

**EXPLANATORY MEMORANDUM TO THE
WATER INDUSTRY (DETERMINATION OF TURNOVER FOR PENALTIES)
ORDER 2005**

2005 No. 477

1. This explanatory memorandum has been prepared by the Department for Environment, Food and Rural Affairs (“Defra”) and is laid before Parliament by Command of Her Majesty.
2. **Description**
 - 2.1 The Water Industry Act 1991, as amended by the Water Act 2003, provides that, in certain circumstances, the Water Services Regulation Authority (and until it is fully established, the Director General of Water Services) (“Ofwat”), the National Assembly for Wales or the Secretary of State may impose a financial penalty on statutory water companies for certain regulatory infringements. Financial penalties must not exceed 10 per cent of the turnover of the company in question.
 - 2.2 This order makes provision for the determination of the turnover of statutory water companies (water undertakers, sewerage undertakers and licensed water suppliers) for the purposes of financial penalties.
3. **Matters of special interest to the Joint Committee on Statutory Instruments**

None.
4. **Legislative Background**
 - 4.1 Section 48 of the Water Act 2003 amends the existing enforcement regime by inserting new sections 22A-22F in the Water Industry Act 1991. The new sections provide enforcement authorities (Ofwat, the National Assembly for Wales and the Secretary of State) with powers to impose penalties on statutory water and sewerage undertakers and licensed water suppliers. Ofwat may impose a penalty for contravention of conditions of appointment, licence conditions and standards of performance. The Secretary of State, the National Assembly for Wales and Ofwat may all impose fines for contravention of, or contributing to contraventions of, statutory requirements, where these are enforceable by them under section 18 of the Water Industry Act 1991.
 - 4.2 Under section 22A(1) and (2), financial penalties must be reasonable in all the circumstances of the case. Under section 22B, the enforcement authorities must publish a statement of policy on penalties and have regard to this when determining whether to impose a penalty and its amount. A joint statement of policy has been produced by the enforcement authorities and is currently before the Director General of Water Services and Ministers for approval. It will be published by 1 April 2005.

4.3 In addition, financial penalties must not exceed 10 per cent of the turnover of the company in question. Turnover must be determined in accordance with an order made by the Secretary of State.

5. Extent

This instrument applies to England & Wales.

6. European Convention on Human Rights

Not applicable.

7. Policy background

7.1 The instrument is being made to give effect to the provisions of the Water Act 2003. The financial penalties regime for the water industry will be in line with the financial penalties regime for the gas and electricity industries.

7.2 Turnover is limited to sales from the regulated activities of water and sewerage undertakers and licensed water suppliers. Where a company is both a water and a sewerage undertaker, the regulated turnover for each will be counted separately. Only one year of turnover is used in the calculation. Where the most recent available turnover is for other than 12 months or a company has not been in business for 12 months, turnover is grossed up or down to 12 months.

7.3 The Secretary of State believes that this approach is fair, strikes the right balance and provides an adequate deterrent. The primary purpose of the financial penalties regime 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 be such as to provide an adequate incentive both to the company in question and to other companies to comply.

7.4 The Order follows the approach taken by the Department of Trade and Industry in its recent consultation on the calculation of turnover for the revised water merger regime and on the approach adopted for financial penalties under the Gas Act 1986, the Electricity Act 1989 and the Competition Act 1998.

7.5 Defra together with the Welsh Assembly Government and Ofwat invited public comments on the draft statement of policy on penalties and the proposed approach to determining turnover. The consultation period ended on 28 January 2005. There were 13 responses to the consultation. Views were broadly supportive of the changes that were made to the draft joint statement of policy following Ofwat's earlier consultation in February 2004. General support was also shown for the principles behind the order to determine turnover for the purposes of determining the maximum level of penalties.

8. Impact

A Regulatory Impact Assessment ("RIA") has not been prepared for this instrument as the assessment was included in the RIA prepared for the provisions of the Water Act 2003 which introduced the financial penalties regime.

9. Contact

Keith Bailey at the Department for Environment, Food and Rural Affairs (Tel: 020 7082 8354 or e-mail: keith.bailey@defra.gsi.gov.uk) can answer any queries regarding the instrument.