



# **Final Determination of dispute under section 45(6A) of the Water Industry Act 1991: Mr Hird v Veolia Water Central**

## **Purpose of this document**

This is a determination of a dispute referred by Mr Hird to the Water Services Regulation Authority (Ofwat) for determination under section 45(6A) of the Water Industry Act 1991, as amended (the Act).

The dispute is between Mr Hird and Veolia Water Central<sup>1</sup> (Veolia) and is in relation to the amount recovered by Veolia Water Central for 3 new water supply connections at The Old Diary, 19 New Haw Road, KT15 2BZ.

Before reaching this final determination, we shared with the parties a draft determination which provided parties with the opportunity to make representations to us.

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<sup>1</sup> We note that from 1 October 2012 Veolia Water Central is referred to as Affinity Water Limited; however, for the purposes of this determination we have referred to it as Veolia Water Central.

## 1 Legal background

Section 45(1) of the Act imposes a duty (subject to certain conditions) on water companies to make a connection, where the owner or occupier of any premises serves 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.

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.

Section 45(6A) of the Act provides that any dispute about whether the expenses were incurred reasonably may be referred by either party for determination by Ofwat.

Ofwat's final decision is binding on the parties to the dispute.

## 2 Facts of the case and chronology

The dispute is between Mr Hird and Veolia (collectively, the parties) and is in relation to the amount recovered by Veolia for 3 new water supply connections at The Old Diary, 19 New Haw Road, Addlestone, Surrey, KT15 2BZ to Veolia's main water networks (mains).

Mr Hird submitted an application for new water supply connections to Veolia, receiving the initial quotation on 2 July 2009. The charges quoted were challenged by Mr Hird and a subsequent quotation of £2022.05 was issued on 11 November 2009. The works were completed on 5 March 2010.

Veolia initially recovered £2022.05. After the work was completed, Veolia reviewed the charges raised and identified an actual cost of £2457.90. The 11 November 2009 quotation was based upon the connections being made via a three way manifold, however the additional costs represented the three separate connections made by Veolia. Veolia decided not to recover the sum difference from Mr Hird.

However, Mr Hird does not consider the amount of £2022.05 to reflect the costs reasonably incurred by Veolia, and referred the dispute to Ofwat on 27 October 2010. On 12 November 2010 Ofwat issued its Request for Information (RFI) to Veolia. Veolia provided its responses to the RFI on 25th November 2010.

On 26 April 2012 a draft determination (**Draft Determination**) was sent out to both parties for comments.

## 2.1 Works carried out by Veolia

Veolia has stated that the works it carried out were:

<b>Method of Connection</b>	Open-cut Excavation
<b>Number of Connections</b>	Three
<b>Ground Surface Type</b>	Carriageway & Footpath
<b>Length of Pipe</b>	1 x 2.8 metres 2 x 2.5 metres
<b>Diameter of Pipe</b>	25 mm Medium Density Poly-Ethylene ("MDPE")
<b>Meter installed</b>	Yes, 3 individual boundary boxes
<b>Works by</b>	Balfour Beatty Utility Solutions Ltd
<b>Reinstatement by</b>	Balfour Beatty Utility Solutions Ltd

## 2.2 Cost of works carried out by Veolia

In its response to Ofwat's RFI, Veolia has stated that the actual costs (excluding VAT) it incurred in carrying out the works were as follows:

Pre-construction site survey	£61.44
Connection, Material and Reinstatement (including Contractor overheads)	£2052.27
Veolia Water Overheads	£344.19
<b>Total Cost</b>	<b>£2457.90</b>

Mr Hird has disputed the reasonableness of the charge of **£2022.05** and subsequently the **£2457.90** charge. VAT has not been charged by Veolia, and we have therefore not considered it in this determination.

### **3 Jurisdiction to determine the dispute**

We are satisfied that the dispute between Mr Hird and Veolia is a dispute about whether the expenses incurred by Veolia in making a connection under section 45 of the Act were reasonably incurred, and therefore that we have jurisdiction to determine this dispute under section 45(6A) of the Act. This is because:

- Mr Hird required Veolia to connect 3 new water supply connections at his property;
- Veolia treated this as a request for a connection under section 45 of the Act, and arranged for an inspector to conduct a site visit; and
- The original charge of £2022.05 raised by Veolia is disputed as being excessive by Mr Hird.

In making a determination under section 45(6A) of the Act, we are required to consider whether the expenses incurred by the undertaker in making a connection were reasonably incurred.

Section 45(1) of the Act allows the owner or occupier of premises to serve notice requiring the undertaker to “connect a service pipe to those premises with one of the undertaker’s mains”. Section 45(1) of the Act neither requires nor permits the person serving the notice to specify how the connection should be carried out. It is the undertaker’s responsibility to decide what works it should carry out to make the connection.

We therefore consider that we should, in determining whether expenses were reasonably incurred, examine both:

- The scope of the works carried out by the undertaker; and
- The costs incurred by the undertaker in carrying out those works.

### **4 Scope of the works carried out by Veolia**

We understand that the initial quote included the cost of a 3 way manifold which Mr Hird queried. However, eventually, a 3 way manifold was not installed. Veolia states that it was unable to make the connections by installing a manifold due to the presence of an electric service in the footpath, and so three separate connections were made by tapping the main. Veolia has provided photos from the construction site to support its contention that gas and electric cables were identified very close to their water mains.

It is clear from the photographs provided by Veolia that there are cables near to the water main. We also note that, in any case, the additional costs for making the connections separately were not passed on to Mr Hird.

## **5 Costs incurred by Veolia**

When considering the costs incurred by Veolia, we have assessed separately the costs for:

- Connection costs, including materials and reinstatement costs; and
- Overheads.

In considering whether the costs incurred by Veolia for making the new connections are reasonable, we have had regard to the scope of the works carried out, the information provided to us by the parties, our experience of other similar cases and the information contained in an independent comparative study we commissioned in 2009 which assessed costs incurred by companies when making new connections (the Hyder report).

The costs considered below are all stated exclusive of VAT for consistency.

### **5.1 Connection, materials and reinstatement costs**

In its original quote, Veolia stated that the connection, materials and reinstatement costs totalled £1677.86. Veolia has explained that the contractor costs represent the costs that the contractor incurs for managing the connection works. This includes, but is not limited to:

- Reviewing/accepting the request for pre-construction site survey and scheduling that visit;
- Reviewing all construction information provided with the work instruction (which may include reviewing information provided by the developer);
- Liaison with local authorities for permission to work in the highway;
- Provision of cost build-up(s) for the construction works;
- Liaison with Veolia Operations department;
- Scheduling works (including construction and reinstatement, plus logistics management of plant and materials);
- Audits during construction by the Health and Safety division;

- Production of as-laid drawings post construction and
- Preparing costs to request payment from Veolia.

We consider the cost components identified by Veolia, including those associated with the overheads incurred by the contractor, to be reasonable on the basis that they accord with our understanding of the work that is undertaken to make new connections. On this basis, we have considered whether these costs have been incurred reasonably and to allow us to do this we have considered the way that the costs have been derived and the reasonableness of the charges.

Veolia has stated that, in order to establish the cost of the service it must provide to customers requiring new connections, Veolia forecasts the number of connections it will need to make and the length of new pipe it will need to lay over a period of time and uses this information to calculate a cost per connection and a cost per metre of pipe required. This average cost is then multiplied depending on the number of connections necessary in an individual case.

It is clear from the list of cost components that are included in the contractors cost that the overall cost includes not only tangible construction costs, but also 'unseen' costs such as managing liaison with local authorities. Whilst there is inevitably some approximation involved in calculating the cost per connection or metre of pipe from an overall cost of a service, this does not appear unreasonable to us. There may be other methodologies for the calculation of costs, but this 'top down' methodology is a frequently used methodology and we have encountered this in other cases.

We are therefore satisfied that the components of the charge and the derivation of the charge are reasonable. What is left is for us to consider the reasonableness of the level of the charge initially applied by Veolia: **£1677.86**. Based on our experience of similar cases and our knowledge of the work necessary to make new connections, on the face of it, the charge initially imposed by Veolia does not appear unreasonable.

However, we have cross-checked this by assessing the information in the Hyder report. Hyder considered a total of 9 different scenarios: the costs of making a connection of up to 2 metres, 4 metres and 9 metres in each of the verge, the footway and the road. We have used this information to cross-check our assessment of the reasonableness of costs incurred by water companies in cases which are similar to this one, and we therefore consider this information to provide us with an appropriate benchmark against which to assess the reasonableness of

the total costs incurred by Veolia in respect of the connections. As none of the scenarios considered by Hyder exactly mirror the work carried out by Veolia in this case, we have used the data in the Hyder report about the cost of connection of up to 2 metres in the carriageway and about the cost of a connection of up to 2 metres in the footway. We set out the results of Hyder's comparison in **Table 1**.

**Table 1 Benchmark costs from Hyder study**

	<b>Minimum charge</b>	<b>Median charge</b>	<b>Maximum charge</b>
2m connection in footway, 32mm pipe, 1 connection	£203.92	£394.79	£925.78
2m connection in carriageway, 32mm pipe, 1 connection	£246.62	£449.89	£1469.35
<b>Total (footway and carriageway)</b>	<b>£450.54</b>	<b>£844.68</b>	<b>£2395.13</b>

Whilst there is some approximation involved in this cross-check, we are confident that it provides a reasonable and proportionate basis on which to compare the costs charged by Veolia in this case to the minimum, median and maximum charges identified in the Hyder report.

The total cost initially charged by Veolia for three connections was £1677.86 (3-way manifold). The final costs incurred by Veolia for three separate connections amount to £2113.71 (£2052.27+ £61.44; see paragraph 2). Both these costs fall within the range identified by Hyder (see Table 1 above) and we consider that this supports our view that both the initial quote and the final costs incurred by Veolia were not unreasonable.

This is based on our analysis of the information provided by the parties, including the information about the cost components and the derivation of the costs, our knowledge of costs in other cases and our cross-check using the Hyder report.

## **5.2 Overheads**

Overhead costs cover all costs incurred in making the connection, which are not covered by connection work, materials or permanent reinstatement. It includes, for example, billing and invoicing costs; planning and design costs; appointment and

supervision of contractors; warning notices costs; depot on-costs (such as the collection of materials), set up costs and inspection.

Veolia states that its own overheads amounted to £344.19, based on a flat per connection charge of 114.73. Overhead costs are frequently disputed and we considered the cost charged by Veolia in this case very carefully, using the same process we used to examine the reasonableness of the connection charge – i.e. we have considered the appropriateness of the cost components, the cost has been derived and the reasonableness of the final charge.

Veolia has explained that its overheads include (but are not limited to) the costs associated with:

- Assessment and acceptance/rejection of an application;
- Design and hydraulic analysis;
- Producing job packs;
- Producing and issuing quotes and re-quotes;
- Processing payments;
- Supervising on-site work
- Approving of and putting meters into charge; and
- Setting up billing accounts.

Under section 45(6A) we have powers to consider costs incurred in the necessary work to make a connection. On this basis, we are concerned that some of the cost components identified by Veolia do not fall within this remit, for example costs associated with setting up billing accounts or costs associated with approving and putting meters into charge.

Aside from these examples however, we consider the cost components identified by Veolia to be reasonable on the basis that they accord with our understanding of the work that is undertaken to make new connections. Veolia has stated that, in the same way that the contractor's charges are established, its own overheads are calculated using the overall cost of running the relevant department within Veolia and dividing that by a forecast of the number of connections and lengths of pipe that will be installed over a period of time to establish a per connection/metre of pipe overhead charge.

Whilst there may be other methods available, this method of costs calculation is not in itself unreasonable. We are therefore satisfied that, aside from some specific cost components, the components of the charge and the derivation of the charge

are reasonable. What is left is for us to consider the reasonableness of the level of the charge.

Veolia has stated that the cost of its overheads amounts to £344.19 (£114.73 per connection). In order to take account of the elements of the overhead charge that we dispute, we have cross-checked this resulting charge against our view in some previous cases where the water company in question has been unable to provide a satisfactory breakdown of the cost components making up the overhead charge.

In some cases, Ofwat has considered that, for a standard single connection, overheads should not exceed £80.00, with additional connections being incurring an overhead of £25.00 per connection. This would result in an overhead charge in this case of £130.00 (i.e. £80.00 + £25.00 + £25.00).

Whilst we are satisfied in this case that the level of detail provided by Veolia and the way that the cost has been derived is reasonable, given our concerns about some of the cost components identified we consider that an overhead charge of £130.00 is reasonable (see Table 2).

## **6 Comments on the Draft Determination**

### **6.1 Veolia's comments on the Draft Determination**

On 11 May 2012, Veolia provided its comments on the Draft Determination. Veolia clarified that the original quote estimated the cost of installing a 3-way manifold. However, Veolia stated that it has since provided the actual cost for the connection, materials and reinstatement (£2113.71), a cost Veolia considers to be reasonable for three single connections.

We have made the necessary changes in this final determination to reflect the actual cost of £2113.71 incurred by Veolia. However, for the purposes of this determination we have considered £2022.05, the initial amount quoted by Veolia and paid for by Mr Hird (see paragraph 2.2), as Mr Hird disputes the reasonableness of this amount.

Veolia also pointed out that Ofwat's allowance for overheads charges has not changed in 14 years and that inflation has not been considered. With reference to the allowance for overheads set by Ofwat at £80, we have received representations that it needs to be reviewed and we plan to do so. However, in the meantime, the current allowance of £80 applies.

## 6.2 Mr Hird's comments on the Draft Determination

On 13 May 2012, Mr Hird responded to the Draft Determination. Mr Hird asserted that a 3 way manifold was not supplied and queried the costs incurred by Veolia, including the costs for the two additional connections. Mr Hird also states that Veolia's measurements from the tappings to the second and third pipes are incorrect.

## 6.3 Veolia's response to Mr Hird's comments on the Draft Determination

For clarity and the avoidance of any doubt in this regard, Veolia confirmed on 10 October 2012 that its costs are based on contractual rates and that there are additional costs in installing three independent connections. Veolia also pointed that in this case it has not recovered the actual costs incurred in making three separate connections which are as follows:

Pre-construction site survey	£61.44
3 no. 25mm service tap-in to parent main (type 1 / 2 cwy)	£788.10
5 m Lay 25mm service pipe (no excavation)	£46.05
1.8 m Lay 25mm service pipe (footway)	£1117.23
1.0 m Lay 25mm service pipe (type 1 / 2 cwy)	£92.11
3 no. Install 25mm service connection to customer's property (footway)	£573.51
Contractor Overhead	£435.27
<b>Total</b>	<b>£2113.71</b>

## 7 Conclusions and Final Determination

Based on the analysis set out above and the parties' comments on the Draft Determination, we consider that the total costs reasonably incurred by Veolia for the provision of new connections in this case are as follows (exclusive of VAT) in **Table 2** below:

**Table 2 Analysis of costs**

	<b>(A) Veolia's Quote and amount paid by Mr Hird (£)</b>	<b>(B) Veolia's restated costs (£)</b>	<b>(C) Ofwat's view(£)</b>
Connection, materials and reinstatement	1677.86 (3-way manifold)	2113.71 (3 separate connections)	<b>1677.86</b> (3-way manifold) <b>2113.71</b> (3 separate connections)
Overheads	344.19	344.19	<b>130</b>
<b>Total</b>	<b>2022.05</b>	<b>2457.90</b>	<b>1807.86</b> (3-way manifold) (C1) <b>2243.71</b> (3 separate connections) (C2)
<b>Refund</b>			<b>214.19 (A-C1 or B- C2)</b>

## 7.1 Refund payable to Mr Hird

We note that Mr Hird was originally charged a total of £2022.05 excluding VAT for the cost of the connections work which he found to be excessive. Subsequently, we have been informed that the actual costs incurred by Veolia in making the connections amount to £2457.90 (see paragraphs 2.2 and 6.3 above). We also understand that Veolia has decided not to recover the difference between from Mr Hird..

Mr Hird alleged some discrepancies (see paragraph 6.2) in measurements from the tappings to the second and third pipes. We do not believe that these have any material significance on this final determination.

For the purpose of this determination we have determined that the expenses reasonable incurred by Veolia in making the connections amount to £1807.86 (excluding VAT) for a 3-way manifold connection or £2243.71 for three separate connections. We believe that Veolia's overheads should not have exceeded £130,

as set out in section 5.2 above. Veolia Water is directed to pay Mr Hird the amount of £214.19, calculated as per Table 2 above.

## 7.2 Interest

Under section 48 of the Act, interest must be paid on any sums that have been deposited with a water undertaker as security in relation to domestic water main connection works (pursuant to s47(2)(a) of the Act). Security is money that a customer may be required to pay in advance of work being done. Section 48 provides that the undertaker shall pay interest “on every sum of 50p so deposited for every three months during which it remains in the hands of the undertaker” at rates approved or determined by Ofwat.

On the facts of this determination, Ofwat’s view is that interest is payable on Mr Hird’s security deposit, calculated in accordance with section 48 of the Act. In calculating any interest due to Mr Hird, the parties should apply interest rate(s) in accordance with the attached Ofwat “Information Notice 11/05” and it’s Appendix 1.

The amount of any interest payable is for the Courts to determine, if Mr Hird and Veolia are unable to agree this amount. With a view to helping the parties to agree the amount of any interest payable without involving a Court, **Appendix A** sets out guidance. This anticipates the approach we think a Court is likely to take in determining the amount of interest payable in this case.

This final determination is binding on both parties.

## Appendix A

Guidance regarding section 48 of the Water Industry Act 1991 (“the Act”)

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
<p><b>£1807.50</b></p> <p>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</p>	<p><b>From: 11 November 2009</b></p> <p>i.e. the date on which Veolia received Mr Hird’s security deposit</p> <p><b>To: 4 October 2010</b></p> <p>i.e. the date on which £1807.50 ceased to be held as security and instead became payment (i.e. the date on which the company issued its invoice for its works) <b>but</b> in terms of whole 3 month periods in accordance with section 48 of the Act</p>
<p><b>£214</b></p> <p>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</p>	<p><b>From: 11 November 2009</b></p> <p>i.e. the date on which the company received Mr Hird’s security deposit</p> <p><b>To:</b> The date on which £214 is returned to the customer, in terms of whole 3 month periods in accordance with section 48 of the Act</p>