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Trust in water

# Draft derogations guidance

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**ofwat**

## About this document

This document sets out guidance for applications by licensees and appointees for derogations from compliance with obligations in the Wholesale Retail Code ('WRC').

A licensee may submit a request to Ofwat for a derogation from compliance with a specific obligation in the WRC and/or any WRC subsidiary document. The power to grant derogations from compliance with these specific obligations [will be][was] introduced when the WRC [is][was] issued by the Authority.

Unless a derogation from compliance with a specific obligation in the WRC is granted by Ofwat, all licensees and appointees are expected to comply with all the obligations in the WRC. Derogations will not be granted retrospectively and Ofwat will still consider whether enforcement action is proportionate in the circumstances.

A derogation is a direction from Ofwat which relieves a licensee or appointee from compliance with certain of its obligations to comply with the WRC which it is required to undertake as part of its licence.

In terms of Wales it is envisaged that companies can apply for derogations in the same way English companies can.

This document includes:

- our approach to derogations;
- the process for requesting a derogation from the WRC;
- the criteria for requesting a derogation;
- the assessment process for derogations; and
- additional information and appendices that may be useful to applicants.

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## **1. Background on derogations**

In this chapter we explain what a derogation is and the circumstances in which we believe a derogation may be appropriate.

Each derogation granted by Ofwat will generally apply for a predefined and agreed timescale. Only in rare circumstances would we grant a derogation that applies for an indefinite period.

### **1.1 What is a derogation from the market codes?**

A derogation is a direction from Ofwat which relieves a licensee or appointee from compliance with a specific obligation in the WRC.

A derogation will be granted to an individual licensee or appointee and cannot be transferred.

A derogation granted by Ofwat will be for a fixed period of time and will have an expiry date (except in rare circumstances where a derogation is granted for an indefinite period) and may contain triggers for the termination of such a derogation (such as customer numbers, revenue etc). Derogations will be reviewed and performance towards compliance monitored.

Derogations will only be granted in respect of obligations set out in a specific provision of the WRC and as detailed in the derogation and all remaining obligations in the WRC must continue to be complied with.

A derogation should not provide a licensee or appointee with a competitive advantage and will only be granted where such an advantage is perceived following an assessment by Ofwat of measures that can be applied to offset that advantage.

### **1.2 Target audience for this derogation guidance**

This guidance document is aimed at companies (licensees and appointees) operating within the retail business market. It seeks to clarify the process for requesting a derogation from compliance with specific obligations in the WRC.

### **1.3 When would a derogation be required?**

There may be occasions when a licensee or appointee is not in a position to comply with an obligation in the WRC. The company may consider that compliance with such obligations is a disproportionate burden in its particular circumstances, which may have an impact on its ability to run its business and provide services to customers. In the circumstances it seems appropriate for that company to apply to Ofwat for relief from the obligation to comply with particular provisions of the WRC.

Companies may also request a derogation because they believe the scale of the regulatory burden is very significant and adversely affecting their companies operations. Any request would be required to provide sufficient proof of the extent of the regulatory burden, as the request cannot be made on the basis of a company being unable or unwilling to comply with their obligations. Ofwat has a responsibility to enforce licence breaches.

Below are some examples of circumstances when a derogation may be sought by a company:

- to mitigate the consequences of non-compliance with obligations in the WRC due to unforeseen (short term) circumstances;
- to mitigate the consequences of non-compliance with obligations in the WRC in the short term while a vital piece of water/sewerage infrastructure is being repaired or serviced;
- to mitigate the consequences of non-compliance with obligations in the WRC while changes to the market codes are being made and where unforeseen issues have arisen; and
- to allow a small company time to ensure it meets the requirements of the market operator's performance framework [within the WRC (CSD 0002); and
- to ensure proportionality for a company with a small number of eligible customers; and
- Retrospective derogations will not be granted by Ofwat.

Ofwat will consider the extent to which the situation warrants enforcement action being taken and we will consider the timing, notification, and remedial action, the completeness of the information provided and scale of the breach.

### **1.4 Timescale of derogations**

When deciding the appropriate period of time a derogation will apply we will consider the applicability of one of the following three periods:

**Definite** – a specific period of time agreed with Ofwat at which point compliance with the WRC should resume.

**Indefinite** – this would continue until a further derogation is made, or until Ofwat decides that the derogation is causing significant detriment to customers and revokes it. Such derogations would rarely be granted and companies would need to take measures to prove that customer detriment and/or competitive advantage would not be a consequence.

**Triggers** – Ofwat may include triggers within derogations for the termination of such a derogation (such as customer numbers, revenue etc).

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## 2. Derogation principles

Ofwat is keen to keep the derogations process as streamlined as possible to aid companies. We have designed and are implementing a proportionate regulatory framework to support retail market overall, and that we therefore expect requests for derogation to be unusual.

We do, however, understand that particularly small companies, such as some new appointees, or companies with very few eligible customers such as those in Wales could still face disproportion burdens in complying with the fullest extent of the regulatory framework and as such are putting in place a derogations process.

Our principles for derogations are as follows:

Where a company is applying for a time limited derogation, the information requirement should be proportionate to the time period requested in the application.

- For example, if the period for the derogation should be considered when applying. The level of detail within the request from the company should reflect the scale of the derogation.

Where a company is applying for a derogation from compliance with an obligation that involves system critical or market code principles which are considered essential for market operations any evidence supplied to Ofwat would need to be substantial and compelling to support the application.

- For example, meter reads and settlement are required for market operation and so derogations would not be possible in this area. Any activity related to these processes would therefore require significant information to allow even a time limited derogation.

Where a company is applying for a derogation similar to one that has been granted previously to another licensee or appointee this previous application can be referred to. This will help us to maintain a consistent and proportionate approach.

Ofwat may request further information if it considers the application differs from the derogation it previously granted.

### 3. Submitting an application for a derogation

Where a licensee has identified that it does not, or will not be in a position to comply with relevant obligations within the WRC it can make a request to Ofwat for a derogation.

The application form for derogations is available within this guidance and the intention is to allow electronic submissions via the Ofwat website.

#### 3.1.1 Minimum requirements of a derogation request

The request should include as a minimum:

- **Details of the applicant** – full name and address of the licensee or appointee concerned and contact details of the person handling the request.
- **Description of the derogation request** including the section of the WRC or subsidiary document to which the request applies
- **An explanation of why the non-compliance has occurred or is expected to occur** and detail of any pre-emptive/mitigation steps that have been taken and what actions you are proposing to take to ensure compliance is restored as soon as is reasonably time period.
- **A comprehensive assessment of the impact of the non-compliance** which should include where possible qualitative data of the impact of non-compliance. We require companies to consider the impact on their business, potential impacts on the market operator and potential impacts on customers.
- **Proposals and timelines for restoring compliance** – where possible these should include any contingency in timescales that may be required.
- **A description of how customer impact will be minimised**
- **A description of how the granting of this derogation would not unreasonably adversely affect competitors**
- **Any additional information to support your request**

Companies are advised to give as much notice as possible when making derogation requests since a derogation will not be granted unless Ofwat is satisfied that the request is justified. The speed with which we consider the application for derogations will reflect the quality of the application.



## 4. Assessment and consultation of a derogation request

### 4.1 Ofwat's role

Each derogation request will be assessed by Ofwat individually on its own merits and against the minimum requirements in paragraph 3.1.1 above.

In its assessment Ofwat will have regard to its statutory duties under the Water Industry Act 1991 and the Water Act 2014 and will always consider amongst other things the impact on:

- **Customers:** we will consider the extent to which non-compliance impacts on customers, for example through poor customer experiences. The application should demonstrate that it protects the interests of consumers;
- **Competition:** for example, any competitive advantage or other hindrance of the competitive process that may arise from granting the derogation;
- **Resilience:** how the request could affect the resilience of the Water and waste water services, environmental obligations And whether there would be any adverse effects on the functions and activities of each company and their ability to finance them;
- **Better regulation:** does the request align with Ofwat's goal of ensuring regulation is proportionate. There should be no significant risks or adverse impacts associated with the non-compliance to the licensee or appointee, or other relevant licensees or appointees and no substantive objections from other parties, which would prevent Ofwat from granting the derogation;
- **Practicality:** We will take into account the impact on the market operator to operate its system if a derogation were granted and the ability of other licensees and appointees to comply with their WRC and statutory obligations. Companies should demonstrate there are no additional measures or reasonable options that could be taken (time and cost) to mitigate the non-compliance, eliminating the requirement for a derogation; and
- **Other parties affected:** where relevant, we will seek the views of affected parties before making a decision. There should be no significant risks or adverse impacts associated with the non-compliance to the licensee or appointee, or other

relevant licensees or appointees and no substantive objections from other parties, which would prevent Ofwat from granting the derogation.

Each submission does, however, need to provide sufficient detail for Ofwat to make an assessment of the effect of a derogation. Where we determine that there is insufficient information for these purposes we will seek further information or clarification from the applicant.

## **4.2 Consultation**

As part of the assessment process Ofwat may seek advice or comments from any affected parties including through the consultation process.

These parties may include, but are not limited to:

- the market operator;
- Defra;
- affected licensees and appointees;
- other licensees and appointees;
- industry stakeholders, including the Drinking Water Inspectorate, Environment Agency, CCWater; and
- any independent party for expert assessment.

Consultation with any of the above parties will be at Ofwat's discretion bearing in mind the need for a timely process.

## 5. Ofwat's decision

If Ofwat considers that the derogation request is justified, it will then grant the necessary relief to the licensee from the relevant obligation generally for a specified time period.

Ofwat will then issue a written confirmation and reasons for granting the derogation which will also be placed on a public register (please see transparency section 6) for all other licensees and appointees, customers and stakeholders to view.

Ofwat reserves the right to refuse a derogation request or if appropriate may issue temporary or short term derogations where a submission has sufficient merit or a strong enough rationale to justify this pending further investigation regarding the application to be undertaken.

If Ofwat refuses a derogation request Ofwat may still consider whether enforcement action.

### 5.1 Timeline

After acknowledgement of an application being complete an applicant can expect a decision within 40 business days.

## **6. Derogation transparency**

We recognise that transparency is important. We intend to be as transparent and open as possible about the process for assessing derogations by consulting widely as appropriate and by publishing all derogations granted in the public register on the Ofwat website.

This will provide everyone with an understanding of the nature of the derogations granted which in turn will inform any arrangements market participants have with the companies who have been granted derogations.

If a derogation has been granted in the past does not mean any similar application will be granted in the future. Each application will be assessed on its own merit. However the existence of derogations in similar circumstances can be cited in support of an application where applicable.

### **6.1 Public Register**

The public register on Ofwat's website will contain all of the WRC derogations that have been granted. In due course we will tag and categorise each application whether granted or refused to allow companies to access these quickly and easily.

We will also produce webpages that describe the process for applying for derogations in accordance with this guidance document. We will also make the application form available online.

## 7. Appendix: Derogation application form

Name of licensee \_\_\_\_\_

Address 1 \_\_\_\_\_

Address 2 \_\_\_\_\_

Address 3 \_\_\_\_\_

Town/city \_\_\_\_\_

Postcode \_\_\_\_\_

Date \_\_\_\_\_

### Details of the derogation request

Reference to code document \_\_\_\_\_

Reference to section \_\_\_\_\_

Reference to sub section \_\_\_\_\_

Version number \_\_\_\_\_

Link to document \_\_\_\_\_

**Description and a rational as to why non-compliance has occurred or would be expected to occur absent the requested derogation.** and detail of any pre-emptive/mitigation steps that have been taken and what actions you are proposing to take to ensure compliance is restored as soon as is reasonable possible.

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**A comprehensive assessment of the impact of the non-compliance** which should include where possible qualitative data of the impact of non-compliance.

- Customers
- Competition
- Resilience
- Better regulation
- Practicality
- Other parties affected



**Proposals and timelines for ending the derogation** – there are no additional measures or reasonable options that could be taken (time and cost) to mitigate the non-compliance, eliminating the requirement for a derogation;





**Any additional information to support your request**

A large rectangular box with a thin black border, intended for providing additional information. The box is currently empty except for a large, light gray watermark that reads "DRAFT" in a bold, sans-serif font, oriented diagonally from the bottom-left to the top-right.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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