



WATER ACT 2003  
WATER SUPPLY LICENSING

**Guidance on Access Codes**  
**Consultation responses and RIA**

June 2005

# Consultation on guidance on access codes

## Summary of responses and final regulatory impact assessment

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### Appendix 1: Guidance on access codes consultation - list of respondents

# 1. Introduction

In October 2004 we consulted on our draft guidance on access codes<sup>1</sup>.

From autumn 2005, non-household customers who are likely to use at least 50 Ml of water a year at eligible premises will have the option of switching from their existing water undertaker to an alternative water supply licensee. These will be able to compete by purchasing a wholesale supply of water from an existing water undertaker and selling it to a customer (a retail supply), or by introducing water into a water undertaker's supply system and selling it to a customer (a combined supply). Water undertakers must provide access to licensees on terms that comply with the licensing provisions of the Water Industry Act 1991 (WIA91) and our guidance on access codes.

Each water undertaker is required by Condition R to produce and publish an access code setting out the basis upon which they will permit access to their supply system. Our draft guidance on access codes sets out the standard details that we expect each water undertaker to include in its access code and thus in its access agreements with licensees. We asked for views on our proposed guidance. In particular, we wanted to know if our proposals are practical, or are likely to cause problems and if so what these problems are and how we might address them.

This paper summarises the responses we received and explains how we are taking account of them in the final guidance on access codes. If you wish to discuss any aspect of this paper, please contact Hayley Purcell on 0121 625 1481 or e-mail [enquiries@ofwat.gsi.gov.uk](mailto:enquiries@ofwat.gsi.gov.uk).

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<sup>1</sup> 'Water Act 2003: Water Supply Licensing. Access Code Guidance' (October 2004).

## **2. Responses to the consultation**

### **2.1 Summary**

We received responses from 32 stakeholders including 18 water and sewerage companies operating in England and Wales, Water UK, WaterVoice and four potential new entrants to the market place. The Water Management Society, English Nature, House Builders Federation and Scottish Water also responded and gave us general comments about the consultation. A list of respondents is in appendix 1, and copies of all replies are available to read in our library.

Generally, respondents support the work to produce the guidance and the work of our Technical Advisory Group (TAG) to develop policy. They are keen for the TAG to continue to consider relevant issues.

We have summarised the responses to each question and set out how we address the points in the paragraphs headed 'Our conclusions'.

### **2.2 Key points raised in the responses to the consultation**

This section summarises the key points that were made in reply to the consultation and explains our response to these issues.

#### **a) Secondary and sewerage undertakers**

There is general concern that there is not enough explanation about the roles of secondary and sewerage undertakers. We have clarified and expanded the position of secondary and sewerage undertakers in the final guidance.

#### **b) Processes for combined and wholesale applications**

Respondents generally feel that the guidance would benefit from covering combined supplies and wholesale supplies separately. We have revised chapter 3 of the guidance to set out separate processes for wholesale and combined supply applications.

#### **c) Costs principle and pricing methodologies**

Water undertakers and potential licensees ask for more explanation and clarity of our approach to the costs principle and the pricing methodology for access pricing. We explain our revised approach in paragraphs 2.5.4 and 2.5.6.

#### **d) General costs of implementing the new regime**

Water undertakers raise concerns about recovering the costs associated with implementing the new regime and handling disputes. Water undertakers ask how they will recover the costs of tasks such as handling enquiries and applications, and calculating access prices. They comment that the guidance assumes that water undertakers should take responsibility for (and thus bear the cost of)

implementing the water supply licensing (WSL) regime. However, they say that there is no allowance for this in the price limits.

Water undertakers would also like more clarity on the interaction between the periodic review and the access pricing regime. WaterVoice and other respondents are generally concerned that the costs of implementing the new regime should not fall on customers who are ineligible to benefit from the competitive framework.

The price limits set in 2004 did not include an explicit allowance for the costs of administering the new regime. Water undertakers can recover the costs of processing applications from the applicant. The remaining administrative costs, including the costs involved in making strategic supply designation requests and providing copies of access codes on request are likely to be very small.

To the extent that administering the new regime does add to a water undertaker's operating expenditure this will be incorporated as part of the water undertaker's base operating costs when prices limits are next set in 2009.

**e) General clarity**

Respondents asked for more clarity on the roles and responsibilities of regulators, and on the definitions of terms that are used in the legislation and the guidance. We have revised the guidance to explain these issues further and added certain terms to the glossary. In particular, respondents asked for more explanation about "connectivity". For example, respondents asked us to clarify the nature of the requirements for physically connecting the licensee's source to the licensee's customer and for confirmation that supplies by displacement will be permitted. We have clarified these points in our revised explanation of connectivity in section 1.1 of the guidance.

**f) Process for making determinations**

Respondents asked about the processes for handling disputes under the new regime. We will explain our proposed process in our forthcoming consultation on the WSL determinations procedure.

**g) Timetable**

Water undertakers wanted more information about the timetable for implementing the new regime. In April 2005 we issued WSL 1/05 to explain about the fourth commencement order relating to the Water Act 2003. WSL 1/05 can be found on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk). We will issue WSL letters to inform stakeholders of further information about the timetable.

**h) General comments on guidance on access codes**

Respondents made a variety of general comments in their responses raising issues that they felt strongly about or did not think that the guidance had covered. Where relevant, we have addressed these points in our guidance or in this

summary of responses. Full copies of all replies to the consultation are in our library.

## **2.3 Role of the advisory groups**

Respondents suggested the following work areas for our TAG or Customer Transfer Protocol (CTP) sub-group.

- Develop a template for a common code. Please see our conclusion on the first question in section 2.5.
- Develop a standard industry confidentiality agreement. Please see our response to question 2.
- Consider the information requirements during the application process, the information flows needed for safe and efficient management of the water undertaker's supply system and whether to develop a basic framework. We have taken account of respondents' comments on information requirements throughout the guidance.
- Develop a common approach to flow balancing. Section 5.5 of the guidance now provides more detail on balancing as a result of respondents' views.

## **2.4 Concurrent consultations**

In 2004 we also consulted on the following issues relating to licensing.

- Water undertakers' new conditions of appointment and Water Supply Licence conditions for potential licensees.
- Policy proposals on exceptions regulations and exemptions.
- Eligibility, licensing, customer transfer protocol and strategic supplies.

We are reviewing the responses to all the consultations for links and related issues. We will also review all of the final guidance documents to ensure that our approach is consistent. In addition, drafts of the final guidance documents are, and will be, reviewed and commented on by the TAG. Once the guidance is published, we will monitor how the market develops and consider whether and when we need to revise them. In this way, we will ensure that all of the issues are covered in a consistent and transparent manner.

## **2.5 Responses to individual questions**

**Question: Do you agree with our proposal to develop a template for a common code?**

Most respondents supported this proposal saying it should be possible to develop a common supply system access code in the future. This will ensure that there is

a consistent approach to agreeing access terms across the industry and reduce the possibility that work will be duplicated. However, there are mixed views about a template for a common code. Should it be a specific industry-wide code or should water undertakers be allowed to retain a certain amount of flexibility to develop company-specific codes?

We received the following additional comments.

- Some customers and other stakeholders said we need to ensure that potential water supply licensees work with water undertakers to develop the common framework.
- One potential licensee said water undertakers should be required to justify any departures from the standard.
- Some water undertakers said it is important that the template is broad enough to reflect individual water undertakers' policies and processes. One water undertaker suggested that the template should be broad at first, but could become more prescriptive.

## **Our conclusions**

We think it is inevitable that each water undertaker will need to retain some flexibility to deal with its own circumstances. The Access Code Template sub-group of the TAG has drafted an access code template with input from many industry stakeholders. This sets out in detail a structure for access codes. We are issuing the template under cover of MD202 and expect water undertakers' access codes to follow this. We will continue to discuss the development and use of the template with our advisory group.

### **2.5.1 Obligations**

#### **Question 1: Do you think we strike the right balance between the obligations placed on water undertakers and licensees through this guidance and the conditions of appointment and conditions of a Water Supply Licence?**

Respondents generally felt that we have struck the right balance but commented that we will be in a better position to judge this later in the process, when the whole competition framework is in place and we have finished consulting on other related issues.

We received the following additional comments.

- The Drinking Water Inspectorate's (DWI) main concern is that the quality of the water at the point of supply is not compromised.
- One water undertaker asked for clarification about water undertakers' rights, responsibilities and obligations to comply with regulatory requirements and how to handle circumstances where the water undertaker's supply system has been

contaminated by an incident arising from use of non-mains water. Another respondent commented that we should be able to act pre-emptively, using the Licence Conditions, in situations which threaten public health or safety.

- One water undertaker was uncomfortable with the suggestion that its operational standards should be transparent and that it should publish the risk assessment criteria it uses. It said water undertakers' policies and operational standards carry inherent intellectual property value that would be diminished if the documents were passed to licensees. Licensees should be required to formulate their own relevant policies, standards and procedures for assessment by DWI and the water undertaker.
- Water undertakers also pointed out that the guidance should state that the water undertaker retains the ability to prevent access to its supply system where it can reasonably demonstrate that there are hydraulic and pressure management issues or water quality concerns. It should include some discussion of the second and third statutory conditions under which the duty on water undertakers to provide access does not apply.
- One water undertaker commented that there is a lack of clear guidance on the requirement for financial guarantees by water undertakers. Others agreed that water undertakers need financial guarantees saying they may incur significant expenses.
- A water undertaker said it should be made clear that they are not required to satisfy themselves that the premises to be supplied by a licensee are eligible. It is the licensee who would be breaking the law in supplying an ineligible customer, and while the water undertaker will co-operate in providing relevant information, the obligation must rest with the licensee.

## **Our conclusions**

We considered respondents' comments carefully and feel that the revisions we have made will achieve the right balance at this stage. We have revised section 3.1.2 on the initial stage of the application to explain the licensees' responsibility for eligibility. We will not require water undertakers to ask for financial guarantees, although parties may agree to cover these in the terms and conditions of their access agreements.

We consider it necessary for water undertakers' operational standards to be transparent to the parties operating in and supporting the competitive regime. The sharing of such information could be covered by a confidentiality agreement if the relevant undertaker thought this was necessary. As the risk assessment criteria that water undertakers use when developing a new resource is available in their water resources management plans we now see no need for them to publish this separately.

Section 3.6 of the guidance sets out the possible reasons for objection to a licensee's application for access. The conditions under which the sections 66A-66C WIA91 duties do not apply to water undertakers are listed in section 2.1.2.

We have revised section 3.1.2 to clarify that it is the licensee's responsibility to ensure that premises are eligible.

We have inserted text about DWI's role in section 3.1 on the application process and in the flow chart on combined supply applications. Water undertakers and licensees should also refer to DWI's guidance Information Letter 13/2004, 'Common Carriage: Guidance on Drinking Water Quality Aspects' (November 2004), and any updated versions of that Information Letter or other guidance that DWI may produce. We note the suggestion that DWI should assess a licensee's policies and procedures. However, DWI has no role in assessing operational standards. These are for the licensee and the water undertaker to agree.

## **2.5.2 Application process**

### **Question 2: Do you agree with the proposals set out regarding confidentiality agreements?**

Most respondents considered that we should develop a standard industry confidentiality agreement. Any case-specific additions may be negotiated between licensees and water undertakers in individual access agreements. They suggested that this would reduce the scope for disputes and delays and save time and money.

We received the following additional comments.

- One stakeholder said the list of items should be kept to those that needed to be confidential, saying that in the past water undertakers have declared most things to be confidential even in non-competitive situations.
- One potential licensee said it is difficult to assess the current proposals as the legislation relating to confidentiality is currently developing, citing the Environmental Information Regulations 2004 and the Freedom of Information Act 2000 (FOIA).
- The same potential licensee also asked for clarification about the level of proof that would be required to show confidentiality agreements have been broken. Licensees have to prove 'beyond reasonable doubt' that a water undertaker has breached an agreement because the obligation for confidentiality is written into the water undertakers' Conditions of Appointment. However, the water undertaker only has to prove 'in probability' under contract law that the licensee has breached an agreement.
- Some water undertakers said confidentiality agreements should not be designed in a way that prevents them from communicating with their customers.

- Water undertakers commented that Condition R would be a better place to stipulate confidentiality requirements. We could then enforce any confidentiality obligations and the water undertakers and licensed water suppliers would not need to rely on taking court action to pursue a remedy, which might be difficult and costly.

## **Our conclusions**

It is not appropriate for us to provide or draft an agreement for use by the parties, but we would be happy to be part of any discussions about its scope.

Condition R and Standard Licence Condition 2 of the WIA91 oblige undertakers and licensees not to use or disclose information received during the process of discharging their duties under sections 66A-66C WIA91, unless the information is needed to discharge those duties or is required by law. Condition R also requires undertakers to have confidentiality provisions in place. We have clarified the legal obligations in section 3.5 of the guidance.

We have noted that water undertakers should take account of their obligations under the Environmental Information Regulations 2004.

### **Question 3: Do you think the information requirements set out above are sufficient?**

Most water undertakers felt that it will be necessary to ask for more information but most other stakeholders feel that the requirements are sufficient.

We received the following additional comments.

- DWI considered that the proposed information requirements are the minimum required to assess the technical feasibility of a combined supply application. It welcomed the suggestion that it be kept fully informed of combined supply proposals and that they should be approached if there are water quality issues arising from feasibility studies.
- WaterVoice considered that the water undertaker should provide the licensee with information about any plans to change the direction of flow that might impact on the proposed arrangements.
- A potential licensee asked if the Water Act 2003 has been interpreted correctly in relation to the entry point being upstream of the customer's premises.
- Another potential licensee pointed out that unless the water undertaker passes information to the licensee, the requirement for connectivity to be downstream makes it impossible to identify eligible customers.

- Water undertakers felt it will be necessary to provide more information in many areas. These include water quality, supply and demand patterns, resource planning and outage and emergency procedures.
- Water undertakers said that the licensee should be required to validate its information and suggest that our reporters could do this.
- One water undertaker suggested that licensees should provide information about the status of DWI's audit process at the time of detailed application, and keep the water undertaker informed of progress.
- Another water undertaker commented that the list is not exhaustive. Water undertakers should be allowed the flexibility to stipulate further, but not excessive, criteria in their access codes to reflect local and case-specific conditions.
- Some water undertakers considered that the data asked for is insufficient for a full feasibility study. However, another pointed out that it may be onerous to ask licensees for some of the information. For example, water undertakers should be able to provide details of the monthly supply patterns for existing customers.

### **Our conclusions**

We agree that, at certain stages of the process, water undertakers may need to ask for more information from licensees. We have revised the list of information that will be needed to cover the categories that water undertakers have raised. However, we recognise that water undertakers should not ask licensees to provide information where they already hold the information have access to this using their own systems.

We note the comments about the validation of information. Standard Licence Conditions include a provision to revoke the Licence if the licensee provides water undertakers with information that is false or misleading in a material particular.

As we have revised the definition of connectivity, as outlined in section 2.2.e), the concerns noted above in relation to connectivity are no longer relevant.

**Question 4: Do you agree that this guidance should not specify reasonable information requirements during each stage of the application process, but leave these to negotiations between water undertaker and licensee?**

Most respondents agreed with our proposed approach on this issue, although one commented that it is probably impossible to see all the circumstances at this stage and suggested that we revise the guidance after a period of time.

We received the following additional comments.

- DWI considered that the guidance should not be too prescriptive as negotiations will depend on local conditions, but said that a consistent approach should be taken to water quality issues to avoid the risk of anti-competitive behaviour.
- WaterVoice and another stakeholder were concerned about possible delays in the application process. They suggested that the guidance should specify the essential minimum information we require. WaterVoice commented that we may need to issue supplementary guidance if frequent disputes arise over information requirements.
- Some potential licensees disagreed with our proposed approach. They said the guidance should specify information requirements for each of the application processes and that we should devise a standard set of core information required for the wholesale process and combined supply process separately.
- A water undertaker said that if DWI certifies that the licensee's work complies with the relevant drinking water parameters and has the necessary safeguards, then the water undertaker could take a lighter view of information requirements.

### **Our conclusions**

We have revised our guidance following comments and advice from our TAG, which considered the information requirements during the application process. The guidance does not specify minimum information requirements for each stage of the process, but does suggest the type of information that needs to be exchanged.

DWI does not certify or approve work, but it satisfies itself that the licensee is meeting the regulatory requirements. The onus is on the water undertaker to be satisfied, given that it has responsibility for the quality of the water supplied at the consumer's tap.

### **Question 5: Do you agree with the proposed timescales for each stage of the application process? Please explain your response.**

Most respondents disagreed with these timescales. Water undertakers raised concerns about how the timescales will operate. Some potential licensees and other stakeholders were concerned that the process is too long, but some considered that the timescales are too short. Although respondents recognised that it will inevitably be longer for first-time applicants they felt there was scope to reduce the timescales. In general, respondents felt it was difficult to assess timescales now and we should review them in the light of experience.

We received the following additional comments.

- DWI stated that it would respond promptly to any requests for information or action required, in accordance with its internal Code for Enforcement targets.
- A potential licensee considered that if the first application for a supply licensee is more onerous than subsequent applications, this would act as a potential deterrent for new entrants who may only want to move to those companies who have established customers.
- Water undertakers felt it would be helpful to clarify the involvement of Ofwat and DWI and how this might satisfy aspects of the water undertakers' responsibility for due diligence.
- Water undertakers also commented that there must be clarity in the process, to identify the actions that are within the control of the water undertaker and those which are not. For example, where outside agencies are involved we should not penalise water undertakers for failing to meet timescales if they can show best endeavours and transparency throughout the application process. Allowance should be made for the complexity of applications. The timetable should recognise that the clock may need to stop if the licensee and water undertaker are awaiting information or reports from third parties.
- Some water undertakers commented that they will not be able to honour the results of assessments indefinitely and should be able to set deadlines for licensees to respond to these. If these deadlines are not met, water undertakers should be allowed to make new assessments.
- One water undertaker considered that it may be more appropriate to devise an overall timescale since it may be difficult to meet the proposed timetable for each of the individual stages. The allowance of 40 days for undertaking detailed contract negotiations is unduly optimistic, especially for the first agreement and additional time should be allowed.

## **Our conclusions**

In the absence of practical experience, it is difficult to estimate with much certainty how long an application would take. In recent discussions at the TAG, members agreed that the current draft timescales are acceptable but will need to be monitored and reviewed in the light of experience. To address the issue of water undertakers waiting for information from other parties, such as DWI or the Environment Agency, we have explained that in some cases the water undertaker and licensee might agree to 'stop the clock' until information is received.

We are not the prosecuting authority for section 70 of the WIA91 and it will be up to all parties involved to demonstrate to DWI that they have taken due diligence.

## **Question 6. Do you think that we have identified the key stages of the application process?**

Most respondents felt that there needed to be more stages in this process.

We received the following additional comments.

- WaterVoice agreed that the key stages of the application process have been identified, but expected variations in the process with each application.
- Another stakeholder commented that there needs to be reference to the Environment Agency and its duty to ensure the efficient use of water resources. It suggested that the Environment Agency needs to be contacted in the introductory phase so that all parties are aware of the impact of any water resources changes.
- One potential licensee felt that there was further scope to combine and streamline the processes, by looking at the experiences in gas and electricity.
- Several water undertakers identified the additional stages that they consider should be covered. These include:
  - disputes handling;
  - situations where customers change their minds about switching licensees;
  - responding to emergency situations;
  - strategic supply designations;
  - systems testing;
  - situations where there are concurrent applications;
  - when the application requires civil works to be undertaken;
  - due diligence process.
- One water undertaker commented that it should be possible for DWI to highlight any potential problems at the application stage. There is merit in DWI approving wholesale and combined supply applications, before water undertakers embark on lengthy and costly detailed assessments.

### **Our conclusions**

We have not revised our guidance to incorporate the extra stages requested. This is because we consider that they are adequately covered in the guidance on access codes or in another guidance document, or because there is sufficient flexibility in the process to address them. For example, our forthcoming WSL determinations procedure will explain how we will deal with disputes, and situations where customers change their minds about switching supplier are covered in the CTP.

DWI has highlighted potential problems in its guidance on common carriage. Both parties should use this guidance in seeking to resolve potential issues. However, DWI does not approve applications. DWI will only become involved in the event of

a dispute, when it will provide its views on how to proceed. This does not amount to approving an application.

**Question 7. Do you think we should set out timescales for each stage of the process or should we simply set out an overall period of time within which we expect agreements to be made?**

Most of the water undertakers who commented on this disagreed with the proposal and referred to their comments on question 5. Most other respondents agreed that there should be separate timescales for each stage of the process.

We received the following additional comments.

- WaterVoice felt that the timetable should be rigorous and said that there is scope to reduce the overall period of time for reaching agreements.
- Water undertakers commented that the length of the application process will vary according to the technical difficulty of the application and it may be best not to prejudge this issue. There should be more consideration of the effects on the timescales of concurrent applications, staff resources and delays in receiving information from outside parties.
- One water undertaker also commented that the timescales needed to be compatible with those specified for the strategic supply designation process.

**Our conclusions**

We note the concerns about the timescales, but have decided in the light of recent discussions at the TAG not to revise our guidance. We will review the timescales in the light of experience.

**Question 8: Would you find it helpful if our guidance specified separate application processes for applications for a wholesale supply and for a combined supply?**

Most respondents generally supported this proposal, saying that the two processes are discrete but we should ensure that there is no unwarranted overlap between the two processes.

**Our conclusions**

As outlined in section 2.2.b), we have revised our guidance.

**Question 9. Do you think that the corresponding flow diagrams accurately reflect the steps involved in the application process?**

Most respondents felt that the flowcharts were helpful and accurate. Water undertakers suggested some improvements.

We received the following additional comments.

- Water undertakers said that the timescales were not accurate as they do not account for the time taken for the licensee to produce minimum information at the application stages. Also, there is no reference to when fees should be paid or to systems testing.

### **Our conclusions**

We have modified the flowcharts to correspond with the new, separate parts on wholesale and combined supply applications.

### **Question 10. Do you agree with the proposed activities set under each key stage of the application process?**

Most respondents broadly agreed with the proposed activities.

We received the following additional comments.

- WaterVoice said that there is no activity covering the point that the licensee should provide evidence that their customer meets the eligibility criteria. Also, we should develop an audit process to ensure customers are above the 50 MI/year threshold.
- Water undertakers commented that the process needs to include confirmation from customers that they wish to continue with the transfer and provision for agreeing debt repayment. There is a need to assess premises for compliance with the current regulatory requirements. In addition, we should include a further explanation of the role of DWI, the need for the Environment Agency to approve the transfer, links to the strategic supply designation process and greater clarity about the outputs required at each stage of the process.

### **Our conclusions**

We have included a requirement for the licensee to confirm eligibility to the water undertaker at the initial application stage. We consider that issues about customer transfer are already covered in the guidance or in the Customer Transfer Protocol (CTP). The roles of the regulators are covered as necessary, although the Environment Agency does not have a significant role in the CTP.

The role of DWI is clearly set out in its annual reports and that role will continue under competition. We will work closely with DWI and the Environment Agency as necessary.

**Question 11. Do you agree with the proposed reasons for objection?  
and**

**Question 12. Are there any other reasons for objection that need to be included here?**

We have summarised the responses to both of these questions together. The respondents broadly agreed with the proposed reasons for objection. They pointed out that the list should not be seen as exhaustive and suggested that we should develop it when we have more experience. Respondents also raised concerns that there is duplication between the access application process and the CTP. Water undertakers proposed several additional objections.

We received the following additional comments.

- One stakeholder said that the emphasis is on the water undertaker challenging such things as eligibility and suggests this may be burdensome. We should take a proactive approach in ensuring that licensees do not supply customers that are not eligible.
- One stakeholder said there should be no barrier to a customer changing supplier because of outstanding debt because in competitive markets this issue is no barrier. However, WaterVoice agreed with us that there should be no transfer where there is outstanding debt because of a poor payment history. But stakeholders generally commented that water undertakers should not be able to delay or block consumers from changing supplier because of minor debt issues.
- WaterVoice also said that reasons for objection should be kept to a minimum, and should reflect legal or technical issues that cannot be overcome.
- Potential licensees said that the reasons for objecting should be objectively measurable. For example, it should be possible to provide a definition of debt.
- One water undertaker said there should be more detail on what constitutes unacceptable water quality situations.
- Water undertakers felt that this chapter is generally confused about cases where an objection must be made and those where it may be made. For example, connectivity and eligibility appear to be presented as negotiable rather than mandatory reasons for objection. A water undertaker can object to any situation that it considers would put at risk its existing or probable future obligations to supply water for domestic purposes.
- Water undertakers also commented that this chapter would benefit from rigorous cross-referencing to, in particular, the forthcoming exception regulations and exemption orders. Also there appears to be confusion as to how the application process and the CTP will interact.

- Water undertakers suggested additional objections including:
  - objections from other parties such as sewerage or secondary water undertakers, English Nature, DWI or the Environment Agency;
  - if the customer changes their mind;
  - the water undertaker has accepted an alternative proposal from another licensee;
  - providing inadequate or false information;
  - failing to provide sufficient financial or technical guarantees;
  - inadequate product or public liability insurance;
  - failure to meet systems testing;
  - not meeting regulatory requirements;
  - the direction of flow is not acceptable;
  - reasons of national security; or
  - where the customers have outstanding debt to a sewerage undertaker.
  
- A water undertaker pointed out that the CTP recognises the possibility of a customer requested objection and the guidelines should also allow for a similar type of objection, or a process for a licensee to withdraw their application in these circumstances.

### **Our conclusions**

We have revised the possible reasons for objection in the guidance, taking into account respondents' suggestions, and stated that parties should be able to negotiate solutions to some issues. We accept that water undertakers, licensees (in the case of a customer transferring from one licensee to another), DWI and secondary water undertakers may have reasons to object and have revised the text accordingly. Water undertakers must be able to provide evidence in support of an objection.

In response to concerns about unnecessary duplication in the access application process and the CTP we have removed debt as a reason for objection during the applications for access. Debt is defined in Condition R and Standard Licence Condition 5 as the customer's failure to pay the old supplier's charges for the supply of water for 30 days or more after the date of the supplier's demand notice. As the parties can negotiate debt repayment up until the point that a customer transfers, it is more appropriate for debt repayment to be addressed in the CTP.

We have revised the text of the guidance on access codes to clarify that it is the licensees' responsibility to prove eligibility.

### **Our question: We asked consultees whether they had any additional comments on the application process.**

Respondents raised a variety of issues and made some drafting suggestions to improve clarity and consistency. Water undertakers were concerned that the guidance is vague in some areas.

We received the following additional comments.

- Water undertakers considered that there needs to be more information about the costs of the application process. The final guidance should include the costs applicable for each stage of the process.
- One water undertaker considered that the guidance should clearly outline the nature and level of communication that the water undertaker can expect to have with its existing customer during a licensee's application for access.
- Another water undertaker said that the safety systems will need to show that both retail and combined licensees are capable of receiving, interpreting and communicating supply system safety data and information to both customers and water undertakers in a timely fashion. Licensees will also need to demonstrate capability of compliance with the operation of the CTP.
- One water undertaker did not want processes that will lead to a high level of transactions, saying that the suggested elements of the application process must be proportionate.

### **Our conclusions**

We have revised the guidance to take account of the drafting suggestions. It is for water undertakers to decide how best to recover from licensees the costs of assessing applications for access to their supply systems. Water undertakers should be able to continue communicating with their customers as they did before receiving the licensees' application.

**Question 13. How much detail should the guidance prescribe for the terms of the contract?**

**and**

**Question 14. Are the essential issues covered in the list above? Should anything be added to it or deleted from it?**

We have summarised the responses to questions 13 and 14 together. Most respondents agreed that we should set out a standard list of terms, but commented that this will not be exhaustive and should allow water undertakers and licensees flexibility to agree case-specific details. Respondents suggested that the list would need revising in the light of experience. Around half of the respondents suggested additional terms for the list in the guidance.

We received the following additional comments.

- A stakeholder commented that it would be useful to limit legal basis to English law as is common to these contracts.
- DWI considered that its role in resolving disputes should not form part of the standard terms and conditions, but should be referred to in the access code.

- One water undertaker felt it would be useful if the guidance clarified the headings that are listed, which it considers are of little value on their own.
- Another water undertaker asked what 'best endeavours' refers to, saying it may depend on the circumstances whether 'best' or 'reasonable' endeavours would be more appropriate. This should be a matter for parties to negotiate and specify in the agreement.
- Respondents made the following suggestions for terms that should be included:
  - purpose of the agreement;
  - right, duties and obligations of the parties;
  - consequences of termination;
  - consequences of breach of contract;
  - a 'material changes' clause;
  - a 'third party rights' clause;
  - a 'Press Release announcements' clause;
  - conditions precedent;
  - meters;
  - monitoring and control arrangements;
  - emergency procedures;
  - drought planning;
  - provision of information;
  - point of supply;
  - ownership of connections;
  - volume;
  - hydraulic limits (flow and pressure);
  - price;
  - debt;
  - customer service;
  - levels of service; and
  - demand forecasts.

## **Our conclusions**

We have revised the suggested terms of the contract to include most of the terms suggested by respondents and removed the reference to DWI's role in handling disputes. We have clarified in the text that the contract will bind both parties to the conditions specified in the access code.

We have rationalised the process for wholesale applications. Water undertakers and licensees will first agree in a master agreement the main terms and general conditions that will apply to wholesale agreements between them. Secondly, for each customer they will exchange the data required to create a schedule to add to the master agreement that contains the site-specific agreements.

**Question 15. Do you agree that the customer’s water supplier should be the first point of contact in all instances (except in emergencies where this might be impractical)?**

Most respondents agreed, but some suggested that there may be operational situations where the water undertaker will need to be contacted directly by the customer. This will be case-specific and should be dealt with in the access agreement. Water undertakers said that licensees and water undertakers should agree communication procedures in advance. Also, licensees should have a clear responsibility to keep the supply system operator fully informed of any incident or situation which could impact on service to customers.

We received the following additional comments.

- WaterVoice pointed out that business customers in the chemical industry need to maintain day-to-day contact with the incumbent water undertaker on water quality issues that affect the running of their business. Where water undertakers would incur costs with this kind of arrangement, WaterVoice considered that this should be reflected in the access price.
- A water undertaker commented that a relevant part of any ‘avoided cost’ calculation is likely to include consideration of the customer service savings made by a water undertaker through no longer having direct and frequent contact with that customer.

**Our conclusions**

We have revised the guidance to refer to arrangements with business customers. We explain our response to the comments on costs in section 2.5.4.

**Question 16. If a customer of a water only water undertaker switches to a licensee, what provisions should be in place to ensure the relevant sewerage undertaker can be contacted by the licensee? Should a condition specify that the licensee liaises directly with the sewerage undertaker on behalf of its customer or should the customer be entitled to contact the sewerage undertaker directly?**

Most respondents favoured the continuation of the relationship between the customer and their sewerage service provider and generally considered that there does not need to be a Licence Condition to cover this situation.

We received the following additional comments.

- WaterVoice said that customers must be able to retain direct contact with the sewerage undertaker if they have a query that has no bearing on the licensee. To do otherwise would create unnecessary administrative work and potential delays in resolving sewerage related queries.

- One water undertaker commented that the new competition provisions in the WA03 relate only to clean water so there is no obligation to change sewerage arrangements. The wastewater undertaker should agree on a case-by-case basis whether the licensee should act as billing agent for the customer's wastewater charges. For existing trade effluent customers, it is essential that water undertakers maintain a direct relationship for contractual reasons.
- Another water undertaker said that customers should liaise with sewerage undertakers as happens now, except where the sewerage undertaker and the licensee have a commercial agreement for the contact to be carried out by the licensee on behalf of the sewerage undertaker.

## **Our conclusions**

We have revised the guidance to specify that sewerage undertakers should generally retain their existing relationships with their sewerage customers.

### **2.5.3 Operational issues**

#### **Question 17. Do you agree that licensees must ensure their water is compatible with water undertaker's water?**

All respondents agreed that it is the licensee's responsibility to meet quality standards so that its water supplies are wholesome and compatible with the water undertaker's supplies. However, respondents queried the definition of compatibility.

We received the following additional comments.

- DWI welcomed acknowledgement that water undertakers may apply higher operational standards to the water leaving their water treatment works in order to ensure compliance at the point of supply and said it expects combined licensees to meet these operational standards. DWI also expects all licensees to take account of compatibility issues in their negotiations with water undertakers.
- Potential licensees commented that 'compatible' does not necessarily mean 'identical' supplies. There is scope for onerous conditions to be placed on licensees. Customers' preferences for particular characteristics of water quality are not uniform.
- Another water undertaker commented that even where all criteria set by the water undertaker are met, some customers may notice a change in taste. There may be costs associated with notifying customers of this change. Licensees should work with water undertakers to ensure the quality of water delivered to the tap rather than simply at the supply system input point, meets the water undertaker's requirements.

- A water undertaker points out that it is not within our remit “to assess whether an operational standard is more stringent than it needs to be”. Standards are determined by the water undertaker’s board of directors who are responsible for compliance with statutory obligations and delivering standards of service.
- One water undertaker considered that water undertakers must be free to stipulate water quality parameters over and above DWI and statutory requirements, as long as they are transparent and also applied to water undertakers’ own operations. However, another water undertaker commented that generally we should not expect the licensee to ensure compatibility over and above what the water undertaker currently offers to its other customers. The exceptions are where this is an accepted requirement for the particular customer in question (where it may have been negotiated as part of the access agreement as an ‘added-value’ service) or where the new entry presents new water quality issues to be addressed.

### **Our conclusions**

Overall water quality in the distribution system must not be compromised by competition. The water quality must meet regulatory standards, although we acknowledge that customers may have their own preferences for water quality, in terms of its taste, odour or other factors. We have revised our guidance to clarify the requirements for a water undertaker to discuss these issues with the licensee.

We note the comments about defining compatibility and have discussed this with DWI. DWI considers that this is complex and will need to be considered on a case-by-case basis. Water undertakers and potential licensees will need to take account of chapters 28-35 of DWI’s guidance on common carriage and, if necessary, undertake quality modelling.

We note the comment about our role in assessing application of operational standards. We are likely to do this if there is a dispute.

### **Question 18. If water quality changes after a scheme goes live, should licensees have to change their inputs to ensure compatibility criteria? If so, who should bear the cost of this?**

Generally, respondents agreed that where there are regulatory or statutory reasons for licensees to change their inputs they should bear the costs of this work. This will ensure compatibility is a basic principle of providing a supply. Water undertakers viewed this as a normal business risk and considered that ineligible customers should not bear any additional costs. However, some respondents said there may be situations where it is appropriate for water undertakers to bear the costs of ensuring compatibility. For example, where a water undertaker asks for changes in water quality for its own internal reasons not related to external requirements.

We received the following additional comments.

- A water undertaker said that if a licensee has included a range of water quality parameters in their application and water undertakers accept this, then the additional costs should not be borne by the licensee. Where there are increased costs because of a general change in water quality requirements, these can be shared amongst all affected customers, maintaining the ARROW principle.
- Another water undertaker suggested that it may be helpful if the guidance outlined some potential scenarios where the quality of water in the supply system altered and how to assign responsibility for ensuring the licensee's source continued to meet compatibility criteria.
- Another water undertaker commented that as the competitive market develops, it will be necessary to consider how a second (or additional) new entrant affects both the supply conditions of the water undertaker as well as the first (or existing) new entrant(s). These situations will have water quality implications and will require our guidance. Any new entrant should ensure compatibility with both the water undertaker and any other "connected" licensee.

## **Our conclusions**

We have revised the guidance to explain where it may be appropriate for the water undertaker to bear the costs of ensuring compatibility and to refer to situations to say that second and subsequent licensees must ensure that the water they introduce is compatible with that already in supply. We note the requests to include in the guidance some scenarios covering changes in water quality. The guidance sets out a broad framework without being too prescriptive. Respondents commenting on the regulatory impact assessment (RIA) support this approach. We do not consider that there would be value in providing scenarios as requested as there may be too many variations for a single scenario to be helpful and prescribing a number of scenarios might reduce the opportunity for flexibility.

**Question 19. What information flows do you think are reasonably required for the safe and efficient management of the water undertaker's supply system? Please explain your response.**

**and**

**Question 20. Do you think this information should be set out in the Access Code or left to access agreements?**

The responses to these questions are considered together as many of them cover the same points. Most respondents felt that we should include a basic framework for information flows in the guidance. Licensees and water undertakers can then negotiate more detailed information on a case-by-case basis as part of access agreements. Several respondents supported the proposal to set up a sub-group of the TAG to consider this issue further. Respondents suggested various items for inclusion in the information flows.

We received the following additional comments.

- One potential licensee pointed out that in some cases it may be appropriate to link the control equipment of the licensee to the telemetry of the water undertaker.
- A water undertaker said that licensees should be required to meet the same instrumentation and telemetry standards that the water undertaker uses for its own sources.
- A water undertaker said that any telemetry/real-time information deployed at the licensee's source should be made available to water undertakers in a timely and appropriate manner, so that inputs are safeguarded.
- A water undertaker commented that guidance is needed on the rights of a water undertaker to deal with circumstances where a retail licensee's customer is reasonably suspected of causing a quality or operational problem in the water undertaker's system. In particular, guidance would be helpful on rights of access and sampling, the right to recover associated costs, and whether water undertakers could bring a prosecution under the WA03.
- Water undertakers commented that the proposed Licence Condition 2 sets out the requirements for licensees to co-operate with the water undertaker and behave in a responsible manner. The two parties must agree day-to-day working procedures with whatever information flows they deem necessary to allow safe and efficient management of the supply system. Drinking water quality and security of supply are of paramount importance to customers.

### **Our conclusions**

We have included in the guidance a non-exhaustive list of the basic information flows that may be needed, based on respondents' suggestions. We have also explained what else might be required from the licensee. We consider that this framework is flexible enough to enable water undertakers to develop their own requirements on a case-by-case basis, as appropriate. The details can then be developed in the individual access agreements.

### **Question 21. Do you think that the approach to drought and resource planning is reasonable and practical?**

Most respondents broadly agreed that the approach is reasonable.

We received the following additional comments.

- A water undertaker commented that if the licensee fails to meet the information requests from the water undertaker they should be subject to the same penalty as for a statutory water undertaker failing to meet a similar information requirement.

- One water undertaker pointed out that new sources have to go through the abstraction licensing process which lays down requirements for providing environmental impact and supply/demand balance information to the public and Environment Agency. Water undertakers should not retain sole responsibility for the production of water resources and drought plans as, in some cases, it will be necessary for the licensee to indicate future plans for the source over the planning period (ie 25 years).
- Another water undertaker commented that water undertakers are expected to undertake an annual review of their water resources plan and to notify the Environment Agency of any changes to the plan immediately. This will enable licensees to notify water undertakers of any changes as soon as is reasonably practicable.
- A water undertaker asked for more clarification of the different levels of risk of interruption to supply and how this might be applied in practice. For example, how water undertakers might discuss a regional strategy towards drought and resource plans. Depending on the resources available, the licensee might need to be party to future planning within the environmental framework.
- A water undertaker commented that if the licensee's supply is provided under an agreed different level of service, then the situation could arise where water use restrictions are imposed on the water undertaker's customers before they are imposed on the licensee's customer(s) (or vice versa).
- A water undertaker commented that water undertakers operate their systems in a given way in the event of a drought order and may reduce or allow flows and pressure to drop. While it may be possible to encourage direct demand reduction by large, easily defined customers, it is difficult to prevent the majority of customers continuing with their demand. So it is possible that general demand upstream would prevent supplies reaching a licensee's customer downstream, even if the licensee had introduced his supply at the head of the system.
- The same water undertaker said that wholesale supplies may affect water undertakers' security of supply index, which have a direct impact on water available for use by a water undertaker, or introduce a new uncertainty into the supply/demand balance.
- Some water undertakers also considered that licensees and customers should agree between them the extent of protection from interruption. Our guidance should list situations where all customers may suffer a reduction in service and specify whether customers in a same class may suffer different service reductions according to their water supplier.

## **Our conclusions**

We have revised our guidance to explain that water resources management plans describe the risk assessment criteria and how the abstraction licensing process

includes the requirements for licensees to provide environmental impact and supply/demand balance information to the public.

We agree that licensees and customers should decide between themselves the extent of protection from interruption, which must be consistent with what is in the access agreement. Individual water undertakers can develop their own policies about issues, such as the impact of wholesale supplies operating during drought orders, and whether or not all classes of customers should be subject to the same risk of interruption.

We do not consider that wholesale supplies are likely to affect water undertakers' security of supply index.

**Question 22. What level of detail do you think is required in this guidance to cover compensation issues?**

Most respondents considered that there should be some explanation of compensation issues in the guidance, but opinions varied on whether the guidance should set these out in detail or just provide a basic framework.

We received the following additional comments from water undertakers.

- One water undertaker said the guidance should specify what happens if water undertakers' and licensees' customers are both affected by the same incident.
- One water undertaker said that more detail is needed on compensation issues to avoid unnecessary disputes. Compensation may be required in a variety of circumstances, including where a secondary or sewerage undertaker has been involved. However, another water undertaker considered that the guidance on access codes should avoid non-statutory areas and reflect the legal requirements only.
- One water undertaker said that water undertakers, acting as supply system operators, would in general offer a common service standard to all customers on their supply system. If licensees sought to offer a different, say higher, service standard (with compensation provisions) to its customers this would need to be reflected in contracts with the water undertakers which would address the issue of additional costs and any associated compensation provisions.
- Water undertakers generally considered that more information is needed on what we consider would be "adequate product and public liability insurance" to ensure that funds are available to maintain licensees' assets to agreed performance capabilities. We should outline a number of scenarios in which compensation claims arise for water quality or service failures. Compensation should not be set in access codes as it may be negotiated on a case-by-case basis.

## Our conclusions

Water undertakers and licensees should agree the appropriate level of product and public liability insurance for each access agreement. Under Standard Licence Condition 5 the water undertaker can check immediately after the supply commences that the licensee has the required level of insurance.

We agree that water undertakers and licensees should agree the finer points of compensation arrangements on a case-by-case basis and set these out in the access agreements. This is reflected in the guidance.

### **Question 23. Do you agree with our proposed approach towards metering?**

Most respondents agreed with our proposals.

We received the following additional comments.

- One stakeholder commented that provision should be made to incorporate the data into the water undertaker's data recording process, for example via telemetry.
- WaterVoice was concerned that a metered customer of a licensee will be able to choose to be charged on an unmeasured basis at the discretion of the licensee, suggesting that eligible customers with a consumption level of 50 Ml/year should be compulsorily metered.
- A water undertaker commented that it should be a requirement of the licensee to provide a meter reading for billing purposes at the normal meter reading cycle of the water undertaker. It should be a requirement of the application process that a licensee informs the sewerage undertakers so they can acquire details required for their billing process. If a licensee fails to meet its obligations for meter reading information then the licensee should be subject to the same penalty as a statutory water undertaker failing to meet similar duties and obligations.
- Another water undertaker said that there must not be any assumption that the licensee will conduct all meter readings. Water undertakers will need to ensure that water and trade effluent volume meters are read at the same time.
- One water undertaker considered that water undertakers should be allowed to continue to supply the meter readings to the sewerage undertaker if they so choose. Sewerage undertakers should also be allowed to pass on to the customer any justifiable additional costs that arise as a result of the customer switching to the licensee.
- Another water undertaker said it is unfair to expect the water undertaker to own and maintain a meter that is on the property of a customer it no longer supplies, without allowing the water undertaker to pass on the costs associated with maintaining and reading that meter to the licensee. This should be done through access charges.

## **Our conclusions**

We have revised the guidance to explain that Standard Licence Condition 5 provides for licensees to inform sewerage undertakers of any premises that are connected for the first time and section 205 of the WIA91 provides for the sharing of meter readings. It is for licensees and their customers to agree the basis of charging. We consider that this provides the framework for the relevant undertaker and licensee to agree on the frequency of meter readings between themselves and in consultation with any sewerage undertaker as appropriate.

We note the comment that it is unfair to expect the water undertaker to own and maintain a meter on the property of the customer it no longer supplies. However, the costs to the water undertaker of maintaining and reading the meter are covered by the costs principle. We consider that it is unlikely that a licensee would agree to charge its customers on an unmeasured basis but if it does so, then this is a matter for them to agree between themselves.

### **Question 24. Do you have any propositions on how to address flow balancing?**

Views on this point were mixed. Most water undertakers thought it would be beneficial to have more guidance on this point, and some suggested it would be helpful to have worked examples in the final guidance. Water undertakers raised technical points and considerations, but there appears to be no consensus on how these issues should be handled. Several water undertakers supported the proposals for the TAG to examine these issues further. Few other stakeholders responded to this point, saying it is more appropriate for water undertakers to comment on the practicalities of flow balancing.

We received the following additional comments.

- One potential licensee said that combined supply test scenarios overseen by us have been instructive in this area. The daily balancing should not be required as control data and telemetry could be shared with the water undertaker in long-term supply agreements.
- Another potential licensee commented that case-specific arrangements on flow balancing should be specified within the access agreement. The guidance should specify a default standard.
- One water undertaker said water undertakers should be able to retain the ability to stipulate their requirements for flow balancing on a case-by-case basis. Another said that, if flow balancing is included in the access guidance, then it will need to cover all possible scenarios.
- One water undertaker commented that it may be more productive to commission a specific piece of expert analysis rather than rely upon the answer being developed from first principles by a sub-group.

## **Our conclusions**

We discussed these issues with the TAG. There was little interest in discussing the detail of flow balancing and some consensus that a specified mechanism was unnecessary. So we have included in the guidance a list of the basic mechanisms for supply system balancing that should be specified in the access code, but we do not propose to go further than this at this stage. Water undertakers and licensees should agree case-specific balancing arrangements in their agreements.

### **Question 25. Do you agree with the emergency procedures outlined in this section?**

Most of the respondents were in broad agreement with the proposals, and commented that there has to be close liaison with the parties over these issues and clarity in the access agreement about where the responsibilities lie.

We received the following additional comments.

- DWI considered there is a need to differentiate between the response to an event, as required under the Water Undertakers (Information) Direction 2004, and the response to an emergency as required under the Security & Emergency Measures Direction (1998).
- WaterVoice was pleased to note the proposal for licensees to follow the best practice procedures of water undertakers by informing the Consumer Council for Water of drinking water quality incidents. This process has worked well when incidents have occurred and provides customers with additional reassurance that the safety of drinking water is being addressed at all times.
- One water undertaker considered that the procedures are insufficient because they concentrate only on quality aspects. Security of supply and hydraulic or pressure aspects also need to be considered in order to further the consumer objective. Both combined and retail licence holders should be involved with emergency planning activities carried out by the statutory water undertaker. Also, further guidance would be appropriate on water for fire fighting purposes and fire hydrant flushing.
- Another water undertaker commented that licensees should be required to comply with nationally agreed security standards, and, where appropriate, those measures required for specific local circumstances. The Information Direction from Defra and the associated guidance issued in DWI Information Letters should apply equally to water undertakers and licensees. The guidance should also outline the licensee's responsibility for the operation and maintenance of its own pipe work from its source up to the point of input to the water undertaker's supply system.
- Some water undertakers wanted greater clarity on the accountabilities for pollution events and the role of the relevant water undertaker in managing

emergency situations. Where licensees are found to be the cause of incidents or emergencies they will be charged for the costs incurred by the relevant water undertaker. How will water undertakers ensure that the water supply licensee is responsible enough to report any water quality issues in time for the water undertaker to take action?

- One water undertaker said it would require licensees to undertake continual water quality monitoring at the point of connection to the supply system as an extra safeguard.

### **Our conclusions**

We note the comments made. Several respondents thought that we should clarify what arrangements should be in place for emergency situations. At the time of negotiating an agreement, all parties must be fully aware of all the regulations and statutory requirements that they must meet. On this basis, water undertakers and licensees should arrange between themselves the procedures that should be in place, which are likely to depend on local circumstances. For this reason, we have not revised our guidance on this area. We have referred to the Security & Emergency Measures Direction (Water and Sewerage Undertakers) (1998), as suggested by DWI. This Direction will be supplemented by a new Direction to cover licensees, which will set out the planning requirements and the need to notify the water undertaker of an emergency.

### **Question 26. Does this guidance correctly identify the key issues that relate only to retail activities and those issues that relate to combined activities?**

Respondents generally thought that the guidance did not clearly distinguish between the issues that apply to retail activities and those that relate to combined activities. They commented that the consultation implies that quality, pressure, safety and emergency issues relate only to combined licensees, which is incorrect. The guidance also needs to be clearer about safety related issues involving retail only licensees.

### **Our conclusions**

We acknowledge that the guidance did not clearly distinguish between the two regimes. We explain in section 2.2.b) that we have now included separate processes. We have also made some drafting changes to clarify the guidance.

### **Question 27. Does this guidance correctly identify those issues that relate to access to water undertakers' potable supply systems and those issues that relate to water undertakers' non-potable supply systems?**

The majority of respondents who commented on this issue pointed out that the guidance gives no consideration to non-potable supply situations.

We received the following additional comments.

- One water undertaker said there are no material differences (other than water quality parameters) in the processes required for access to potable and non-potable systems.
- Another water undertaker commented that the absence of DWI in the process for non-potable common carriage could lead to additional requirements for the licensee to provide information to the water undertaker and this should be set out clearly.
- Another water undertaker said that as non-potable supply is not covered by the WA03, the regulation of competition is such that supplies will be governed instead by the Competition Act.

### **Our conclusions**

We agree that there are few differences in the process required for access to potable and non-potable systems. We have specified that the guidance therefore applies to both types of system.

We note the comment about non-potable supplies not being covered by WA03. We consider that this is an incorrect interpretation of the WIA91. The supply system is defined in section 17B(5) of the WIA91.

### **2.5.4 Access charges**

#### **Question 28. Do you agree that water undertakers need to provide indicative access prices in addition to case-specific access prices?**

Respondents generally agreed that indicative access prices will be useful, but were concerned that the mechanism is overly complicated. Water undertakers commented that the requirements as they are drafted are too onerous and not proportionate to the value that can be derived from them. Three water undertakers said that indicative prices should only be produced for the zones where eligible customers are located. However, water undertakers disagreed about the volume of water for which indicative prices should be calculated. Water undertakers suggested that indicative prices should be calculated on the basis of both 50 MI/annum consumption and 100 MI/annum consumption.

#### **We received the following additional comments.**

- WaterVoice considered that we could help to aid transparency by identifying those companies that have followed a best practice approach in setting out indicative access prices.
- A stakeholder commented that the over-complicated methodology for calculating the access prices could deter new entrants to the market.

- One water undertaker suggested that an alternative to indicative prices would be to identify zones or sub-zones where access is likely to be higher or lower cost.
- Another commented that water undertaker should be able to limit the number of indicative prices to reflect the make up of the potential eligible customers.
- Several water undertakers asked for clarification about the requirements for publishing the indicative access prices; where these will be published; what we will expect water undertakers to publish; and what we will do if water undertakers do not publish their indicative access prices by summer 2005.
- Water undertakers said the method of calculating indicative prices should remain commercially confidential between water undertakers, reporters and us to protect water undertakers from placing in the public domain investment budgets for construction projects that they wish to go out to tender for. We should share calculations with reporters and ourselves only, and we will have a duty to object to external requests under the FOIA.
- One water undertaker asked for clarification about the following:
  - whether the detail and nature of the audit process for indicative prices has been established;
  - the circumstances under which indicative access prices can be applied in place of case-specific prices; and
  - whether water undertakers will be required to produce indicative prices every year even when competition has bedded in and real case information may be available.
- One water undertaker considered that providing indicative price signals for customers using 100 MI/annum is unlikely to be useful as this corresponds to demand of less than 0.3 MI per day.
- Some water undertakers commented that indicative prices should be produced for the beginning and end of each regulatory determination period.
- Water undertakers felt it was not possible to assess average water resource zone (WRZ) marginal operational and capital costs without making assumptions on the timing and duration of entry. We should specify a single scenario. This would also avoid the possibility that some prospective suppliers will be able to assess water undertakers' budgets.

## **Our conclusions**

Indicative access prices need to be published by water undertakers by August 2005 as part of their access codes. The specification for this information is described in the guidance on access codes. Indicative prices will have to be updated annually. We have the power to take enforcement action if water undertakers fail to comply.

In response to the comments received through this consultation and discussion with stakeholders in our advisory group, we have reduced the scope and simplified the format for the indicative access price information that water undertakers need to publish. We think that this revised structure will still provide meaningful price signals to potential entrants whilst significantly reducing the workload for water undertakers.

We have incorporated the suggestion to identify low and high cost WRZs by requiring information on WRZ deficits for a 25-year period.

The industry advisory group recommended that water undertakers provide access prices for two specified volumes. We think this strikes a reasonable balance between the suggestion to limit the number of indicative prices and the need to provide information for a range of eligible customers.

Some water undertakers expressed concern that indicative price information may include some detail that is commercially sensitive. We think that the format that we have now specified for published indicative prices addresses this concern.

**Question 29. We welcome your views on the extent of additional retail information that is necessary from water undertakers.**

Respondents' views were split on this issue. Water undertakers questioned the proposal to expand the June Returns, saying it would add significantly to the regulatory burden and there must be good reasons to request additional data. Most other respondents supported the proposal to extend the scope of the June Returns.

We received the following additional comments.

- WaterVoice considered that the methodology outlined in appendix 2 of the consultation paper should ensure that retail costs show greater consistency between companies. It was pleased that water undertakers would be asked to provide supporting commentaries as these would make company assumptions explicit and assist with the interpretation of figures.
- One potential licensee considered that we should insist on full activity-based cost disaggregation so that the real cost of serving customers is understood.
- Another potential licensee asked if the central assumption is that ARROW costs should be calculated at different levels for different stages of market penetration, how will the first customer switch be effectively enabled?
- One water undertaker considered that the proposal to expand the June Returns must be examined in a proper regulatory impact assessment.
- Another water undertaker said that as this information will be produced to calculate both indicative and case-specific prices there will be an element of duplication in producing it as part of the June Return process.

- Several water undertakers raised concerns that the timetable for water undertakers to produce indicative prices appears to be mismatched with the June Return process. As companies will need to set up data capture processes to enable this data to be produced to an auditable standard it will not be available for JR2005. It will not be until JR2006 that the additional retail information requirements can effectively be built into the structure of table 21. So in the beginning, the industry may be developing access prices based on out-of-date data.

## **Our conclusions**

We have considered the whether the June Return is the best route to collect additional retail information. Our reasons for requiring this information is to ensure that indicative price calculations are correct and to provide background information to enable the resolutions of dispute. We also need to avoid unnecessarily increasing the regulatory burden on companies.

We think that by requiring water undertakers to be prepared to provide indicative and case-specific prices on the basis of the table, and using company reporters to review indicative price calculations, we can avoid a significant extension of the scope of the June Return while still ensuring a significant degree of cost disaggregations. In the event that we need additional information to resolve specific disputes, then this will be subject to an individual request to the water undertaker concerned. Water undertakers will therefore need to maintain a record of the detailed calculations and assumptions that they have applied to produce indicative and case-specific access prices.

### **2.5.5 Glossary of terms**

#### **Question 30. What additional terms should be defined here?**

Respondents listed the following terms as needing definition or clarification.

- Access price.
- ARROW.
- Balancing in relation to volumes input by licensees compared with volumes used by their customers.
- Connectivity and whether this is optional.
- Compatibility, comparable/incomparable.
- CTP.
- Direction of flow.
- Drought plans.
- Greater clarity needed between terms 'access code template', 'access code' and 'access agreement'.
- 'Indicative' and 'case-specific' in the context of access pricing.
- The concept of non-discrimination.
- Recoverable in other ways.
- Regulatory rate of return.
- Supply system as referred to in the definition of licensee.

- It should be made clear where references to WIA91 apply to the Act as amended by WA03.
  - Consumer Council for Water.
  - Instruments of Appointment.
  - Potable and non-potable supplies.
  - Sewerage undertaker.
  - Strategic supply.
  - Water Meters Regulations 1988.
  - Transparency, in relation to the licensees' access to information used by us to make judgements about disputed access charges.
  - Water Resource Zone.
- WaterVoice said that the glossary of terms needed to be in plain English to be easily understood. WaterVoice appreciated that this is a specialised area and statutory meanings apply, but would like to see descriptions simplified as much as possible.

## **Our conclusions**

We have expanded our glossary to include, in particular, those terms not explained in the main text of the guidance.

### **2.5.6 Detailed methodology for calculating access prices**

#### **Question 31. Is figure 1 complete? Are there any other cost elements that should be included?**

Most respondents agreed that figure 1 is complete. Several water undertakers commented that there should be flexibility to extend the list of costs elements with experience. Respondents also said that we should differentiate more clearly between the case-specific and indicative detailed access price guidance. Around a quarter of respondents made suggestions for items that should be included in the list, including:

- abstraction licences;
- chemicals;
- power;
- building and grounds maintenance;
- control equipment operating costs;
- manpower;
- appropriate overheads;
- additional administration costs, including meter reads and balancing; and
- costs of ensuring compliance with the water supply guidance.

We received the following additional comments.

- A stakeholder commented that none of the worked examples for retail prices include costs recoverable in other ways.

- Water undertakers commented that the additional costs to water undertakers of operating the access regime should be included, possibly as a PLUS item in wholesale and common carriage, for both indicative and case-specific prices.
- Water undertakers also asked for confirmation that indicative wholesale costs should be calculated at a company-wide level, while indicative common carriage costs are to be calculated at a WRZ level.
- One water undertaker said that the guidance should clarify whether the licensee's element of the supply must be at least 50 MI or whether the eligibility criteria only relate to the customer's whole supply.
- Another water undertaker commented that costs reduced or avoided may be fixed, partially fixed or volume related, and this should be recognised in lines 5–12.

### **Our conclusions**

We have removed figure 1 and included instead more detailed guidance in two separate appendices (case-specific prices in appendix 2 and indicative prices in appendix 3 of the guidance on access codes). The guidance confirms that indicative prices will normally be calculated at a company level (except if different tariff zones exist). It also clarifies that the licensee's element of the supply must be at least 50 MI although this can be split between wholesale and combined supplies.

**Question 32. Is it necessary to replicate the table showing average operational costs of water resources for a range of volumes rather than a single representative volume?**

**and**

**Question 33. (Page 65) Is it necessary to replicate the table showing the average capital costs of water resources for a range of volumes rather than a single representative volume?**

Respondents raised similar points in response to these two questions so we are summarising their answers together. Most respondents considered that it is not necessary to replicate these tables for a range of volumes. Water undertakers also disagreed about the length of time that these tables should cover. Water undertakers suggested that the tables should assume that the water is put into the system for five years, for a range of times up to 25 years, and for 25 years.

We received the following additional comments.

- The tables are already too complicated for the purposes of calculating indicative prices. The table showing average operational costs requires 15 pieces of data for each WRZ, with each piece of data itself being based on five calculations.

- It will be necessary to calculate the margin between retail prices and access prices in five-year blocks so that the interaction between access pricing and the periodic reviews can work in the way described in the guidance.
- Calculations for any of the WRZ should be done for one volume only, and 100 MI or 1% of WRZ supply should be the usual benchmark volume unless there is a good reason to use another volume.

### **Our conclusions**

We have simplified the scope of the information required. Please see our response to Q28.

### **Question 33. (Page 71) It has been proposed that a standardised spreadsheet be provided to water undertakers for them to calculate common carriage ARROW costs. Is this both desirable and necessary?**

Potential licensees broadly agreed that it is desirable for water undertakers to provide a standardised spreadsheet, although water undertakers qualified their support by saying that these must be able to take account of company-specific factors such as cost bases and different tariff structures.

We received the following additional comments.

- One potential licensee said that if water undertakers agreed to have their spreadsheets examined, there may not be a need for a standard sheet. But if water undertakers' spreadsheets were not accessible, then a standard spreadsheet would be necessary.
- One water undertaker suggested it would be more useful to have a worked example in the guidance.
- Another water undertaker said a common template would be valuable in the event of disputes. Our TAG should investigate, advise and test a format which meets the requirements of the costs principle in calculating ARROW costs.
- However, other water undertakers said a standard template would not be useful. There is no need to have a standard format for indicative price calculations since only reporters and ourselves will be seeing them.

### **Our conclusions**

Several respondents stressed that the format of cost categories needs to be flexible to accommodate company specifics. Consequently, we do not propose to provide a standardised spreadsheet, but we have included a table of different cost headings, which each water undertaker must complete when calculating their access prices.

We have provided worked examples in the guidance as requested by respondents.

## **2.5.7 Regulatory impact assessment (RIA)**

**Question 34. Do you consider that our analysis of the benefits and costs of the approach we have taken in the consultation is complete? If not, please explain why?**

**Question 35. What other benefits or costs do you feel should be included? If possible please quantify these?**

**Question 36. Are our assumptions about who will be affected reasonable?**

**Question 37. Have we under- or over-estimated the effects on those identified?**

Most respondents who commented on the RIA generally agreed with our approach, saying that the guidance should allow flexibility. Some noted that there were specific areas where a greater degree of guidance might be beneficial and reduce administrative costs. Also, respondents generally thought that our assumptions were incomplete and that we under-estimated the effects of the new regime on the industry. Respondents commented that the RIA was not clear about the additional costs to WaterVoice and it did not consider the possible costs to non-eligible customers. However, several commented that it was difficult to answer these questions fully at this stage.

We received the following additional comments.

- We do not indicate how much the implementation of the new regime is likely to cost or how these costs will be recovered. If this is to be via water undertaker's licence fees, then this should be detailed and we should consider whether a full regulatory impact assessment is warranted.
- Using industry-wide generic assumptions and methodologies to calculate indicative prices will lead to differences between indicative and final prices. So the potential benefit of providing "a means to more readily resolve disputes over the validity of final prices" is unlikely to be realised.
- The effects on us of administrating the dispute process in the early stages may be under-estimated.
- The costs to other industry stakeholders should be included. It would also be useful for us to ring-fence the costs and income, and to publish annually the details of those associated with developing and managing the competition framework. This will prove an auditable trail, which will prove useful in the promised three-year review of the competitive framework and determining whether new entrant licensee charges are reasonable.
- No market research has been done to establish the potential demand for switching and the level of churn that can be expected once competition commences so the benefits and costs cannot be determined sensibly.

- Indicative access prices may understate the true costs of access. There will be other costs associated with allowing access and these may be larger in the earlier stages of competition.
- The relative cost and workload burden on small water companies will not be small and the issue of cost recovery should not be dismissed in this manner.

### **Our conclusions**

We note the suggestion that a full RIA should be issued. The purpose of the partial RIA that was issued with the access code consultation was to inform stakeholders of the options for developing guidance on access codes and the likely costs of these options and to give stakeholders the opportunity to comment on these proposals. The final, full RIA at chapter 3 takes the responses to this consultation into account.

The costs of administering the regime may be higher in the early stages and we have revised the RIA to reflect this. We acknowledge that we may have under-represented the costs to stakeholders such as WaterVoice and DWI so we have revised the RIA to include the likely costs to these stakeholders. We have also added text referring to our views on the effect on non-eligible customers. In addition, we have outlined how we will review the RIA.

We note the comments on the costs of implementing the new regime. We explain in section 2.2.4 how the industry will be expected to recover these costs. We have also made some minor amendments to the RIA to reflect the comments that have been made. However, having considered all the comments, we feel that the RIA is a reasonable reflection of the costs and benefits.

### **3. Final regulatory impact assessment**

#### **3.1 Purpose of the regulatory impact assessment**

Our consultation on the guidance on access codes formed part of the framework for implementing the water supply licensing provisions of the WIA91. Following this, section 66D(4) WIA91 requires us to issue guidance in accordance with which the terms and conditions of agreements under sections 66A-CWIA91<sup>2</sup> shall be made. Prospective suppliers will be able to apply for a Water Supply Licence in August 2005, with the overall regime due to commence in autumn 2005.

This regulatory impact assessment (RIA) looks separately at the non-price and price chapters of the guidance and the likely costs and benefits to water undertakers, licensees and other stakeholders, of following the approach that is set out. It incorporates comments made in response to the consultation. The assessment of costs and benefits included in this RIA is mainly qualitative. Although there will be a degree of fixed costs associated with extending competition, we expect that the scale of these will be moderate because of the size of the initial market. Having said this, it is possible that the costs of implementing the new regime will be higher in the initial stages before the parties involved have established policies and procedures. Over the longer term we expect that the extent and magnitude of costs and benefits will depend more on the number of new entrants and the level of competitive activity in the market.

We will review this RIA and its assessment of the costs to the industry when we next review the guidance on access codes.

##### **3.1.1 Responses to the partial RIA**

We received 32 responses to the consultation and around a third of respondents commented on the draft RIA. In general, respondents agreed with our approach on both the price and non-price chapters of the guidance, including our preference in both cases for option 2. However, many respondents were concerned that we had under-estimated the costs to various stakeholders. These comments have been taken into account in this final RIA.

Our assessment of the benefits and costs to the industry follows.

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<sup>2</sup> Sections 66A to 66C WIA91 set out the duties on water undertakers to provide a supply of water to a licensee and/or to permit a licensee to introduce water into the water undertaker's water supply system. These sections also set out the circumstances in which a water undertaker's duties do not apply.

## **3.2. Non-price options and rationale**

### **3.2.1 Summary of options**

In the partial RIA we identified and considered two options for implementing the non-price framework of the new regime, summarised below:

- **Option 1:** Issue strict guidance with no degree of flexibility to allow case-specifics to be taken into account.
- **Option 2:** Issue firm access guidance, but with the flexibility that enables case-specifics and new situations to be considered.

#### **Option 1**

We felt that this option would initially increase regulatory certainty and create clarity for both water undertakers and licensees as they would know from the guidance exactly what was expected of them. However, if water undertakers and licensees followed prescriptive guidance this would reduce the scope for innovation and the opportunities for entering into access agreements. It could also place unnecessary burdens and costs on both water undertakers and licensees because they would need to ensure that every agreement complied with the guidance and covered all issues, even if they were not required for the agreement in question. These costs would then, ultimately, be passed on to customers.

#### **Option 2**

We felt that this option would provide enough certainty to ensure that all water undertakers approach their access codes consistently while allowing them to take into account case-specifics in access agreements tailored to meet the licensee's and customer's circumstances and preferences.

This option would also allow stakeholders to seek innovative approaches and procedures that best meet the requirements of a specific agreement, encouraging licensees to seek out competitive opportunities. It recognises that water undertakers are in a much better position than us to know which technical issues should remain company-specific.

We considered that option 2 would offer a more balanced approach that would encourage competitive activity in the water industry. The industry supported our preference for option 2.

### **3.2.2 Benefits of this approach**

This section summarises the expected benefits of supporting option 2.

## **Benefits to water undertakers/licensees**

- It enables water undertakers/licensees to plan policies to implement the licensing provisions more effectively.
- It reduces the uncertainties for water undertakers, by clearly setting out firm guidance regarding issues that should be complied with.
- It allows water undertakers and licensees to negotiate case-specifics rather than having to conform to strict policy guidelines.
- It offers greater scope for water undertakers to take an innovative approach to developing access codes.

## **Benefits to customers**

We can better accommodate customers' needs by this option as it is firm enough to reduce the scope for water undertakers to misinterpret the guidance, but allows some flexibility for case-specifics. Licensees might see strict guidance as a barrier to entry, thus reducing the number of new suppliers those customers can choose from.

Also, greater scope for water undertakers to be innovative means greater scope for savings to be passed on to customers.

## **Benefits to us**

By allowing licensees and water undertakers a certain degree of discretion to decide what works best for them according to the specifics of their arrangement, this might reduce the need for regulatory intervention.

### **3.2.3 Costs of this approach**

This section summarises the expected costs of supporting option 2.

#### **Costs to us**

We expect that there will be some increased costs to administer the guidance. There is a danger that where guidance is not completely prescriptive, parties to an access agreement might not be able to agree all issues and so refer the dispute to us. This could increase our costs as more resources could be needed to deal with a larger number of disputes. However, we expect that as our experience of dealing with disputes develops, and precedents are set, our costs for this area of work would decrease.

#### **Costs to water undertakers**

There will be some costs to water undertakers in implementing the guidance. For example, a water undertaker will incur costs in revising its existing access code for common carriage to take into account this guidance. The water undertaker will also incur costs in revising its access code as experience of the regime develops, as well as costs associated with publishing the code and keeping it under review.

There will also be costs involved in assessing applications for access, drawing up access agreements and negotiating contract terms with the licensee.

### **Costs to licensees**

There will be costs involved in putting together applications for an access agreement with the water undertaker and negotiating contract terms. There may also be costs involved in ensuring provisions are consistent with those of the water undertaker where necessary. For example, there may be some costs involved in ensuring that the licensees' emergency plans are consistent with those of the water undertaker.

### **Costs to ineligible customers**

The direct costs incurred by undertakers associated with access applications will be recoverable from licensees. Water undertakers' general costs associated with the competitive regime are likely to be small and will be recovered from licensees or allowed for in price limits as appropriate.

### **Costs to Drinking Water Inspectorate (DWI) and Consumer Council for Water (CCW)**

There may be an increase in costs to DWI because they will have to assess applications for Water Supply Licences. The CCW has no powers to administer the new regime or resolve disputes so we do not expect it to incur costs in this area.

## **3.3 Price options and rationale**

Our guidance on access codes sets out the framework for calculating the access charges in accordance with the WIA91. This chapter of the RIA looks at the necessity for water undertakers to publish indicative prices.

### **3.3.1 Summary of options**

In the partial RIA, we identified and considered two options:

- **Option 1:** Water undertakers will not be required to publish indicative access prices.
- **Option 2:** Water undertakers will have to provide indicative access prices by applying a methodology specified by Ofwat.

#### **Option 1**

Under this option, water undertakers would only provide licensees with access prices in response to a specific enquiry and would not be required to publish this information. We felt that this option might inhibit the development of competition,

as it would be difficult for potential entrants to identify areas where access prices could reasonably be expected to be lowest.

## **Option 2**

This was our preferred option. It would require water undertakers to publish indicative access prices for all water resource zones that serve eligible customers, in accordance with the methodology set out in the guidance on access codes. This would enable water undertakers to release indicative price information to potential licensees on a comparable basis, enabling entrants to make more reliable assessments about where to focus their competitive entry.

We preferred option 2 because we felt that option 1 could have a negative effect on competition. Stakeholders supported this.

### **3.3.2 Benefits of this approach**

This section summarises the expected benefits of supporting option 2.

#### **Benefits to water undertakers/licensees**

- It reduces the uncertainties for water undertakers, by clearly setting out firm guidance that should be complied with when developing indicative access prices.
- It allows licensees to make more reliable assessments about where to focus their competitive entry.
- It provides a suitable benchmark for assessing the validity of final prices as the impact of case-specific factors should largely account for any differences between indicative and final prices.
- It provides licensees with information on a comparable basis so that they can make reliable assessments of where to focus competitive activity.

#### **Benefits to us/customers**

Option 2 provides us with a means to more readily resolve disputes over the validity of final prices. This would minimise any increase in our costs to deal with disputes, thus limiting any associated increases for customers.

### **3.3.3 Costs of this approach**

This section summarises the expected costs of supporting option 2.

#### **Costs to us**

There will be some costs for us as we will need to monitor the indicative prices produced by water undertakers. However, indicative access prices may provide us with a means to more readily resolve disputes regarding final prices. We may incur increased costs of handling queries and disputes in the early stages of implementing the regime but any such costs may decrease with experience.

### **Costs to water undertakers**

There will be some costs to water undertakers in implementing the indicative pricing proposals we have outlined in the guidance. As these proposals will require water undertakers to draw largely upon information that is already required for water resource planning any cost increases should be small.

### **Costs to licensees, DWI and CCW**

There will be no costs to these stakeholders as the water undertaker will have to ensure that the indicative prices they offer adhere to the methodology set out in this guidance.

## **Appendix 1: guidance on access codes consultation - list of respondents**

### **Potential licensees**

Aquavitae UK Ltd  
Lanara Group  
Waterlevel  
Scottish Water

### **Water undertakers**

Anglian Water  
Bristol Water  
Bournemouth & West Hampshire Water  
Dee Valley Water  
Dŵr Cymru – Welsh Water  
Folkestone & Dover Water  
Northumbrian Water  
Portsmouth Water  
Severn Trent Water  
South East Water  
Southern Water  
South West Water  
Sutton and East Surrey Water  
Thames Water  
Three Valleys Water  
United Utilities Water  
Wessex Water  
Yorkshire Water

### **Other stakeholders**

Drinking Water Inspectorate  
Energy Information Centre  
Engage Consulting Ltd  
English Nature  
Gemserv  
House Builders Federation  
Major Energy Users Council Limited  
The Chartered Institute of Purchasing and Supply  
The Chartered Institution of Water and Environmental Management  
The Water Management Society  
Water UK  
WaterVoice

