent us giving detailed feedback to a complainant.

4. The legal framework

4.1 Enforcement orders – section 18

55. If we (or the Secretary of State) are satisfied that a regulated 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 of the WIA91, we are under a duty to impose an enforcement order. We can also enforce against a regulated company that causes or contributes to another regulated company contravening its licence or statutory obligations⁴. For example, if an undertaker reasonably requests information from a licensee to enable it to report to Ofwat and the licensee fails to comply with that request, with the result that the undertaker is in breach of its licence, we could take enforcement action against the licensee. Similarly, if an infrastructure provider fails to make the infrastructure available to the undertaker, once built, thereby causing the undertaker to breach its statutory obligations, we could take enforcement action against the infrastructure provider.

4.2 Exceptions to the duty to enforce – section 19

56. The duty to enforce is subject to certain exceptions set out in section 19 of the WIA91. These exceptions include:
- if the contraventions or likely contraventions are trivial in nature, or the extent to which the company caused or contributed to a contravention was trivial;
 - if the company has given and is complying with an undertaking to take all appropriate steps to ensure compliance. If a company provides an undertaking and subsequently fails to comply with that undertaking, we are under a duty to pursue an enforcement order, subject to the other exceptions set out in section 19 of the WIA91.

⁴ Section 18(1A) of the WIA91 provides that if an undertaker causes a licensee to breach its licence conditions or a licensee causes an undertaker to breach its conditions of appointment, we may take enforcement action against the party that caused the other party to breach its licence conditions.

4.3 Financial penalties – section 22A

57. Under section 22A of the WIA91, we can impose financial penalties on undertakers if they are in breach of their statutory duties or licence conditions⁵. Ofwat must, under section 22B of the WIA91, publish a statement of policy with respect to the imposition of penalties and the determination of the amount of any penalty. We have done this by issuing a '[Statement of policy with regards to financial penalties](#)' jointly with the Secretary of State and Welsh Ministers.
58. Under the WIA91, the maximum penalty that we can levy is 10% of the regulated company's turnover (in a relevant year)⁶. This figure is in respect of each breach and is not cumulative over a year – that is, we i.e., Ofwat, could fine up to 10% of a company's turnover for each respective breach. All financial penalties are borne by shareholders rather than customers.
59. In setting penalties, we consider aggravating and mitigating circumstances, for example whether there have been repeated contraventions or failures, or whether the company has taken appropriate action to rectify the situation. Although we have the power to set penalties of up to 10% of a company's turnover, in the past, where a substantial penalty has been imposed it has been between 0.3% and 3.5% of the company's turnover.

4.4 Special administration orders – sections 23-25

60. The ultimate enforcement tool is an application for special administration. With the consent of the Secretary of State or, if appropriate, the Welsh Ministers, we can 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:
- there has been or is likely to be a contravention of a principal duty⁷ or an enforcement order where, in either case, it is serious enough to

⁵ The Secretary of State is also able to impose financial penalties, but only for a breach of a statutory duty.

⁶ As defined in the Water Industry (Determination of Turnover for Penalties) Order 2005, SI 2005 No. 477.

⁷ 'Principal duty' means a water undertaker's general duty to develop and maintain an efficient and economical water supply system; and a sewerage undertaker's general duty to provide a system of public sewers (see sections 37 and 94 of the WIA91). With regard to retailers and infrastructure providers, 'principal duty' means any condition of its licence or any statutory requirement imposed on it by its licence (see section 24 (7) of the WIA91).

make it inappropriate for the company to continue to hold its appointment or licence; or

- the company is or is likely to be unable to pay its debts.

61. 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.
62. As at the beginning of 2016, neither the Secretary of State nor Ofwat have needed to apply to the High Court for a special administration order in relation to an undertaker.

4.5 The regulation of infrastructure providers

63. All of the above paragraphs setting out the legal framework apply to all water companies that we regulate, i.e. undertakers, retailers and infrastructure providers. In relation to undertakers and retailers our enforcement powers are set out in the WIA91. In the case of infrastructure providers they are set out in the WIA91 read with the Water Industry (Specified Infrastructure Projects)(English Undertakers) Regulations 2013. These regulations apply the WIA91 to the regulation of infrastructure providers. Some provisions are applied without modification and some provisions are applied in a modified form.

4.6 The Water Act 2014

64. The Water Act 2014 (WA14) amends the WIA91. Some of the amendments introduce new obligations on companies, which are enforceable by us. Other amendments introduce a new enforcement tool that allows us to issue directions to companies if we consider a company is not complying with a code or rule issued by us. If a company fails to comply with our direction, we may take enforcement action against the company for that failure. For example, section 143 of the WIA91 (Charges schemes) has been amended to provide that we must issue charging rules to companies. If a company does not comply with a charging rule, we can issue a direction to that company and a failure to comply with a direction is enforceable by us under section 18 of the WIA91.

4.7 Enforcement of competition law

65. Ofwat has concurrent powers with the Competition and Markets Authority (CMA) under the CA98 in respect of cases of possible competition law infringements by water or sewerage companies. Specifically, the WIA91 empowers us (as a designated competition authority) to apply and enforce infringements of Chapters I and II of the CA98 and the equivalent EU-level prohibitions in Articles 101 and 102 of the Treaty on the Functioning of the European Union.
66. Chapter I of the CA98 prohibits agreements that may prevent, restrict or distort competition, or are intended to do so, and that may affect trade within the UK. Article 101 is similar, although it requires an effect on trade between EU Member States. Chapter II of the CA98 prohibits conduct by one or more businesses amounting to the abuse of a dominant position in a market that may affect trade within the UK. Article 102 is similar, although an effect on trade between EU Member States is required.
67. The Enterprise and Regulatory Reform Act 2013 amended the WIA91 to provide that “before making an enforcement order or confirming a provisional enforcement order, the Authority (Ofwat) shall consider whether it would be more appropriate to proceed under the Competition Act 1998”, and in practice Ofwat will not make any such order if it concludes that it would be more appropriate under the CA98. Similarly, in practice, we may not impose a financial penalty if we consider that it would be more appropriate to proceed under the CA98.
68. We have reflected the requirements of the Enterprise and Regulatory Reform Act 2013 and our duty to consider the appropriateness of proceeding under the CA98 within our enforcement process (see section 3 above).

5. Contacts within Ofwat

5.1 Casework contact details

CaseManagementOffice@ofwat.gsi.gov.uk

5.2 Whistle blower contact

69. If you are a water company employee or have worked for a company and consider that a company may be breaching its obligations, we would encourage you first to use the whistle blowing procedures in your workplace. If your workplace does not have a whistle blowing procedure, or if you do not feel able to do so (for whatever reason), contact our case management office by email at CaseManagementOffice@ofwat.gsi.gov.uk, by phone on 0121 644 7725, or in writing at:

Case Management Office
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA