23 December 2015

Trust in water

Energetics Limited v Dŵr Cymru Cyfyngedig

Dispute determined under sections 51C and 30A of the Water Industry Act 1991

Charges required by Dŵr Cymru Cyfyngedig Limited in relation to self-lay works at the Ffordd-yr-Ysgol site off Windsor Drive in Flint

Ofwat

www.ofwat.gov.uk

Contents

1. Introduction

A. The complaint

1.1 This determination concerns a dispute referred to the Water Services Regulation Authority ("**Ofwat**") by Energetics Design & Build Limited ("**Energetics**") on 27 October 2010. The dispute relates to the charges required to be paid and the defect liability retention payment required to be provided to Dŵr Cymru Cyfyngedig Limited ("**Dŵr Cymru**") by Energetics under a self-lay agreement dated 18 August 2010 ("**the Agreement**"). The Agreement relates to works undertaken by Energetics for a developer, ("**the Developer**"), at a development site at Ffordd-yr-Ysgol, off Windsor Road in Flint ("**the Site**"). The works undertaken by Energetics included laying 120 metres of water main on the Site ("**the Main**").

1.2 At the point at which the Agreement was signed Dŵr Cymru sought a payment of £5,358.67 from Energetics. This comprised:

- A payment[1] of £4,358.67 for works undertaken by Dŵr Cymru; and
- A defect liability retention payment[2] of £1,000, which Dŵr Cymru required to secure the proper construction of the self-lay works. This amount would be held for a 24-month defects liability period.

1.3 In addition Dŵr Cymru also required Energetics to pay legal fees of £450 plus VAT to its external solicitor at the time of completion of the Agreement.

1.4 Energetics disputes the amounts that Dŵr Cymru required from it on the grounds that it considers:

a) the charges to be exceptionally high;

[1] In the Agreement this payment is called the "Developer's Payment"
[2] In the Agreement this payment is called the "Deposit". Such payments are often referred to as a "surety". This is different to the security payment that a water undertaker may require to be paid under section 51C(4) of the Water Industry Act 1991 towards works provided by the undertaker.

b) the charges to not be within the list of recoverable costs detailed in section 51C of the Water Industry Act 1991 ("**the Act**"), since it considers that the Act does not entitle Dŵr Cymru to charge Energetics for costs where there are no reinforcement works;

c) the defect liability retention payment required by Dŵr Cymru to be exceptionally high in view of the risks that a surety is attempting to mitigate; and

d) the legal fees that Dŵr Cymru had recovered in providing the Agreement to be exceptionally high.

1.5 The Agreement was signed by all parties (it is dated 18 August 2010) prior to the dispute being referred to us on 27 October 2010.

1.6 The parts of the Act relevant to the self-lay provision of water mains are sections 51A to 51E. More specifically, when parties are entering into a self-lay agreement under section 51A, section 51C provides for the financial conditions of compliance, setting out the payments that the parties are required to make. Section 51A provides for a self-lay agreement to include wider terms and conditions (which may include the recovery of other costs or other financial requirements not covered under section 51C), subject to agreement between the parties.

1.7 When referring this dispute to Ofwat, Energetics asked that we consider it under sections 51C and 30A of the Act. However some of the costs disputed by Energetics are beyond those specified as requirements under section 51C of the Act. As such, Dŵr Cymru's recovery of these wider costs is via the wider terms and conditions of the Agreement made under section 51A of the Act. Ofwat's jurisdiction to consider an appeal concerning the wider terms of a self-lay agreement is provided by section 51B of the Act.

1.8 Our approach to determining this dispute has therefore been to consider:

- Firstly, whether we have jurisdiction to make a determination under section 51C (and section 30A) and/or section 51B of the Act;

- Secondly, whether section 51C of the Act permits Dŵr Cymru to require payment of the charges recovered and other costs to be provided; and

- Thirdly, which of the disputed costs should be included in the calculation of the asset value payment for the Site (the amount the

water company pays a person who has constructed a self-laid main at the point of that main being adopted into the water company's network – explained in paragraphs 3.8 to 3.11 below).

B. Purpose of this document

1.9 This is our final determination of this dispute following our consideration of the legal framework for self-lay agreements entered into under section 51A of the Act, as well as the evidence provided to us by both Energetics and Dŵr Cymru.

1.10 This determination follows two draft determinations sent to Energetics and Dŵr Cymru by Ofwat on 29 February 2012 and 10 August 2012 respectively ("**the 2012 Draft Determinations**") and a third draft determination sent to the parties on 3 August 2015 ("**the 2015 Draft Determination**").

1.11 The 2012 Draft Determinations set out our views at the time, namely that section 51C(3) of the Act limits the costs that can be recovered for the adoption of a water main to those specific items listed in sections 43(4)(a) and (b) of the Act (i.e. any water mains, tanks, service reservoirs, pumping stations or any additional capacity within an existing main) and that since Dŵr Cymru did not provide any of these specific items, it was not entitled to recover any of the disputed costs from Energetics in this case. The 2012 Draft Determinations also set out our view at the time that whilst sections 51A(7) and (8) set out terms that may be included in a self-lay agreement, these sub-sections do not specifically refer to the costs that may be recovered in relation to connections per se, and that it is section 51C which provides the financial conditions relating to adoption of a water main.

1.12 Both parties responded to the 2012 Draft Determinations. In letters dated 25 May 2012 and 17 August 2012, Energetics supported the conclusions of the 2012 Draft Determinations. Dŵr Cymru provided substantial comments in its letters dated 27 March 2012, 14 September 2012, 19 July 2013 and 14 September 2013.

1.13 On 10 July 2013 Energetics requested that we consider its further representations regarding the costs to be included within the asset value calculation in this dispute with Dŵr Cymru.

1.14 Ofwat wrote to both parties on 26 September 2013 responding to the issues relevant to this determination raised in the letters dated 10 July 2013 and 19 July 2013 from Energetics and Dŵr Cymru respectively. Our letter explained

that Ofwat considered that the costs recoverable under section 51C(3) are limited to those items set out in section 43(4)(a) and (b). The letter also explained that, having considered the parties representations, Ofwat considered that the costs reasonably incurred by Dŵr Cymru in providing the associated infrastructure, required to connect the adopted main to the existing network, fall within the scope of section 43(4), and hence should also be included in the calculation of the asset value payment for the Site. The letter also stated that Ofwat does not consider the timing of when associated infrastructure is built to be key to establishing whether or not it is built as a consequence of the adoption of the main, but rather that associated infrastructure can be considered to be necessary in consequence if it is to facilitate the connection of the new main to the existing network and allow the adoption of the new main.

1.15 Energetics and Dŵr Cymru responded to Ofwat's letter of 26 September on October 2013 and 5 December 2013 respectively. The matters raised in these letters, and all other previous correspondence, were taken into account in the preparation of the 2015 Draft Determination which was issued to the parties to the dispute in August 2015.

1.16 The 2015 Draft Determination set out our view that in this case we only have jurisdiction to determine which of the disputed costs are recoverable under section 51C. We concluded that under section 51C Dŵr Cymru is entitled to recover costs of £2,659.81 arising from works it undertook to incorporate the Main into it existing network. We stated that Dŵr Cymru is not entitled to recover the remaining disputed charges and costs under section 51C. We concluded that we do not have jurisdiction to amend these terms because the Agreement was agreed between the parties before the dispute was referred to Ofwat. We concluded that the costs recoverable under section 51C and the design and inspection and supervision costs Dŵr Cymru incurred in relation to the Main should be included as part of the costs reasonably incurred used to calculate the asset value payment, but that the legal fee and defects liability retention payment should not form part of the calculation.

1.17 Both of the parties responded to the 2015 Draft Determination on 11 September 2015. In addition, on 12 November 2015, we met with Dŵr Cymru to discuss a number of developer services issues. That meeting included a brief discussion about this dispute, but the comments provided in that meeting did not differ from those raised in Dŵr Cymru's written representations on the 2015 Draft Determination. Both parties' comments have been considered in this final determination.

C. Overview of our determination

1.18 Our final determination is detailed in chapter 4 of this document, but is summarised below.

1.19 In light of the legal framework of the Act and the evidence we have gathered from the parties to the dispute, we have determined that:

- We have jurisdiction (under sections 51C and 30A) to determine which of the disputed costs are recoverable under section 51C, as per Energetics' original referral to us.

- We do not have jurisdiction to consider the other disputed costs which fall outside of those recoverable under section 51C. This is because they form part of the terms of the Agreement, which was agreed and signed between the parties prior to the disputed terms being referred to Ofwat for appeal.

- Dŵr Cymru is entitled to recover total costs of £2,659.81 under section 51C of the Act. These costs were reasonably incurred by Dŵr Cymru in incorporating the Main into the existing network by means of a branch connection (the "**Connection Works**"). These costs comprise:

    - the installation of the Connection Works (£2,013.64);
    - the design of the Connection Works (£460.08);
    - the inspection and supervision fees of the Connection Works (£70.69); and
    - the water sampling and analysis of the Connection Works (£115.40).

- Dŵr Cymru is not entitled to recover the following payments and financial requirements from Energetics under section 51C of the Act. These costs relate to the Main provided by Energetics and have been recovered under the terms of the Agreement. The Agreement was agreed between the parties before Energetics referred the dispute to Ofwat for appeal. We therefore have no jurisdiction to amend the terms relating to the recovery of the following payments:

    - design of the Main (£1,061.82);
    - inspection and supervision of the Main (£637.04);
    - legal fees (£450 plus VAT); and
    - defect liability retention payment (£1,000, refundable after the defects liability period).

- The costs of the Connection Works (as set out in Table 3) and the design, inspection and supervision and legal costs (set out in Table 4) should be included as part of the costs reasonably incurred used to calculate the asset value payment since these would have been costs incurred in providing the Main via a requisition. The defects liability retention payment should not form part of the calculation of the asset value payment since these would not be costs reasonably incurred had the Main been provided by means of a requisition.

- Within 20 working days of this final determination Dŵr Cymru should provide Energetics with details of their final calcuation of the asset value payment, clearly reflecting the costs included above and make any resulting adjustments in payment.

2. Factual background

A. The Parties

Complainant

2.1. Energetics is a multi-utility infrastructure provider (electricity, gas, telecoms and water) and asset owner. It provides design and build services through to final connection and on-going operation of regulated energy networks. Energetics expanded into the self-lay water market in England and Wales, where it has a strong presence in the North West, the Midlands and Wales.

Company

2.2. Dŵr Cymru is appointed under the Act to provide water and sewerage services to customers in Wales and parts of England. The Site is located within Dŵr Cymru's area of appointment as a water and sewerage undertaker.

B. The Site

2.3. The Site is a development of 32 new premises at Ffordd-yr-Ysgol, off Windsor Drive in Flint, Flintshire. The water supply to the premises is for domestic purposes only.

C. The Agreement

2.4. In March 2010 the Developer submitted a requisition request to Dŵr Cymru to provide a water supply to the Site. In response to the request Dŵr Cymru designed and priced the requisition scheme and provided the Developer with a mains design for the Site. Subsequently the Developer decided that it would use a self-lay organisation (SLO) to provide the Main on the Site and appointed Energetics to do this. The Developer informed Dŵr Cymru that it intended to self-lay the Main on the Site and asked Dŵr Cymru to re-issue terms directly to Energetics.

2.5. Dŵr Cymru sent a letter dated 17 June 2010 to Energetics setting out the amounts that Energetics would have to pay Dŵr Cymru in relation to the

adoption of the Main by Dŵr Cymru. These amounts were valid for three months and totalled £5,358.67 comprising:

- A payment[3] of £4,358.67 for works to be undertaken by Dŵr Cymru; and

- A refundable defect liability retention payment[4] of £1,000, that Dŵr Cymru required in respect of the proper construction of the self-laid works. This amount would be held by Dŵr Cymru for a 24-month defects liability period.

2.6. The letter also confirmed that service connection fees and infrastructure charges would be due for payment by the Developer or Energetics before connection[5] and that legal fees for preparing the self-lay agreement (£450 plus VAT) would be payable by Energetics to Dŵr Cymru's external solicitor at the time of completion of the agreement.

2.7. On 23 June 2010 Dŵr Cymru's external solicitors sent copies of the proposed self-lay agreement to the Developer requesting signature on behalf of the Developer and Energetics. The Developer signed the copies of the proposed self-lay agreement and on 28 June 2010 the Developer forwarded them to Energetics to sign.

2.8. On 2 July 2010 Energetics wrote to Dŵr Cymru with a formal complaint concerning the terms of the proposed agreement. It complained that:

- Dŵr Cymru's charges associated with the scheme were not detailed and did not fall within section 51C of the Act because the scheme did not involve any reinforcement works;

- the defect liability retention payment was not detailed and was exceptionally high given the value of the scheme and that the risks that Dŵr Cymru was attempting to mitigate were negligible where accredited SLOs complete the work with insurance in place and the

[3] In the Agreement this payment is called the "Developer's Payment"
[4] In the Agreement this payment is called "Deposit". Such payments are often referred to as a "surety". This is different to the security payment that a water undertaker may require to be paid under section 51C(4) of the Water Industry Act 1991 towards works provided by the undertaker.
[5] The service connection fees and infrastructure charges are not part of this dispute and determination.

water company has a fully-funded inspection regime overseeing every stage of the works;

- the legal fees for preparing the agreement were exceptionally high in comparison to the scheme value and the charges of other water companies; and

- the asset value payment amount was not detailed and appeared to be exceptionally low.

2.9. On 13 July 2010 Energetics sent a cheque payment of £5,358.67 to Dŵr Cymru under cover of a letter stating that it had signed the agreements and made the payment under duress. Dŵr Cymru's solicitor acknowledged receipt of the signed agreements and payment on 20 July 2010.

2.10. On 23 July 2010 Dŵr Cymru replied to Energetics enclosing a breakdown of the charge it required for the works to be provided by it. These costs are detailed in Table 1 below.

Table 1: Charges breakdown for works provided by Dŵr Cymru

Description of cost	Cost
Costs relating to the provision of the Main	
Design of the Main	£1,061.82
Inspection and supervision of the Main	£637.04
Costs relating to the incorporation of the Main (the Connection Works)	
Design of the Connection Works	£460.08
Connection to Dŵr Cymru's existing network	£2,013.64
Inspection and supervision of the Connection Works	£70.69
Water sampling & analysis of the Connection Works	£115.40
Total	**£4,358.67**

2.11. Dŵr Cymru's letter of 23 July 2010 also provided a further explanation of the additional charges and financial requirements required in Dŵr Cymru's letter of 17 June 2010 (detailed in Table 2 below). Dŵr Cymru stated that the costs incurred in the preparation of its standard legal agreement were a fixed sum incurred for all schemes and did not vary according to the size of the scheme. It also stated that it would make a charge for any required amendments / redrafting required to the standard agreement. Dŵr Cymru stated that it calculated its defect liability retention payment requirement on the basis of 10% of the developer's payment or as a minimum of £1,000.

Table 2: Other payments recovered from Energetics

Description of cost	Cost
Legal fees for preparing the self-lay agreement - payable directly to Dŵr Cymru's external solicitors	£450 (plus VAT)
Defect liability retention payment[6] of "£1,000 being the security required in respect of the proper construction of the Self Lay Works…"	£1,000 (refundable after a defect liability period of 24 months)

2.12. With the exception of the legal fees, ŵr Cymru requested payment of all of the charges in Tables 1 and 2 above, at the time of signing the Agreement. The legal fees were due to be paid when the Agreement was completed, and were payable directly to Dŵr Cymru's external solicitors.

2.13. In addition to providing a costs breakdown, Dŵr Cymru's letter of 23 July 2010 stated that "it is in neither party's interest to proceed when a mutually acceptable agreement has yet to be reached. For this reason we are not prepared to proceed until Energetics is content with our approach and charges".

2.14. On 26 July 2010 Dŵr Cymru's solicitor returned the agreement to Energetics stating that the inclusion of the words "under duress" was unacceptable. The solicitor enclosed a fresh agreement for signature.

2.15. On 27 July 2010 Energetics returned the Agreement signed. In its covering letter Energetics stated that items it had raised with Dŵr Cymru had not been resolved but that as it was required to progress the works to meet its customer's (the Developer's) expectations it was still signing the Agreement under duress and would be seeking Ofwat's view. Energetics continued to correspond with Dŵr Cymru about its proposed costs during July and August 2010.

2.16. Energetics subsequently installed the Main and on 8 October 2010 Dŵr Cymru carried out water sampling and analysis.

[6] In the Agreement this payment is called the Deposit

2.17. In an email dated 11 October 2010 Dŵr Cymru confirmed to Energetics that it would not alter its view on the payments requested.

2.18. On 29 December 2010 Dŵr Cymru made an asset value payment of £6,463.30 to Energetics.

D. Request for a determination

2.19. On 27 October 2010 Energetics referred its dispute with Dŵr Cymru to Ofwat. Energetics sent three separate letters disputing the amounts that Dŵr Cymru recovered on the grounds that:

- the charges were exceptionally high;
- the charges were not within the list of recoverable costs detailed in section 51C of the Act, since it considered the Act does not entitle Dŵr Cymru to charge Energetics for the costs where there are no reinforcement works;
- the defect liability retention payment required by Dŵr Cymru was exceptionally high in view of the risks that a surety is intended to mitigate; and
- the legal fees that Dŵr Cymru had recovered in providing the Agreement were exceptionally high.

2.20. In each letter Energetics stated that it considered Dŵr Cymru's actions to be anti-competitive, a breach of its licence and an abuse of its monopoly position.

2.21. On 28 October 2010 we formally opened a case for investigation.

2.22. As set out in sections 1.10 to 1.17 above, we have previously issued three draft determinations for this case and have received a number representations from the parties. These have all been considered in preparing this final determination.

3. The legal framework

This section outlines the key legislative provisions relevant to this case.

A. Definition of a water main

3.1. Section 219 of the Act provides the following definition of a water main:

> "any pipe…which is used or to be used by a water undertaker…for the purposes of making a general supply of water available to customers or potential customers of the undertaker…, as distinct from for the purpose of providing a supply to particular customers".

3.2. This definition includes tunnels or conduits which serve as a pipe and to any accessories for the pipe.

B. Supplies for domestic purposes

3.3. Where an owner or occupier of premises requires a supply of water for premises in a particular locality (such as a development site) for domestic purposes:

(i) Under section 41 of the Act, the owner or occupier of premises in a particular locality may requisition the water undertaker to provide a water main to provide a supply of water to premises to be used for domestic purposes. Subject to the conditions set out in section 41 of the Act being fulfilled, the water undertaker is under a duty to provide the water main ("requisition"); or

(ii) the owner or occupier of the premises in that locality may choose to construct the required water mains and/or service pipes themselves and reach an agreement under section 51A(1) of the Act for that infrastructure to be vested in the local water undertaker at an agreed date, provided it is constructed in accordance with the terms of the adoption agreement agreed between the parties ("self-lay").

C. Self-lay adoption agreements

3.4. Section 51A of the Act provides that a water undertaker may agree with any person constructing or proposing to construct a water main or a service pipe

for domestic purposes that, if the relevant infrastructure is constructed in accordance with the terms of its self-lay adoption agreement, the undertaker will, following completion of the work, at some specified date or event, declare the water main and / or service pipe be vested in them (otherwise termed as "adopted").

3.5. Under section 51A(3) of the Act, a person proposing to construct a water main or a service pipe may make an application in writing to a water undertaker requesting them to make a self-lay adoption agreement under section 51A. This application must be accompanied by such information the water undertaker may reasonably require.

3.6. Section 51A(6) specifies that in deciding whether or on what terms to grant an application for a self-lay adoption agreement, the water undertaker shall have regard in particular to any effect or potential effect on the quality of water supplies and to any increased danger to life or health that it considers may result.

3.7. Section 51A(7) states that the terms of a self-lay adoption agreement under section 51A(1) relating to a water main may, in particular, include terms:

a) for the provision (at the expense of the person constructing or proposing to construct the water main) by,

   i) that person; or
   ii) the water undertaker

   of such associated infrastructure at or downstream of the point of connection with the water undertaker's supply system as it is necessary to provide in consequence of incorporating the new water main into that system;

b) providing that, if the water main and the associated infrastructure are constructed in accordance with the terms of the agreement, the water undertaker will, in addition to declaring the water main to be vested in it, declare the associated infrastructure to be so vested;

c) where the water undertaker considers that the proposed main is, or is likely to be, needed for the provision of water supply services in addition to those for which the person is proposing to construct the main:

i) requiring that person to construct the main in a manner differing, as regards materials or size of pipes, depth or otherwise, from the manner in which that person proposes, or could otherwise be required by the water undertaker, to construct it; and
ii) providing for the repayment by the water undertaker of any extra expense reasonably incurred by that person in complying with that requirement;

d) for the connection of the new water main to the water undertaker's existing supply system at the point or points specified in the agreement;

e) for any service pipes which the person constructing or proposing to construct the new water main proposes to connect to that main to be constructed in accordance with the terms of the agreement and, subject to that, to be vested in the water undertaker at the same time as the main.

D. Self-lay conditions of compliance

3.8. Section 51C of the Act sets out the financial conditions of complying with an agreement to adopt self-laid mains (entered into or to be entered into under section 51A of the Act). The section provides for two financial transactions:

i) Sections 51C(2) and (3) of the Act provide for the water undertaker to recover certain costs it reasonably incurs in connection with the adopted main from the person constructing or proposing to construct that self-laid main. This is sometimes termed the "developer payment". The water undertaker may, under section 51C(4), require a security payment in relation to the developer payment.

ii) Section 51C(5) of the Act requires the water undertaker to pay the person constructing or proposing to construct the self-laid main the "discounted offset amount" at the point of the main being adopted. This payment is often called the "asset value payment".

3.9. Subject to the terms of the adoption agreement agreed between the parties under section 51A of the Act, these payments can be made to/from the developer or the SLO who has constructed the adopted main on its behalf.

3.10. Sections 51C(6) – 51C(9) of the Act set out the approach to be used to calculate the discounted offset amount. This involves taking the sum of the

"estimated offsets" for each of the 12 years following the vesting in the water undertaker of the water main. For each of the 12 years following the adoption of the main, the “estimated offset” is the lesser of:

i) the estimated revenue in respect of the adopted main for that year; and
ii) the annual borrowing costs of a loan that would be required for the provision of that main.

3.11. These annual figures are discounted (to determine their net present value) and added up for the 12 year period to calculate the discounted offset amount.

3.12. As a result of the two financial provisions set out above, with the potential for one payment to go from the water undertaker to the developer / SLO and another from the developer / SLO to the water undertaker, where both payments are due it is common for the water undertaker to net one payment off against the other, resulting in a single financial transaction taking place.

E. Costs that can be included in the calculation of the developer charge and asset value payment

3.13. The calculation of the asset value payment and developer payment rely on establishing the costs reasonably incurred in providing the new water main (the self-laid main to be adopted) and in incorporating the adopted main into the undertaker’s supply system.

3.14. The provisions within section 51C of the Act cross-refer back to sections 43 and 43A of the Act for the purposes of calculating the developer payment and the asset value payment respectively.

3.15. Section 51C(3) of the Act states that the developer payment comprises the costs referred to in section 43(4)(a) and (b) of the Act. The references to “the new main” in section 43(4)(a) and (b) of the Act are substituted as if they were references to “the incorporation of the adopted main into the undertaker’s supply system”. This provides that the water undertaker shall take into account costs reasonably incurred in connection with the adopted main equivalent to:

a) "the costs reasonably incurred in providing such other water mains and such tanks, service reservoirs and pumping stations as it is necessary to provide in consequence of the incorporation of the adopted main into the undertaker's supply system; and

b) such proportion (if any) as is reasonable of the costs reasonably incurred in providing or procuring the provision of any such additional capacity in an earlier main as falls to be used in consequence of the incorporation of the adopted main into the undertaker's supply system."

3.16. As a result of this section, the water undertaker's calculation can include costs they reasonably incur as a result of them providing wider works or capacity (be that in new or existing / reinforced infrastructure) that may be physically located outside of the specific site / locality that is the subject of the self-lay (i.e. in the wider network), but which are considered necessary to provide in consequence of the self-laid main in order to provide a supply to that site / locality.

3.17. Section 51C(8) of the Act also refers back to section 43 (via section 43A) of the Act in stating that the costs used for establishing the annual borrowing costs used in turn to calculate the asset value payment calculation should be the same as those that would have been included in the calculation of the requisition charge had the adopted main been requisitioned, i.e. the costs reasonably incurred in providing both the adopted main and the works that are necessary in consequence of its provision.

F. Disputes regarding self-lay agreements

3.18. Section 51C(11) of the Act provides that any dispute regarding the payments required to be made (i.e. the developer payment or the asset value payment) under the provisions of section 51C of the Act can be referred to Ofwat for determination under section 30A of the Act.

3.19. Section 51B of the Act provides that, subject to specific exemptions, a person constructing or proposing to construct a water main or service pipe may appeal to Ofwat where the water undertaker:

a) has refused an application under section 51A [for a self-lay adoption agreement];

b) has offered to grant such an application on terms to which that person objects; or

c) has failed, before the end of two months from the making of such an application, either to refuse the application or to give notice to the applicant of the terms on which it is prepared to grant the application.

3.20. On hearing an appeal under this section, Ofwat may:

a) uphold the refusal of the water undertaker to grant the application or to modify the terms offered; or

b) on behalf of the water undertaker, refuse the application or enter into any agreement into which the water undertaker might have entered on the application.

3.21. Where Ofwat makes an agreement under sub-paragraph (b) above on behalf of a water undertaker, it may do so on such terms as it considers reasonable or, as the case may be, on the terms offered by the water undertaker subject to such modification as it considers appropriate for ensuring that the terms of the agreement are reasonable. An agreement entered into on behalf of a water undertaker under this section shall be deemed, for the purposes of the Act, to have been entered into under section 51A.

3.22. Section 51B(5) states that in deciding on an appeal Ofwat may include such incidental, supplemental and consequential provision (including provision requiring either party to pay a sum in respect of the costs or expenses incurred by Ofwat) as it thinks fit, and any such provision as to costs or expenses shall be enforceable as if it were a judgement of a county court.

4. Our final determination

4.1. We set out our final determination in this chapter, having considered all of the evidence provided to us by both Energetics and Dŵr Cymru.

4.2. Our determination focuses on:

A. whether we have jurisdiction to make a determination under section 51C (and section 30A) and/or section 51B of the Act;

B. whether section 51C of the Act permits Dŵr Cymru to require payment of the charges recovered and other costs to be provided; and

C. which of the disputed costs should be included in the calculation of the asset value payment.

A. Jurisdiction to make a determination

4.3. The dispute relates to the costs payable by an SLO to a water company under a self-lay agreement. A section 51A agreement may provide for the recovery of the following type of costs:

a) costs calculated and required under section 51C of the Act. A dispute about these costs may be referred to us for determination; and

b) additional costs that are not envisaged by section 51C. The right to recover these costs is a contractual right, that must either be agreed, or in the absence of agreement referred to us for appeal under section 51B of the Act.

4.4. Section 51C(1) of the Act provides that the section applies “where an agreement is, or is to be, entered into under section 51A…”. Section 51C(11) of the Act says “any dispute between the water undertaker and the other person as to the payments to be made or the security to be provided by virtue of this section may be referred to the Authority for determination […]”.

4.5. Section 51B(1) of the Act provides that, subject to specific exceptions, a person constructing or proposing to construct a water main or service pipe may appeal to Ofwat “where the water undertaker: …(b) has offered to grant such an application on terms to which that person objects; …”.

4.6. By virtue of these sections of the Act a dispute under section 51C is referable either before or after a section 51A agreement has been agreed, whereas an appeal under section 51B can only be lodged before a section 51A agreement is agreed by all parties.

Complainant's view

4.7. Energetics considers that Ofwat has jurisdiction to consider this dispute under section 51C. In a letter dated 29 December 2010 Ofwat asked Energetics whether it was still in dispute with Dŵr Cymru about the terms and conditions of the Agreement for the Site. In a letter dated 19 January 2011 Energetics responded saying that it was contractually required to progress the construction of the Main for the Developer and was left with no option but to sign the Agreement with Dŵr Cymru under duress. Energetics said that in signing the Agreement it clearly stated it was "signing under duress" and highlighted its intention to refer the dispute to Ofwat to investigate and take action against Dŵr Cymru for anti-competitive behaviour, a breach of its Licence and an abuse of its monopoly position.

4.8. The 2015 Draft Determination concluded that Ofwat only has jurisdiction to consider those of the disputed costs that were recovered under section 51C because Energetics had signed the section 51A agreement before referring the dispute to Ofwat. In its response to the 2015 Draft Determination Energetics reiterated its view that the parties were in dispute at all stages. It also stated that the 2015 Draft Determination's assertion that Energetics could have appealled to Ofwat earlier lacks any credibility as the process leaves no realistic opportunity for Ofwat to determine an appeal within the timescales within which Energetics had itself to meet its contractual obligations to the Developer. Energetics highlighted that this is demonstrated by the length of time it has taken to settle this dispute.

4.9. Energetics also stated in its response to the 2015 Draft Determination its view that the Water Act 2014 gave Ofwat powers to order, vary (or terminate) a section 51A agreement and that, as the disputed items feature in the Agreement, it believes we can address all of the disputed elements of the Agreement.

Company's view

4.10. In its letter to Ofwat dated 14 September 2012 Dŵr Cymru raised its concerns that Ofwat had expanded the scope of its determination beyond the issues

Energetics had referred to us, which Dŵr Cymru considered to be limited to just those costs recoverable under section 51C. Dŵr Cymru stated that Ofwat had widened the complaint to determine whether any costs should be payable, but had only considered which of the disputed costs are recoverable under section 51C, and not whether those costs might otherwise be recoverable under the full terms of the Agreement.

4.11. Dŵr Cymru's letters of 27 March 2012 and 14 September 2012 state that the terms of a self-lay agreement are not limited to those matters within section 51C(3) and that as a matter of law, a self-lay agreement is allowed to make provision for a water company to provide services in addition to the matters prescribed under section 51C(3). Dŵr Cymru states that the specific provisions allowable in a self-lay agreement are not set out exhaustively in the Act. It states that this is demonstrated by the fact that there are separate provisions for resolving disputes under section 51C (as regards matters under section 51C) and section 51B (as regards other terms that may be included in a self-lay agreement).

4.12. Dŵr Cymru states in its letters of 27 March 2012 and 14 September 2012 that any such additional services requested by the SLO and agreed to be provided by the water company become enforceable against the water company under section 51A(9). Further, the person who requested the services has a contractual obligation to pay for those services. Dŵr Cymru states that such additional services could include: design work for the self-laid main; identification of the connection point of the self-laid main to the water company's existing network; as well as any necessary integrity checks of connections made (even if the connection is made by the SLO) or of the quality of water to pass through the self-laid main.

4.13. Dŵr Cymru states that it would make no sense were the SLO prevented by statute from requesting the water company to provide any such additional services (by virtue of limiting terms to those under section 51C), nor if the provision of such services were subject to a separate agreement not subject to the statutory dispute mechanism, since they would clearly relate to the proposal to vest the self-laid works in the water company (which would require a connection being made).

4.14. In its letter of 27 March 2012, Dŵr Cymru notes that if the costs of such additional services cannot be recovered, the services would effectively be provided free of charge to SLOs, despite such costs being incorporated in the costs reasonably incurred if the works were requisitioned. In its letter of 14 September 2012 Dŵr Cymru states that Ofwat should not misuse a dispute referred and determined under section 51C to prevent Dŵr Cymru from

recovering monies for works and services provided through the self-lay agreement and in relation to statutory provisions. Dŵr Cymru states that section 51A must be read as a whole and that consideration of the dispute under section 51C only has perhaps led Ofwat to consider that all and any charges within a self-lay agreement must be permitted within section 51C.

4.15. In its letter to Ofwat dated 27 March 2012, Dŵr Cymru expressed the view that section 51B of the Act provides a mechanism for Energetics to appeal the terms of section 51A self-lay agreements. Dŵr Cymru states that Energetics could have appealed in respect of Dŵr Cymru's charges for its "additional services". Dŵr Cymru also states that Energetics did not put forward any counter-proposal as regards the terms of the Agreement.

4.16. In its letter to Ofwat dated 27 March 2012 Dŵr Cymru asserts that we should therefore limit our determination to the issues raised in a letter from Energetics to Dŵr Cymru dated 2 July 2010 (related to costs recovered under section 51C, see paragraph 2.8 above), because all of the works had been completed by the time Energetics had complained to us on 27 October 2010. Dŵr Cymru asserts that the letters from Energetics to Dŵr Cymru dated 2 July 2010 and to Ofwat dated 27 October 2010 did not contest the principle of Dŵr Cymru's right to certain costs (for example, supervision or inspection of the self-lay works) nor to costs such as legal costs, merely the level of those costs.

4.17. In its letter of 14 September 2012, Dŵr Cymru states that Energetics would have known that in signing the Agreement it thereby compelled Dŵr Cymru to provide the additional services set out in the Agreement. Dŵr Cymru further states that disputes under section 51C are referable either before or after a self-lay agreement is concluded, but that disputes under section 51B are only referable before a self-lay agreement is concluded. In Dŵr Cymru's view an appeal under section 51B must be lodged before the self-lay agreement is signed and Energetics did not do so.

4.18. Dŵr Cymru does not accept that there has been duress at law in this dispute. In its letter to Ofwat dated 14 September 2012, Dŵr Cymru referred to Energetics' delay in responding to the proposed terms of the agreement as a reason why it considered that the Agreement was not made under duress. Dŵr Cymru is of the view that if the Agreement is void then the effect is that the Main is not vested in the water company. However, in any event, it considers that the consequences of any alleged duress is to make the Agreement voidable rather than void.

4.19. Dŵr Cymru is therefore of the view that:

a) As Energetics did not pursue an appeal to Ofwat prior to the Agreement being entered into we do not have the jurisdiction to determine this dispute under section 51B of the Act; and

b) In light of section 51B of the Act being the appropriate route of appeal, section 51C of the Act does not provide an appropriate avenue for Energetics to seek determination in this case.

Our determination

4.20. We are satisfied that the parties are in dispute and we have jurisdiction to consider the charges recoverable under section 51C(11) and section 30A of the Act.

4.21. The complaint made by Energetics to us on 27 October 2010 covered the same issues as the complaint Energetics made to Dŵr Cymru on 2 July 2010, except the latter referred to an additional issue relating to the calculation of the asset value payment. Whilst the calculation of the asset value payment was not explicitly referred to us initially by Energetics, it is clear that it is relevant to and affected by our determination of what costs are recoverable by Dŵr Cymru. Accordingly, we consider it appropriate for us to consider this issue in our determination, to ensure that costs are treated consistently for the purposes of section 51C(3) and the annual borrowing costs used in sections 51C(7) and (8) of the Act. This is the only element of the asset value calculation that our determination considers, as set out in section C below.

4.22. Energetics has stated that it had a contractual obligation to the Developer to construct the Main and considered it had no option other than to sign the Agreement to satisfy this. Because of this, when signing the Agreement Energetics made it clear to Dŵr Cymru that it considered that it was doing so under duress.

4.23. It is outside our remit to comment on whether duress could be proven in this instance. However we agree with Dŵr Cymru that even if duress were to be proven, the Agreement would remain in full force and effect unless and until it was rescinded by Energetics.

4.24. We recognise that an SLO may be under contractual and/or commercial pressures to commence work for its contracted developer as soon as possible and therefore need the required self-lay agreement to be in place as promptly as possible. This can sometimes pose difficulties for the timely negotiation of terms and conditions with a water company and/or the referral and conclusion

of appeals to Ofwat. These difficulties can be particularly pronounced for small development sites, such as the Site subject to this dispute.

4.25. We note the points made by Energetics regarding the credibility of the process and time taken to complete determinations referred to Ofwat and the difficulties this can pose for an SLO if it has contractual obligations and timescales to meet for its developer customer. Timing was evidently important in this case as Energetics had contractual obligations to progress works for the Developer. However, Energetics could have appealed to Ofwat under section 51B(1)(b) of the Act once it had sight of, and concerns with, the proposed agreement and ahead of signing the Agreement. It is clear from the correspondence we have reviewed that Energetics had been offered terms to which it objected. Energetics did not however appeal to Ofwat at that point. As the complaint to Ofwat occurred some months after the Agreement was signed and after the works were completed, we consider that we do not have jurisdiction under section 51B of the Act to determine those disputed costs that fall outside of section 51C.

4.26. Energetics is correct to state that the Water Act 2014 makes provision to amend section 51C of the Act, which includes a provision to give Ofwat powers to vary or terminate an agreement made under section 51A. Whilst the Water Act 2014 has now been enacted by Parliament, these amendments are yet to come into force and therefore our powers remain limited to the existing provisions of the Act. We therefore consider that in this case we are only able to consider those disputed costs recoverable under section 51C of the Act.

B. Charges and requirements allowed under section 51C of the Act

Complainant's view

4.27. In its original complaint to both Dŵr Cymru and Ofwat, Energetics disputed the amounts required by Dŵr Cymru on the grounds that the Act does not entitle Dŵr Cymru to charge Energetics any costs where no reinforcement works are required.

4.28. In its letter dated 4 October 2013 Energetics confirmed that it agreed with Ofwat's conclusion in our letter of 26 September 2013, that the costs recoverable by means of the cross-referral in section 51C(3) should only relate to sections 43(4)(a) and (b), and not section 43(4) in its entirety.

4.29. As discussed at paragraph 4.39 below, Dŵr Cymru indicated that in applying its charges, it was following Ofwat's self-lay guidance. In relation to the following of Ofwat's guidance, Energetics agrees with the content and conclusions of the 2012 Draft Determinations, which stated that: legislation takes precedence over any guidance; that the self-lay guidance did not replace the legislation; that it had no statutory force; and that water companies must comply with the legislation, as must Ofwat, in making a determination.

4.30. In its letter dated 10 July 2013 Energetics stated that although section 51A(7) states that a self-lay agreement "may, in particular, include terms…for such associated infrastructure at or downstream of the point of connection…", Energetics did not consider that the Act states that these costs should be borne by the person constructing the main. Energetics also state that it is wrong to treat "associated infrastructure" as provided "in consequence" of the adoption of the new main because the associated infrastructure was built before the adoption of the new main.

4.31. In its letter of 4 October 2013 Energetics states that whilst it understands the legal interpretation Ofwat set out in its letter of 26 September 2013 (which concluded that the costs of the associated infrastructure were recoverable under section 51C(3), see paragraph 1.14 above), it does not consider that it fully addresses nor satisfies the overriding competition requirement where the water company is offering better terms for requisition agreements than for self-lay agreements. Energetics states that where a water company recovers costs as a condition within an adoption agreement the SLO is disadvantaged when compared with a requisition which would include these costs in the calculation of the requisition charge (hence applying an income offset). Energetics states that Ofwat's determination should "include a clear rule that the terms being offered under requisition and self-lay must ensure complete commercial comparability conditions and in respect of this dispute the upfront payments for costs reasonably incurred by Dŵr Cymru should have been the lesser of its anticipated costs or the relevant deficit to ensure Competition Act compliance".

4.32. In its response to the 2015 Draft Determination Energetics reiterated its view that a "clear rule" is required and stated that the 2015 Draft Determination did not clearly position Ofwat on:

- The regulator's obligation to create and maintain an open competitive market supporting freedom of customer choice and reducing the market share monopoly position of the incumbent water company.

- That charges recoverable must be in proportion to and equitable with the cost incurred, and the commercial risk and must be applied with parity irrespective of whether the application was under the self-lay or the requisition provisions.

- That high charges, low asset payments and administrative and legal obstructions should not be used by a water company as a means of protecting their monopoly share against competition as this will lead to self-lay being more expensive to the customer and thus not commercially viable.

- That surety retainers or bonds must be reflective of the risk involved, who is carrying the burden of risk, the likelihood of rectification and the quality performance of the water company.

4.33. In its response to the 2015 Draft Determination Energetics confirmed that it agreed with our conclusion with regards the charges recoverable by Dŵr Cymru under section 51C for works undertaken by Dŵr Cymru to incorporate the Main into the existing network. Energetics noted that these conclusions reflected those of other determinations we have made on these issues and recent guidance published by water companies' representative body, Water UK.

Company's view

4.34. In a letter to Ofwat dated 15 November 2010 Dŵr Cymru stated that the legal basis on which it recovered costs from Energetics for the Site was under sections 51C(4) and (5) of the Act, which it states allows for costs reasonably incurred by the water company in connection with the adopted main to be recovered, and also provides for security payment to be required.

4.35. In its subsequent letter of 12 September 2012, Dŵr Cymru stated that section 51A of the Act does not limit the services that may be provided by the relevant water company under a section 51A self-lay agreement to those services referred to in section 51C(3) of the Act. Therefore section 51C of the Act does not limit the costs a water company is entitled to recover. It states that accordingly, where services which are provided by a water company under a section 51A self-lay agreement fall outside those referred to in section 51C(3) of the Act, the water company should be paid for those services by the relevant person.

4.36. In its letters dated 15 November 2010, 19 July 2013 and 5 December 2013 Dŵr Cymru further set out its view that in the 2012 Draft Determinations and Ofwat's letter of 26 September 2013 Ofwat has misconstrued section 43(4) of the Act, by stating that section 51C(3) cross-refers only to its sub-sections (a) and (b) and not to the opening words of section 43(4). Dŵr Cymru stated that this would result in the costs that can be recovered being limited to those set out in 43(4)(a) and (b). Dŵr Cymru stated that the cross-reference in section 51C(3) is to section 43(4) as a whole, including its preamble. It states that the sub-sections are not intended to stand alone and were instead to be qualified by the opening text of section 43(4) which states "For the purposes of this section the costs reasonably incurred in providing a water main ("the new main") shall include -…". In its letter of 19 July 2013 Dŵr Cymru stated that the reference in section 51C(3) to the sub-sections was not intended to be exhaustive but to emphasise that both sub-sections of the section as a whole needed to be taken into account.

4.37. Dŵr Cymru further stated that the fact that section 51C(3) provides that the recoverable costs are those equivalent to those in section 43(4)(a) and (b) "… as if references there… to the provision of the new main were references to the incorporation of the adopted main into the undertakers supply system" demonstrates that the references to section 43 include the opening text, as otherwise this wording in section 51C(3) would have no meaning. Dŵr Cymru stated that this is because the subsections (a) and (b) do not include references to "the new main", whilst the opening words to section 43(4) do.

4.38. In its costs breakdown Dŵr Cymru has stated that its water sampling and analysis costs relate to the Connection Works rather than the Main.

4.39. In its letters dated 27 March 2012 and 14 September 2012 Dŵr Cymru stated that it acted in accordance with Ofwat's self-lay guidance (which was in place at the time the Agreement was signed but which was subsequently withdrawn in 2010). In referring to the guidance, Dŵr Cymru's letter of 27 March 2012 in particular referred to companies being entitled to charge for and be paid the costs of works they reasonably undertake in connection with self-laid works; network reinforcement costs being only one of the possible costs for a water company; companies being entitled to require deposits from SLOs; and companies being able to recover the costs of preparing self-lay agreements. Dŵr Cymru asserted that in making the 2012 Draft Determinations we did not apply our own self-lay guidance.

4.40. As regards Energetics' comments in its letter dated 10 July 2013 about the wording of section 51A(7) of the Act (see paragraph 4.24 above), Dŵr Cymru confirmed in a letter to Ofwat dated 5 December 2013 that it agrees with the

statement in Ofwat's letter of 26 September 2013 that section 51A(7) provides that the costs of associated infrastructure should be "...(at the expense of the person constructing or proposing to construct the water main)".

4.41. On the further related issue concerning the wording "in consequence", in its letter of 5 December 2013 Dŵr Cymru stated that the timing of the building of the associate infrastructure in relation to the timing of the adoption of the new main is not key to establishing whether or not the associate infrastructure was built as a consequence of the adoption of the new main. Dŵr Cymru stated that it agrees with the view Ofwat set out in the 2012 Draft Determinations that the "associated infrastructure" is built "in consequence" of the adoption if the purpose of building the "associated infrastructure" is to facilitate the connection of the new main to the existing network and allow the adoption of the new main.

4.42. In responding to the 2015 Draft Determination, Dŵr Cymru welcomed its finding that water companies are able to enter into a commercial agreement to supplement the provisions of section 51C. It stated that this reinforces that water companies can continue to innovate to provide customer-centric solutions.

4.43. Dŵr Cymru welcomed the 2015 Determination's broader interpretation of costs recoverable under section 51C. However it stated its view that it made no sense to prohibit the recovery of legal fees and the defects liability retention payment, which it considers to also be requirements needed to support the provision of the main by the SLO. It stated that the 2015 Draft Determination was incorrect to say that the legal costs and liability retention payment would not have an equivalent under a requisition. Dŵr Cymru stated that, in common with other water companies, it has stringent contractual arrangements and parent company guarantees from the term contractor[7] to whom it outsources its services for requisitions, which performs a similar role to the defects liability retention payment.

4.44. Dŵr Cymru also stated that the legal fee it required Energetics to pay (£450 +VAT) was based, following a competitive tender process, on the average cost incurred as a result of the time generally spent working on a self-lay agreement. Dŵr Cymru noted that in this case, because there was significant

[7] A "term contractor" is a term frequently used to refer to a third party contractor that a water company appoints to deliver services on its behalf.

correspondence with Energetics over the form and content of the Agreement, the legal fees actually incurred would have been considerably higher.

4.45. Dŵr Cymru's response also noted that the 2015 Draft Determination was different in several material respects from the 2012 Draft Determinations. It believes that this highlights the complexity of the issues in this case and also the way that practices have changed since this dispute arose in 2009-10. Dŵr Cymru stated its view that, given the length of time taken to reach a final determination, the issues at the heart of the dispute are no longer a reflection of its operational practices. Dŵr Cymru noted that it has recently reviewed the services it provides to SLOs, including consideration of all elements of its charges; a review of sureties and retention requirements and consideration of alternative provision to cover the identified risks; and meetings with SLOs and developers to understand how services to these customers can be improved. This has resulted in amendments to Dŵr Cymru's policies and procedures. Dŵr Cymru also noted that it no longer outsources the preparation of self-lay agreements to external lawyers.

Our determination

4.46. Section 51C(3) of the Act sets out the costs that a water company is entitled to recover when it provides works that are considered necessary to provide in consequence of incorporating the self-laid water mains into its existing supply network (i.e. works that are not incurred directly in relation to the self-laid main). As stated at paragraph 3.15 above, for the purposes of establishing the costs reasonably incurred by the water company in connection with the adopted main, section 51C(3) of the Act cross-refers back to sections 43(4)(a) and (b).

4.47. Dŵr Cymru is incorrect when it says in its letter dated 19 July 2013 that subsections (a) and (b) of section 43(4) do not include references to "the new main". There are only two subsections ((a) and (b)) under section 43(4), both of which refer to "the provision of the new main" when used for a main requisitioned under section 41 of the Act. When cross-referred to for the purposes of section 51C(3), these references to "the provision of the new main" in section 43(4)(a) and (b) of the Act are substituted as if they were references to "the incorporation of the adopted main into the undertaker's supply system".

4.48. It is our view that section 51C(3) would have referred to section 43(4) if it was intended that the section 43(4) preamble wording (immediately prior to the subsections) be included in this cross-reference: "For the purposes of this

section the costs reasonably incurred in providing a water main ("the new main") shall include—". As this wording has been excluded from the cross-reference in section 51C(3), the costs that can be required by Dŵr Cymru under section 51C(3) in this case are limited to the costs reasonably incurred in providing such other water mains and such tanks, service reservoirs and pumping stations as it is necessary to provide in consequence of the incorporation of the adopted main into the undertaker's supply system (in accordance with the cross-referral to section 43(4)(a)). The cross-referral to section 43(4)(b) relates to the costs of providing additional capacity in an earlier main which is not relevant to this dispute. There is no provision under section 51C(3) for the water company to recover costs it incurs directly in relation to the provision of the self-laid main itself (rather than the self-laid main's incorporation into its supply system).

4.49. In the 2012 Draft Determinations we concluded that Dŵr Cymru was not entitled to recover costs from Energetics for connecting the Main to the existing supply system, on the basis that neither section 43(4)(a) nor section 43(4)(b) of the Act explicitly reference this item of work. We likewise concluded that the other costs that Dŵr Cymru has requested payment for in relation to the adoption of the main in this case are not specified in section 51C(3) of the Act, and therefore could not be recovered under the Agreement by Dŵr Cymru.

4.50. Section 219(1) of the Act provides the definition of a water main as "any pipe…which is used or to be used by a water undertaker…for the purposes of making a general supply of water available to customers or potential customers of the undertaker…, as distinct from for the purpose of providing a supply to particular customers".

4.51. Having considered this matter further in the light of Dŵr Cymru's representations on the 2012 Draft Determinations and further legal advice we have sought on this issue, we have concluded that the connecting pipe between the Main and Dŵr Cymru's existing supply system qualifies as "… such other water mains … as it is necessary to provide in consequence of the incorporation of the adopted main into the undertaker's supply system" as cross-referenced in section 43(4)(a) of the Act. Therefore we determine that Dŵr Cymru is entitled to recover the costs it reasonably incurred in undertaking the Connection Works. This is because the Connection Works were "necessary in consequence" of the incorporation of the Main into the existing network. This is regardless of whether or not there was a need for any network reinforcement works as a result of the incorporation of the Main.

4.52. Having established that the Connection Works were necessary in consequence of the incorporation of the Main, we subsequently considered which costs were reasonably incurred in providing the Connection Works. We recognise that when water companies or SLOs provide new infrastructure, their costs are not limited to just materials and labour. They also incur 'non-construction costs' that are part and parcel of providing the works, such as costs relating to design, inspections and water sampling, and other such administration costs. Where they are reasonably incurred we consider that such non-construction costs will be part of the costs incurred in providing works.

4.53. As a result of our conclusions that the Connection Works can be considered to be "necessary in consequence" of the incorporation of the Main and that non-construction costs can be costs reasonably incurred in providing works, we determine that Dŵr Cymru is entitled to recover from Energetics the costs set out below in Table 3 under section 51C(3) for providing the Connection Works.

Table 3: Costs recoverable from Energetics under section 51C(3)

Costs relating to the incorporation of the Main	Cost
Design of the Connection Works	£460.08
Connection to Dŵr Cymru's existing network	£2,013.64
Inspection and supervision of the Connection Works	£70.69
Water sampling[8] & analysis of the Connection Works	£115.40
Total	**£2,659.81**

4.54. As set out in Tables 1 and 2 above, Dŵr Cymru recovered a series of other costs from Energetics beyond those incurred in providing the Connection Works, which relate to the provision of the Main itself. Table 4 below shows

[8] The Agreement states the water sampling and quality analysis is of the Main (see schedules 2 and 3 by reference to interpretation clause 1.1). Such costs would not be recoverable under section 51C(3). However, in the breakdown of costs provided by Dŵr Cymru, there are no costs claimed under water sampling and quality analysis of the Main. Rather the water sampling and quality analysis costs of £115.40 are claimed under off-site works undertaken by Dŵr Cymru which relate to the Connection Works.

the costs and requirements that Dŵr Cymru has recovered but which are not provided for under section 51C(3).

Table 4: Costs not recoverable under section 51C(3)

Description of payment	Cost
Costs relating to the provision of the Main	
Design of the Main	£1,061.82
Inspection and supervision of the Main	£637.04
Other Costs	
Legal fees for preparing the Agreement - payable directly to Dŵr Cymru's external solicitors	£450 (plus VAT)
Defect liability retention payment[9] of "£1,000 being the security required in respect of the proper construction of the Self Lay Works…"	£1,000 refundable after a defect liability period of 24 months

4.55. In this case, we have determined that the costs set out in Table 4 are not recoverable under section 51C. As set out in paragraph 4.3 above, there is scope for water companies to recover further costs, beyond those recovered under section 51C(3), by means of the terms of a self-lay agreement entered into under section 51A of the Act. However in this case we do not have jurisdiction to determine the charges set out in Table 4 under section 51B (see paragraph 4.25 above), nor to amend the terms of the Agreement relating to the recovery of these charges.

4.56. On the related points raised by Energetics in its letters dated 10 July 2013 (see paragraph 4.30 above), section 51A(7) provides that the terms of a self-lay agreement may include terms for the provision of associated infrastructure that is necessary to provide in consequence of incorporating the new main to the undertaker's supply system, and states that such provision is at the expense of the person constructing or proposing to construct the new main. Whilst in most cases such "necessary in consequence" works will be provided in advance of or in parallel with the provision of an adopted main, the timing of provision is not a prerequisite to the works qualifying as being necessary in consequence, which instead hinges on whether the infrastructure falls to be used as a consequence of the adopted main.

[9] In the Agreement this payment is called the Deposit

4.57. We note the issue raised by Energetics in its letter of 4 October 2013 regarding competition law requirements of water companies and the points raised in their response to the 2015 Draft Determination, set out in paragraph 4.32 above. As set out in paragraphs 4.69 to 4.71 below, we consider that the cross references in sections 51C(3) and 51C(8) to sections 43 and 43A have the effect of providing for broad equivalence in the treatment of costs when calculating either the requisition charge (for requisitioned mains) and the developer charge (for self-laid mains).

4.58. We are satisfied that a water company has the ability to recover further costs beyond those captured under section 51C (via the terms of an agreement entered into under section 51A). Where it does so, it must consider competition law requirements, in particular for the provision of non-contestable services; ensuring that charges are recovered on an equivalent basis where the service(s) provided are equivalent.

4.59. Agreement terms may include charges for contestable services that an SLO has used from the water company, such as design services. We would expect charges to be reflective of the costs of the service provided. As noted in paragraph 4.25 above, in this case we do not have jurisdiction to determine such charges.

4.60. We note Dŵr Cymru's comment in its response to the 2015 Draft Determination (set out in paragraph 4.43 above) regarding the contractual arrangements and parent company guarantees it requires of its term contractor, which it considers perform a similar role to defects liability retention payments. It is important that water companies recognise that for the purposes of their statutory duties, including their compliance with competition law, their term contractor is acting as the water company itself. A comparison of terms should consider what a water company would require of itself if it was providing the works itself (i.e. in-house), rather than a comparison with the contractual terms arising from the water company's decision to outsource services, since the latter would not be a comparison of an equivalent service to that provided by an SLO.

4.61. Whilst we note Dŵr Cymru's comments (see paragraph 4.39 above), in relation to it following our guidance in place at the time, as an independent economic regulator we have discretion to issue guidance and when appropriate to withdraw it. The self-lay guidance was not statutory guidance. Water companies must comply with the relevant legislation, as must we when making a determination. Dŵr Cymru's comments on the guidance in particular focused on the recovery of charges for works provided by the water company, which we have addressed in this section B of this determination.

C. Asset value payment calculation

4.62. As explained in paragraph 4.21 above, whilst the calculation of the asset value payment was not explicitly referred to us initially by Energetics, it is clear that it is relevant to and affected by our determination of what costs are recoverable by Dŵr Cymru. We are therefore not determining the level of the asset value payment itself; we are only determining which of the disputed costs Dŵr Cymru should include in the calculation of the asset value payment, in light of our conclusions above.

4.63. In its letter dated 17 June 2010 Dŵr Cymru stated that its (estimated) asset value payment was £5,864.18. On 29 December 2010 Dŵr Cymru made a final asset value payment of £6,463.30 to Energetics. Although Dŵr Cymru has provided us with a breakdown of the estimate asset value payment (which was the figure Energetics disputed in their correspondence with Dŵr Cymru) we have not had sight of a breakdown of the calculation of the final, higher asset value payment that Dŵr Cymru paid to Energetics.

Complainant's view

4.64. In its letter of 10 July 2013 Energetics stated that because the works comprise elements done by themselves and by Dŵr Cymru, the costs of the new main and associated infrastructure should all be included in the calculation of the asset value payment. Energetics stated that excluding the costs of works provided by the water company from the asset value payment calculation (but allowing the recovery of these costs as a condition in the self-lay adoption agreement) would result in a significant difference to a comparable requisition offer, under which all of the construction elements are included in the asset value payment calculation. Energetics noted that testing and disinfection is carried out to "provide" the Main and that this reinforces the need to include these costs in the asset value payment calculation.

4.65. Energetics stated that not including such costs in the asset value payment calculation would allow the water company legal justification to offer different prices or terms to similar customers, which it considers to be in breach of the Competition Act 1998. Energetics stated that the costs of the Connection Works should be recognised in an enhanced asset value payment and that a cost comparability condition needs to be clarified in our determination.

4.66. In its response to our 2015 Draft Determination Energetics stated its disappointment that Ofwat has not seen a breakdown of Dŵr Cymru's final asset value payment calculation. It states that part of Energetic's fundamental

complaint to Dŵr Cymru was the lack of a transparent objective justification for its low asset payment, and that the 2015 Draft Determination failed to clarify why in this instance Dŵr Cymru has calculated and offered terms which Energetics considers makes the competitive alternative economically unviable in Dŵr Cymru's area of supply.

4.67. Energetics stated that the final determination needs to address this omission or include a requirement that Energetics and Dŵr Cymru enter into a new agreement on the asset value payment to finalise this project within a reasonable time. It proposed that this be included in this final determination to provide clarity to the wider sector on our policy expectations. Energetics noted that it also disputed other projects with Dŵr Cymru and both parties have agreed to put them in abeyance pending this dispute being determined.

Company's view

4.68. In its letter dated 5 December 2013, Dŵr Cymru enclosed its costs sheet for the Site to illustrate its approach to calculating self-lay charges and the costings that it used to calculate the asset value payment of £6,463.30 that was paid to Energetics on 29 December 2010. This costing sheet sets out the scheme's contestable and non-contestable costs, such that the final total scheme value (£7,089.60) includes both those estimated costs incurred by Energetics (£2,730.93) and those incurred by Dŵr Cymru (£4,358.67). Dŵr Cymru stated that the asset value payment is in effect what it would cost Dŵr Cymru to install the infrastructure and that if the SLO can undertake this work more efficiently than Dŵr Cymru, it achieves its margin. Dŵr Cymru stated that it adheres to the principle that the assessment of the components of the charges and payments should be approached in the same way, whether calculating the asset value payment for self-lay or calculating the charges under a requisition. It also stated that if Ofwat deems that certain costs are not recoverable from the SLO, these costs would be subsidised by existing customers and a serious change in approach.

Our determination

4.69. As set out in paragraphs 3.10 and 3.17 above, section 51C(7) and (8) state that the asset value payment is calculated using the costs reasonably incurred had the adopted main been provided by means of a requisition (i.e. the costs reasonably incurred in providing both the Main and the Connection Works). These costs are established in accordance with subsections (3) to (5) of

section 43A, which in turn refer to subsections (2) to (6), (8) and (9) of section 43.

4.70. Therefore the costs reasonably incurred used to calculate the asset value payment should include:

- the costs set out in Table 3, since these were reasonably incurred in providing the Connection Works and which are considered necessary in consequence of the Main by virtue of section 43(4)(a); and

- the design and inspection and supervision costs set out in Table 4 (since these relate to the provision of the Main and would have been incurred had the Main been requisitioned). These should form part of (rather than being additional to) Dŵr Cymru's estimate of the costs (both construction and non-construction costs) it would have incurred in providing the Main if it had been requisitioned.

- The legal fees set out in Table 4, since we are satisfied that such costs could reasonably have formed part of the costs incurred in providing the Main if it has been requisitioned

4.71. The remaining financial requirement in Table 4 as regards the defects liability retention payment should not form part of the calculation of the asset value payment since these would not be costs reasonably incurred had the Main and Connection Works been provided by means of a requisition.

4.72. Within 20 working days of this final determination Dŵr Cymru should provide Energetics with details of their final calcuation of the asset value payment, clearly reflecting the costs included above and make any resulting adjustments in payment.

5. Conclusion

5.1. In light of the legal framework of the Act and the evidence we have gathered from the parties to the dispute, we have determined that:

- We have jurisdiction (under sections 51C and 30A) to determine which of the disputed costs are recoverable under section 51C, as per Energetics' original referral to us.

- We do not have jurisdiction to consider the additional disputed costs which fall outside of section 51C. This is because they form part of the terms of the Agreement which was agreed and signed between the parties prior to the disputed terms being referred to Ofwat for appeal.

- Dŵr Cymru is entitled to recover total costs of £2,659.81 under section 51C of the Act. These costs were reasonably incurred by Dŵr Cymru in incorporating the Main into the existing network by means of providing the works to connect the Main to the existing network by means of a branch connection (the "**Connection Works**"). These costs comprise the:

    - design of the Connection Works (£460.08);
    - connection to Dŵr Cymru's existing network (£2,013.64);
    - inspection and supervision fees of the Connection Works (£70.69); and
    - water sampling and analysis of the Connection Works (£115.40).

- Dŵr Cymru is not entitled to recover the following payments and financial requirements from Energetics under section 51C of the Act. These costs relate to the Main provided by Energetics and have been recovered by means of the terms of the Agreement. The Agreement was agreed between the parties before its referral to Ofwat for appeal. We therefore have no jurisdiction to amend these terms and therefore Dŵr Cymru remains able to require these costs from Energetics in accordance with the terms of the Agreement:

    - design of the Main (£1,061.82);
    - inspection and supervision of the Main (£637.04);
    - legal fees (£450 plus VAT); and
    - defect liability retention payment (£1,000; refundable after the defects liability period).

- The costs of the Connection Works (as set out in Table 3) and the design, inspection and supervision and legal costs (set out in Table 4) should be included as part of the costs reasonably incurred used to calculate the asset value payment since these would have been costs incurred in providing the Main via a requisition. The defects liability retention payment should not form part of the calculation of the asset value payment since these would not be costs reasonably incurred had the Main been provided by means of a requisition.

- Within 20 working days of this final determination Dŵr Cymru should provide Energetics with details of their final calcuation of the asset value payment, clearly reflecting the costs included above and make any resulting adjustments in payment.