

# CONSULTATION



**Access  
code  
guidance**

# ACCESS CODE GUIDANCE - CONTENTS

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# FOREWORD

## Common carriage and access codes

Common carriage can increase customer choice by enabling competitors to enter local markets without duplicating assets unnecessarily. Competitors can apply to the incumbent water and sewerage and water-only companies (referred to as 'undertakers' throughout this document) for common carriage.

Undertakers risk infringing the Competition Act 1998 (CA98) if they refuse access to their facilities without objective justification, or if they offer access on unreasonable terms. Most incumbents insist that all applicants for common carriage be licensed, as it gives them better protection when they are not at fault. In applying CA98 to common carriage cases, we would consider whether an incumbent was dealing with its concerns in the least restrictive way possible. The situation has become clearer since we issued MD158 in January 2000. In our view it may not be unreasonable, in most cases, for incumbents to insist that all applicants for common carriage be licensed, as long as they consent to the unlicensed entrant becoming licensed and expedite this process. In applying CA98 we will also consider whether the facility that competitors wish to access is 'essential'<sup>1</sup>. A facility can be viewed as essential if access to it is indispensable in order to compete in a market and duplication is either impossible, extremely difficult or highly undesirable for public policy reasons. Many of the capital assets of water and sewerage undertakers could be regarded as essential facilities.

Common carriage access codes describe how undertakers will provide access to their networks. They have an important role in the development of competition. They should:

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

By Autumn 2000, all undertakers<sup>2</sup> had published their own access codes. These drew upon advice provided by Ofwat in a series of letters to Managing Directors<sup>3</sup>. There are a number of similarities in the way that the codes deal with specific issues, but there are also a number of differences. There are some good ideas, which merit wider adoption. And there are some ideas that may infringe CA98.

## Objectives and coverage

This document sets out and seeks views on draft access code guidance for undertakers in England and Wales. The guidance is meant to encourage faster adoption of best practice across the industry. It provides criteria which undertakers should adopt if they wish to minimise the risk of their access codes breaching CA98.

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<sup>1</sup> 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).

<sup>2</sup> Excluding Albion Water and Cholderton & District Water.

<sup>3</sup> MD154, MD158, MD162, MD163, all of which are available from [www.ofwat.gov.uk](http://www.ofwat.gov.uk).

It also sets out standards for the behaviour of both undertakers and applicants making and implementing common carriage agreements. It indicates how Ofwat 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, although many of the principles set out here would also apply to common carriage of wastewater. Undertakers risk infringing CA98 if they refuse access to water or sewerage facilities without objective justification, or if they offer access on unreasonable terms. We would welcome views on whether it would be desirable for Ofwat to develop guidance on common carriage specifically in sewerage services.

On 30 March 2001, the Government announced proposals for the licensing of entrants into the water industry. It intends to consult on these proposals in autumn 2001. 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. It may need to be modified in response to any changes in legislation.

Undertakers know that they need to develop their codes, both in the light of experience with common carriage applications and by drawing on others' ideas. Some are already working on behalf of the Water UK Competition Group to review all of the current access codes. Their objective is to establish the scope for a national access code. We welcome this initiative. A number of potential entrants and customer groups have called for the development of a national code to facilitate competition. Ofwat's guidance sets out the core principles on which such a code could be based, and begins to provide some of the detail. As such, it can be viewed as a step towards a national code. However, undertakers should not expect or wait for a national code to be developed before progressing with common carriage.

## **Format**

Part 1 of the guidance addresses general issues that cut across different areas. Part 2 is structured within a format that we recommend all undertakers should adopt. Using a common format would be one way of reducing confusion for potential applicants.

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

## **Consultation and next steps**

We would like comments, **by 5 December 2001**, on:

- The key issues in the text boxes in sections 1, 2, and 3.
- Whether it would be desirable for Ofwat to issue guidance specifically on common carriage in sewerage services.

- Whether a requirement for unlicensed entrants to obtain an inset appointment before being granted access to an incumbent undertaker's network would be an unnecessary barrier to entry (section 1.2 refers).
- The type and extent of information an applicant needs to submit for the undertaker to be able to provide proposed prices (sections 2.1.2 and 2.2 refer).
- Whether Ofwat should collect all of the indicative and standard prices from undertakers and publish these on the Ofwat web site.

Contact details are set out below.

We will supplement these written comments with limited focus group work during the consultation period. All the responses will then be reviewed and final guidance will be issued in January 2002. Undertakers will be invited to revise their codes by April 2002.

I look forward to receiving your comments and to future progress in the development of common carriage.

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

**Philip Fletcher**  
**12 September 2001**

## CONTACT DETAILS

Please send written comments, **by 5 December 2001**, to:

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If you have any queries about this document, please contact Beryl Brown on 0121 625 1426.

Unless otherwise requested, the responses will be placed in the Ofwat library and made available to the public.

# PART 1: GENERAL GUIDANCE

## 1.1 Essential facility

**Ofwat expects:**

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

Undertakers risk infringing the Competition Act 1998 (CA98) if they refuse access to their facilities without objective justification, or if they offer access on unreasonable terms. In applying CA98 to common carriage cases, we will consider whether the facility that competitors wish to access is 'essential'.

Before they consider common carriage applications, some undertakers expect the applicant to prove that the facility it wishes to access is essential. We consider that applicants should not be expected to do this. While the competition authority would assess on a case-by-case basis whether a facility was essential, many of the capital assets of undertakers (including their networks) could be regarded as essential facilities. It is up to undertakers to decide whether a facility is essential because the risk of a CA98 infringement lies with them, not with the applicant. However, applicants should be prepared to provide on request information that the undertaker reasonably needs to establish whether a facility is essential.

## 1.2 Licensing

**Ofwat believes:**

- In most cases, it may not be unreasonable for undertakers to insist they deal with licensed applicants, as long as the undertakers consent to unlicensed entrants becoming licensed and expedite this process.

**Ofwat expects:**

- Undertakers to insist that applicants match their own operational standards, provided these are reasonable. Appropriate arrangements for monitoring those standards would be part of the access agreement (see Part B, Section 3). The agreement can also contain penalties if an entrant does not meet agreed standards, provided these penalties are reasonable.
- Undertakers to demonstrate in their access codes how they would enable unlicensed applicants to become licensed.

The Government recently proposed that legislative provision be made to license new entrants into the water industry. Under these proposals, entrants and undertakers 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. The Government is expected to consult on the proposals in autumn 2001.

Until such proposals are implemented, however, the Water Industry Act 1991 (WIA91) remains in force. Under WIA91, entrants can only attain licensed status by applying to become undertakers through the inset appointment process or by taking over an existing undertaker.

It is possible that there will be some unlicensed common carriage applicants who want to compete with existing undertakers and remain unlicensed. At present, there is no specific legal requirement for common carriage applicants to be either licensed or unlicensed.

Some incumbents have stated that they are prepared to deal with unlicensed applicants, as long as they have the necessary experience, technological skills and financial support.

Most incumbent undertakers, however, have insisted that they would allow only licensed undertakers to access their networks. This approach, which can be described as 'mandatory licensing', stems largely from their concerns that unlicensed entrants are not exposed to criminal liability for supplying water that is unfit for human consumption, as incumbents are under section 70 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.

Ofwat may therefore be required to consider a complaint under CA98 about refusal to allow access by unlicensed applicants. In so doing, we would consider whether the incumbent was dealing with its concerns in the least restrictive way possible. In some cases, the applicant's common carriage proposal would pose no threat to drinking water quality (if, for example, it related to access solely to a non-potable water system). In these cases, where potable water was not involved, the issue of liability under s.70 would not arise. Therefore, it would not be reasonable for an incumbent to insist that the applicant be licensed.

In most cases, however, it is likely that the applicant's proposals would involve access to the incumbent's potable water network. If the incumbent insisted that the applicant should be licensed, we would need to decide whether that represented an unnecessary barrier to entry.

On the one hand, obtaining a licence would involve applying for an inset appointment, which would place an additional burden on the applicant. We would consider whether insisting on the applicant obtaining a licence would enable the incumbent to delay the entry of a competitor unnecessarily.

On the other hand, we recognise the seriousness of criminal liability. Requiring the applicant to be licensed provides the incumbent with additional comfort in the event of a prosecution under s.70. If the entrant were already an undertaker, and either it or the incumbent failed to exercise due diligence to prevent the supply of water unfit for human consumption, DWI would prosecute whichever party was responsible. If the entrant were not licensed, DWI would only be able to prosecute the incumbent.

The situation has become clearer since we issued MD158 in January 2000. Each case will depend on its own facts. But it is Ofwat's view that it may not be unreasonable, in most cases, for incumbents to insist that applicants are licensed, as long as the incumbent co-operates in the process by which unlicensed entrants

become licensed. We would expect the incumbent to achieve this by giving consent to an inset appointment (under section 7(4)(a) of the WIA91), unless there was an objectively justifiable reason not to do so. Incumbents should also demonstrate in their access codes how they would effect this.

Whether applicants are licensed or not, it is appropriate for undertakers to insist that applicants match the standards to which the undertakers operate, provided these standards are reasonable. Appropriate arrangements for monitoring those standards would be part of the access agreement (see Part B, Section 3). Access agreements may also include penalties if the entrant fails to meet the agreed standards, provided these penalties are reasonable.

### 1.3 Updating access codes

**Ofwat expects:**

- Undertakers to update their access codes to reflect developments in best practice.
- The latest version of each undertaker'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. Undertakers will need to review their codes and update them where necessary to reflect these developments. The latest version of each undertaker's code should be available on its web site, clearly indicating the date on which it was last updated. Undertakers 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.

### 1.4 Co-operation

**Ofwat expects:**

- Undertakers and applicants to co-operate in sharing information and in resolving day-to-day operational problems.

Common carriage arrangements will require the undertaker and applicant 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:**

- Undertakers to impose the same requirements in respect of an applicant's source as they would impose if the source belonged to the undertaker.
- Charges for access to be consistent with undertakers' existing charging policies.

We expect the undertaker to require the same sampling and monitoring from the applicant that it would require if the applicant's source belonged to the undertaker. Undertakers must not place undue requirements on applicants, as these could be regarded as a barrier to entry.

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

## 1.6 Arbitration, disputes and the Competition Act 1998

### **Access codes should:**

- Set out a mechanism for resolving disputes.

### **Ofwat expects:**

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

In some cases, applicants and undertakers may be unable to agree on the terms for common carriage or disputes may arise when an agreement is in place. If an applicant considers that an undertaker's behaviour has been unreasonable, it may 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 to date include:

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

When a complaint is made to Ofwat, we will first consider whether there are grounds for investigation under CA98. An investigation is a formal process, which 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.

The purpose of such investigations is to 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 Environment Agency would be consulted as

appropriate where a dispute involved quality or environmental issues. The Director's decision would be subject to appeal to the Competition Commission Appeal Tribunals. Detailed guidance is provided in the Competition Act guideline 'The Application in the Water and Sewerage Sectors' (OFT 422).

We would expect most issues to be resolved by the parties without recourse to Ofwat. Access codes should include a mechanism for resolving such disputes. The parties may agree to accept the decision of an independent arbitrator. This does not over-ride the Director's ability to investigate potential infringements of CA98.

## 1.7 Terms of contract

### **Ofwat expects:**

- Applicants to be able to choose the duration of the common carriage contract, subject to reasonable conditions.
- Undertakers to retain ownership of infrastructure assets beyond the point of entry to the network.
- Applicants to make arrangements for their customers to revert to the undertaker if the access agreement is terminated.
- Access agreements to provide for the undertaker to assume interim control of the applicant's assets in the event that the applicant goes out of business (at least, in the absence of other arrangements), in order to fulfil its duty to supply.

Parties need to agree contractual terms for the successful operation of common carriage. Those terms should normally be agreed without recourse to Ofwat.

One important issue that parties need to agree is the duration of a common carriage agreement. Some undertakers have stated preferences for minimum and maximum time limits, which reflect their uncertainty about how common carriage might work. It is important that applicants have enough incentive to pursue common carriage. Undertakers should not use time limits as a deterrent to entry. The applicant should be able to choose how long it wants to share the undertaker's network, subject to reasonable conditions. For example, in some cases it may be appropriate to link the common carriage agreement to the period for which an applicant holds an abstraction licence. Any extension of the agreement would then depend on the successful renewal of that licence. In other cases, it may be that network modelling does not wholly resolve all the issues, and that a trial operating period is necessary to observe the effect of common carriage. In such cases the agreement could include provision for termination if it becomes apparent that common carriage in that particular instance is not viable. The applicant's customers should be made aware of this possibility and provision made for them to revert back to the undertaker. But trial operating periods should not be used to test unresolved quality issues.

Parties also need to agree on ownership of assets installed as part of the common carriage arrangement. It is reasonable that the undertaker should usually own infrastructure assets beyond 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 the upgrading of the undertaker's network to make common carriage viable.

Some undertakers indicated that, if an entrant goes out of business, its resources should be transferred to the undertaker. Applicants should not be obliged to accept this condition for access. Undertakers would normally have an opportunity to purchase assets from the receiver of the failed business. However, it would be reasonable and desirable for access agreements to allow the undertaker to assume interim control of these assets, in the absence of other arrangements, to fulfil its duty to supply.

## 1.8 Customer protection issues

### **Access codes should:**

- Explain how responsibility for customer service will be assigned in a common carriage agreement.

### **The undertaker 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 undertaker's remaining customers are not affected adversely.
- Offer applicants the same service levels, in terms of supply failures caused by network problems, that apply to the undertaker's customers.

### **The undertaker should not:**

- Act as regulator of 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.

A number of customer issues need to be addressed as entrants come into the market, but common carriage agreements will **not** normally be the appropriate place for this. Undertakers can expect entrants to meet, but not exceed, standards that ensure that the levels of service received by the undertaker's remaining customers are not affected adversely. It is not otherwise appropriate for undertakers to act as regulators of the levels of service provided by entrants to their customers. These are matters for entrants and their customers to agree.

Conversely, undertakers should offer applicants the same service levels, in terms of supply failures caused by network problems, which they provide to their own customers.

Common carriage allows an entrant access to shared infrastructure but the owner retains operational control. Parties need to consider carefully how responsibility for customer service is assigned in a common carriage agreement. Access codes should explain how this would be done.

## 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 undertaker should:**

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

Customers require a clear point of contact at all times for emergencies, general enquiries and complaints. It seems sensible, therefore, for the entrant to be the first point of contact for all enquiries from its customers. Agreements should set out how complaints are then assigned, and transferred, between the entrant and undertaker.

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

The undertaker, as the owner of the asset (eg the network), should retain responsibility for investigating all enquiries about operational issues, including those from the entrant's customers. The entrant and undertaker should agree time-scales within which the undertaker will respond to enquiries originating from the entrant's customers. The entrant should take responsibility for financial enquiries, such as billing, for its customers.

## 1.8.2 Transfer/Switching

### **Ofwat expects:**

- Transfers to be made in good time with a clear changeover date in place.
- That the undertaker must not impose its own data transfer system, or that of an associate company, on an applicant.

### **Access codes should set out:**

- How customer communication will be managed.
- The customer details needed to ensure the smooth transfer of customers from an undertaker to an entrant and a timetable for this exchange.
- The customer details needed for emergencies and planned/unplanned interruptions.

- How an undertaker 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 be the source of a number of complaints. Customers could reasonably expect to have an identifiable point of contact at all times and mistaken transfers should not occur. Transfers should always be made in good time with a clear changeover date for each case. The responsibility of both parties in the transfer process should be clearly identified to avoid misunderstanding.

The undertaker could reasonably request customer details that are necessary to the smooth transfer of customers to an entrant. The undertaker may also require details to ensure that service levels remain high 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.

Views are invited on how to manage the mechanics of data transfer. Our view is that the undertaker should not impose its own data transfer system, or that of an associate company, on an applicant.

Any 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 an undertaker's customer services.
- Entrants to take responsibility for billing and debt collection.

Undertakers will wish to recover money owed to them but customer debt (particularly for small amounts) need not necessarily be a barrier to switching. Parties should have an agreement that ensures the undertaker can recover the charges owed. Alternatively, entrants may be prepared to purchase the debt of customers who switch.

## PART 2: STRUCTURED GUIDANCE

### 2.1 Application process

Undertakers' access codes have separated the application process into a number of stages. In this section we set out and discuss the stages that Ofwat considers a common carriage application should normally follow. This is not intended to be prescriptive but to indicate what applicants 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 undertaker will make details of decisions and studies available to an applicant.

**Ofwat expects:**

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

- Stage 1: Initial contact

An undertaker should make its access code available to any potential applicant on request. Ofwat expects undertakers' codes to explain how applications will be progressed.

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 undertakers' codes should contain to meet this objective.

Undertakers should be prepared to meet prospective applicants at this stage in order to clarify any issues arising from their reading of 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 an undertaker 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 undertaker to:

- provide the applicant 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 undertaker will provide in response.

- Stage 3: Detailed application - feasibility study and testing

On the basis of a detailed application, undertakers 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 likely charge for any feasibility studies before they are started. They should also agree how the results will be shared. Some undertakers have said that they will provide applicants 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. Ofwat expects all undertakers to take this approach.

- Stage 4: Negotiation of contract

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

## 2.1.2 Information requirements

### **Access codes should:**

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

### **Ofwat expects:**

- Undertakers to require only the information needed to progress the application at each stage.
- That undertakers should not duplicate information requirements.

Access codes should set out the information normally required at each stage of the process. Undertakers should require only the information needed to progress the application at each stage. Undertakers should explain the specific information requirements for each case at the initial contact stage, and they should be prepared to explain why the information is needed. To facilitate this, applicants need to provide a broad outline of their access proposals at that stage.

**Views are invited on what information is essential for the undertaker to calculate proposed prices. In particular, we would welcome views on the need for applicants to provide information about exit points either at stage 2 or stage 3.**

Delays are likely when applications are incomplete. Satisfactory submission of information is the responsibility of the applicant. However, undertakers should take reasonable steps to minimise delay by ensuring that their requirements are clear and that applicants know the detail required to complete an application. Many access codes include outline lists of the information, and detail, required for each stage of an application. Ofwat considers that these lists are essential.

Ofwat does not expect applicants to have to resubmit information they have already provided. This applies also to repeat applications to the same undertaker, although undertakers may require repeat applicants to update information previously provided in order to account for any changes in circumstances.

It is likely that the parties would need a confidentiality agreement. Undertakers' access codes should contain a draft confidentiality agreement. Any restrictions this placed on data sharing would need to be objectively justifiable. Co-operation by the undertakers, perhaps under the auspices of Water UK's common carriage working group, could speed up the development of a 'best practice' confidentiality agreement.

### 2.1.3 Timescale

**Access codes should set out:**

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

**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 undertakers 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 would entail more analytical work, should normally be completed within eight weeks. Unreasonable delay by undertakers could be an infringement under CA98.

Undertakers should set out expected timescales and keep applicants informed if these are unlikely to be met. A staged approach to processing applications should not be seen as an opportunity to delay common carriage agreements.

### 2.1.4 Application fees

**Ofwat expects:**

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

**Access codes should set out:**

- How the undertaker will calculate the actual costs of processing an application.

- What opportunity applicants will have to review the basis of costs.
- How an entrant would be charged if it withdrew during the application process.

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

Undertakers' standard application fees vary from £50 to £5000. The fees are not comparable because they cover different amounts of work by the undertaker. However, we consider that, in assessing initial applications, undertakers should only undertake such work as is necessary to fulfil the aims set out under stage 2, as described above.

Applicants should only be charged for the actual costs incurred by the undertaker in processing an application. If an application is withdrawn during the process the applicant should only pay for the costs incurred to that point (including any unavoidable future costs that the application may have triggered).

Applicants 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. Ofwat expects all undertakers to ensure that all charges are transparent.

## 2.2 Pricing issues

Access codes should contain sufficient information for a prospective applicant to form a broad view of how much it is likely to pay for access. Undertakers should explain the basis for their proposed access charges. They should publish indicative prices and, where possible, standard prices. We propose that undertakers provide all of their access prices to Ofwat for publication on Ofwat's web site.

It is reasonable to expect an undertaker to indicate all aspects of its 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. Undertakers should not set indicative prices unrealistically high to deter applicants.

Following an application, undertakers should not delay in providing proposed prices based on case-specific circumstances. Failure to provide – or excessive delay in providing – proposed 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 undertakers' access prices.
- Indicative prices and, where possible, standard prices (further guidance on what Ofwat would expect undertakers 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.
- Undertakers to submit their access pricing schedules for publication on Ofwat's web site.

Undertakers should indicate the complete structure of their access charges. This may, where justifiable, 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 undertaker under certain circumstances. Undertakers should indicate their arrangements for provision of:

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

## 2.2.2 Use of system

**Access codes should set out:**

- Standard use of system prices (for undertakers basing prices on regional average accounting costs), broken down into charges for access to separate elements of the system (e.g. 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 undertakers using the 'Efficient Component Pricing Rule' – ECPR).
- Indicative use of system prices based on regional or zonal average LRMCs (for undertakers basing prices on Long Run Marginal Cost – LRMC).
- Information an applicant must provide for the undertaker to derive a proposed price and how long it would normally take to provide that price.

**Ofwat expects:**

- Undertakers 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.
- Undertakers to demonstrate consistency between their access charges and their current tariffs.
- Consistency 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 provided within four weeks and proposed prices should be provided normally within eight weeks.
- Allocation of the rate of return element of costs (for undertakers 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 a variety of ways. MD163, 'Pricing issues for common carriage', set out Ofwat's position. In it we said that:

"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."

We did not object in principle to any of the main alternative approaches to calculating access prices.

Ofwat supports the underlying objective of the 'Efficient Component Pricing Rule' (ECPR) – to ensure that entry only occurs when it results in lower costs in aggregate. But undertakers should note that, where they charge on this basis, Ofwat would expect consistency between claimed avoidable costs, on the one hand, and bulk supply prices and claims for supply/demand expenditure on the other. Undertakers can also expect their competitors to look for such consistency. For example, if the avoidable costs of resources and treatment (proxied by LRMC) are low, competitors may be more likely to seek a 'brokerage' inset appointment by obtaining an inexpensive bulk supply from the incumbent undertaker.

Calculating ECPR prices removes the need for some of the other charges listed below. For example, if an applicant sought provision for security of supply from the incumbent undertaker, 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. Undertakers should avoid these.

Calculating average costs as a basis for access prices is not entirely straightforward. In particular, the rate of return element of undertakers' costs has 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 strictly correct way to do this. We expect undertakers to allocate the return consistently with the way in which they allocate it for calculating tariffs to final customers.

Undertakers adopting approaches other than ECPR should publish charges for access to separate elements of the system (e.g. 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 applicants intend to supply only large users, it would be unreasonable to charge them for access to the local distribution network if the undertaker does not charge its large users for this service. Where applicants wish to use undertakers' bulk networks to supply customers on new developments, but to use their own local distribution networks, they should only be charged for bulk distribution.

Whatever methodology is adopted, Ofwat expects undertakers to demonstrate consistency between their access charges and their current tariffs. In particular, if undertakers charge for access on the basis of local costs, but maintain regional average charges for their existing customers, or vice versa, then Ofwat will expect them to justify this.

### **Timescale for provision of prices**

In their access codes most undertakers state their intention to base their use of system charges on regional average costs. Given that undertakers 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. We consider that published prices should be standard, rather than indicative.

Where undertakers 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. Proposed prices should be provided within eight weeks. To facilitate this, applicants must accept their responsibility to provide sufficient information in their application to enable the undertaker to provide a final price.

**Views are invited on what information is essential for the undertaker to calculate a proposed 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:**

- Applicants to be able to choose who carries out the greater part of any necessary work on connections.
- Consistency with policy on requisition charges.
- Consistency between network extension/reinforcement and use of system charges to avoid over-recovery of costs.
- Proposed charges for connection and network extension/reinforcement to be made available to applicants normally within eight weeks.

There should be no presumption that undertakers will carry out all necessary work on connections. Much could be done by the applicant or by a third party appointed by the applicant. The applicant should be able to choose who carries out this work. There needs to be some involvement by the undertaker to ensure that appropriate standards of water quality, safety and workmanship are met. Ofwat has recently issued a consultation paper on the related issue of self-lay policy for new developments<sup>4</sup>.

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<sup>4</sup> 'Competition in the provision of new water mains and service pipes', published 9 August 2001.

- 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 common carriage, future revenue from use of system charges could be offset against the capital costs of network extension/reinforcement. Undertakers should not recover network extension/reinforcement costs twice from separate charges. Nor should they charge applicants for network reinforcement costs unrelated to providing common carriage.

- Timescale for provision of prices

Undertakers should publish indicative charges for connection and network extension/reinforcement under a range of typical circumstances.

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). This is provided that applicants 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.
- 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:

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

Top-up supplies refer to water supplied by the incumbent undertaker on a continuing or regular basis to supplement the entrant's own supplies. Undertakers do not have a duty to provide top up supplies to entrants, but they do have a duty to supply final customers in their area of appointment on request. It would be for the undertaker to decide whether to bill the entrant or the entrant's customers for water supplied to meet any shortfall in the entrant's supplies. In most cases, however, it would be in the interests of all parties for customers to be billed by one company (i.e. the entrant).

## Accounting for leakage

Undertakers 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 put forward different methods for doing this. Most intend to make an allowance for leakage. Some then intend to charge the entrant for water supplied by the undertaker to account for water lost as leakage. Others would ask the applicant to supply sufficient water to cover its customers' demands and water lost as leakage. Ofwat's view is that applicants should normally use their own supplies to cover water lost as leakage. We would expect this to be more economic because applicants would typically secure a place in the market by providing low cost water.

Undertakers employ a wide range of methods for accounting for water lost via leakage. Methods of measurement include the regional average level of leakage, the Ofwat target level, the greater of these two, the economic level of leakage (ELL) both at a regional level and a zonal level, and simply an agreed level of leakage. Ofwat considers that zonal assessments of ELL would provide the best basis for encouraging efficient resource use. In practice, undertakers may not have ELL assessments as such at the zonal level, but they should have zonal leakage targets consistent with their regional ELL. Where access is sought only to part of the distribution network, the quantity of water required to replace leakage should be lower than when access is sought to both bulk and local distribution.

Where the undertaker is to provide water to cover leakage, it will need to apply an appropriate price to the agreed quantity. 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, applicants may plan to supply only part of a customer's needs. It would be for the parties involved (including the customer) to decide whether the customer should be billed separately by the two suppliers, or solely by one of the suppliers. 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 undertaker.

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 undertaker's resources, then such arrangements may be inconsistent with the above definition of top-up supplies. If the arrangements are more akin to a standby facility, then charges should be made on that basis.

## 2.2.5 Standby supplies

### Ofwat expects:

- That applicants should normally plan to meet their customers' demands even in dry weather conditions.
- Nevertheless, undertakers should not refuse access on the basis that an entrant's resources do not meet minimum hydrological conditions as specified by the undertaker. Instead, undertakers' standby charges should reflect the volume and reliability of the entrant's capacity and the implications of that for the undertakers' capacity costs.

Standby supplies refer to water supplied by the undertaker on a periodic or intermittent basis to supplement 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. As with top up supplies, undertakers do not have a duty to provide a standby facility to entrants, but they do have a duty to supply final customers. Again, in most cases it would be in the interests of all parties for customers to be billed by one company.

- Security of supply

Some undertakers expect the applicant's resources to be sufficient to meet its customers' demands under hydrological conditions as specified by the undertaker. It could be unreasonable to refuse access to an applicant if its resources did not meet such conditions. However, it would be reasonable for undertakers to use a risk assessment of the applicant's resources, consistent with industry best practice, as the basis for making arrangements for stand-by supplies.

- Duty to supply

Most undertakers have indicated that they will charge for the cost of fulfilling their duty to supply. Some intend to impose a fixed standby charge to cover the cost of maintaining sufficient standby capacity and a volumetric charge to cover the cost of any water supplied. That is reasonable. However, undertakers' standby charges should reflect the volume and reliability of the applicant's capacity.

## 2.3 Operational issues

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

It would be reasonable for undertakers to expect entrants to comply with the relevant legislation and the same codes of practice to which the undertaker works. Thus it may be unreasonable to impose more stringent operational requirements on licensed entrants.

### 2.3.1 Water quality and sampling

**Ofwat expects:**

- Undertakers to retain responsibility for suspending access to the system if there is any risk of non-compliance with the Water Supply (Water Quality) Regulations 1989, as amended, or with the Water Supply (Water Quality) Regulations 2000.
- Entrants to match the undertaker's own internal quality standards.
- Licensed applicants to be allowed to choose whether to carry out their own sampling and analysis.

Undertakers should make clear that they have the responsibility to refuse or to suspend access to a system. This is standard practice if there is a risk that water quality will breach the requirements defined in 'The Water Supply (Water Quality) Regulations'<sup>5</sup> ('the Regulations'). A trial period would allow operational procedures and practices to be clearly established, but should not be used to test unresolved quality issues. Entrants should comply with the undertaker's own internal quality standards, including its standards for plumbosolvency control and fluoridation.

#### Sampling and monitoring

It is important to establish who will be responsible for water quality sampling for both compliance and operational monitoring. The applicant 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 Regulations. Entrants should note that any party putting treated water into the public supply network must comply with the requirements for cryptosporidium under regulations 27, 28 and 29 of the Water Supply (Water Quality) Regulations 2000.

In the Drinking Water Inspectorate's Annual Report for 1999, the Chief Inspector noted that, under current law, a licensed water undertaker under the Water Industry Act 1991 would be responsible for all aspects of drinking water quality regulations, at the customer's tap, independent of other users' systems. The DWI audits water companies to check compliance with their duties in respect of drinking water quality. It may prove helpful to consider the range of issues audited by the DWI and to highlight these requirements to the applicant. The items included in these technical audits are a good starting point for negotiation and clarification.

### 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:**

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

<sup>5</sup> SI 1989 no. 1147 and SI 2000 no. 3184.

It is reasonable that the undertaker should retain responsibility for the operation, maintenance and control of its infrastructure in its appointed region.

### **Maps and plans**

It is important for the applicant and the undertaker 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 e.g 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. (e.g. fire fighting).

### **Fire fighting**

Arrangements regarding 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 will be a consideration where the applicant's source has a significant impact on the network.

### **Unauthorised use of water**

Potential unauthorised standpipe use should be addressed, in terms of both water usage and of possible discolouration. The undertaker should indicate to the applicant its experience of the usual local extent of the problem. Lockable hydrants could be an option for the applicant to consider with the co-operation of the undertaker.

## **2.3.3 Drought /resource planning**

### **Access codes should set out:**

- The information required of an applicant as part of its risk assessment.

### **Ofwat expects:**

- Entrants to comply with reasonable requests for information necessary for the undertaker to fulfil its statutory duty to supply, including information necessary to enable the undertaker to prepare its Water Resource Plan.

As part of their detailed applications (stage 3), applicants 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 undertakers should be provide further clarification where necessary.

Risk assessment of water resource reliability is also important. It is discussed in section 3 under 'Standby Supplies'. Access codes should set out the information required to undertake such an assessment. Entrants should comply with reasonable requests for information that is necessary for the undertaker to fulfil its statutory duty to supply.

Consistent with their statutory duty to supply, undertakers 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 undertakers, 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 undertaker to specify when it will carry out work on assets within the shared network and whether this will affect supplies to the applicant's customers.
- Access agreements to contain a minimum notification period for planned work.

The undertaker should specify when it will carry out work on assets within the shared network and whether this will affect supplies to the applicant's customers.

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.

### **2.3.5 Metering and flow balancing**

**Ofwat expects:**

- The method of charging/reimbursement for over- or under-supply by an entrant to be symmetrical.

It is reasonable for an undertaker to measure flows supplied by the entrant and the water taken by the entrant in supplying its customers. This need not imply that only measured customers are eligible to switch suppliers. 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 is a pragmatic solution to potential network problems. This should be capable of controlling pressures and flows within the ranges specified by the undertaker.

The two parties should agree the balancing period for the purpose of charging for volumes 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 undertaker should be taken into account. The method of charging/reimbursement for over or under supply by an entrant should be symmetrical.

### 2.3.6 Emergency procedures and contacts

**Ofwat expects:**

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

Responsibilities and procedures for failure of plant or contamination/pollution incidents need to be agreed between the parties before live connection. It is vital to ensure that reporting to the DWI continues as indicated in the Water Undertakers (Information) Direction 1998, in DWI Information letters 3/94 and 13/99, and in the reporting requirements of regulations 17 and 18 of the Water Supply (Water Quality) Regulations 2000 when they come into force. Liaison with the Environment Agency (EA) is important for both pollution control and water resources.

Entrants should be thoroughly briefed before live connection on any relevant emergency action plans. An undertaker could reasonably expect an applicant to provide details on and to demonstrate its emergency procedures. Responsibilities and procedures for local incident management teams also need to be defined in the access agreement. It would be good practice to include entrants in exercises to foster understanding of procedures.

An undertaker 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:**

- Undertakers to prohibit entrants from sub-letting access to the undertaker's network.

Once an applicant has been allowed access to a network, it should not then 'sub let' the access agreement to other applicants with their own resources. Additional applicants should deal directly with the undertaker to enable it to maintain control and operation of the system. This should be incorporated into the contractual agreement between the undertaker and the applicant.

## 2.4 Definitions

Access codes should contain a glossary of definitions. 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:

**Applicant** – a party seeking to enter into a common carriage agreement.

**Avoidable cost** – the cost avoided by a company that ceases to supply a particular market or customer.

**Efficient Component Pricing Rule** – calculates access prices by subtracting avoidable costs from the incumbent's appropriate retail price.

**Entrant** – a party who has successfully entered into a common carriage agreement.

**Inset appointments** – a mechanism by which one company can replace another as the statutory undertaker for a specific geographical area.

**LRMC** – long run marginal cost. The change in total costs per unit change in output, measured over a period in which all costs are variable.

**MEA values** – the book value of a company's fixed assets on a Modern Equivalent Asset 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.

**Undertaker** – a licensed water and/or sewerage undertaker under the Water Industry Act 1991 who owns the pipe networks and other infrastructure. Companies can also become undertakers via the inset appointment process. The text distinguishes between the two types of undertakers where necessary

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