



ACCESS CODES FOR COMMON CARRIAGE

March 2002

RESPONSES

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DISCUSSION OF RESPONSES

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FOREWORD

Common carriage and access codes

We published the consultation paper 'Access code guidance: A consultation paper' in September 2001. It set out criteria for operating common carriage agreements that water companies should adopt if they want to minimise the risk of infringing the Competition Act 1998. It also set out standards of behaviour for both companies and entrants, in making and implementing common carriage agreements.

The draft guidance drew upon work already done by water companies in producing their own access codes. Our guidance is meant to encourage the faster adoption of best practice across England and Wales.

We received many detailed comments from companies, customers, potential entrants and other interested bodies. A full list of respondents is set out in Annex 1. Copies of the responses, except those marked confidential, are in our library. We considered all the comments and incorporated most of these into our final guidance to companies. This paper sets out these comments and our response to them, and highlights where we have and have not changed the guidance. We present our guidance as a stand-alone document, to make it easily available to enquirers.

A handwritten signature in black ink that reads "Philip Fletcher". The signature is written in a cursive style with a large, sweeping initial "P".

Philip Fletcher

EXECUTIVE SUMMARY

This paper summarises the views we received in response to the consultation paper. It explains how we took account of these in finalising the guidance. We are publishing version 1.0 of our guidance in conjunction with this paper.

Generally, respondents welcome our involvement in facilitating the development of access codes. They believe our guidance will help developments in common carriage.

Respondents support most of our draft principles, on which water companies should base their access codes. Some emphasise the need for balance between increasing competition, and not compromising water companies' legal responsibilities for water quality and to existing customers. We have taken account of these concerns in our guidance.

There was no issue in our guidance with which all respondents disagree. In most cases, we expand and clarify our guidance, rather than change the underlying principle.

The one important exception to this is the issue of mandatory licensing. This is where incumbent companies insist they will only deal with entrants that are licensed under the Water Industry Act 1991 (WIA91). Our initial view was that this insistence might not be unreasonable, in most cases, as long as companies helped the licensing process. But since the consultation, we have examined the issues in more detail as part of our on-going work on complaints under the Competition Act 1998 (CA98). We conclude that it is unreasonable for incumbent companies to insist on mandatory licensing.

If you wish to discuss any aspect of this paper, please contact Phillip Dixon, Senior Economist, on 0121 625 1445, or email enquiries@ofwat.gsi.gov.uk.

RESPONSES TO OUR CONSULTATION

PART 1: GENERAL GUIDANCE

1.1 Essential facilities

About half of the respondents who comment on this issue wholly agree with Ofwat's view that entrants should not have to prove assets are essential. Typically, entrants caution against the essential facility argument being used to delay entry, and incumbents comment that assets should not be regarded as essential in every case. We agree with both of these views. Only one company takes the view that the law does require entrants to carry the burden of proof, although it notes that irrespective of who proves what, in the absence of an appropriate set of criteria to test what is essential, parties will find it difficult to agree. **We have not changed our guidance on this issue.**

Some respondents ask for more guidance on what assets may be essential, and the criteria used to determine whether a facility is essential. We discussed this in our Competition Act 1998 (CA98) guideline "The Application in the Water and Sewerage Sectors" (OFT 422), and in MD 154 (November 1999). It is our view that while the definition of an essential facility must be undertaken on a case by case basis, many of the capital assets of water and sewerage companies could be regarded as essential facilities. In principle, this could include pipe networks and service reservoirs, treatment works and unused water resources. **We have expanded our guidance on this point.**

Entrant companies suggest that once an asset is recognised as essential, this should be publicised to facilitate competition. However, the factors determining whether a particular facility is essential will depend on each individual case. A facility that might be essential in one case might not be in another. **We have not changed our guidance on this.**

Other respondents ask for guidance on what might be an objective justification for refusing common carriage applications. Our CA98 guideline (in para 4.17) refers to two examples where a competitor refuses to give adequate assurances on water quality, or to contribute to necessary reinforcement costs. There may be other examples, depending on the circumstances of the application. But incumbent companies should not forget that their access codes are working documents to facilitate common carriage, not a means to deter competition. In cases where access is refused, it is for the incumbent companies to demonstrate they had objective justification for so doing. **We have amended our guidance on access codes to make this clearer.**

Some respondents ask whether the guidance should be more specific about the information required from the entrant. We agree that it should, up to a point, and **have amended our guidance accordingly**.

1.2 Licensing

Most parties respond on this issue, and none disagrees with the general principle that entrants should, ideally, be licensed. However, since the consultation, we have examined the issues in more detail as part of our on-going work on complaints under CA98. We have concluded that mandatory licensing cannot be justified on the grounds that it is required to protect the incumbent from being unfairly charged with an offence under section 70 WIA91. Consequently, **we have changed our view** and believe that it is not reasonable, under CA98, for incumbent companies to insist on mandatory licensing. **We explain this in detail in our guidance**.

However, several respondents question what we mean by incumbent companies expediting the licensing process, and suggest that it is we who grant licences. Some also say their access codes should not set out how entrants could become licensed, and a few incumbent companies remark that they should not facilitate the licensing process, merely not object to it.

It is our role to consider applications for inset appointments, and to grant those applications if we consider it appropriate to do so. Companies can expedite the inset process by agreeing to an application under section 7(4)(a) of the WIA91. Alternatively, if an application was made which did not require the incumbent's consent, for the premises of a large user (section 7(4)(bb)) or a greenfield site (section 7(4)(c)), then the incumbent could choose not to object to the application. In each of these cases, however, the incumbent would still be able to provide comments to us, or object to the application if there were reasonable grounds for doing so. **We have clarified our guidance on this point**.

1.3 Updating access codes

Twenty respondents comment on this issue, and sixteen agree that codes should be updated to reflect best practice, although a number recognise that best practice will take some time to emerge. Some ask how frequently updates should be made, and whether we would also update our guidance.

Entrants need to be assured that the access codes they use reflect the incumbent companies' general policy as closely as possible. In particular, where an incumbent makes a significant change to its approach to common carriage, for example by applying a different pricing method or by reconfiguring part of its network, we would expect them to reflect those changes in their access codes without delay. But it would be unreasonable to expect incumbents to continually amend the text of their codes to account for every small change, as long as those

changes were made clear to entrants during negotiations. We support a flexible approach to updating, rather than a rigid process.

It is for incumbents to decide when to amend their codes. It would seem reasonable for them to make a general review of their codes every year, and to incorporate all necessary changes. Similarly, as common carriage develops, we will review our guidance to ensure that it reflects current best practice. However, companies' reliance on our guidance should diminish over time, so we will aim to review our guidance in 2004 (or sooner if legislation is introduced). **We have added these points to our guidance.**

As common carriage develops and companies review and update their access codes to reflect best practice, there may be agreements that have been made on the basis of out of date access codes. It would be sensible for access codes to set out how agreements will be reviewed and amended, to take account of incumbents' latest approach to common carriage and any changes in the legislation.

1.4 Co-operation

All of those who respond agree with the importance of co-operation. Some note that individual agreements will specify how entrants will interact with incumbents, and that failure to co-operate will be covered by the mechanism to resolve disputes. **We have not amended our guidance on this.**

1.5 Non-discrimination

Most respondents agree with the guidance as currently drafted.

One potential entrant cautions against a requirement always to match the existing company's standards, as these may be unnecessarily high. To be required to match them would remove the ability and incentive to save costs. We agree with this in principle, although companies would need to look at each case individually, and the onus would be on the entrant to show why it did not need to meet those standards.

Some respondents say that non-discrimination should not apply to quality sampling. For example, special sampling regimes may have to be introduced as a result of shared access, and to ensure responsibility can be assigned in the event of a quality failure. However, we believe that companies should not be free to impose more onerous sampling regimes on entrants than they would impose on themselves for the same source. To do so could be a breach of CA98. **We have not changed our guidance on this.**

One respondent suggests that companies should be able to dismiss a common carriage application 'out of hand' if it were based on a source or point of entry

that the incumbent would not consider viable. As noted above, it is for companies to judge whether a common carriage application is viable. But if an application were rejected we would expect good reasons to be given to the entrant for doing so, as well as the opportunity to solve the problem or propose an alternative. Companies will remain network controllers and so the onus is on them to explain why a particular approach would not work. **We have referred to this point in our guidance.**

1.6 Arbitration, disputes and the Competition Act 1998

About half the respondents comment on this issue, and most agree with the need for a mechanism to resolve disputes, although one respondent suggests that this mechanism should be in the individual agreement, rather than the code itself. We expect companies to agree specific details with entrants on a case-by-base basis, but the code should contain general information about resolving disputes.

Two respondents suggest that there will be many disputes in the first few years of common carriage, and that our caseload will be high. We agree that until experience develops, entrants and incumbents will probably find many points on which they will need to negotiate an agreement. However, we expect most of these to be resolved without recourse to us. We do not expect companies to use potential disputes as a means of deterring entry, nor should entrants expect to involve us in the detail of their commercial negotiations. We would be concerned if either party sought to refer disputes to us without first making serious attempts to reach agreement. We want to be satisfied that the parties had tried to reach an agreement, before we consider a dispute. **We have made these points in our guidance.**

1.7 Terms of contract

Many comments were made on different aspects of this section of our guidance. Two respondents note that the clauses in our guidance may not be relevant to individual agreements, so it should only state that parties need to agree terms. We agree that it is for companies to agree with entrants what contractual terms are necessary and appropriate. Our guidance does not attempt to cover every possible scenario, but notes some important issues for companies to consider. **We have amended our guidance to reflect these points.**

Tree companies argue that both parties need to agree on duration, for technical reasons. Three others agree that the entrant can decide on duration, subject to the incumbent being able to recover its costs over that period, and there is agreement about who supplies the customers on termination of the agreement. In practice, entrants are likely to want long term or indefinite agreements, while incumbents will need to be satisfied that any costs incurred can be recovered and there are no technical reasons to preclude the entrant's preferred duration. **We have amended our guidance to include these points.**

Several companies agree (and one disagrees) with the possibility of using trial periods to test whether a common carriage agreement is viable. **We accept the Drinking Water Inspectorate's (DWI) view that trial periods should not be used, but incumbents should instead follow the DWI's guidance on the water quality aspects of common carriage. We have changed our guidance on this.**

A number of respondents comment that access codes should set out what happens when an agreement ends or the entrant exits the market. Some companies argue that non-household customers should not expect to be able automatically to revert to the previous supplier, particularly if the customer's new supplier obtained an inset appointment for that customer. Others would welcome returning customers, as long as they had the means to supply them. One incumbent argues that common carriage constitutes an interruption to the supply previously provided by the incumbent to the customer.

Customers need to be aware of the arrangements for continuation of supply. They also need to be aware of the potential costs and consequences of changing to a common carriage supplier, particularly the risk that their previous supplier may be unable to supply them if the new supplier cannot do so. Incumbents do not have an absolute duty to supply water for non-domestic purposes in any circumstances. So if customers switch and then wish to revert to the incumbent, they will be subject to the statutory process for seeking a new non-domestic supply under section 56 of the WIA91, which does not guarantee them a supply. But the incumbent will still be subject to its statutory duty under the WIA91 to supply water for domestic purposes, should the entrant's customers seek it. There are ways of addressing this need to have water available to fulfil a duty to supply water for domestic purposes. The most effective option is for the entrant to agree to transfer its resources to the incumbent when the entrant left the market. In this case, the incumbent would not need to keep its own resources available, and would not charge the entrant for this service. **We have added these points to our guidance.**

Views vary on the issue of taking over the entrant's assets. One respondent believes that incumbents should be contractually entitled to take over the entrant's assets, although it recognised that entrants might be unwilling to accept this. Another suggests that the incumbent should only have temporary control of the assets. We think entrants should not be obliged to agree to transfer ownership of their assets to the incumbent, but it is sensible for them to do so (see above). It is also sensible for the incumbent to ensure continuation of supply for domestic purposes by being able to operate these assets if an entrant fails, subject to the law governing succession of abstraction licences. Access agreements should set out how this would happen. **We have added this point to our guidance.**

One incumbent thinks that the assets would have to meet the incumbent's minimum standards, and that the incumbent may require a bank bond to cover the cost of remedial repairs. We see this as overly restrictive on entrants. It would be better for the incumbent to stipulate the level of assets required for common carriage, and for both parties to agree arrangements for regular review of those assets, to ensure they are maintained properly. **We have added this point to our guidance.**

Two respondents ask for more guidance on whether the incumbent should retain capacity for the customers it loses, and if so, how it should be compensated. The issue of charges for stand-by and top-up supplies is addressed in sections 2.2.4 and 2.2.5 below.

1.8 Customer protection issues

Just over half of respondents comment on these issues. None disagrees with the general principle that codes should set out how customer service issues will be dealt with. Some note, however, that access codes should not be too prescriptive, and that specific details of service levels have to be agreed on a case by case basis. One respondent considers that if an entrant wants to buy a higher level of service (for a higher access charge) than is currently provided, we should not prohibit this. We agree, and note that the corollary also applies. The incumbent must ensure that its other customers are not affected if the entrant receives a different level of service. In all common carriage agreements, the starting point is for companies to treat entrants in the same way as they treat their own customers. **We have included these points in our guidance.**

1.8.1 Customer contact – queries and complaints

Nineteen respondents comment, and most agree that entrants should be the initial point of contact for all queries. Some note that customers should not be prohibited from contacting incumbents directly with operational issues. A few respondents say it is important for both parties to agree on who is responsible for managing complaints, and for the customer to be clear who they deal with.

Our view remains that it is the entrant who must expect to handle all complaints initially, to be responsible for dealing with non-operational complaints and to ensure that operational queries are efficiently transferred to the incumbent. **We have not changed our guidance.**

One company raises the concern of operational issues that are caused by the entrant. In general, we envisage common carriage to mean that the customer's premises remain connected to the incumbent's network. Operational issues are therefore clearly the incumbent's responsibility. But it is possible that an entrant may operate its own local network, which sits between the incumbent's network and the customer's premises. In these cases, it may not always be the

incumbent's network that causes the problem. Therefore, the entrant and incumbent will need to agree how to investigate operational queries. In the first instance, it may be sensible for the incumbent to continue to investigate all operational enquiries, and to transfer further investigation to the entrant if it concludes that the fault is theirs. **We have added this point to our guidance.**

1.8.2 Customer transfer and switching

Twenty companies comment on this aspect of our guidance. Several of them (including potential entrants and data transfer companies) suggested that a single, common data transfer system should be agreed at an early stage. Others note that neither the incumbent nor the entrant should be able to impose its own system on the other, which implies the need for both parties to agree how to manage customer switching. Others say that customers must not be confused, that companies already cope with customers moving around, and that a simple system could be acceptable until switching activity increases to an agreed level. One customer representative warns that the ability of incumbents to prevent customer transfers must be restricted.

In our view, common carriage is likely to develop at a measured pace. Consequently, the initial level of switching activity is likely to be low, and not all companies will experience it to the same degree. Therefore, it does not seem appropriate to develop a single, common transfer system that applies to all companies, until we have some indication that such a system is warranted. We would not want to encourage companies and their customers to incur time and expense developing a complex electronic system when a simple, less expensive paper-based system would suffice. Also, companies already deal with customers moving within and between their areas. It would seem reasonable for companies to extend this system, until a new one is needed. We would not want companies to insist on a more complex system and use this as a reason to delay all potential common carriage agreements. Ofwat will keep this under review. **We have incorporated this into our guidance.**

1.8.3 Billing and debt collection

Most of the comments on this section were about debt. All respondents agree with our view that entrants should not be obliged to use an incumbent's customer services.

No respondent disagrees with our view that customer debt should not be a barrier to switching, although several companies suggested that the entrant must first assume the debt. We agree with the comment that customers must not switch as a way to avoid paying their bill or to avoid disconnection. We also agree with the caution that entrants would not avoid paying access charges if their customers did not pay their bills. Entrants must assume the risk of non-payment if they take customers away from the incumbent. Two companies say

they would offer their billing/debt collection services to entrants as an optional service. We have no objection to companies offering additional services to entrants as long as these are optional. **We have added these comments to our guidance.**

PART 2: STRUCTURED GUIDANCE

2.1 Application process

Companies' access codes have separated the application process into a number of stages. Our guidance sets out and discusses the stages that we consider a common carriage application should normally follow. This is not intended to be prescriptive but to indicate what entrants should expect as a minimum. Both parties may benefit from some flexibility in the process.

2.1.1 Stages of application

Two respondents think the guidance is too prescriptive, and one thinks a different breakdown of the stages may be more appropriate. One incumbent suggests that companies should be allowed to devise their own structure. Two respondents believe that it would be difficult to distinguish between stages 2 and 3 in practice. Eight other respondents agree with our guidance.

Our guidance is meant to help companies and entrants develop their own common carriage arrangements. It is not meant to be prescriptive, but it suggests what entrants could expect from the process, and how companies might build their experience in handling applications. **We have not changed our guidance.** Companies can and should develop their own codes and ways of progressing common carriage deals, but the onus remains with them to avoid infringing CA98.

One respondent says it is good practice to provide a process map in the access code. We agree that this might make the process clearer for the entrants and **have modified our guidance to suggest that companies might include this in their codes.**

One respondent says that access codes cannot contain enough information to allow entrants to decide whether to submit an application. Three companies echo this point, in terms of pricing information. However, one water company states that it will give standard prices in its access code and one entrant comments that if the energy industries can publish prices, so could the water industry. Two respondents say they could not give an indicative price until the end of stage 2.

We believe that access codes must contain enough information to allow entrants to judge whether to make a formal application. We believe it would be too

onerous on both parties if every common carriage proposal had to be discussed with the incumbent before the entrant decided whether to proceed. **We have not changed our guidance on this.** We believe incumbents can include indicative prices (and where possible, standard prices) in their codes. For more discussion of pricing issues, see section 2.2.

2.1.2 Information requirements

Half of all respondents comment on this issue. Ten companies support the current guidance. We agree with companies who agree that information requests should not be duplicated, that there is a balance between flexibility and being prescriptive, and that incumbents should not have to progress an application on the basis of incomplete information. **We have added these points to our guidance.**

We think that including information requirements in the access code minimises the possibility of duplicating effort in the initial application stage. It also allows the entrant to plan its application better. **Therefore we have not changed the current guidance.**

We acknowledge that applications will vary but expect companies to specify a minimum information requirement and outline in their access codes areas where further information may be needed. We note that some companies already produce standard questionnaires for common carriage entrants, and think it may be possible to produce best practice questionnaires in the future, as common carriage develops. **We have incorporated these points into our guidance.**

Ten respondents reply to our request for views about exit points. Four companies say entrants should give information about their exit points at stage 2, although one of these says the information is unlikely to be detailed until stage 3. Two others say this information should be provided early in the application process.

One company says it needs information on exit points to determine whether the facility the entrant intends to use is essential. Four companies say that information about exit points is important to plan network extension/reinforcement work associated with the application. One respondent believes more information would be necessary if the entrant intends to supply new customers. One entrant is concerned that providing commercially sensitive information is inappropriate and should not be compulsory.

We acknowledge the concern that revealing exit points (and hence, in most cases, the identity of the target customers) to the incumbent company could enable it to attempt to prevent the customers switching. However, it is inevitable at some stage that the company will know which of its customers the entrant is targeting. And it is not unreasonable to expect the incumbent to try to keep its

customers. But what incumbents must not do is delay the common carriage application in order to keep the customers. It is reasonable for the incumbent to have information about exit points in order to plan how the common carriage agreement will affect how it runs its network. We believe that the entrant should be protected against inappropriate use of information revealed to the incumbent if it signs a confidentiality agreement. It is also our view that companies must make indicative access prices available before entrants reveal their proposals.

Taking these comments into account, we think that it is reasonable for entrants to provide information about exit points at stage 2. **We have updated our guidance accordingly.**

Eight respondents agree that there should be a confidentiality agreement. Two think that the agreement should be common to all companies. One entrant says Water UK should not be involved in standardising confidentiality agreements. We have invited views on the formation of a working group, to review developments in common carriage and consider how companies should update their codes to implement best practice. We believe confidentiality agreements is something this proposed working group might consider.

2.1.3 Timescale

Eight respondents, including companies, customers and potential entrants, agree with our suggested timescales, as long as the entrant has provided the information. Other companies say that timescales should be averages, that they could be longer if the entrant agrees, that they depend on the number and complexity of common carriage applications with the company, and that it would be unwise for us or them to commit to maximum timescales without experience of handling applications.

It is clear that respondents have different views about what is a reasonable length of time to progress an application. Typically, companies suggest our guidance should not be too prescriptive, and warn against setting timescales that are too short, especially with little experience of common carriage. Potential entrants, on the other hand, suggest that our timescales are too long.

We believe that our guidance is reasonable. It would not be sensible to set timescales that are too short when there is little experience of handling applications. Neither would it be sensible to weaken incentives on companies to develop that experience, by setting timescales that are too long. We consider the suggested benchmark timescales are conservative and could become shorter as experience develops. **Therefore, we have not changed our guidance at this stage, but will review it in the light of experience.**

2.1.4 Application fees

Most respondents agree with our guidance. One potential entrant suggests that incumbents should bear the cost of applications, to ensure an efficient process. We do not agree. **We have not changed our guidance on this.**

2.2 Pricing issues

Twenty-two respondents comment. Fifteen companies specifically comment on publishing prices. Most agree with our view, although some say prices for every company would need to be published at the same time, with a note that they are not comparable. Four companies disagree with the idea of publishing, suggesting that prices are case-specific and indicative prices would mislead entrants. One company does not agree with Ofwat publishing prices on its website. Most of the other respondents agree with the idea of publishing prices.

Our view remains that companies should publish indicative or standard prices in their access codes. **We have not changed our guidance on this.** We also think that entrants may benefit from these prices being available in the same place, to aid cross-reference and comparison. As one company points out, this is likely to happen soon after prices become available from each company, and it is better for it to be organised properly to avoid misleading comparisons. We still request that companies provide us with their prices for publication on our website. **We have not changed our guidance on this.**

2.2.1 Access price components

Five respondents agree that we have correctly identified the access price components. Two commentators believe we should make costs transparent, while one respondent thinks the company should explain where prices depart from their methodology. We agree with these statements. We have consulted on changes to the accounting information which companies provide to us each year. Companies must be able to show consistency in the way they calculate access prices. **We have added this point to our guidance.**

One respondent thinks that if the incumbent provides zonal access charges it could encourage 'cherry picking'. We do not agree. The closer access charges are to the actual costs of supplying customers, the less scope there will be to exploit existing cross-subsidies.

One company says we need more guidance on the basis of charging for top-up and stand-by supplies. We discuss these in detail in sections 2.2.4 and 2.2.5 below.

2.2.2 Use of system

A few respondents (mainly potential entrants and customer representatives) say they need standard prices. Some want a standard method of calculating prices,

while others welcome the ability to choose between methods. One potential entrant says that Ofwat must prohibit the use of the Efficient Component Pricing Rule (ECPR), as avoidable costs may be subjective and difficult to calculate. A few companies agree that prices should be updated annually.

In principle, none of the three main approaches to calculating access prices is unreasonable under CA98. Ofwat does not, therefore, have the power under current legislation to require companies to adopt a single method. We believe that it is for companies to decide their approach to access pricing. **We have not changed our view that companies can use one of three main ways to calculate access prices.**

One company says it is likely that companies will use a mix of methods in practice. We believe that companies are able to decide their approach to access pricing, but we do not expect them to use different methods for different cases. They must not choose the one that suits them best (in terms of the resulting access price) in each individual case. This inconsistency could be a breach of CA98. They must apply a given approach to access pricing consistently. This does not mean they cannot change their approach over time. But they must clearly signal a change in their method and continue to apply it consistently, to avoid a possible infringement of CA98. **We have made this clear in our guidance.**

One customer group says access prices should be broken down, but one company argues this is not possible, and another says it could distort comparisons. **We remain convinced that prices should be given for each of the activities involved, particularly for bulk and local distribution, where companies use long run marginal cost (LRMC) or accounting costs as their approach. If they use ECPR, estimates of the avoidable cost of each activity should be given.**

Several companies comment on the particular methods of setting prices. On ECPR, some note that this method is consistent with opportunity cost, and so needs to be based on the most recent water resource plan. Also, avoidable costs will be low if the common carriage agreement is short or the new supply is too small to avoid capital costs of new resources. **We agree with these statements and have added them to our guidance.** But it is also the case that a company may benefit from common carriage if it allows them to reduce or remove a headroom deficit. This benefit must also be reflected in the access price. **We have added this point to our guidance.**

One company says avoidable costs will vary in each case, and can only be provided to entrants individually. We do not agree. Estimates of avoidable costs can be used to provide indicative access prices. For example, the avoidable costs of resources and treatment are proxied by the company's LRMC estimates, which are publicly available.

One respondent suggests that different entrants will require different levels of security of supply, and therefore this aspect of charges based on ECPR still needs assessing case by case. **We agree, and have included this point.**

Two companies do not think they always have to prove consistency between avoidable costs and tariffs or bulk supply charges. One notes that bulk supply prices could be outdated and thus not comparable or they might calculate bulk supply prices differently from Ofwat. We have some sympathy with this view, although in most cases we would still expect consistency. The other company considers that tariffs and bulk supply prices are not comparable with avoidable costs, as they would normally cover unavoidable costs as well. But they should still be consistent in the sense that, for a company with resource constraints, we expect both bulk supply prices and avoidable costs to be relatively high, meaning relatively low access charges and allowing much-needed new supplies from competitors.

On average costs, one company says that the rate of return is not specifically allocated to elements of the retail price. Thus, how can this method be consistent with retail prices? We have said that this element of setting access prices based on average costs is not straightforward. However, companies' final prices do include a rate of return, and those prices cover all aspects of the service. Therefore, it is reasonable to expect companies to include a rate of return in the access charge, but that this must be consistent with the final tariff. **We have not changed our guidance on this point.**

On LRMC, one entrant notes that all companies must use the same method for calculating their LRMC estimates, and for setting access prices. We have given guidance to companies on the basis for estimating LRMC. Two respondents question the relevance of LRMC as a method, stating that it is not relevant to a fully competitive market. We do not agree, as sustainable competition must take account of changes in demand and resources over time, not just respond to short run factors.

We asked for views on what information is essential for the company to calculate a price. Only four companies reply. One says it would be similar to the information needed to calculate end user tariffs. Another says it would have to understand the full range of services needed by the entrant, and the division of responsibilities, to set a price. One considers that it would need more than the standard amount of information set out in the code, in some cases. The fourth says it includes information on entry and exit points, proposed volumes, peak flows and flow patterns, proposed duration and quality sampling arrangements. It also says it is important to know whether the customer is new or existing. **We have included this information in our guidance.**

Only two companies comment on the timescale for providing prices. One says these should be indicative times, and that the company would need to justify any delays. The other says ECPR prices could be provided more quickly. In the light of the few comments received, **we have not changed our guidance.**

2.2.3 Connection and network extension/reinforcement

A few respondents agree with the whole section and a further few agree with the point on connections. Eight of the nineteen companies who comment think they cannot provide typical charges for connection/reinforcement, though one thinks indicative connection costs could be provided. We appreciate that network reinforcement costs may vary between cases, but we still think the company is able to provide indicative prices for a range of circumstances. For example, price to upgrade different pipe sizes per metre, indicative prices for different volumes, price to transfer between water resource zones if appropriate. The indicative price is calculated on the assumption that any technical difficulties are resolved during the application process, as with the use of system price. Companies would be able to provide standard connection charges in their access codes. **We have not changed our guidance on this.**

Most companies agree that connections must be made in line with their self-lay policies, and one suggests that the incumbent must have control of the network at the time of connection. **We have clarified this in the guidance.**

A few respondents comment on the point about consistency with requisition charges. Two companies agree with our draft policy. Three companies say the entrant must pay in full for network extension and reinforcement (not via the commuted sum) because the incumbent would not receive any extra revenue. One of these notes that requisition arrangements do not apply to water supplied for non-domestic purposes, which is likely to be the main focus for common carriage. Another argues that access charges do not include any element for new infrastructure, so there will be no over-recovery of charges if entrants fully fund the costs of network reinforcement or extension. One entrant comments that there must be no benefit to the company if the entrant pays for the extension and reinforcement.

We acknowledge the arguments raised by some companies, but the principles underlying any charges for extension or reinforcement of the network at the customer end must be consistent with those underlying requisition charges. In calculating the latter, future revenue from charges to final customers is offset against the capital cost of network extension or reinforcement. In the case of new customers connecting to the system in the context of common carriage, the capital cost of network reinforcement should be offset by future revenue from use of system charges. Where network reinforcement is required solely because the entrant is connecting to the network in a particular place, the entrant should pay all of the costs. Entrants should not be charged for network reinforcement costs

unrelated to providing common carriage. **We have clarified our guidance on this.**

Also, we note that most business customers are likely to require a water supply for both domestic and non-domestic purposes. The requisition arrangements are likely to apply to most common carriage proposals.

One company acknowledged that reinforcement may benefit several entrants but only the first would bear the costs. We agree this situation may arise, although it is unlikely. However, the 'lumpy' nature of investment in water infrastructure means it is a risk the entrant must manage.

One respondent thinks the company should share the costs of network modelling and feasibility studies across all customers. But when network reinforcement is undertaken for the benefit of the common carriage entrant, it would be unfair to expect the company's remaining customer base to bear the costs.

There were few comments about the suggested timescale to produce a price – one entrant believes it is too long, and two companies believe it is too short. We think the timescale is reasonable, given the work involved to produce a price for network reinforcement and **have not changed the guidance.**

One entrant believes the incumbent should provide these charges at the same time as use of system charges. We agree that the company should confirm the final use of system charge during stage 3, as we state in the guidance.

2.2.4 Top-up supplies

Companies generally agree with our guidance, but some comment on particular points.

Some companies comment that charges for top-up supplies would be higher than standard tariffs if taken only at peak times. One respondent considers there should be top-up charges at rates agreed with the entrant. Another believes we must have accounting separation and that the incumbent should charge the same for top-up supply as it does to its retail business. One respondent thinks resource constraints may mean the incumbent prefers not to offer a top-up supply. One of the respondents considers that top-up supply is purely for balancing the system and the incumbent should apply penalties for severe under-supply.

We acknowledge that some companies have seasonal tariffs, and that top-up supplies might also reflect seasonal differences in costs. As for other aspects of common carriage pricing, charges for top-up supplies must be consistent with tariffs for end users. And these prices must be transparent. **We have added**

these points to our guidance. In some cases, requests for top-up will be used for system flow balancing, which is discussed in section 2.3.5 below.

Some respondents note that the customer should receive one bill, from the entrant. We agree, and **have changed our guidance to reflect this.**

On who should provide water for leakage, two respondents suggest entrants can either supply the leaked water or pay for it in the access charge. One respondent thinks the entrant should supply the water, and one believes the water should come from the most economic source, which might be the entrant's or the incumbent's. One respondent says the avoidable cost of leakage is zero (because leakage will be the same after entry as before). Therefore, it argues that the entrant should simply input as much water as its customers take, and leave the incumbent to supply water lost as leakage.

We accept that entrants should have a choice in whether they supply the water or buy it from the company. **We have made this clear in our guidance.** If the company does not require water from the entrant, it must make it clear that its access charge does not include a charge for supplying water lost to leakage.

Several companies say they do not intend to change their methods of calculating leakage. Other respondents comment that the industry should establish the method for leakage calculation that encourages the most efficient use of water, and that the entrant should pay for no more than the company's average leakage level (to avoid paying for the incumbent's under-investment). We encourage companies to adopt a consistent approach to leakage, based on a company's own economic level of leakage (ELL) appraisal or a pragmatic approach, if one was not available. We think companies should support this work by adopting a standard method of managing leakage in common carriage agreements, as a matter of good practice, based on the same approach. **We have not changed our guidance on this.**

2.2.5 Stand-by supplies

Sixteen companies comment on this section. A few companies appear concerned that allowing entrants to request stand-by supplies from the company will give the entrant an advantage. They suggest that they could refuse entry if the entrant cannot meet demand in dry weather conditions. We do not agree. Entrants are unlikely to have as wide a range of resources available to them as companies have, and therefore may have less flexibility to meet their customers' demands in droughts or if their source is contaminated. Stand-by supplies seem to be a sensible contingency to allow the entrant to keep supplying their customers. But the onus remains on entrants to plan to meet their customers' demand, and they must expect to pay a reasonable charge for stand-by supplies. Companies' charges will take account of the probability and impact of the entrant needing stand-by. Where companies' resources are constrained, entrants will

have to plan carefully how they intend to meet their customers' demands, particularly if they are new customers. **We have added these points to our guidance.**

One company thinks the stand-by fixed charge is driven by the cost of reserving headroom. Another thinks that the costs of stand-by supply could be significant. One respondent believes the fixed stand-by charge should be zero in regions where water is plentiful. A few of those who commented think companies and entrants should negotiate stand-by supply separately, and take account of peak and seasonal factors.

We agree that one of the factors influencing stand-by charges is the cost to the company of keeping capacity available, and that these should be covered in a fixed charge. However, it does not have to be a dedicated capacity. We do not agree that this should be zero in water rich areas, as there will always be an opportunity cost incurred in reserving capacity, but it might be lower than in water scarce areas. **We have added this point to our guidance.**

2.3 Operational issues

Most companies agree with the general principle in our guidance. But three respondents comment that access codes can only give generic information, which will not be sufficient for entrants to assess the viability of their applications. And one remarks that it would only be possible at stage 2 or 3 to assess if a proposal was viable. However, we believe that the operational information in the access code need not be exhaustive. It should be possible to give the entrant an overview of the operational issues that will arise from its application, which will allow it to assess whether to proceed. **We have not changed our guidance.**

One company asks for further guidance on responsibility for the Water Fittings Regulations, the Water Quality Regulations, maintaining customers' service pipes, installing exit meters and making payments under the Guaranteed Standards Scheme (GSS). Incumbent companies are responsible for enforcing Water Fittings Regulations, for promoting water efficiency and where appropriate for maintaining customers' service pipes. This incumbent could be the entrant via an inset appointment, or the existing company. We discuss Water Quality Regulations in section 2.3.1 and exit meters in section 2.3.5. Incumbent companies are liable to make GSS payments and will continue to be liable in common carriage arrangements, unless the entrant obtains an inset appointment for the customer's premises. However, the parties should agree how payments will be made. It would be sensible for them to agree that all payments are made by one of them (to avoid confusion and to ensure customers do not get paid twice). And where the other party is at fault, recover payments from that party. We expect the company and entrant to agree compensation contractually. **We have added these points to our guidance.**

Two respondents say they need guidance on pressure and flows. We mention flow balancing in section 2.3.5 as part of the ongoing network management arrangements between companies and entrants. We expect the incumbent and entrant to address any issues of pressure and flow during the application process.

2.3.1 Water quality and sampling

Many of the comments we received expand on several areas of our guidance.

Most companies agree that they should suspend access if the entrant's water breaches the Water Quality Regulations, though one comments that all network users should be responsible. It may be more efficient for the entrant to suspend access if it can do this more quickly than the company, but the company holds ultimate responsibility. However, we think it is more appropriate if incumbent companies have the right to suspend access, rather than the responsibility to do so. **We have changed the guidance accordingly.**

One company states that the entrant must inform the company if there is a risk of non-compliance. We think this is sensible, and **have amended our guidance to include this point.** One company says that entrants should pay penalties if they breach the Water Quality Regulations. We expect the company and the entrant to agree in the access agreement how penalties would be applied for any breach of the access agreement.

Respondents also comment about the standards of water they expect from entrants. One company says that the water should simply be compatible with the incumbent's water, rather than match it, because this is less restrictive. We think this is sensible, and **we have changed our guidance accordingly.** Another says that it is particularly important for the entrant to match the company's standards where these are more stringent than the Water Quality Regulations. **This is already implied by our guidance, but we have made it clearer.**

Some companies argue that aesthetic issues should be included in our guidance, such as colour, smell taste and hardness. These are very important to customers. We expect companies to include these aspects in their access agreements. **We have clarified our guidance to cover this point.**

The remaining comments are about trial periods. One potential entrant says that trial periods should not be used, but the incumbent should help the entrant to overcome difficulties. One company says that customers must not be used to test new water blends. Two companies support trial periods to test quality issues, but not as a substitute for thorough prior analysis. One company thinks the parties should seek advice from the DWI if the trial period does not resolve quality issues.

We agree that the entrant and company must work together to resolve quality issues. It seems sensible for them to consult the DWI if there are problems that neither party can easily resolve. As noted, quality can include factors like taste and hardness, changes which customers can perceive but would do not endanger health. The DWI has given guidance to water companies on the drinking water quality aspects of common carriage¹. It believes that as long as the guidance is followed, it does not see any significant difficulties relating to water quality in common carriage. It does not believe that trial periods should be used in any common carriage situation. We accept DWI's view. Water companies should refer to DWI's guidance rather than use trial periods to test common carriage arrangements. If companies and entrants are still in doubt after modelling a common carriage scenario, they should contact DWI for advice. **We have amended our guidance to reflect this point.**

2.3.2 Network management and control

Twenty companies respond to this section. Most agree without comment.

Two companies say that the guidance should treat water for firefighting in the same way as for leakage, by adjusting the network water balance. Two companies think that as they retain network control, they must liaise with the fire authority and provide the water for firefighting. One entrant believes the incumbent should be responsible for firefighting water and share the costs among all customers. One company says that if the entrant is responsible for firefighting water it has some Supplier of Last Resort (SOLR) responsibility and this will be reflected in the access charge. We currently leave the treatment of water for firefighting open for companies to express their own policy, and **have not changed our guidance.**

One company does not think the unauthorised use of water would be significant.

2.3.3 Drought and resource planning

Half the respondents comment on this section, and most agree with the guidance as drafted. One entrant suggests that information requirements should mirror the incumbent's internal requirement for a new source. We agree, and have **included this point in our view that the information requirement should be reasonable.**

Two respondents say network users should work together to plan resources, one company says incumbents and entrants should both have plans for security of source/supply, another expresses a need to establish responsibilities, and one says entrants must follow the incumbent's plan. One respondent wants a joint strategy on restricting water use during drought. We accept all of these points.

¹ Information Letter 6/2000 - 11 February 2000.

However, we believe it is appropriate to let the company decide what information and level of co-operation it needs from the entrant, provided these are reasonable. Companies could also use their codes to define the roles they expect each party to take. **We have not changed our guidance.**

Four respondents comment about the treatment of customers during a drought. Two companies think it would be impractical to impose selective restrictions depending on the supplier. Another notes that current legislation may make it impossible for the incumbent to impose a drought order outside its own customer base. One respondent says the customer must not receive mixed messages about restrictions on use. When customers switch supplier they take on that supplier's risk, so they should be subject to the restrictions of the entrant's source. It may be that the entrant can offer a more secure service than the incumbent can offer, which is part of the entrant's strategy to compete. In this scenario, the entrant should not automatically have to follow the incumbent's drought restrictions. Equally, if the entrant's source is less reliable, its customers might have to suffer more restrictions than the incumbent's customers, unless the entrant buys stand-by and top-up supplies. We acknowledge the point about mixed messages, but believe that security of supply is an area on which entrants may compete with incumbents, and they should not be denied the opportunity to do so. However, we accept that if such a case arose, both parties would need to handle customer communication carefully.

2.3.4 Maintenance and serviceability of assets

Most respondents who comment agree with our guidance.

Two respondents think the entrant and company should agree a minimum notice period for the incumbent to inform entrants of interruptions, and one says the entrant should be able to stipulate this period. We think the company should be allowed to set the notice period, because it knows its own planning process, and therefore how much notice it can give. However, the notice period must be reasonable, and where possible the company should try to agree a period with the entrant. **We have incorporated this point into our guidance.**

One company says the entrant should receive no more notice than the customer. We do not agree, as this would mean the entrant is left with little time in which to inform its own customers. In practice, the entrant's customers would receive less notice than the incumbent's customers.

Some companies point out that they cannot inform entrants about unplanned work. This is implicit in the guidance, though the company should inform the entrant when the unplanned work commences to allow the entrant to deal with any queries. One respondent notes that the entrant may also need to schedule maintenance and inform the incumbent. If the entrant schedules maintenance on its own assets (we anticipate these to be its source, water treatment facilities and

mains up to the point of connection with the company's network) it is likely to need a stand-by supply, and therefore would need to inform and agree with the company. **We have added this to our guidance.**

2.3.5 Metering and flow balancing

Half the respondents comment on this section. Some companies agree with our view. Some think the system for under- and over-supply should not involve cost-symmetry. A few companies noted that the costs and benefits of over- and under-supply depend on whether the network is in deficit or surplus. For example, under-supply by the entrant can be valuable if the rest of the network is in surplus. This is implied in our guidance, but **we have made this point clearer.**

One respondent feels that balancing should take place over time. We agree with this. One company notes that the balancing period varies, therefore this is difficult to agree in advance. One of the respondents thinks we should provide timescales for metering and flow balancing to avoid delays. One says the entrant should incur penalties for failure to balance. One company says the balancing mechanism must avoid putting a value on the entrant's water that is too low or too high.

Our view is that it is important for the entrant and company to communicate and co-operate over balancing. It seems sensible for the parties to agree a range of volumes within which the entrant can vary its inputs without the company or the entrant incurring any extra costs. This range can be reviewed regularly, and if the entrant is consistently outside that range then it would have to adjust its inputs or its customers' demands, or change the agreed range. Where there is a significant breach of agreed inputs, the company will have to assess whether that was costly (for which it might charge the entrant) or beneficial (where it might reimburse the entrant). In either case, the company must be transparent and fair in how it calculates the value of the cost or benefit. Our request for symmetry relates to the method by which this calculation is made. **We have added these points to our guidance.**

Several respondents comment on monitoring entrants' output and whether the entrant should meter its customers. Issues include how companies should monitor entrants' unmeasured customers' consumption, whether the incumbent would continue to own exit meters or whether the entrant should take them over. One company will consider remote monitoring on an individual basis. One respondent thinks incumbents should not impose telemetry monitoring. One suggests that all customers must be metered whether they pay measured or unmeasured tariffs. Two respondents say water companies should not force customers to take meters. A few respondents think we should not allow measured customers to revert to unmeasured supply on switching

Our view remains that companies must be able to measure flows across their networks. This implies that the entrant must measure its customers' demands, at least in bulk, but it does not imply that the entrant will have to charge its customers on a measured basis. The ownership of exit and entry meters is a matter for agreement between the parties. **We have not changed our guidance on this.**

2.3.6 Emergency procedures and contacts

Fifteen respondents comment, and most agree with the guidance as drafted.

Several respondents comment on responsibility for emergency plans. One company thinks it should audit the entrant's emergency procedure. Two respondents think the entrant and company should review plans regularly. One respondent says that network users have a mutual responsibility to inform each other of emergency action plans. One thinks the company and entrant should share plans to ensure compatibility. One commentator thinks that both entrants and incumbents should have plans.

We agree that entrants and companies should co-operate over emergency plans, and this may involve the company reviewing and commenting on ways to improve the entrant's emergency plan. The focus should be on co-operation and co-development, where changes occur in operating conditions. These proposed solutions to emergency plans are all acceptable, though the entrant may decide it is important to have an emergency procedure even if the company does not require it. One commentator suggested emergency plans should be outsourced to ensure continuity and involvement of all parties. We do not agree, as the network operator must have control at all times. **We have added the relevant points to our guidance.**

2.3.7 Secondary connections

The majority of commentators agree. One thinks that secondary connections should only be allowed on new developments, or if the entrant accepts all the reinforcement charges. One company suggests we add the words 'without the

company's consent' to make this section less restrictive. We agree that the section could be less restrictive, **and have amended the guidance to allow companies to prohibit secondary connections.**

2.4 Glossary of terms

Access codes should contain a glossary of terms. This guidance will not attempt to establish a comprehensive glossary. As an example, however, and to aid readers of this guidance, we have used the following terms in this paper:

Avoidable cost

The cost avoided by a company that ceases to supply a particular market or customer.

Common carriage

More than one company using the same network to supply their customers.

Efficient Component Pricing Rule (ECPR)

A way to calculate access prices by subtracting avoidable costs from the incumbent's appropriate retail price.

Entrant

A party (either an existing or new company) who has successfully entered into a common carriage agreement.

Essential facility

A facility to which access is indispensable in order to compete in a market and its duplication is impossible, extremely difficult or highly undesirable for public policy reasons.

Incumbent

A licensed water and/or sewerage company under the Water Industry Act 1991 who owns the pipe networks and other infrastructure. Entrants can become incumbents via the inset appointment process.

Inset appointment

The mechanism by which one company can replace another as the statutory company for a specific geographical area.

Long Run Marginal Cost (LRMC)

The change in total costs per unit change in output, measured over a period in which all costs are variable.

MEA value

The book value of a company's fixed assets on a Modern Equivalent Asset (MEA) basis. This would be the cost to a new entrant of buying an asset with the same production capability to satisfy the remaining service potential of the asset.

Supplier of Last Resort (SOLR)

The WIA91 duties on the existing water companies to supply premises in their areas, even if the customers have switched to another supplier, if those other suppliers are not able to do so.

Water Quality Regulations

The Water Supply (Water Quality) Regulations 1989 and subsequent amendments. These Regulations specify the standards used to define wholesomeness of drinking water and also specify, under regulation 25, the requirements for using approved substances and products. The DWI enforces these Regulations.

Water Fittings Regulations

The Water Supply (Water Fittings) Regulations 1999. These Regulations replaced the Water Byelaws in England and Wales and are enforced by the water companies.

Water Resource Plan

An incumbent's long term strategic plan for water resource development in its area.

ANNEX 1 Lists of respondents

Water Companies

WaSCs

Anglian Water
Northumbrian Water
Severn Trent Water
Southern Water
Thames Water*
United Utilities Water
Wessex Water
Yorkshire Water

WoCs

Bournemouth and West Hampshire Water
Bristol Water
Cambridge Water
Folkestone and Dover Water
Mid Kent Water
Portsmouth Water
South East Water*
South Staffordshire Water
Sutton and East Surrey Water
Three Valleys Water

Potential Entrants

Access Water
Aquavitae/Direct Water
Centrica
Enviro-logic
United Water

Regulators and Government Departments

North Yorkshire County Council (twice)

Trade Associations

Water UK

Consumer Organisations

ONCC

Other Organisations

Chemical Industries Association
Energy Information Centre/Utility Buyers Forum
Federation of Small Businesses

Data transfer companies

Electralink

Formfill

* denotes confidential response