



ACCESS CODES FOR COMMON CARRIAGE

March 2002

GUIDANCE

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PURPOSE OF THE GUIDANCE

Common carriage means more than one company using the same network to supply their customers. It can increase customer choice by enabling entrants to compete in local markets without duplicating assets unnecessarily.

Competitors can apply to the incumbent water and sewerage companies and water-only companies (referred to as 'incumbent companies' or 'incumbents' throughout this document) for common carriage.

Common carriage arrangements must be run properly to protect customers' health and the integrity of the network. There have to be rules and procedures to govern how companies will provide access to their networks, although none so demanding that they deter competitors from even trying. Access codes set out these rules and procedures. They have an important role in the development of competition. They should:

- contain enough information to enable prospective entrants to assess the viability of their common carriage proposals;
- explain the application process; and
- provide a framework for negotiation between the parties.

The Competition Act 1998 (CA98) came into effect on 1 March 2000. In broad terms, it prohibits agreements, decisions or concerted practices which may restrict competition and may affect trade within the UK (the Chapter I prohibition), and conduct which amounts to the abuse of a dominant position which may affect trade within the UK (the Chapter II prohibition). Further details about the prohibitions are contained in the Competition Act guidelines: 'The Major Provisions', 'The Chapter I Prohibition' and 'The Chapter II Prohibition'. These publications are available on the Office of Fair Trading's website at www.of.gov.uk.

Companies risk infringing CA98 if they refuse access to their facilities without objective justification, or if they offer access on unreasonable terms.

This document is guidance for companies in England and Wales on what they should put in their access codes to minimise the risk of infringing CA98.

It is meant to encourage faster adoption of best practice across the industry. It sets out standards of behaviour for both incumbent companies and entrants, when making and implementing common carriage agreements.

It indicates how we might deal with complaints about common carriage under CA98. All companies must comply with CA98 and should take reasonable steps to resolve disagreements (taking legal advice where necessary) arising from common carriage applications. This guidance should help them to do that.

The guidance refers only to common carriage of water. Much of it would also apply to common carriage of wastewater, although we are not aware of any instance of this. We will give further thought to providing guidance on common carriage for wastewater, though we do not see a need for it at the moment. If companies are approached for common carriage for sewerage,

they must treat it in the same way as an application for water common carriage.

BASIS OF THE GUIDANCE

On 30 March 2001, the Government announced proposals for the licensing of entrants into the water industry. It intends to consult in spring 2002. Ofwat welcomes the prospect of new licensing provisions to clarify accountability and simplify entry. Meanwhile, the attached guidance refers to common carriage under existing legislation, and the Drinking Water Inspectorate's (DWI) guidance on water quality aspects of common carriage¹. Our guidance may need to be reviewed if legislation changes.

Companies know that they need to develop their codes, both in the light of experience with common carriage applications and by drawing on others' ideas. A number of potential entrants and customer groups have called for the development of a national code to facilitate competition. Our guidance sets out the core principles on which a national code could be based, and begins to provide some of the detail. It can be seen as a step towards a national code. However, companies should not expect or wait for a national code to be developed before progressing with common carriage.

Review of current practice

By autumn 2000, all companies² had published their own access codes. These drew upon advice provided by us in a series of letters to Managing Directors³. There are some similarities in the codes, but there are also a number of differences. There are some good ideas, which merit wider adoption, and there are some that may infringe CA98.

Consultation and workshop on draft guidance

We reviewed all the codes and prepared draft guidance on best practice. We consulted on this draft guidance in September 2001. We also held a workshop during the consultation period to explain and clarify issues covered in the consultation. We invited companies, potential entrants and customer representatives to attend. The forum provided an opportunity for organisations and individuals to discuss their points of view and to ask questions.

We received 32 written responses to the consultation paper. A separate discussion paper is available⁴ which discusses the responses, identifies the changes we have made to our guidance, and highlights where we have considered views but not made changes. Respondents generally welcome and support our guidance.

¹ Information Letter 6/2000 - 11 February 2000.

² Excluding Albion Water and Cholderton & District Water.

³ MD154, MD158, MD162, MD163, all of which are available from www.ofwat.gov.uk.

⁴ Access codes for common carriage - discussion of responses.

Recent CA98 experience

Some companies and potential entrants have started to pursue common carriage. They have made some progress and raised some important issues, but none has been successful to date.

FORMAT OF THIS GUIDANCE

Part 1 of this guidance addresses general issues that cut across different areas.

Part 2 of this guidance has a structure that we recommend all companies adopt. A common format reduces confusion for potential entrants.

In each section, key issues are highlighted in boxes. The main text describes these in more detail and provides more general advice.

FORUM FOR DEVELOPING ACCESS CODES

We are considering the usefulness of establishing a forum to encourage companies and entrants to work together in developing their access codes. This may be a working group, to review developments in common carriage and consider how companies should update their codes to implement best practice. We believe this could help facilitate common carriage. It should represent existing companies, potential competitors and customers. We welcome views on this idea, on its formation, running and terms of reference should be.

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

PART 1: GENERAL GUIDANCE

1.1 Essential facilities

Ofwat expects:

- That entrants should not have to prove that the assets they wish to access are essential facilities. But entrants should be prepared to provide information that the company reasonably needs to determine whether a facility is essential.

Companies risk infringing CA98 if they refuse access to their facilities without objective justification, or if they offer access on unreasonable terms. Refusal by an entrant to give adequate assurances on water quality, or refusal to contribute to necessary reinforcement costs could be objective justification.

In applying CA98 to common carriage cases, we will consider whether the facility that competitors wish to access is essential⁵. A facility is essential if access to it is necessary in order to compete in the relevant market, and duplication is impossible or extremely difficult owing to physical, geographic or legal constraints (or is highly undesirable for reasons of public policy). The competition authority assesses on a case-by-case basis whether a facility is essential, and in some cases it may not be. But many of the companies' capital assets (including their pipe networks and service reservoirs and treatment works) could be essential facilities.

In some cases, companies' water resources may be essential facilities. The Environment Agency (EA) allocates water resources through its licensing system. In July 2001, the Government published 'Tuning Water Taking', in which it noted that holders of abstraction licences whose actual abstractions were well below the licensed quantity, could be said to be hoarding licences. In such cases, the Government considered that CA98 may be particularly relevant if it can be shown that the retention of those licensed quantities amounts to the abuse of a dominant position and that this was a matter for Ofwat to determine, in consultation with the EA.

Before considering common carriage applications, some incumbent companies expect entrants to prove that the facility it wishes to access is essential. Entrants must not be expected to do this. It is for incumbents to decide whether a facility is essential because the risk of a CA98 infringement for refusing access lies with them. However, entrants should be prepared to provide information that the company reasonably needs to establish whether a facility is essential, on request. For example, a company might ask an entrant to show it had properly considered the alternative ways of supplying its target customers.

⁵ Guidance on essential facilities can be found in the Competition Act 1998 guidelines 'Assessment of individual agreements and conduct' (OFT 414) and 'The Application in the Water and Sewerage Sectors' (OFT 422).

1.2 Licensing

Ofwat believes:

- It is in the public interest for all entrants to be licensed.
- It is not objectively justifiable for companies to insist they deal only with licensed entrants.
- If entrants fail to become licensed, it is reasonable for the incumbent to insist the entrant gives stringent assurances about its operational and technical ability and its managerial competence, before allowing access.

Ofwat expects:

- Companies to insist that entrants match the standards to which they operate. Appropriate arrangements for monitoring those standards would be part of the access agreement. The agreement can also contain reasonable penalties if an entrant does not meet agreed standards.

At present, there is no specific legal requirement for common carriage entrants to be licensed. However, the Government proposed in March 2001 that legislative provision be made to license new entrants in the water industry. Under these proposals, entrants and companies could apply for a licence to produce water for input to the public supply network and/or to retail water services supplied from that network. Use of the public supply network by unlicensed companies would not be allowed. The Government is expected to consult later this year. But until such proposals are implemented the Water Industry Act 1991 (WIA91) and the Competition Act 1998 (CA98) remain the relevant legislation.

We strongly believe it is in the public interest that entrants are licensed. We do not want incumbents or entrants to compromise on health and safety. Licensing is the right way forward, and the most efficient and responsible way of achieving this objective. Other approaches would be more complex and necessarily require greater precautions to be put in place to ensure an equivalent level of protection for the public.

Customers will benefit from the extra protection of being supplied by a licensed entrant. For example, under the Water Supply (Water Quality) Regulations 2000 it is a criminal offence for licensed water companies to fail to meet certain treatment standards. Should there be a failure of the relevant standard by an unlicensed entrant and an associated outbreak of the illness cryptosporidiosis, it would not be possible for DWI to take legal action against the entrant. This could damage the reputation of the incumbent and licensed companies in general, when the incumbent was not at fault. It could undermine confidence in the regulatory regime. Water consumers would find such a situation unacceptable. It is for this reason that the Chief Drinking Water Inspector has advised OFWAT that he too believes that it is essential, to protect public health, for entrants to the drinking water network to be

licensed so that they are equally liable as existing water companies under the Regulations.

Most entrants appear to want to become licensed water companies, and we strongly encourage them to do so. Being licensed allows the entrant to give reassurances to its customers of its fitness to supply. A licence makes it easier to ensure that the entrant meets the required standards (both quality and management). Entrants can apply for a licence, as an inset appointee, at the same time as approaching a company for common carriage. In any case, under the Government's proposals for the forthcoming Water Bill, entrants seeking to use the public network will have to be licensed.

Existing companies can help the licensing process. This does not mean that companies grant licences. That is our role. But they can agree to an inset appointment (under section 7(4)(a) of the WIA91). Or, if an application was made which did not require their consent for the premises of a large user (section 7(4)(bb)) or a greenfield site (section 7(4)(c)), then they could choose not to object to the application. In each of these cases, however, they would still be able to provide us with comments, or object to the application on reasonable grounds.

Despite our belief that it is in the public interest for entrants to be licensed, there may be some unlicensed common carriage entrants who want to remain unlicensed. Some incumbents are prepared to deal with unlicensed entrants, as long as they have the necessary experience, technological skills and financial support. But most incumbent companies insist they will only allow licensed companies to access their networks. This approach ('mandatory licensing') stems largely from companies' concerns that unlicensed entrants are not exposed to criminal liability for supplying water that is unfit for human consumption, as are incumbents under section 70(1) of the WIA91. Incumbents do not wish to be liable when they are not at fault, and feel that insisting that entrants are licensed gives them better protection.

It would be a breach of CA98 to make access to an essential facility conditional upon mandatory licensing unless there were objectively justifiable grounds for imposing such a condition. The suggested concerns about section 70(1) WIA91 do not provide an objective justification for insisting on mandatory licensing. If the incumbent took all reasonable steps and exercised all due diligence to ensure that the water introduced into its network by the new entrant would be fit for human consumption on leaving the incumbent's pipes, then it would have a defence under section 70(3) of the WIA91 to any prosecution. If on the other hand it did not take all such steps and exercise all such diligence, then it is entirely appropriate that it should be exposed to prosecution.

If the entrant were licensed under the WIA91, the incumbent could still be prosecuted, as it still retains its liability under section 70, because that section applies when the water undertaker 'supplies [unfit] water by means of pipes to any premises'. In that context it appears that this wording refers to the act of

delivering water to a place rather than a person. Thus legal action could only be against the water company and not the new entrant.

If an entrant insists on being unlicensed, it is reasonable for the incumbent company to insist the entrant gives stringent assurances about its technical and operational ability and its managerial competence, before allowing access. These assurances may be more stringent than those the incumbent could reasonably expect from a licensed entrant. The company can also introduce reasonable damage clauses as part of the access agreement so the entrant has both a proper motivation not to supply unfit water, and liability if it does. This is a prudent strategy and would be justifiable under CA98.

In judging whether the incumbent was behaving reasonably in the way it treats unlicensed entrants, we would look at how the incumbent was protecting its exposure to breaches of health and safety rules. Even where entrants are licensed, it is appropriate for companies to insist that entrants match the standards to which they operate, provided they are reasonable. Appropriate arrangements for monitoring those standards would be part of the access agreement. Access agreements may also include reasonable penalties if the entrant fails to meet agreed standards.

1.3 Updating access codes

Ofwat expects:

- Companies to update their access codes to reflect developments in best practice.
- The latest version of each company's code to be available on its web site.

Experience gained from common carriage should assist the development of best practice in dealing with difficult issues. Inevitably, it will also raise new issues. Companies will need to review their codes and update them where necessary to reflect these developments. The latest version of each company's code should be available on its web site, clearly indicating when it was last updated. Companies should always apply and communicate the latest policy on common carriage, irrespective of whether it is contained in the latest version of their published access codes.

Generally, companies should update their codes annually. If there are significant changes in their approach to common carriage, we expect them to update their codes immediately. We will update our guidance on access codes in 2004, unless there is a major change that needs to be introduced before then (for example, the introduction of new legislation).

As common carriage develops and companies review and update their access codes according to best practice, early agreements may become out of date. Access codes should set out how agreements will be reviewed and amended to take account of companies' latest policies and changes to legislation.

1.4 Co-operation

Ofwat expects:

- Companies and entrants to co-operate in sharing information and in resolving day-to-day operational problems.

Common carriage arrangements will require the company and entrant to agree regularly how much water crosses the network, its quality, flow rates and patterns of customer demand, and perhaps other information.

We expect the parties to co-operate in managing the common carriage arrangements. That means:

- sharing information about demand patterns, water inputs and network requirements;
- maintaining sampling and measuring devices;
- keeping records of results and making these available for inspection; and
- working together to resolve any day-to-day operational problems.

1.5 Non-discrimination

Ofwat expects:

- Companies to impose the same requirements in respect of an entrant's source as they would impose if the source belonged to the company.
- Charges for access to be consistent with companies' existing charging policies.

We expect incumbent companies to require the same sampling and monitoring from the entrant that they apply to themselves. They must not place undue requirements on entrants, as these could be regarded as a barrier to entry. If there are reasonable doubts about a water source, it may be reasonable for the incumbent to ask for increased monitoring and sampling.

There may be sources (or points of entry to the network) which the incumbent company would not normally use, but which the entrant may propose using. It is for incumbents to judge whether a common carriage application is viable.

But they must give good reasons to entrants for rejecting sources, as well as giving an opportunity to solve the problem or propose an alternative. Incumbents continue to be network controllers and so the onus is on them to explain why a particular approach will not work.

The principle of non-discrimination applies equally to companies' charges for access, which should be consistent with companies' existing charging policies (see section 2.2).

1.6 Arbitration, disputes and CA98

Access codes should:

- Set out a mechanism for resolving disputes.

Oftwat expects:

- Most issues to be resolved by the parties without recourse to us.

In some cases, entrants and companies may be unable to agree on the terms for common carriage or disputes may arise once an agreement is in place. If an entrant considers that a company's behaviour is unreasonable, it can complain to the Director General of Water Services (the Director) or to the Director General of Fair Trading under the CA98. Examples of issues that have prompted complaints include:

- refusal to allow access to the network for common carriage;
- unreasonable delay or refusal to provide information to the entrant; and
- unreasonable delay in processing the application, including the provision of access prices.

When a complaint is made to us, we consider whether there are grounds for investigation under CA98, including whether there is an effect on the market. An investigation is a formal process which normally involves:

- an assessment of the relevant market;
- whether the incumbent has market power; and
- the effect of the incumbent's alleged conduct on competition in that market.

Investigations establish whether the incumbent has infringed CA98. In response to an infringement, the Director can impose a significant financial penalty and directions to stop the offending conduct, agreement or behaviour. The DWI and the EA would be consulted where a dispute involves quality or environmental issues. The Director's decision is subject to appeal to the Competition Commission Appeal Tribunals (CCAT). Detailed guidance is provided in our CA98 guideline 'The Application in the Water and Sewerage Sectors' (OFT 422).

We expect most issues to be resolved by the parties without recourse to us. We do not expect incumbent companies to use potential disputes as a means of deterring entry, nor should entrants involve us in the detail of their commercial negotiations. We would be concerned if either party sought to refer disputes to Oftwat without first making serious attempts to reach agreement. We want to be satisfied that the parties have tried to reach an agreement, before we consider a dispute. Companies may wish to include more detail in their individual agreements and access codes about mechanisms for resolving such disputes. The parties may agree to accept the

decision of an independent arbitrator. This does not override the Director's ability to investigate potential infringements of CA98.

1.7 Terms of contract

Ofwat expects:

- Entrants to be able to choose the duration of the common carriage contract, subject to reasonable conditions.
- Incumbents to retain ownership of infrastructure assets on its side of the point of entry to the network.
- Both parties to agree what happens if the common carriage agreement ends, and to inform customers of the arrangements for continuation of supply.

Both parties need to agree contractual terms for the successful operation of common carriage. Those terms should normally be agreed without involving us. There is no need for every agreement to contain the same terms, as entrants will have different requirements. It is for incumbents to agree with entrants what contractual terms are necessary and appropriate. Our guidance does not cover every issue that needs to be agreed, but those terms include the duration of the common carriage agreement, who owns assets installed as part of the agreement, and what happens when the agreement ends.

Some incumbent companies have stated preferences for minimum and maximum time limits, which reflect their uncertainty about how common carriage might work. It is important that entrants have enough incentive to pursue common carriage. Companies should not use time limits or insist on a short duration agreement as a deterrent to entry. The entrant should be able to choose how long it wants to share the company's network, subject to the company's agreement where there are particular constraints (e.g. technical obstacles to the entrant's preferred duration, or the need to recover network investment). In some cases it may be appropriate to link the common carriage agreement to the period for which an entrant holds an abstraction licence. Any extension of the agreement would then depend on the successful renewal of that licence, and both parties need to agree well in advance what happens to the entrant's customers if the common carriage arrangement ends.

On ownership of assets installed as part of the common carriage arrangement, it is reasonable that the incumbent company owns infrastructure assets on its side of the point of entry so that it retains full control of the integrated network. This would be the case even if the entrant had to fund upgrades to the existing network to make common carriage viable.

Both parties need to agree what happens when the common carriage agreement ends or if the entrant leaves the market (as opposed to a temporary inability to supply, which is covered in section 2.2.5 on stand-by

supplies below). In particular, they need to agree about continuity of supply for the entrant's customers, and what happens to the entrant's assets (especially if the entrant goes out of business).

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. This duty has a cost, because the incumbent has to have enough water in reserve to supply for domestic purposes, even though the entrant may be providing that water in practice for a particular period.

There are ways of addressing this need to have water available to fulfil a duty to supply water for domestic purposes. The incumbent can use its own resources, which have been released by the customer switching to the entrant. In this case, it would be reasonable for the incumbent to charge this cost to the entrant (and its customers) as part of the common carriage agreement. This charge will reflect the value the incumbent would have received from it if it could have used the water elsewhere, taking account of the probability of the entrant needing the service. Or, the entrant could 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. This is the more efficient option, and would benefit the incumbent, the entrant, and the customer. It may be unreasonable (in the absence of an objective justification) for an incumbent to insist on charging for keeping its own resources in reserve where the entrant has offered to transfer its resources to the incumbent should it leave the market. A variation on this latter option is that the entrant is able to satisfy the incumbent that it has options available to it (such as a contract with another water supplier) to provide water to the incumbent if the entrant fails.

It therefore seems sensible for entrants to agree to transfer ownership of their assets to the incumbent if they exit the market as the most economic way of ensuring continuity of supply for their customers. But it should be their decision (and their customers' decision) - they should not be obliged to do so. It is also sensible to agree that the incumbent should be able to operate these assets in the period between an entrant failing and such a sale, subject to the law governing succession of abstraction licences. Access agreements should set out how this would happen.

It is reasonable that the agreement should cover the question of maintenance of the entrant's assets so that the incumbent can be assured they meet the

incumbent's minimum standards. We would not expect the incumbent to insist on the entrant providing a bank bond to cover the cost of remedial repairs. This is 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.

1.8 Customer protection issues

Access codes should:

- Explain how responsibility for customer service will be assigned in a common carriage agreement.
- Provide for the company (in the absence of other arrangements) to assume interim control of the entrant's assets in the event that the entrant goes out of business in order to fulfil its duty to supply.

The company should:

- Retain operational control of the system at all times.
- Expect entrants to meet, but not exceed, standards that ensure that the levels of service received by the company's remaining customers are not affected adversely.
- Offer entrants the same service levels, in terms of supply failures caused by network problems, that apply to the company's customers.

The company should not:

- Regulate the levels of service provided by entrants to their customers.

This section covers those issues related to customer protection that need to be addressed in common carriage agreements and that access codes should clarify.

Common carriage allows an entrant to access the incumbent's infrastructure, but the incumbent retains operational control. Parties need to consider carefully how responsibility for customer service is assigned in a common carriage agreement, excluding those elements of customer service that are a matter purely for the entrant and its customers to agree. Access codes should explain how this would be done.

As a starting point, companies' own customers must continue to receive a service that is no worse than before the common carriage was agreed. To ensure this, companies can stipulate standards which entrants must meet. These standards must not be exaggerated as a means of deterring common carriage.

Because companies remain in control of the network, they must also ensure that entrants and their customers receive the same quality of service as the companies' other customers, for example, if network problems cause supply

failures. Where there is planned maintenance, all affected customers must have the same notice period of interruption to supply. The incumbent must inform the entrant in time for it to tell its customers about the supply interruption.

Access codes must explain how responsibility for each of these issues is assigned between the incumbent and the entrant, including details about customer protection and service levels. In most cases, specific details will be in the individual access agreement.

In some cases, an entrant may request a service that is higher or lower than the company normally provides. If the entrant is willing to pay a higher or lower access charge for this, then we would not prohibit such an agreement taking place. The onus is on the incumbent company to ensure its services to its other customers will not be adversely affected.

1.8.1 Customer contact – queries and complaints

Ofwat expects:

- That customers should have a clear point of contact at all times for emergencies, general enquiries and complaints.

The entrant should:

- Be the first point of contact for all enquiries from its customers.
- Take responsibility for financial enquiries from its customers. Examples include billing and debt collection.

The company should:

- Retain responsibility for investigating all complaints relating to operational issues relating to its network, including those from the entrant's customers.

Customers require a clear point of contact at all times for emergencies, general enquiries and complaints. The entrant should be the first point of contact for all enquiries from its customers. Agreements should set out how complaints are assigned, and transferred, between the entrant and the incumbent.

The role and responsibilities of both parties in dealing with complaints from the entrant's customers must be made clear. Customers need to understand the relationship between the parties and how any investigation will be handled. Parties could, for example, agree text explaining this relationship to accompany the contact details sent out with bills to the entrant's customers.

The incumbent, as the owner of the asset (e.g. the network), is responsible for investigating all enquiries about operational issues, including those from the entrant's customers. It should also be responsible for informing all customers

whose premises are connected to its network about emergencies such as boil water notices. The entrant and company should agree time-scales within which the company will respond to enquiries from the entrant's customers. The entrant should take responsibility for financial enquiries (such as billing) from its customers.

Where an entrant also owns a part of the network, both parties need to agree how to investigate operational queries. In the first instance, it may be sensible for the company to continue to investigate all operational queries, and to transfer the matter to the entrant only if the fault is theirs.

1.8.2 Customer transfer and switching

Ofwat expects:

- Transfers to be made in good time with a clear changeover date in place.
- Companies not to impose their own data transfer systems, or that of an associate company, on an entrant.

Access codes should set out:

- How customer communication will be managed.
- The customer details needed to ensure the smooth transfer of customers from a company to an entrant and a timetable for this exchange.
- The customer details needed for emergencies and planned/unplanned interruptions.
- How a company intends to ensure that, during transfers, customers have an identifiable point of contact at all times and how transfer mistakes are prevented.

Experience from the energy sector suggests that the transfer process can a source of complaints. Customers reasonably expect to have an identifiable point of contact at all times and mistaken transfers should not occur. Transfers should be made in good time with a clear changeover date for each case. Both parties' responsibilities should be clear to avoid misunderstandings. Both parties should agree how to resolve disputes about customer transfers.

The company could reasonably request customer details that are necessary to the smooth transfer of customers to an entrant. The company may also require details to ensure that service levels are maintained during emergencies and planned/unplanned interruptions. This is particularly important for vulnerable customers and customers with special needs. The parties will need to agree their respective responsibilities for information transfer and procedures to ensure that these customers are adequately protected.

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 is not appropriate to develop a single, common transfer system that applies to all companies until we know whether it is warranted. We do 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. Companies already deal with customers moving within and between their areas. It is 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.

Sharing of customer data should comply with the provisions of the Data Protection Act 1998.

1.8.3 Billing and debt collection

Ofwat expects:

- That common carriage agreements should not be dependent on an entrant agreeing to use a company's customer services.
- Entrants to take responsibility for billing and debt collection.

Customer debt (particularly for small amounts) need not necessarily be a barrier to switching. Where a household customer wants to switch supplier, the parties should agree how the incumbent can recover the debt owed to it. For example, entrants may be prepared to pay the debt on behalf of the customers who switch (and choose whether to recover the money from the customers). Non-household customers can be disconnected for non-payment of debt. We do not prescribe an approach. Incumbents should negotiate responsibility for debt as part of the access agreement and state their policy in their access codes.

Customers must not switch as a way to avoid paying their bill or to avoid disconnection. Entrants must assume the risk of non-payment by their customers if they take customers away from the incumbent. This means entrants would still be required to pay access charges if their customers did not pay their bills. Companies may offer their billing/debt collection services to entrants as an optional service.

PART 2: STRUCTURED GUIDANCE

2.1 Application process

Companies' access codes have separated the application process into a number of stages. In this section we set out and discuss the stages we consider a common carriage application should follow. This is not prescriptive, but indicates what entrants should expect as a minimum. Both parties may benefit from some flexibility in the process.

2.1.1 Stages of application

Access codes should explain:

- How an application will be progressed.
- How the company will make details of decisions and studies available to an entrant.

Ofwat expects:

- Applications to proceed in stages so that the entrant can choose to withdraw if it finds at an early stage that its common carriage proposal will not be viable.

Stage 1: Initial contact

A company should make its access code available to any potential entrant on request. We expect companies' codes to explain how applications will be progressed. A process map may help entrants understand what is required at each stage.

Access codes should contain sufficient information on standard or indicative prices and terms of access to allow prospective entrants to assess whether or not to submit a formal application. Sections 2.2 and 2.3 of this guidance set out the pricing information and operational detail that companies' codes should contain.

Companies should be prepared to meet prospective entrants at this stage to clarify any issues arising from the access code. This could include clarifying what information would be required in a specific application.

Stage 2: Initial application

In some cases, prospective entrants may require further information before asking a company to proceed with any detailed feasibility studies and testing to determine the final terms and conditions for access. In these cases, formal applications may be divided into two stages. An initial application should enable the company to:

- provide the entrant with an estimate of any case specific costs (including connection and network extension/reinforcement);
- provide an estimate of likely timescales; and
- highlight any likely difficulties and areas where technical information will be required at a later date.

Access codes should explain what information is required in an initial application and what information the company will provide in response.

Stage 3: Detailed application - feasibility study and testing

On the basis of a detailed application, incumbent companies should be able to carry out any feasibility studies and testing required to determine proposed charges, terms and conditions for access.

Parties should agree the scope and charges for any feasibility studies before they are started. They should also agree how the results will be shared. Some incumbents have said that they will provide entrants with a copy of all findings, and set out the decision and the reasoning behind it before discussing what action is needed to take an agreement forward. We expect all companies to take this approach.

- **Stage 4: Negotiation of contract**

Contract negotiation will depend on the outcome of any studies. However, this should not preclude early discussion of contracts. Providing entrants with a model network access agreement following initial contact, for example, will allow significant contractual issues to be highlighted quickly.

2.1.2 Information requirements

Access codes should:

- Explain the level of information a company requires at each stage of the process.
- Include a draft confidentiality agreement.

Ofwat expects:

- Companies to require only the information needed to progress the application at each stage.
- Companies not to duplicate information requirements.

Access codes should set out the information normally required at each stage of the application process. Companies should only ask for the information needed to progress the application at each stage, but should not be expected to progress an incomplete application. Companies should explain the specific information requirements at the initial contact stage, and explain why the information is needed. To facilitate this, entrants need to provide a broad

outline of their access proposals at that stage. In every case the company will need to balance the need for flexibility and the need to prescribe information.

In particular, entrants will need to provide information about their entry and exit points to the company, so it can assess whether the application is feasible. We believe the entrant should provide this information at stage 2, at least in indicative terms, as long as there is an appropriate confidentiality agreement in place to protect the entrant's proposals and the company has provided indicative access charges. These criteria will help to reduce companies' ability to delay the common carriage application in order to try to prevent the customers switching.

Delays are likely when applications are incomplete. Satisfactory submission of information is the responsibility of the entrant. However, incumbent companies should take reasonable steps to minimise delay by ensuring that their requirements are clear. Many access codes include outline lists of the information, and detail, required for each stage of an application. These lists are essential.

We do not expect entrants to be asked to resubmit information they have already provided. This applies also to repeat applications to the same company, although companies may require repeat entrants to update information previously if circumstances change.

Common carriage agreements are likely to require each party to reveal to the other information which might be commercially sensitive. For example, the entrant will need to tell the incumbent which customers it is targeting, and may be concerned that the incumbent will delay the negotiations while it attempts to persuade the customers not to switch. The parties are likely to need a confidentiality agreement, to protect against inappropriate use of this information. Incumbent companies' access codes should contain a draft confidentiality agreement, to help the process. Any restrictions this placed on data sharing would need to be objectively justifiable. Co-operation by the companies could speed up the development of a 'best practice' confidentiality agreement. This may be an issue for the proposed working group to consider.

2.1.3 Timescale

Access codes should set out:

- Reasonable timescales for processing applications.
- The differing requirements for applications from previous or multiple entrants.

Ofwat expects:

- Responses to initial applications to be made normally within four weeks.
- Responses to detailed applications to be made normally within eight weeks.

Some companies have set out timescales for the application process as a whole, or for specific stages. We think that responses to initial applications should normally take no more than four weeks. Responses to detailed applications, which might entail more analytical work, should normally be completed within a further eight weeks. Unreasonable delay by incumbents could be an infringement under CA98.

Incumbent companies should set out expected timescales and keep entrants informed if these are unlikely to be met. A staged approach to processing applications is not an opportunity to delay common carriage agreements.

2.1.4 Application fees

Ofwat expects:

- Companies to provide initial clarification of company policy and information requirements without charge.
- Companies to ensure that all application charges are transparent.

Access codes should set out:

- How the company will calculate the actual costs of processing an application.
- What opportunity entrants will have to review the basis of costs.
- How an entrant would be charged if it withdraws during the application process.

Companies should be careful not to risk infringing CA98 by charging for every aspect of an application. Entrants should not be charged for clarification of company policy and information requirements.

Companies' standard application fees range from £50 to £5,000. The fees are not comparable because they cover different amounts of work by the company. However, we consider that, in assessing initial applications, companies should only undertake such work as is necessary to fulfil the aims set out under stage 2, as described above.

Entrants should only be charged for the actual costs incurred. If an application is withdrawn during the process the entrant should only pay for the costs incurred to that point (including any unavoidable future costs that the application may have triggered).

Entrants should have the opportunity to review the basis of any cumulative application charges. A number of access codes state that cumulative application charges, mainly associated with feasibility studies, will be recorded on an open-book basis or that the basis for these charges will be available on reasonable notice. We expect all companies' charges to be transparent.

2.2 Pricing issues

Access codes must contain sufficient information for a prospective entrant to form a broad view of how much it is likely to pay for access. Incumbent companies must explain the basis for their proposed access charges. They should publish indicative prices and, where possible, standard prices. We have proposed that companies provide all of their access prices to us for publication on our web site.

We expect incumbents to indicate all aspects of their access charges as early as possible. Where published prices are indicative, rather than standard, they should be based on best estimates of the costs of providing access, using information available at the time. Companies should not set indicative prices unrealistically high to deter entrants.

Following an application, companies should not delay providing prices based on case-specific circumstances. Failure to provide, or excessive delay in providing, prices might be an abuse of a dominant position under CA98.

2.2.1 Access price components

Access codes should set out:

- The structure and basis of companies' access prices.
- Indicative prices and, where possible, standard prices (further guidance on what Ofwat would expect companies to publish under each component is given in sections 2.2.2 to 2.2.5).

Ofwat expects:

- Indicative prices to be based on best available estimates of the costs of providing access. They should not be set unrealistically high to deter entry.
- Companies to submit their access pricing schedules for publication on Ofwat's web site.
- Consistency between companies' access charges and their current tariffs.

Companies should set out the separate elements of their access charges, which include charges for:

- use of system (section 2.2.2); and
- connection (both entry and exit) and network extension/reinforcement (section 2.2.3).

Entrants may ask for their supplies to be augmented by the company under certain circumstances. Companies should indicate their arrangements for provision of:

- top-up supplies (section 2.2.4); and
- stand-by supplies (section 2.2.5).

2.2.2 Use of system

Access codes should set out:

- Standard use of system prices (for companies basing prices on regional average accounting costs), broken down into charges for access to separate elements of the system (unused resources, bulk transport of raw water, treatment, bulk distribution of treated water and local distribution).
- As much information as possible about the degree to which different cost elements are likely to be avoidable (for companies using the 'Efficient Component Pricing Rule' – ECPR). Zonal Long Run Marginal Costs (LRMCs) can indicate likely avoidable costs.
- Indicative use of system prices based on regional or zonal average LRMCs (for companies basing prices on LRMC).
- Information an entrant must provide for the company to derive an indicative price and how long it would normally take to provide that price.

Ofwat expects:

- Companies to update their indicative and standard prices as appropriate and to review them at least annually when tariffs are set. This may be achieved by publishing prices in an annex to each code, updated versions of which could be published separately when necessary.
- Consistency between companies' use of system charges and their current tariffs.
- Consistency, in most cases, between claimed avoidable resources and treatment costs (under ECPR) and charges for bulk supplies.
- Where prices are to be based on local – rather than regional – costs, indicative prices should be available immediately and proposed prices should be provided normally within eight weeks.
- Allocation of the rate of return element of costs (for companies basing prices on regional average accounting costs) to be consistent with the way in which it is allocated for calculating tariffs to final customers.

Methodology

Use of system charges can be calculated in several ways. MD163, 'Pricing issues for common carriage', set out our position. In it we said:

"In assessing disputes or complaints about access prices, Ofwat will focus on the effect of the price on competition in individual cases, and on the cost information on which it is based."

There are three main ways of calculating access prices. Specifically, access prices can be based on:

- average accounting costs (AAC, the book value of the assets to which access is sought);
- LRMCs; or,
- the ECPR.

Most companies indicate they intend to use AAC. Incumbents set their current tariffs to end users on an average cost basis, so access charges based on that method could be more straightforward to calculate than those based on other methods. But calculating average costs requires the rate of return element of companies' costs to be allocated between services to determine a price for each service (e.g. resources, treatment, bulk distribution, and local distribution excluding connection costs). There is no correct way to do this. We expect companies to allocate the return consistently with the way in which they allocate it for calculating tariffs to final customers.

Some indicate that entrants will be charged for any incremental costs of providing common carriage access (including the costs of new investment), although none has suggested it would charge purely on the basis of LRMC. We discuss the calculation of LRMC in detail in MD 170⁶. But the calculation of the marginal costs of bulk transport and distribution is likely to depend on whether the entrant is seeking access to serve new or existing customers, because the impact on the incumbent's system might be different.

One company indicates it would use ECPR. Under this approach, the incumbent calculates the access price by subtracting from its final product price the costs avoided in providing access. So, for an entrant wanting to access the incumbent's bulk and local distribution network, the access price would be the incumbent's final tariff less its avoidable costs of resources, treatment and customer service. It is also possible that common carriage can provide network cost savings to the incumbent, and these should be reflected in the access price.

ECPR is designed to ensure that entry only occurs when it results in lower costs in aggregate. We support this objective. But companies should note that where they charge on this basis, we expect consistency between claimed avoidable costs and claims for supply/demand expenditure. For example, for a company with resource constraints, we would expect both bulk supply prices and avoidable costs to be relatively high, meaning access charges should be relatively low. This would allow new supplies from competitors, where this was beneficial to customers. If the claimed avoidable costs of resources and treatment (which may be proxied by LRMC) are low, incumbents may be required to make new bulk supplies on terms that are consistent with this assessment.

ECPR based prices need to reflect the incumbent's up to date resource plans. Avoidable costs may be low if the common carriage agreement is short or the new supply is too small to avoid capital costs of new resources.

⁶ MD 170 'The role of long run marginal costs in the provision of water and sewerage services', 8 May 2001.

But avoidable costs may be high if entry allows the existing company to reduce or remove a headroom deficit. This benefit must also be reflected in the access price.

Calculating ECPR prices removes the need for some of the other charges listed below. For example, if an entrant sought provision for security of supply from the incumbent company, the costs of providing that security would not be part of the avoidable costs subtracted from the retail tariff. Errors of inclusion (hence over-recovery of costs) are more likely under a top-down approach, such as ECPR. Companies must avoid these. Careful assessment of the avoidable costs on a case by case basis (including the level of security required by the entrant) will help them do this.

Incumbents that use the AAC or LRMC approaches should publish charges for access to separate elements of the system (for example, resources, bulk transport of raw water, treatment, bulk distribution of treated water and local distribution). Their charges for these elements should be consistent with their existing charging policies. For example, where entrants intend to supply only large users, it would be unreasonable to charge them for access to the local distribution network if the company does not charge its large users for this service. Where entrants wish to use companies' bulk networks to supply customers on new developments, but to use their own local distribution networks, they should only be charged for bulk distribution.

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. It is for companies to decide their approach, 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. Such 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.

Whatever method is adopted, we expect consistency between companies' access charges and their current tariffs. In particular, if companies charge for access on the basis of local costs, but maintain regional average charges for their existing customers, or vice versa, then we will expect them to justify this. And where companies offer prices that do not appear to be consistent with their stated method, they must explain why they have done so.

For companies whose geographic area is made up of two or more non-contiguous regions, we expect access charges in each region to be consistent with the tariffs to customers in that region.

Information which companies might need to calculate a price, and which the entrant could provide, includes:

- entry and exit points,
- proposed volumes,
- peak flows and flow patterns,
- whether the customer is current or new,
- proposed duration of the common carriage agreement,
- quality sampling arrangements,
- top-up and stand-by requirements; and
- balancing period.

Timescale for provision of prices

In their access codes most companies state their intention to base their use of system charges on regional average costs. Given that companies should already know what these costs are, and charge their own customers on this basis, it is surprising that only one – South Staffordshire Water – has published an indicative charge. Published prices should be standard, rather than indicative.

Where companies choose to use the ECPR, they should publish as much information as possible about the degree to which different cost elements are likely to be avoidable. This includes elements of avoidable costs that are not likely to change between cases. Zonal LRMCs are an indication of likely avoidable costs. Proposed prices should be provided within eight weeks. To facilitate this, entrants must provide sufficient information in their application to enable the company to provide a price.

2.2.3 Connection and network extension/reinforcement

Access codes should set out:

- Indicative charges for connection and network extension/reinforcement under a range of typical circumstances.

Ofwat expects:

- Entrants to be able to choose who carries out the greater part of any necessary work on connections, subject to companies' self-lay policies.
- Consistency with policy on requisition charges, for connection of new customers.
- Entrants to meet the cost of network extension/reinforcement, where it is solely required for common carriage.
- Proposed charges for connection and network extension/reinforcement to be made available to entrants normally within eight weeks.

Common carriage will require entrants to connect into the incumbents' networks. In some cases, the existing network will need to be reinforced or extended to accommodate the new input. This work is different to that needed to connect new customers to the existing network.

There should be no presumption that incumbent companies will carry out all necessary work on connections. Much could be done by the entrant or by a third party appointed by the entrant. Where the work involves connecting new customers, the entrant must be able to choose who carries out this work, in accordance with the incumbent's policy on self-lay for new developments. The incumbent needs to be involved to ensure that appropriate standards of water quality, safety and workmanship are met.

Methodology

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.

Timescale for provision of prices

Companies should publish indicative charges for connection and network extension/reinforcement under a range of typical circumstances. Such charges might include prices to upgrade different pipe sizes per metre, indicative prices for different volumes, or prices 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.

It should normally be possible to complete the modelling work and feasibility assessment required to determine any proposed connection and network extension/reinforcement charges within the eight week period for detailed applications (stage 3), provided entrants submit the necessary information promptly.

2.2.4 Top-up supplies

Access codes should set out:

- The basis for calculating any allowance for leakage. This should be based on economic levels of leakage (ELL).
- Standard prices for any top-up supplies. Since top-up refers to water supplied on a continuing or regular basis, charges for such water should normally be the same as standard tariffs to final customers.

Ofwat expects:

- Entrants normally to use their own supplies to meet their customers' demands and to make up for water lost through leakage. However, companies could also offer to sell top-up supplies if the entrant's supplies are insufficient.

Top-up supplies refer to water supplied by the incumbent company on a continuing or regular basis to supplement the entrant's own supplies. It is likely that top-up supplies would be made via the same connection to the entrant's premises. In effect, the incumbent company augments the entrant's supply, and the arrangement is between the incumbent and the entrant. Therefore, it would benefit all parties for the customer to be billed solely by the entrant.

Accounting for leakage

Companies have rightly identified leakage control and the costs of replacing water lost to leakage as legitimate costs of running their networks. It is appropriate for them to seek compensation for these costs. They have suggested different methods for doing this. We think entrants should normally use their own supplies to cover water lost as leakage. We expect this to be more economic because entrants will typically secure a place in the market by providing water at lower cost than the incumbent provides.

Companies employ a wide range of methods for accounting for water lost via leakage. We consider that zonal assessments of ELL would provide the best basis for encouraging efficient resource use. In practice, incumbent companies may not have ELL assessments at the zonal level, but they should have zonal leakage targets consistent with their regional ELL. Where access is only for part of the distribution network, the volume of water required to replace leakage should be lower than when access is sought to both bulk and local distribution.

Where the company provides water to cover leakage, it will need to apply an appropriate price to the agreed volume. Since this supply would be made on a continuing or regular basis, charges for it should normally be the same as standard tariffs to final customers.

Partial supplies

In some cases, entrants may plan to supply only part of a customer's needs. It is not unknown for customers to be supplied by more than one supplier and there is no reason in principle why this should not happen. To lose only a part of a customer's demands minimises the adverse impact of competition on the company. It is for the parties involved (including the customer) to decide whether the customer should be billed by one or both suppliers.

Charges for top-up supplies as part of a partial supply arrangement should be the same as standard tariffs if the supply is made on a continuing or regular

basis. However, if partial supply arrangements generate a greater than normal variation in the demands on the company's resources, then such arrangements may be inconsistent with the above definition of top-up supplies. If the arrangements are more like a standby facility, then charges should be made on that basis.

2.2.5 Stand-by supplies

Ofwat expects:

- Entrants to plan to meet their customers' demands even in dry weather conditions.
- Companies not to refuse access on the basis that an entrant's resources do not meet minimum hydrological conditions as specified by the company. Stand-by charges should reflect the volume and reliability of the entrants' capacity and the implications of that for the companies' capacity costs.

Stand-by supplies refer to water supplied by the company on a periodic or intermittent basis to supplement or replace the entrant's own supplies. They may be required, for example, if the entrant's own resources are insufficient to cover extreme dry weather conditions or loss of supply due to pollution incidents.

Entrants are unlikely to have as wide a range of resources as incumbents and therefore are unable to spread the risk of source failure as widely. Stand-by supplies are a sensible contingency, to allow the entrant to keep supplying their customers. But we expect entrants to plan properly and sensibly to meet their customers' demands. This is particularly the case where the entrant is supplying new customers and companies' resources are constrained (and so the availability of standby supplies is not guaranteed).

Entrants can provide their own stand-by supplies if it is cheaper for them to do so. If it is cheaper for the existing company to provide stand-by supplies, entrants must expect to pay a reasonable charge for them. Incumbents' charges will take account of the volume and reliability of the entrant's source, including the probability of it failing and the consequent impact on their resource position. Peak and seasonal factors may also be important. The stand-by charge covers the cost to the company of keeping capacity available, but it does not have to be a dedicated capacity. We do not agree that stand-by charges 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.

As with top-up supplies, it would be sensible for customers to be billed solely by the entrant.

Some incumbents expect the entrant's resources to be sufficient to meet its customers' demands under hydrological conditions specified by them. It could be unreasonable to refuse access to an entrant if its resources did not meet

such conditions. However, it would be reasonable for companies to use a risk assessment of the entrant's resources, consistent with industry best practice, as the basis for making arrangements for stand-by supplies.

2.3 Operational issues

Incumbent companies' access codes should provide enough information to allow entrants to assess the operational viability of their proposals. This need not constitute an exhaustive operational 'handbook'.

It is reasonable for companies to expect entrants to comply with the relevant legislation and the same codes of practice to which the companies work. Thus it may be unreasonable for the company to impose more stringent operational requirements on licensed entrants than it uses itself. Otherwise, incumbents risk infringing CA98.

2.3.1 Water quality and sampling

Ofwat expects:

- Companies to have the right to suspend access to the system if there is any risk of non-compliance with the Water Quality Regulations⁷.
- Entrants to ensure their water is compatible with the company's water.
- Entrants to be allowed to choose whether to carry out their own sampling and analysis.

Incumbents should make it clear that they have the right to refuse or to suspend access to a system. Refusing or suspending access is standard practice if there is a risk that water quality will breach the requirements defined in the Water Quality Regulations (set out in more detail on annex 1). Where an entrant suspects that water quality may be breached, it must inform the company as soon as possible.

In the DWI's annual report for 1999, the Chief Inspector noted that, under current law, a licensed water company under the WIA 1991 is responsible for all aspects of drinking water quality regulations independent of other users' systems. It is therefore necessary for incumbent companies to ensure their common carriage agreements cover this. The DWI has given guidance to water companies on the drinking water quality aspects of common carriage⁸. It believes as long as the guidance is followed, common carriage can operate without impairment to water quality. It does not believe that trial periods should be used in any common carriage situation. We the accept the DWI's view. Incumbent companies should use network modelling to assess the

⁷ Water Supply (Water Quality) Regulations 1989, as amended, the Water Supply (Water Quality) Regulations 2000 (which apply to water companies whose area of supply is wholly or mainly in England) and the Water Supply (Water Quality) Regulations 2001 (which apply to water companies whose area of supply is wholly or mainly in Wales).

⁸ Information Letter 6/2000 - 11 February 2000.

potential effects of common carriage, and follow the DWI's guidance. They should not use trial periods to test common carriage arrangements.

If companies and entrants are still in doubt about the effect of common carriage on quality issues after modelling a common carriage scenario, they should contact the DWI for advice. Companies generally treat their water to a higher standard than specified in the Water Quality Regulations, to allow for variations in water quality as it travels to customers. Entrants must ensure their water is compatible with the company's water. This includes factors such as taste, colour, hardness and smell. Entrants' water must also comply with the company's procedures for plumbosolvency control and fluoridation. Where the company has agreed to the local health authority's request to fluoridate water, the entrant must also agree to do so.

The DWI audits water companies to check compliance with their duties in respect of drinking water quality. Companies may find it helpful to consider the range of issues audited by the DWI and to highlight these requirements to the entrant. The items included in these technical audits are a good starting point for negotiation and clarification.

Sampling and monitoring

It is important to establish who will be responsible for water quality sampling at the entry point for both compliance and operational monitoring. The entrant should have the option of arranging its own sampling and analysis at a suitably accredited laboratory, and this analysis must comply in full with the requirements of the Water Quality Regulations. This does not preclude the company from conducting its own sampling as well, but it should not charge the entrant for doing so. Entrants should note that any party putting treated water into the public supply network must comply with the requirements for cryptosporidium under the Water Quality Regulations.

Water companies are responsible for monitoring the quality of water supplies. This self-monitoring role is subject to continuous audit by the DWI of the sampling and analysis methods and the results. Licensed entrants must be aware that they too will be subject to audit by the DWI.

2.3.2 Network management and control

Access codes should set out:

- Arrangements for the provision of water for fire fighting.
- Arrangements for sharing maps and plans.

Ofwat expects:

- Companies to retain control of operation and maintenance of the network.
- Information sharing to clarify network operational requirements.

The incumbent companies retain responsibility for the operation, maintenance and control of its infrastructure in its appointed region.

Maps and plans

It is important for the entrant and the company to share relevant maps and plans, normally at the detailed application stage. This is subject to objectively justifiable conditions about security and copyright. Information from network modelling should be shared between the parties, for example, to clarify the negotiation of connection costs, such as mains reinforcement. It is also relevant to agreeing operational practices such as regular flushing programmes. It will be important to highlight known areas at risk of discolouration incidents due to flow or pressure fluctuations during routine and non-routine use of the system, for example, firefighting.

Firefighting

Arrangements for the provision of fire-fighting water should be made clear in access codes. They should allow for appropriate adjustments in the demand balance. Maintaining pressure in the system during such incidents is a consideration where the entrant's source has a significant impact on the network.

Unauthorised use of water

Potential unauthorised standpipe use (and theft of water) should be addressed, in terms of both water usage and of possible discolouration. The incumbent should indicate to the entrant its experience of the usual local extent of the problem.

2.3.3 Drought and resource planning

Access codes should set out:

- The information required from entrants as part of its risk assessment.

Ofwat expects:

- Entrants to comply with reasonable requests for information necessary for the incumbent to fulfil its statutory duty to supply, including preparing its water resource plan.

As part of their detailed applications (stage 3), entrants should provide a thorough risk assessment of the proposed source i.e. an assessment of exposure to pollution incidents, vandalism etc. Access codes should set out the information requirements for this assessment and companies should provide further clarification where necessary.

Risk assessment of water resource reliability is also important. It is discussed in section 2.2.5 under stand-by supplies. Access codes should set out the

information required to undertake assessments. Entrants should comply with reasonable requests for information that is necessary for the company to fulfil its statutory duty to supply. It is reasonable for entrants to expect the same information requirements as companies would need to assess their own new source.

Consistent with their statutory duty to supply, companies will retain responsibility for drought planning and the ability to apply for drought orders restricting non-essential use. However, it will be for entrants and companies, consistent with their resource positions, to agree whether their customers should be subject to the same risk of interruptions to supply.

2.3.4 Maintenance and serviceability of assets

Ofwat expects:

- The company to specify when it will carry out work on assets within the shared network and whether this will affect supplies to the entrant's customers or the use of the entrant's sources.
- Access agreements to contain a minimum notification period for planned work.

The incumbent company should inform the entrant when it will carry out work on assets within those parts of the network used by both parties (the shared network) and whether this will affect supplies to the entrant's customers or use of its sources. Companies should negotiate with entrants about when to do this work, to minimise disruption to customers. For example, some large businesses close down for holiday periods, and it would be sensible for work that might otherwise affect their supplies to be done during these times. Entrants may also need to inform the incumbent company about maintenance work on their assets. In these cases, entrants are likely to require standby supplies, and will need to inform the incumbent.

Common carriage agreements need to define the procedures to follow (as well as each party's role) during network maintenance, meter installation and leak repairs. Agreements should contain a minimum notification period for planned work. Where possible, the company should try to agree a period with the entrant. However, the company has to be allowed to set the notice period, because it knows its own planning process, and therefore how much notice it can give. We expect the notice period to be reasonable.

2.3.5 Metering and flow balancing

Ofwat expects:

- Companies and entrants to agree how to balance water flows over time.
- The method of charging/reimbursement for over- or under-supply by an entrant to be fair and transparent.

Ofwat believes:

- Companies can expect to measure how much water entrants input to the network, and how much their customers take out.

It is reasonable for a company to measure flows supplied by the entrant and the water taken by the entrant in supplying its customers. This does not imply that only customers currently charged on a measured basis are eligible to switch suppliers. The entrant must measure its customers' demands, at least in bulk, but it is still entitled to charge its customers on an unmeasured basis. It is for entrants to agree the charging arrangements with each of their customers.

The installation of a control valve on an entrant's supply may be a pragmatic solution to potential network problems. This should be capable of controlling pressures and flows within the ranges specified by the company.

The two parties should agree the balancing period for the purpose of charging for volumes input by the entrant and used by the new entrant's customers. The balancing period should not be too short or involve excessive data collection requirements. There should be sufficient time for a demand cycle to be established.

When considering both telemetry reporting and demand balancing, the current operation of the company should be taken into account. The costs and benefits of over- and under-supply depend on whether the network is in deficit or surplus, and the amount by which the supply differs from the agreed normal 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.

2.3.6 Emergency procedures and contacts

Ofwat expects:

- Responsibilities and procedures for failure of plant or contamination or pollution incidents to be agreed between the parties before live connection.
- Entrants to be thoroughly briefed on any emergency action plans relevant to them, before live connection.

Responsibilities and procedures for failure of plant, or contamination or pollution incidents need to be agreed between the parties before live

connection. It is vital that both parties continue to report to the DWI⁹, and to notify the DWI of any event affecting drinking water that may be of significant risk to public health. Companies and entrants must also liaise with the EA for both pollution control and proper management of water resources.

Entrants should be thoroughly briefed before live connection on any relevant emergency action plans. Incumbents can reasonably expect entrants to provide details on and to demonstrate their emergency procedures. Responsibilities and procedures for local incident management teams also need to be defined in the access agreement. It is good practice to include entrants in exercises to foster understanding of procedures. The incumbent company may wish to audit the entrant's emergency procedure, or share its own plan to ensure compatibility. The plans should be reviewed regularly. An incumbent company could reasonably expect to retain primary responsibility for its own network in these situations. Parties should ensure that any agreement sets out clear lines of responsibility for both informing (including publicising the nature of an incident and any precautions required) and providing a point of contact for customers.

2.3.7 Secondary connections

Ofwat expects:

- Companies should be allowed to prohibit entrants from sub-letting access to the company's network.

Once an entrant has been allowed access to a network, it should not then be able to 'sub-let' the access agreement to other entrants with their own resources, without the incumbent company's agreement. Additional entrants should deal directly with the incumbent to enable it to maintain control and operation of the system. This should be incorporated into the contractual agreement between the company and the first entrant.

⁹ See the Water Undertakers (Information) Direction 1998, DWI Information letters 3/94 and 13/99, and the Water Quality Regulations.

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 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 SUMMARY OF WATER REGULATIONS

- **The Water Supply (Water Quality) Regulations 1989, as amended.**
- **The Water Supply (Water Quality) Regulations 2000 (which apply to water companies whose area of supply is wholly or mainly in England.)**
- **The Water Supply (Water Quality) Regulations 2001 (which apply to water companies whose area of supply is wholly or mainly in Wales.)**

Water mains and pipes approved for use in the public water supply system

Materials for water mains and communication pipes must meet the requirements of Regulation 25. Failure to meet this requirement is an offence under Regulation 28.

The DWI enforces these Regulations.

Mains and pipes which have been so approved are listed by the DWI. The list is published twice a year, and can be obtained from DWI (telephone: 020 7944 5956; or, from the DWI website: <http://www.dwi.gov.uk/cpp/pagea.htm>)

The list is replicated in the Water Fittings and Materials Directory, which is published by the Water Regulations Advisory Scheme (WRAS) (telephone: 01495 248454; or WRAS's website address is www.wras.co.uk)

WATER SUPPLY (WATER FITTINGS) REGULATIONS 1999

On 1 July 1999, the Water Supply (Water Fittings) Regulations replaced the Water Byelaws in England and Wales. They prevent the waste, misuse, undue consumption and contamination of public water supplies in domestic and commercial plumbing installations.

Copies of the Water Fittings Regulations are available from the HMSO website at www.legislation.hms.gov.uk/stat.htm - Full text of Statutory Instruments 1999 - No's 1148 and 1506, or can be purchased by telephoning HMSO on 0870 600 5522.

The water companies enforce the Regulations. Further advice should be sought from them or from the Water Regulations Advisory Scheme on 01495 248454 or from its website at www.wras.co.uk. The Scheme, in partnership with DEFRA, has also produced the Water Regulations Guide to provide more detailed explanation of the requirements. Copies are now available from the Scheme, priced at £14.95 each.