

15 June 2016

Trust in water

Mr O'Connor and Southern Water: Final determination of dispute determined under sections 45(6A) and 30A of the Water Industry Act 1991 L

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1. Introduction

Purpose of this document

- 1.1 This is the final determination of a dispute referred by Mr. Peter O'Connor ('**the Complainant**') to Ofwat, on 8 October 2015, for determination under sections 45(6A) and 30A of the Water Industry Act 1991 ('**the Act**'). The dispute is between the Complainant and Southern Water Services Ltd ('**Southern Water**') and is about whether the expenses incurred by Southern Water in connecting one new water supply at [REDACTED] ('**the Site**') were reasonable.
- 1.2 This final determination was preceded by a draft determination which we issued on 29 March 2016 to both parties. In the draft determination, we set out the facts on which we based our determination and invited parties to make representations to us.

2. Background

The parties

Complainant

2.1 The Complainant is the owner of the Site.

Company

2.2 Southern Water is appointed under the Act to provide water and sewerage services to customers in the counties of Kent, Hampshire, East and West Sussex and the Isle of Wight, where the Site is located.

The Site

2.3 The Site is located at [REDACTED]. The Complainant owns a property at [REDACTED] which consists of three separate flats; [REDACTED]. The water supply connection that is the subject of this dispute (**'the Connection'**) is [REDACTED].

The request for a water supply connection

2.4 On 25 September 2014, the Complainant submitted an application to Southern Water for the Connection and paid a £336 application fee. On 5 November 2014, the Complainant received a quotation from Southern Water for £4,837.40 (**'the Quotation'**).

2.5 The Quotation is set out in detail in table 1 below:

Table 1: Southern Water initial quotation

Description	Cost
The works	£3,900.33
Trench inspection fee	£82.00
Post construction administration fee	£48.84

Description	Cost
VAT	£806.23
Total	£4,837.40

- 2.6 On 7 November 2014, the Complainant paid the amount set out in the Quotation in full. Southern Water subsequently made the Connection on 26 January 2015.
- 2.7 Making the Connection involved excavating and reinstating a single trench of 2.6m in the footway and 4.5m in the carriageway, laying a 25mm pipe and installing a meter. The Connection was from Southern Water's water main in the road along the property boundary. Southern Water required the road to be closed.
- 2.8 The Complainant considered that the work could have been carried out completely in the footway, which would not have then required the road to be closed. He considered a connection could have been made off the existing connection to the other two flats. However, Southern Water considered that the existing supply was not sufficient to enable an additional connection without an unacceptable loss in water pressure to the existing properties.
- 2.9 The Complainant was not offered a refund, and as he considers the expenses incurred by Southern Water to be unreasonable, on 8 October 2015 he referred the dispute to Ofwat.
- 2.10 Upon receipt of the complaint, we asked Southern Water to provide us with a more detailed breakdown of the works set out in the Quotation. The breakdown Southern Water provided is set out in Table 2 below:

Table 2: Southern Water detailed breakdown on the initial quotation

Description	Cost
The works (construction cost)	£1,386.46
Road closure permit	£1,312.32
Road closure signage	£449.95
Construction management fee	£751.60
Trench inspection fee	£82.00
Post construction admin fee	£48.84
VAT	£806.23

Description	Cost
Total	£4,837.40

3. Legal framework

- 3.1 Section 45(1) of the Act imposes a duty on water companies (subject to certain conditions) to make a connection, where the owner or occupier of any premises serves a notice on the company requiring it, for the purposes of supplying water for domestic purposes, to connect a service pipe to those premises with one of the water company's mains.
- 3.2 Section 45(6) of the Act provides that the water company may recover from the person who has required it to make a connection the expenses reasonably incurred by it in making the connection.
- 3.3 Section 45(6A) of the Act provides that any dispute about whether the company's expenses were incurred reasonably may be referred by either party to Ofwat for determination.
- 3.4 Ofwat's decision is binding on the parties to the dispute. By virtue of section 45(6A) of the Act, read in conjunction with section 30A (5) of the Act, this determination is enforceable as if it were a county court judgment.

4. Jurisdiction to determine the complaint

4.1 Ofwat is satisfied that the dispute between the Complainant and Southern Water is a dispute about whether the expenses incurred by Southern Water in making a connection under section 45 of the Act were reasonably incurred, and therefore that Ofwat has jurisdiction to determine this dispute under section 45(6A) of the Act. This is because:

- the Complainant required Southern Water to connect one new water supply connection at his property;
- Southern Water treated this as a request for a connection under section 45 of the Act; and
- the charge raised by Southern Water is disputed as being excessive by the Complainant.

5. Our draft determination and representations

5.1 On 29 March 2016, Ofwat issued a draft determination to both parties. The determination considered:

- the reasonableness of the total amount the Complainant was required to pay to Southern Water for the works involved in making the Connection; and
- the reasonableness of the amount the Complainant was required to pay to Southern Water as an 'application management fee'.

5.2 After considering the evidence provided to us by both parties and the conclusions from the Hyder report¹ and the Review of Section 45 costs report², we provisionally determined that:

- The total expenses Southern Water can recover from the Complainant for the water supply are £3,482.34. Southern Water must therefore return £1,359.76 to the Complainant;
- A reasonable charge for the application management fee is £105.30. Southern Water must therefore return £4.70 to the Complainant; and
- In line with our guidance on interest rates set out in Ofwat's Information Notice 11/05, Southern Water must calculate the interest due to the Complainant, and reissue a final invoice to the Complainant within 20 working days of our final determination.

5.3 In the draft determination, we separated Southern Water's costs into the following specific categories:

- The works;
- Road closure permit;
- Road closure signage;
- Construction management fee;

¹ The Hyder report - A Comparative Study: Cost of new water supply connections work (24 March 2010) http://www.ofwat.gov.uk/publications/commissioned/rpt_com_20100928s45hyder.pdf

² Review of section 45 costs - Independent review of section 45 administration and overhead costs on behalf of the Water Services Regulation Authority (Ofwat) (August 2013)

- Trench inspection fee;
- Post-construction administration fee; and
- Application fee.

5.4 We then considered those costs against benchmark costs in the Hyder report and 'the Review of Section 45 costs' report to assess their reasonableness.

Complainant's representations

5.5 The Complainant responded to our draft determination on 5 April 2016, and made the following two points.

Need for a new connection

5.6 When the Complainant bought the property in 1991, it consisted of three separate flats (one two-bedroom flat and two one bedroom flats) supplied by a single water supply connection. In 1992, Southern Water installed a second water supply connection at the Complainant's request. The Complainant considers it was not necessary for Southern Water to install a third new water connection from its main in the road to his property. He considers that it would have been sufficient for Southern Water to separate one of the existing two supplies. This would not have required the road to be closed, and road-closure costs constituted a large proportion of Southern Water's quoted costs. The Complainant refutes Southern Water's belief that doing this would lead to a loss of pressure to existing properties. His rationale for considering this is:

- There was no problem with the water pressure when the three flats were running off one single water supply connection in 1991;
- Southern Water's contractor, Clancy Docwra, told him the connection could easily be made in the pavement; and
- His property consists of four bedrooms, three bathrooms and three kitchens and was served by two water supply connections before he asked for a further separate supply. The Complainant provided photographs of neighbouring, similar sized properties which were supplied by one supply only.

VAT

5.7 The Complainant stated that he had already paid £806.23 in VAT to Southern Water, and considers that this should be taken into account in the amount Southern Water refunds to him.

Southern Water's representations

5.8 On 20 April 2016, we received Southern Water's representations. It made comments about the specific costs set out in our draft determination.

The works

5.9 Southern Water's construction cost (£1,386.46) for the Connection was based upon the specific circumstances of the Connection, the work involved and contracts that have been competitively tendered. Because this cost falls within the Hyder report's range of recommended costs and is only £404.67 more than the report's recommended median cost, Southern Water does not believe that Ofwat has sufficiently demonstrated that this cost was not incurred reasonably within the meaning of the Act.

5.10 Southern Water also considers that Ofwat's approach of substituting its own costs, derived from the Hyder report, which was commissioned six years ago, is flawed, as it fails to take account of the particular circumstances of each case.

Road closure signage

5.11 Southern Water considers that it provided evidence that these costs were incurred and considers we should also acknowledge that the Complainant has already been given a discount on signage costs.

Construction management fee

5.12 Ofwat has determined in this, as well as in previous disputes, that developers should not be required to make any contribution at all to general overheads, which are included in Southern Water's charges. Southern Water does not share this view. Southern Water believes that it is appropriate, and consistent with the provisions of the Act, that developers, as a class of customers, should

bear a reasonable share of the general overheads of a water company, rather than these costs being borne entirely by domestic and non-household customers. Southern Water thinks Ofwat should make clear in the final determination, why Ofwat believes it is equitable that these costs should be borne only by other classes of customer.

Application fee

5.13 Southern Water considers its application fee of £110 was reasonable as it is only £4.70 higher than the benchmark figure of £105.30 set out in the Review of Section 45 costs report. It considers the difference is accounted for by the difference in wage levels in the south east of England compared to the rest of the country.

Post construction administration fee

5.14 Ofwat has assumed a benchmark cost of just £105.30 for all activities including the administrative processing of an application, technical assessments (including in many cases site visits), provision of an estimate to the customer, subsequent billing, reconciliation and collection of charges, and supervision of works carried out to ensure the right level of service is delivered to the customer. The benchmark cost is based on the unpublished Review of Section 45 costs report. Southern Water does not consider the post-construction administration fee is included in the Review of Section 45 costs report, and considers that this cost should be reinstated in the final determination.

6. Final determination

Ofwat's response to representations

6.1 We provide below our response to the Complainant's representations.

Need for a new connection

6.2 The initial work to create the three flats that constituted the property owned by the Complainant was undertaken prior to 1991 when the Complainant bought the property, and the decision to serve it via a common supply pipe was in accordance with industry practice and legislation in force at that time.

6.3 Legislation was introduced in 2008 that sets out the pressure water companies must maintain. Section 10 of The Water Supply and Sewerage Services (Customer Service Standards) Regulations 2008 (also known as the Guaranteed Standards of Service (GSS)) requires water companies to maintain a minimum water pressure, and pay compensation if pressure falls below that standard.

6.4 Water companies are under no obligation to separate a supply. Further separating one of the existing supplies may have led to low water pressure - which in turn may have resulted in Southern Water being liable for compensation payments.

6.5 We therefore consider it reasonable that Southern Water required a new connection.

VAT

6.6 Ofwat only has legal powers to determine the expenses reasonably incurred by a water company for providing a new connection. We do not have any role or powers in relation to taxation. The customer will need to liaise with the water company, and where necessary HMRC, to reconcile any excess VAT which may now have been paid as a result of our determination of a lower connection charge.

6.7 We provide below our response to Southern Water's representations.

The works

- 6.8 In our draft determination, we compared the cost of the works with the median cost of £981.79 set out in the Hyder report. Southern Water has not provided any evidence to us to suggest that the Connection was particularly onerous or to support its claim that there were circumstances which made the Connection costlier than usual for a single connection of this type in its other areas of operation. Given this lack of evidence and taking into account, amongst other things, the length of the service pipe that was laid, the types of ground that were excavated and the time taken to complete the work, we consider that construction costs should be compared to at the median costs recommended in the Hyder report for connections of this nature.
- 6.9 We note Southern Water's claim that its actual construction cost in total for the Connection was within the recommended range of costs and was also not significantly different from the recommended median cost in the Hyder report. We consider that the range provided by the Hyder report allows us to take into account the specific circumstances of different cases. Where there is evidence that a particular connection was particularly onerous or different from a standard connection, we will allow costs closer to the higher end of the range. With regard to Southern Water's comment that the Hyder report was commissioned six years ago, we consider that there is nothing to suggest that it does not remain a valid basis for benchmarking costs. However, we acknowledge the need to update the costs in the Hyder report in line with inflation, and will do so in due course.

Road closure signage

- 6.10 We note that Southern Water gave the Complainant a discount on the costs of road closure signage. It charged its original quote of £300, rather than the actual costs of £439.65.
- 6.11 Southern Water provided evidence that it paid its contractor (Clancy Docwra) £149.95 as a management handling fee for it to liaise with the signage contractor. In general we do not find it reasonable for companies to charge multiple management and administration fees, beyond that charged in the initial application fee. In this case, the management handling fee constitutes over 33% of the road closure signage costs of £449.95 and in other circumstances is not a cost we would allow. However, in light of Southern Water's discount on the actual road closure signage costs, we accept this charge.

Construction management fee

6.12 We agree with Southern Water that property developers should, as a class of customers, pay a reasonable share of an undertaker's overhead costs. But this is with the proviso that in the context of new connections the resulting amount is related specifically to a relevant supply connection and reflects costs that have been reasonably incurred. In order for us to make those assessments, companies need to send to us the necessary evidence. On this occasion, Southern Water did not send us such evidence.

6.13 It can be inferred from table 2 that the construction management fee constitutes 18% of the total costs for the Connection. It is not clear to us which underlying activities (and their associated costs) relate to this management fee. Therefore, we are unable to take a view as to whether or not this 18% fairly reflects costs that have been reasonably incurred. For this reason, we do not consider it appropriate for the construction management fee to be included as part of the reasonably incurred expenses for the Connection.

6.14 Again, we do not find it reasonable for companies to charge multiple management and administration fees, beyond that charged in the initial application fee. We expect water companies to be transparent with their customers, and fully explain what the administration fee they charge constitutes.

Application management fee

6.15 We consider that a fee for processing an application is a legitimate charge which forms part of the overall administration and overhead charge for making a water supply connection. The Review of Section 45 costs report suggests a reasonable charge for administration and overhead costs of £105.30, and this has been based on information provided by ten water companies across England and Wales. Where we are presented with compelling evidence, we would consider that evidence in our assessment. It is for companies to provide that evidence and, on this occasion, Southern Water did not. Therefore, we do not consider that Southern Water can reasonably charge the customer an amount which exceeds £105.30.

Post-construction administration fee

6.16 The Review of Section 45 costs report suggests a reasonable charge for administration and overhead costs of £105.30, and this has been based on information provided by ten water companies across England and Wales. Where we are presented with compelling evidence, we would consider that evidence in our assessment. It is for companies to provide that evidence and, again on this occasion, Southern Water did not. We do not accept its argument that because staff costs in the south east of England are greater than elsewhere in the country, we should allow more than the £105.30 suggested by the Review of Section 45 costs report. This report, and the Hyder report, were based on information from a range of companies spread across the country and therefore we consider that the range of costs provided in both reports has already accounted for this discrepancy. Therefore, we do not consider that Southern Water can reasonably charge the customer an additional amount for post construction administration.

6.17 We reiterate that we do not find it reasonable for companies to charge multiple management and administration fees, beyond that charged in the initial application fee.

Conclusions

6.18 Having considered the representations from the Complainant and Southern Water we have made certain changes to the conclusions set out in our draft determination, and list these changes in the table below:

Table 3: Changes to draft determination

Description	Charge	Reasonable charge	Refund
The works	£1,386.46	£981.79	£404.67
Road closure permit	£1,312.32	£1,312.32	0
Road closure signage	£300.00	£300.00	0
Road closure contractor management fee	£149.95	£149.95	0
Construction management fee	£751.60	0	£751.60
Trench inspection fee	£82.00	£82.00	0
Post construction administration fee	£48.84	£0	£48.84

Description	Charge	Reasonable charge	Refund
Total (exc. VAT)	£4,837.40	£3,632.29	N/A
Application management fee	£110.00	£105.30	£4.70
Refund	N/A	N/A	£1,209.81

6.19 Consequently we conclude that Southern Water should refund the Complainant the sum of £1,209.81 (plus interest).

6.20 If the Complainant and Southern Water are unable to agree the amount of interest payable, the matter can be referred to the Courts for a determination.

6.21 With a view to helping the parties to agree this amount without involving a Court, the table in Appendix A sets out guidance to be read in conjunction with Ofwat's Information Notice 11/05 on interest rates. This anticipates the approach we think a Court is likely to take in making such a determination for this particular dispute.

A1 Guidance regarding section 48 of the Water Industry Act 1991

The table below sets out Ofwat's view regarding the amounts and time periods on which a Court is likely to award interest in this case.

Amounts on which interest is payable	Time periods during which interest is payable on this amount
£3,632 i.e. the reasonable cost of connection works as determined by Ofwat, rounded down to the nearest 50p in accordance with section 48 of the Act	From: 7 November 2014 i.e. the date on which the company received the customer's security deposit To: the date on which the supply was considered provided and money held by the company became payment rather than security but in terms of whole 3 month periods in accordance with section 48 of the Act
£1,209.50 i.e. the amount of the security deposit less the reasonable cost of works as determined by Ofwat, rounded down to the nearest 50p in accordance with section 48 of the Act	From: 7 November 2014 i.e. the date on which the company received the customer's security deposit To: the date on which £1,209.50 is returned to the customer, in terms of whole 3 month periods in accordance with section 48 of the Act