

Title: Updating Ofwat's enforcement powers IA No: Defra 1417 Lead department or agency: Defra Other departments or agencies: Welsh Government, Ofwat	Impact Assessment (IA)		
	Date: 5/1/2012		
	Stage: Final		
	Source of intervention: Domestic		
	Type of measure: Primary legislation		
Contact for enquiries: David Jones, 020 7238 5989, david.s.jones@defra.gsi.gov.uk			
Summary: Intervention and Options			RPC: GREEN

Cost of Preferred (or more likely) Option			
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?
n/a	n/a	n/a	Yes
			Zero net cost

What is the problem under consideration? Why is government intervention necessary?

When water companies breach their conditions of appointment, licence or statutory provisions it can have a detrimental impact on customers through reduced customer service and potential increases to bills. When imposing a financial penalty on a Water Company (22c WIA 91) for such a breach, Ofwat are not always able to calculate the appropriate penalty to recompense for the impact of the breach as the investigation period is restricted to 12 months from a breach or failure occurring. This period is inadequate: i) where evidence of a breach does not come to light until the 12 month period has elapsed: ii) where repeated or prolonged incidences of the same breach take place outside or beyond a 12 month period. Currently if companies submit inaccurate data Ofwat are not always able to redress the impact on Price Reviews. An extension to the investigation period to five years would enable this.

What are the policy objectives and the intended effects?

Government is seeking to strengthen the ability of Ofwat to regulate the industry in the interests of consumers by improving their existing enforcement tools. The extension will give Ofwat more time to fully consider the nature and implications of breaches therefore enabling a more accurate assessment of penalties. It will also enable Ofwat to investigate and impose penalties (if necessary) on breaches that have not come to light until the 12 month period has elapsed. The proposed increase in the investigation period to 5 years will provide a strong deterrent to future non compliance and could reduce the number of breaches as companies will be aware that penalties will reflect the full nature and impact of the breach. This protects customers and also ensures that companies do not profit from a breach. Companies can currently appeal to the High Court against such penalties; this will remain.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

- Do nothing – base case.
- Option 1 – A change to primary legislation to address a specific deficiency in the existing enforcement regime: the time limit for pursuing contraventions. Two sub options considered: extension to two years or five years.

Option 1 is preferred because it can bring about significant benefits without significant costs. An extension to 5-years is preferred as it enables a more comprehensive and accurate assessment of protracted cases and is consistent with the Price Review timeframe.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 10/2015					
Does implementation go beyond minimum EU requirements?				N/A	
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		Micro No	< 20 No	Small No	Medium Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)				Traded: N/A	
				Non-traded: N/A	

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible SELECT SIGNATORY: _____ **Richard Benyon** _____ Date: _____ **9 June 2013** _____

Summary: Analysis & Evidence

Policy Option 1

Description: Change primary legislation to allow a longer period for enforcement

FULL ECONOMIC ASSESSMENT

Price Base Year n/a	PV Base Year n/a	Time Period Years n/a	Net Benefit (Present Value (PV)) (£m)		
			Low: n/a	High: n/a	Best Estimate: n/a

COSTS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	n/a	n/a	n/a
High	n/a	n/a	n/a
Best Estimate	negligible	negligible	negligible

Description and scale of key monetised costs by 'main affected groups'

There are no monetised costs associated with this option. Water Companies are under a statutory duty to supply Ofwat with financial information and evidence relating to compliance with licence conditions. Therefore this proposal does not place any additional burden or costs on companies. It merely enables Ofwat to act appropriately in cases where evidence of a breach is identified more than 12 months after it occurred; and in cases where there have been repeated or prolonged instances of the same breach. Further information on the zero cost in assessment is included in section 6.3 of the Evidence Base.

Other key non-monetised costs by 'main affected groups'

Ofwat does not believe that the change to the time limit will materially impact the level and depth of analysis required in individual cases, or result in a change in the number of contraventions which Ofwat investigates. There is therefore no anticipated additional staff cost to Ofwat. The change will not introduce new obligations on companies, so Ofwat does not consider that it will materially impact on the administrative burden placed on water companies in the day-to-day running of their business. The only financial impact will be on companies responsible for infringements (who could – rightly – face larger penalties).

BENEFITS (£m)	Total Transition (Constant Price) Years	Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	n/a	n/a	n/a
High	n/a	n/a	n/a
Best Estimate	n/a	n/a	n/a

Description and scale of key monetised benefits by 'main affected groups'

It has not been possible to assign monetary benefits because there is a high degree of variability in the type and scale of cases and no adequate means of calculating the likelihood or frequency of contraventions by companies. Neither has it been possible to estimate the increased value of historic penalties had the 12 month investigation restriction not applied. This is because the amount and scope of information collected in each case did not take into account contraventions and impact over a longer timescale.

Other key non-monetised benefits by 'main affected groups'

Ofwat have imposed eight financial penalties totalling £74,342,000 since gaining powers in 2005. In all cases the penalty did not take into account the full extent of the contravention due to the time limit imposed. In addition in two further cases a financial penalty could not be applied due to the 12 month restriction. Option 1 would enable Ofwat to impose a more accurate penalty that reflected the nature, scale and impact of a breach, ensure more compliance with better regulation principles and natural justice, provide a greater deterrent to companies and remove the incentive to delay notification of a breach. Customers benefit as companies will be more accountable when they contravene licence conditions, so that to the extent that companies face larger penalties consumers will receive correspondingly greater compensation.

Key assumptions/sensitivities/risks	Discount rate (%)	3.5
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BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:	In scope of OIOO?	Measure qualifies as
Costs: 0	Yes	Zero net cost
Benefits: n/a		
Net: 0		

Evidence Base (for summary sheets)

1. Background and legal context

1.1 Background

The water and sewerage industry in England and Wales was privatised in 1989. Private companies were licensed to own and operate the assets of the state owned water boards and provide water and sewerage services to customers and recover the costs of providing these services by billing them directly. As water and sewerage services are recognised as essential and are monopolistic in character an economic regulator, Ofwat, was established to regulate the revenue companies could recover from customers, to ensure compliance with statutory duties and to protect customers.

Water and sewerage companies must comply with their licence or 'Instrument of Appointment' and supporting Guaranteed Service Standards (GSS). Together with statutory responsibilities, Licence Conditions ensure that water companies operate safely and efficiently and provide satisfactory customer service and value for money. All licence conditions support these core principles though specific conditions can vary from company to company to reflect particular circumstances. Licence conditions can be modified in certain circumstances.

Ofwat work proactively with companies to ensure compliance with licence conditions and avoid any breach occurring. Ofwat issue guidance to companies on their responsibility to comply with licence conditions and the circumstances in which a breach could occur, if not acted upon. Previous enforcement action and case precedent also serve as a guideline to the likelihood of a breach occurring. Avoiding a breach in licence conditions is a priority for companies in order to avoid reputational damage and the costs of the penalty that may result from an investigation. These actions have led to a decline in the number of formal enforcement actions in recent years. However, in the rare case that a breach does occur Ofwat requires robust powers to ensure the impact on customers and environment is redressed through an appropriate penalty. There is also a need to investigate and penalise companies that deliberately submit false or misleading information in order to cover up a breach, or who delay reporting a breach in order to avoid a penalty.

1.2 Ofwat's enforcement powers

The Water Industry Act 1991 (WIA91) (as amended), provides for Ofwat to enforce three different kinds of contravention:

- breaches of conditions of an appointment or licence;
- breaches of statutory requirements enforceable under section 18 of the WIA91 (the "statutory requirements"); and
- breaches of certain customers service standards known as "guaranteed service standards" or "GSS").

The WIA91 also provides Ofwat with the following enforcement related powers:

- the power to issue provisional or final enforcement orders for specified contraventions;
- the power to impose financial penalties; and
- the power to acquire information for enforcement purposes.

Ofwat has a duty (subject to limited exceptions set out in section 19 of the WIA91) to impose an enforcement order for ongoing breaches either of the conditions of an appointment or licence, or of any of the statutory requirements. Ofwat may not impose an enforcement order in respect of failure to meet the GSS.

Ofwat may impose financial penalties for historic or ongoing breaches of the conditions of an appointment or licence, any of the statutory requirements, or the GSS. Section 22C of the WIA91 provides that financial penalties may only be imposed if an enforcement order is made in respect of the contravention, or if a notice requiring information under section 203 of the WIA91 or a notice proposing a penalty under section 22A(4) is issued within 12 months of the contravention.

Ofwat may request information for enforcement purposes under section 203 of the WIA91 for suspected breaches either of conditions of an appointment or licence, or of any of the statutory requirements, but not suspected breaches of the GSS.

There is an established, transparent process in place to consult on any proposed penalty. This enables a water company to challenge the judgement and/or penalty, which will then be considered by Ofwat. This reduces the likelihood of an appeal. A water company can appeal a penalty through the High Court.

1.3 Ofwat's approach to enforcement

Ofwat committed in its strategy (Ofwat's Strategy: Taking a forward look, Ofwat (April 2008))¹ to "enforcing compliance in a reasonable and transparent way", It published its approach to enforcement in March 2009² in which it explained that it aimed to take account of the Macrory principles (see Regulatory Justice: Making Sanctions Effective – Professor R B Macrory, BRE 2006³) which states that sanctions should:

- aim to challenge the behaviour of the offender;
- aim to eliminate any financial gain or benefit from non-compliance;
- be responsive and consider what is appropriate for the particular offender and regulatory issue, which can include punishment and the public stigma that should be associated with a criminal conviction;
- be proportionate to the nature of the offence and the harm caused;
- aim to restore the harm caused by regulatory non-compliance, where appropriate; and
- aim to deter future non-compliance.

Ofwat also aims to ensure that its decisions are fair, reasonable and transparent, and compliant with the principles of natural justice (in particular, that a decision maker should take into account all relevant facts).

2. What is the problem under consideration? Why is Government intervention necessary?

The existing financial penalties regime restricts Ofwat's ability to fulfil its duty to regulate the industry effectively and protect customers' interests.

The regulatory regime in the water industry currently uses five-yearly reviews of price controls. Companies submit forward-looking business plans for each review of price controls, and Ofwat sets price limits on the basis of this information.

Ofwat works proactively with water companies to ensure compliance with licence conditions. This includes warning companies of a potential breach and working with them to rectify the issue before the breach occurs. This process is covered in guidance issued to companies. This proactive approach combined with the deterrent of the reputational damage to a company of breaching its licence conditions means that breaches are rare and declining in number. However, when they do occur they can impact customers' bills and therefore Ofwat require a robust mechanism to investigate the case and assess a suitable penalty to redress the breach.

¹ [http://www.ofwat.gov.uk/legacy/aptrix/ofwat/publish.nsf/AttachmentsByTitle/rpt_fwd_ofwatstrategy.pdf/\\$FILE/rpt_fwd_ofwatstrategy.pdf](http://www.ofwat.gov.uk/legacy/aptrix/ofwat/publish.nsf/AttachmentsByTitle/rpt_fwd_ofwatstrategy.pdf/$FILE/rpt_fwd_ofwatstrategy.pdf)

² http://www.ofwat.gov.uk/regulating/enforcement/pap_pos_enforcementapproach.pdf

³ <http://www.berr.gov.uk/files/file44593.pdf>

The 12 month restriction to the investigation period has hampered Ofwat in carrying out thorough, comprehensive investigations and has prevented them from taking into account the full nature, scope, duration and impact of the breach in calculating the penalty. This has meant that water companies have not redressed the impact that the breach in their licence condition had caused. Another weakness of the restricted investigation period is that companies are able to delay notification of a breach of a licence condition in the knowledge that this may prevent a penalty being imposed.

Since Ofwat gained the powers to impose financial penalties for historic contraventions on 1 April 2005, Ofwat has pursued financial penalties from a number of companies. Four companies had reported inaccurate data (in two cases deliberately) over a period of several years. In three cases this data led to the companies' regulated price limits being set too high at one or more periodic price review.

In all of the cases, the 12 month time limit had two adverse consequences:

- Ofwat could not take full account of the duration of the consequences; and
- Ofwat could not penalise the company of the most serious contravention (reporting of inaccurate or false data at a price review) which led to a serious consumer detriment, but rather had to penalise the company for the less serious contravention of ongoing misreporting in the companies' annual regulatory return. Ofwat required the companies to provide informal undertakings to provide redress to customers and ensured the companies did so in each case.

Ofwat also investigated a further case where a company deliberately reported false data in its annual return over a period of at least five years. In this case, Ofwat only became aware of the contravention when the company notified Ofwat (i.e. twelve months after the last instance of false reporting). Consequently, Ofwat was unable to impose a financial penalty for a serious contravention (deliberate misreporting), due to being effectively 'timed out' by the twelve month time limit.

The twelve month time limit provides an incentive to companies to delay reporting a contravention until such time as the twelve month time limit would prevent Ofwat from imposing a financial penalty. This may also diminish the incentive to comply with the threat of a financial penalty.

The Government has considered two alternatives extending the time limit in section 22C to:

- two years; or
- five years

Based on the analysis of costs and benefits (see section 5.3 below), the extension to five years is expected to deliver significant additional benefits over the extension to two years without introducing significant costs. A five year investigation period would enable the full impact of a breach, including any effect on price limits set at last review (at maximum, five years previously), to be taken into account in assessing the level of penalty. This would not be possible in all cases with a 2 year investigation period, in particular those cases where the breach comes to light more than two years after the last price review. We therefore propose an extension of the time limit in section 22C to five years, which would align with the 5 yearly cycle of reviews of regulated prices. The same conclusion was reached by DECC and Ofgem where there are also five yearly price reviews for certain energy companies.⁴

3. What are the policy objectives and intended effects

The policy proposals aim to:

- increase the proportionality of enforcement by allowing regulators to use existing enforcement tools more flexibly;
- reduce the costs of enforcement by simplifying and harmonising processes to avoid unnecessary complexity;
- strengthen the deterrent effects of existing powers as companies will be aware that a longer investigation period will enable the full scope and impact of a breach to be assessed and therefore the level of penalty will reflect this. They are therefore more likely to ensure that a breach does not occur;
- remove unhelpful incentives, such as enabling companies to potentially avoid a penalty by delaying notification of a breach of licence conditions; and

⁴ http://www.decc.gov.uk/assets/decc/legislation/energybill/1_20100226093304_e_@@_energybillia.pdf

- ensure that any financial penalties imposed can focus on the most serious breaches, and those which result in the most serious consumer detriment.

4. What policy options have been considered?

Ofwat has considered two possible policy options:

- do nothing (i.e. no legislative change);
- implementation of legislative change.

4.1 Do nothing

The ‘do nothing’ option would make no changes to legislation and would rely on Ofwat maximising any non-legislative approaches to seeking redress for infringements. In practice, Ofwat had some success with “informal redress” from companies, but this is not considered an adequate approach in the long term because it does not reflect an accurate assessment of the nature, scale and impact of a breach and therefore the appropriate level of penalty. As such, the issues and detrimental consequences identified in section 2 above would largely not be corrected. The Government does not believe this is an acceptable outcome, and it does not meet Ofwat’s policy objectives.

The ‘do nothing’ option is used as a reference case when assessing the costs and benefits of the Government’s proposals.

4.2 Implementing legislative change

The proposal is to extend the time limit in section 22C WIA91. This has been assessed in section 5 below. Although it has not been possible to monetise costs and benefits, in concept any additional administrative cost on Ofwat and companies is negligible and there are significant benefits. The only financial impact will be on companies responsible for infringements (who could – rightly - face larger penalties) and consumers (who will rightly receive correspondingly greater compensation). Ofwat intends to review the changes within three years of commencement to verify the extent of benefits delivered.

The preferred option is to implement this proposal, as this delivers the policy objectives without imposing any significant costs.

5 Consultation

The UK and Welsh Government carried out a public consultation on the draft Flood and Water Management Bill⁵ which included the proposal covered by this impact assessment. Consultees were asked “*Do you agree that these changes will enhance Ofwat’s ability to protect customers?*”

Fifty five responses included comments on this question. Respondents largely supported the proposed changes with approximately sixty per cent of respondents (primarily public bodies, individuals and businesses) offering unqualified support for all the proposals. Respondents (including the majority of water companies that replied) either supported, or accepted the rationale for, an extension to the time limit for financial penalties. The Consumer Council for Water (CCWater) strongly supported aligning the time limit with the five-year price review period. Some water companies questioned the need for a change. Several companies expressed concerns about the potential financial impact on companies of an extension to the time limit, and some suggested that any change should be accompanied by a review of the appeals mechanism for Ofwat’s enforcement decisions.

The consultation responses were carefully considered. The concern of some water companies to the change was acknowledged, however this was balanced by the desire to protect consumer interests by ensuring the appropriate level of penalty was levied to fully redress the impact of a breach of licence conditions. The suggestion of a review of the appeals mechanism was also carefully considered. However, given the very low number of cases, the creation of a specific appeals mechanism was considered a considerable and disproportionate expense. The current system of using the High Court was considered appropriate and represented value for money. Ofwat have an established and transparent process for consulting on any proposed penalty prior to it being imposed. This enables

⁵ <http://www.official-documents.gov.uk/document/cm75/7582/7582.pdf>

water companies to challenge the judgement and/or penalty and any such challenge would be considered by Ofwat. This process reduces the likelihood of an appeal.

The draft Bill was also subject to pre-Legislative scrutiny by the Environment, Food and Rural Affairs Select Committee⁶. Recommendation 34 of the Committee's report said:

"We agree that the period during which penalties can be imposed by the regulator should be extended. However, we consider it proportionate for the provision of the Clause to be balanced by a clear appeal mechanism separate from the regulator."

In its response to the Committee's concern, the Government said the legislation already provided the right of appeal to the High Court against the imposition of financial penalties and that this represented a reliable, proportionate and value for money appeals process.

The Committee also wanted to understand the impact of financial penalties could have on the cost of capital at future price reviews attributed to the imposition of penalties should not be passed on to the customers in the regulator's determinations. The Government's response confirmed that financial penalties can only be imposed where water companies have breached their statutory obligations and the cost of capital was set on the basis of a fully compliant industry. The Government also said that where a water company breached its statutory obligation and faces a financial penalty that sum is met by its shareholders and is not passed onto customers.

6. Costs and benefits

6.1 'Do nothing' option

As explained in section 4.1 above, Ofwat has assessed the costs and benefits of the proposal by reference to the 'do nothing' option. Therefore, the 'do nothing' option is assumed to have neither costs nor benefits.

6.2 Option 1 – Extend time limit in the financial penalties regime

In assessing the costs and benefits of this proposal, two sub-options were considered: an extension to five years or an extension to two years.

Costs

Under either alternative, the change will not introduce new obligations, so it is not considered that it will materially impact on the administrative burden placed on water companies in the day-to-day running of their business.

Whenever Ofwat suspects a past or ongoing contravention, it investigates fully to understand the extent and duration of any failings, and the underlying causes of those failings. However, in many cases Ofwat is restricted in determining the extent of damage to consumers and calculating the appropriate redress as the investigation period is limited to 12 months. Ofwat only takes a decision on what, if any, further action is required once the investigation is complete. This helps ensure that both Ofwat and the company take all necessary steps to ensure future compliance and protect the interests of consumers.

The proposed amendment will not change this approach and although an extended deadline may result in longer investigations for some cases, and some cases being investigated that would not have been under the current 12 month restriction, Ofwat do not anticipate any increased staffing or resource costs.

Although this proposal will not alter Ofwat's approach to investigating contraventions, it could alter the range of remedies available when Ofwat has determined that a breach has occurred. In particular, it could provide Ofwat with the scope to pursue financial penalties in some cases where time limitation would currently prevent such action.

Ofwat has limited data on which to base any assumptions about the number or level of additional penalties which it might be able to pursue. Ofwat has only had the ability to impose financial penalties since 1 April 2005. Since then, Ofwat has imposed eight financial penalties totalling £74.3m and ranging

⁶ <http://www.publications.parliament.uk/pa/cm200809/cmselect/cmenvfru/555/555i.pdf>

from £42,000 to £34.7m⁷ (as a result of the seriousness and impact of the contraventions, and the large differences in turnover of the companies concerned). Ofwat has been prevented from imposing one further penalty by the time limit. Even where it did impose penalties, Ofwat has not always been able to penalise the most serious breach or take account of the whole extent of the issue.

It is not possible to quantify the penalties which might have been imposed in these cases if time limitation provisions had been different, as that potentially would have required Ofwat to “price” a different contravention. This is not a simple mechanical exercise (e.g. multiplying up by the extra length of time). In making its decisions on the quantum of any specific financial penalty, the Ofwat Board considers the seriousness and impact of the specific contravention, including whether it was part of a multiple contravention.

Going forward, Ofwat will mitigate any impact of the proposed change by seeking transitional provisions in the legislation to ensure that contraventions which were previously ‘timed out’ for enforcement purposes remain outside the scope of any extended time limit.

Benefits

Either alternative would remove the current incentive (explained in section 2 above) on companies to delay reporting suspected problems until after the time limit for imposing a financial penalty has passed. This is because under either alternative, a company could not delay reporting a contravention until after the time limit without knowingly reporting incorrect information in at least one annual return. This is a serious offence in its own right (for which Ofwat has imposed significant penalties). Removing this incentive should improve the effectiveness of financial penalties as a deterrent to future contraventions, and thereby increase compliance within the industry.

However, the key benefits of extending the time limit all arise from the increased flexibility provided to Ofwat in determining the appropriate remedies for a contravention. These include:

- more scope to pursue financial penalties where it currently could not; and
- when pursuing financial penalties, more scope to take account of long-term contraventions and to address the impact on consumers.

This improved flexibility will allow Ofwat to ensure that all penalties imposed reflect the gravity of the contravention. This will further improve the effectiveness of financial penalties as a deterrent.

All of these benefits will be greater with a five-year timescale because this will enable cases to be assessed that i) may not have been identified within two years of the breach; and ii) protracted or multiple cases that span more than two years. An extension to five years will therefore enable an accurate assessment of the case and potential penalty for a higher number of cases. A further benefit of an extension to five years is that it would allow Ofwat to capture the effects, if there are any, on the preceding review of prices, since regulated price limits are set on a five-year cycle. This means that Price Review settlements that were affected by serious infringements, such as reporting false or incorrect information, could always be rectified through appropriate penalties. This would represent a powerful reinforcement of the incentives to provide correct information.

A two-year time limit would only allow effects on price controls to be captured if a contravention is detected in the first two years of the price control period and therefore would only be possible in a small proportion of cases.

Conclusion on alternatives

It is the Government’s view that both alternatives will have similar negligible impacts on the costs incurred by Ofwat and the industry. However, the government recommends an extension to five years as this will produce significantly more benefits. It will enable the full scope and impact of longer-term contraventions to be assessed, many of which could not be investigated fully within two years. It also enables cases to be investigated where the breach is discovered more than two years after it occurred. The alignment with the Price Review cycle is also a significant benefit as a five year investigation period would ensure that breaches do not impact on Price Review calculations. Any impact on previous price

⁷ http://www.ofwat.gov.uk/regulating/enforcement/not_fne_svt_promisrep080408.pdf

reviews from a breach could be redressed through an appropriate penalty for the water company responsible. This will lead to a fairer price review process and greater protection for customers.

The five year option provides Ofwat with a much stronger deterrent to ensure that water companies comply with their conditions and submit accurate information. It also removes any incentive for companies to delay reporting a breach in the hope that Ofwat will run out of time to investigate and impose a penalty.

In conclusion the government favour the five year option as it provides a much stronger enforcement tool, will enable more comprehensive investigations and accurate penalties in a greater proportion of cases, provide a strong deterrent to miss-reporting or delayed notification and provide greater protection for customers.

6.3 One In One Out Assessment and justification of classification as Zero cost In

This proposal is intended to give Ofwat more flexibility in enforcing against breaches of licence conditions and statutory duties and therefore enable a more accurate assessment of the level of penalty to redress the impact of a breach. The extension of the time limit from 12 months to 5 years will enable Ofwat to investigate more cases and take into account more information, thereby enabling a more comprehensive and accurate assessment of the appropriate level of penalty. This will provide a greater deterrent to companies breaching their conditions and greater protection for customers.

Water Companies are under a statutory duty to supply Ofwat with financial information and evidence relating to compliance with licence conditions. Therefore this proposal does not place any additional burden or costs on companies. It merely enables Ofwat to act appropriately in cases where evidence of a breach is identified more than 12 months after it occurred; and in cases where there have been repeated or prolonged instances of the same breach. At present, Ofwat may have evidence that such breaches have taken place but they lack the power to impose a penalty that reflects the full impact of the breach.

The proposed change will also prevent companies from evading a penalty by waiting until 12 months have elapsed before notifying Ofwat of a breach in their licence. The impact on companies will, therefore, be limited to those that are in breach of their licence conditions. The water industry is a natural monopoly in which the absence of competitive pressure can create negative incentives, for example to price-discriminate against certain groups of customers. Ofwat's role is to manage these through effective regulation. This includes the imposition of penalties designed to provide redress for customers.