



**Dispute referred under sections 42, 45 and 30A of the  
Water Industry Act 1991**

**Provision of water infrastructure to The Millworks,  
Brasted, Kent (“The Site”)**

**Millwood Designer Homes vs. Thames Water**

**Final Determination**

**December 2014**

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Appendix 1 - final requisition charge calculation

# 1. Introduction

## A. The complaint

- 1.1 On 23 August 2013 Millwood Designer Homes (**'Millwood Homes'**) referred a dispute to us for determination under sections 42, 45 and section 30A of the Water Industry Act 1991 (**'the Act'**).
- 1.2 The dispute is between Millwood Homes and Thames Water (**'Thames Water'**) (together **'the Parties'**) in respect of the reasonableness of the amounts that Thames Water has sought to recover from Millwood Homes to pay for the provision of a new water main (**'the New Main'**) and connecting 12 new properties to the water supply (**'the Connections'**). The New Main and the Connections will provide a water supply to a development of 12 houses known as The Millworks in Brasted, Kent (**'the Site'**).
- 1.3 Specifically we have been asked to determine the following issues that are in dispute between the Parties:
- i. the reasonableness of the approach taken by Thames Water in requesting security from Millwood Homes prior to providing the New Main (**'Reasonableness of the approach when requesting security for the New Main'**);
  - ii. the reasonableness of the final amount Thames Water is now seeking from Millwood Homes following provision of the New Main (**'Reasonableness of the final requisition charge for the New Main'**);
  - iii. the reasonableness of the expenses incurred by Thames Water in making the Connections at the Site (**'Reasonableness of expenses incurred in making the Connections'**); and
  - iv. whether (and how much) interest is payable by Thames Water to Millwood Homes in respect of the payments (including infrastructure charges) for the New Main and the Connections at the Site (**'Interest payable'**).
- 1.4 We are satisfied that the Parties are in dispute and that we have jurisdiction to make a determination in accordance with sections 42(6)(a), 42(6)(b), 45(6A) and 30(A) of the Act regarding the security and final charges for the Site.

## **B. Purpose of this document**

- 1.5 This is our final determination for this dispute and it shall be binding and enforceable in accordance with the provisions of section 30A of the Act.
- 1.6 Before making this final determination we issued a draft determination to the Parties on 30 September 2014 inviting representations and/or objections on this. Millwood Homes submitted representations on 7 October 2014. Thames Water submitted representations on 21 October 2014. Details of the Parties' representations on our draft decision and where necessary our response to these are set out in chapter 4 (our determination) below.

## **C. Overview of our determination**

- 1.7 Our conclusions and reasoning are set out in full in chapter 4 of this document, but an overview of our conclusion in respect of each issue we have been asked to determine is set out below.

### **i. Reasonableness of the approach when requesting security for the New Main**

- 1.8 We have concluded that Thames Water acted unreasonably by initially offering Millwood Homes the option to pay security in the form of a bond, only to later withdraw this option (after Millwood Homes had taken out the bond and presented this to Thames Water) and request a cash payment as security instead.
- 1.9 We have determined that Thames Water should compensate Millwood Homes for the costs it incurred in taking out the bond for payment of security. The amount of compensation payable is equal to the costs incurred by Millwood Homes in taking out the bond. This amounts to £2,327.71.

### **ii. Reasonableness of the final requisition charge for the New Main**

- 1.10 We have determined that the final charge that Thames Water can recover from Millwood Homes for the provision of the New Main is £24,034.38. This is lower than the security amount of £32,161.59 that Thames Water recovered from Millwood Homes prior to carrying out works and thus a refund of £8,127.21 is now payable to Millwood Homes.
- 1.11 We have determined the amount of the final charge by concluding that the total actual costs incurred by Thames Water in providing the New Main were reasonable. This is because we consider that these costs do not appear to be substantially higher than might be expected for the work that was carried out.

1.12 We have however concluded that the amount of revenue that should be offset against the costs reasonably incurred by Thames Water as part of the final charge calculation (set out in the Act<sup>1</sup>) should be greater than Thames Water has allowed for in its own calculations. This reflects the fact that the 12 properties on the Site were connected to the main in the same year that the main was provided and hence earlier than assumed in Thames Water's own calculation of the charge.

### **iii. Reasonableness of expenses incurred in making the Connections**

1.13 We have determined that the expenses that Thames Water can recover from Millwood Homes) for making the Connections amount to £3,333.23. This is less than the charge of £4,972.22 Thames Water is seeking to recover.

1.14 We have arrived at this conclusion by reviewing the actual costs incurred by Thames Water against the benchmark costs outlined in two independent reports (described in chapter 4 below) that we have commissioned to understand typical costs for service connections. On the basis of these reports we have concluded that while the construction costs in this case were reasonable, the overhead and administration costs incurred by Thames were unreasonably high and should be reduced.

### **iv. Interest payable**

1.15 In line with the provisions of the Act we consider that interest is payable by Thames Water to Millwood Homes on:

- a. the security amount of £32,161.59 it recovered for the New Main (from the date the security was paid until the date the New Main was provided);
- b. the £8,127.21 refund due for the New Main (from the date the New Main was provided until the date the refund is paid);
- c. the security of £9,596 Thames Water recovered in advance of making the Connections (from the date the security was paid until the date the final connection was made); and
- d. the £6,262.77 refund due on the Connections (from the date the last connection was made until the date the refund is paid).

1.16 Thames Water should apply interest rate(s) in accordance with [Ofwat's Information Notice on interest rates](#). The amount of any interest payable is for the Courts to determine, if Thames Water and Millwood Homes are unable to agree this amount.

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<sup>1</sup> Described in the Legal Framework chapter

## 2. Factual Background

### A. The Parties

#### (i) Thames Water

2.1 Thames Water is appointed under the Act to provide water and sewerage services to customers in London and the Thames Valley. The Site is within Thames Water's area of appointment.

#### (ii) Millwood Homes

2.2 Millwood Homes is based in Tonbridge, Kent and its developments can be found in locations throughout Kent, Sussex and Surrey.

### B. The Site

2.3 The Site is a housing development located in Brasted, Kent and comprises 12 houses.

### C. The New Main

2.4 On 5 June 2007 Millwood Homes requested a quote from Thames Water for the **"installation of the water supplies"** in respect of the new development at the Site.

2.5 On 26 September 2008 Thames Water provided a requisition quote to Millwood Homes. The scope of the works to be carried out was described as follows:

**"Lay approx. 130 metres of 100mm Fuchs Steel main to serve the development of 12 new domestic properties..."**

2.6 Based on its estimated costs, as part of its quotation for the above works Thames Water offered three payment options to Millwood Homes. This included a choice of two options for payment in accordance with sections 43 and 43A of the Act. The other option for payment presented by Thames Water was described as a **"commercial arrangement not covered by the Act"**. The options given were as follows:

- 1) Option one – Millwood Homes to pay Thames Water a **"Commercial Commuted Sum"** of £32,161.59 (payable in advance of works).

- 2) Option two – Statutory Commuted Sum of £32,161.59 (payable in advance of works) based on the discounted aggregate deficit method of payment as set out in the Act<sup>2</sup>. Thames Water added that **“Alternatively, we will accept a bond for the relevant amount from an acceptable bondsman. We will provide on request the wording we require to be used in such a bond.”**
- 3) Option three – Undertaking with security amounting to £46,153.24 (payable in advance of works) based on the relevant deficit method of payment set out in the Act<sup>3</sup>. In its description of this option Thames Water stated that **“The security can be paid by way of a deposit of money and this will accumulate interest at a prescribed rate. Alternatively, we will accept a bond for the relevant amount from an acceptable bondsman. We will provide on request the wording we require to be used in such a bond.”**
- 2.7 On 30 September 2008 Millwood Homes selected option three above by providing security in the form of a bond for the New Main to Thames Water. The bond amounted to £46,554.13<sup>4</sup> and cost Millwood Homes £2,327.71 to take out.
- 2.8 On 8 October 2008 Thames Water wrote to Millwood Homes stating that it **“...would still require a cheque to be held as security.”**
- 2.9 On 13 October 2008 Millwood Homes replied to Thames Water asking why a cheque was needed as well as a bond for the payment of security. On 21 October 2008 a representative of Thames Water responded by stating that **“...Thames Water will not accept a bond as suitable security at the current time. I will require a cash deposit as suitable security in line with the figures supplied for the three options detailed within the mains quote.”**
- 2.10 On 22 October 2008 Millwood Homes wrote to Thames Water, enclosing a cheque in the sum of £32,161.59 as the security payment.
- 2.11 On 25 February 2009 Thames Water provided the New Main i.e. construction of the main was complete and it was available for use.

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<sup>2</sup> Described in chapter 3 (Legal Framework)

<sup>3</sup> Described in chapter 3 (Legal Framework)

<sup>4</sup> Millwood Homes has explained that it provided a bond for a higher amount (£46,554.13) than that which was quoted by Thames Water (£46,153.24) on 26 September 2008. This is because the bond taken out was based on an earlier quotation from Thames Water dated 19 March 2008. Millwood Homes has noted that Thames Water failed to provide it with a revised quotation earlier than requested and so the bond actually provided was slightly higher than that sought in Thames Water's revised quotation dated 26 September 2008.

## **D. The Connections**

- 2.12 On 16th October 2008 Thames Water provided a quotation to Millwood Homes for the amount of £16,508 for making the Connections at the Site based on their estimated costs. This included £9,596 towards the costs of making the Connections and £6,912 for the payment of infrastructure charges<sup>5</sup>.
- 2.13 On 18 November 2008 Millwood Homes made a payment of £16,508 to Thames Water.
- 2.14 The first of the Site's connections was made on 21 February 2009 and the last connection was provided on 14 April 2009.

## **E. The request for a determination**

- 2.15 Millwood Homes requested a determination by us on 23 August 2013 in respect of various issues connected with the amounts that Thames Water has required Millwood Homes to pay for the New Main and Connections.
- 2.16 Specifically we have been asked to determine the following issues that are in dispute between the Parties:
- i. reasonableness of the approach to requesting security for the New Main;
  - ii. reasonableness of the final requisition charge for the New Main;
  - iii. reasonableness of expenses incurred in making the Connections; and
  - iv. Interest payable.
- 2.17 We are satisfied that the Parties are in dispute and that we have jurisdiction to make a determination in accordance with sections 42(6)(a), 42(6)(b), 45(6A) and 30(A) of the Act regarding the security and final charges regarding the New Main and the Connections.

## **F. Our investigation**

- 2.18 We wrote to the Parties on 7 March 2014 to confirm that we had opened an investigation to determine this matter.
- 2.19 In order to obtain further information to enable us to make our determination we sought further information from both parties on 28 April 2014. Thames

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<sup>5</sup> Described in chapter 3 (Legal Framework)

Water responded on 27 May 2014 and Millwood Homes responded on 18 May 2014.

- 2.20 After receiving Thames Water's response to our information request we sought additional information and clarification on 17 July 2014. Thames Water provided this to us on 31 July 2014.
- 2.21 We issued a draft determination to the Parties on 30 September 2014. Millwood Homes submitted representations on 7 October 2014. Thames Water submitted representations on 21 October 2014.
- 2.22 Based on Millwood Homes' representations we sought additional information from Thames Water on 22 October 2014. Thames Water provided this information on 14 November 2014.

### 3. Legal framework

3.1 This chapter outlines the key legislative provisions relevant to this case.

#### A. Duty to comply with water main requisition

3.2 Under section 41(2) of the Act, an owner or occupier of premises may require a water undertaker to provide a water main to provide a supply of water to the premises to be used for domestic purposes (a '**requisition**'). 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.

3.3 Under section 41(1)(c) and section 42(2) of the Act, as part of the duty to comply with a water main requisition, a water undertaker can recover a contribution from the owner or occupier of the premises towards the costs of providing the water main (the '**requisition charge**').

#### B. Requisition charge

3.4 Sections 42 – 43A set out the financial conditions for complying with a mains requisition. The requisition charge a water undertaker is allowed to recover is calculated by reference to:

- i) the annual borrowing costs of a loan of an amount that would be required to cover the costs reasonably incurred in providing the main; and
- ii) the revenue which will be recovered by the water undertaker by means of the new main (i.e. the bills paid by customers connected to that main, which is in turn derived from the occupancy rates of the premises connecting) over each of the 12 years following the provision of the water main.

3.5 Where, in any of those 12 years, the revenue exceeds the borrowing costs, the owner or occupier of the premises will not be required to make any payment. Where the borrowing costs exceed the revenue, the water undertaker is entitled to require the owner or occupier of the premises to pay the difference to the water undertaker.

3.6 Section 42(2)(a) provides for the owner or occupier of the premises to pay the water undertaker the requisition charge either by way of an annual amount over each of the 12 years following provision of the water main (the '**relevant deficit**'), or a single lump sum payment made following provision of the water main, which is referred to as the discounted aggregate deficit (the '**DAD**') and

is commonly called the ‘**statutory commuted sum**’. The relevant deficit is calculated in accordance with section 43 of the Act and the DAD is calculated in accordance with section 43A of the Act.

- 3.7 The final requisition charge can only be requested once the water main has been provided.

### **C. Costs that can be included in the calculation of a requisition charge**

- 3.8 The calculation of the requisition charge relies on establishing the costs reasonably incurred in providing a new water main. Section 43(4) of the Act states that the costs reasonably incurred in providing a water main shall include:

- 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 provision of the new main”.**
- 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 provision of the new main”.**

- 3.9 In setting out how the requisition charge should be calculated as well as stating what wider costs can be considered reasonably incurred, section 43(2) of the Act specifically provides that costs incurred in the provision of additional capacity beyond that required cannot be considered “costs reasonably incurred” when calculating the requisition charge:

**“The annual borrowing costs of a loan of the amount required for the provision of a water main is the aggregate amount which would fall to be paid in any year by way of payments of interest and repayments of capital if an amount equal to so much of the costs reasonably incurred in providing that main as were not incurred in the provision of additional capacity had been borrowed...”**

- 3.10 This is expanded on by section 43(6) of the Act, which states:

**“Any reference in this section to the provision of additional capacity in a water main provided in pursuance of a requirement under any enactment is a reference to such works carried out or other things done in connection with the provision of that main as are carried out or**

**done for the purpose of enabling that main to be used for the purpose in addition to those for which it is necessary to provide the main in order to comply with the requirement”.**

- 3.11 There are no specific provisions in section 43 of the Act setting out how costs should be apportioned when additional capacity is provided by the water undertaker.

#### **D. Security payments**

- 3.12 Although the final requisition charge can only be requested once the water main has been provided, security can be requested in advance by the water undertaker under section 42(1)(b).
- 3.13 Section 42(4) provides for interest to be paid on any sums deposited with a water undertaker as security for provision of a water main. This is calculated on the basis of every sum of 50p deposited for every three months in which it remains in the hands of the undertaker.

#### **E. Duty to make connections with main**

- 3.14 Section 45(1) of the Act imposes a duty on a water undertaker (subject to certain conditions) to make a connection, where the owner or occupier of any premises serves notice on the water undertaker requiring it to connect a service pipe to those premises with one of the water undertaker's mains for the purposes of supplying water for domestic purposes.
- 3.15 Under Section 45(6) of the Act the water undertaker may recover from the person who has required it to make such a connection the expenses reasonably incurred in making the connection.
- 3.16 Section 46 imposes a further duty on a water undertaker to carry out such ancillary works as are required for purpose of making the service pipe connection with the main. This comprises the laying of so much of the service pipe to be connected with the water main as it is necessary to lay in a street.
- 3.17 These expenses can only be requested once the service connections have been made. Ahead of providing the connections, section 47(2) of the Act provides that a water undertaker can reasonably require a security payment from the person requesting a service connection as a condition for complying with its section 45 duty.

3.18 Under section 48, where “any sums have been deposited with a water undertaker by way of security for the discharge of any obligation, the undertaker shall pay interest at such rate as may be approved or determined by Ofwat on every sum of 50p so deposited for every three months during which [the deposit] remains in the hands of the undertaker.”

## **F. Infrastructure charges**

3.19 Infrastructure charges are charges that a water or sewerage undertaker is entitled to raise pursuant to a charges scheme and section 146 of the Act. They are payable when connecting premises to a public water supply or public sewer for the first time for domestic purposes. They are charged separately for water and sewerage services.

3.20 The Act’s provision for raising an infrastructure charge is separate and independent of the provisions related to providing and charging for a main requisition under sections 41 – 43 of the Act and for a service connection under sections 45 and 46 of the Act.

3.21 The methods for calculating the amount of infrastructure charges a water undertaker can recover are set out in Condition C of a water and sewerage undertaker’s Instrument of Appointment (i.e. its licence).

## **G. Disputes**

3.22 Section 42(6) of the Act provides that any dispute between a water undertaker and any other person regarding the undertakings or security required for the purposes of section 42 of the Act or the amount required to be paid in pursuance of any such undertakings can be referred by either party to Ofwat for determination under section 30A of the Act.

3.23 Section 45(6A) of the Act allows any dispute between a water company and any other person as to whether the expenses related to service connections were incurred reasonably to be referred to Ofwat by either party for determination.

## 4. Our draft determination

4.1 This chapter sets out our final determination of the specific issues referred to us by Millwood Homes. These include the:

- Reasonableness of the approach when requesting security for the New Main;
- Reasonableness of the final requisition charge for the New Main;
- Reasonableness of expenses incurred in making the Connections; and
- Interest payable.

4.2 As noted above, the Parties' provided representations on our draft determination of this matter. Millwood Homes accepted our conclusions apart from those relating to the reasonableness of the final requisition charge for the New Main. In addition, although it accepted our conclusions on interest payable, it did make suggestions for additional text on that issue (see paragraph 4.64 below).

4.3 In its response to our draft determination, Thames Water stated that it agreed to our determination in respect of each issue listed above but did make comments in respect of our conclusions regarding reasonableness of the approach when requesting security for the New Main and on interest payable. Thames Water also provided additional information to us in response to Millwood Homes' representations on the reasonableness of the final requisition charge for the New Main.

4.4 Details on the Parties' representations and, where necessary, our response to these are set out below.

### A. Reasonableness of the approach when requesting security for the New Main

#### Millwood Homes' view

4.5 Millwood Homes contends that Thames Water did not act reasonably when seeking security for the New Main. In its view it was unreasonable for Thames Water to seek a cash security payment of £32,161.59 when a bond had already been provided on 30 September 2008 for the sum of £46,554.13, in accordance with the quotation offered by Thames Water dated 26 September 2008.

- 4.6 Millwood Homes argues that it was compelled to pay the cash security amount (which it did on 22 October 2008) to avoid further delays as Thames Water was refusing to provide the New Main until it had received the security it was requesting.
- 4.7 Millwood Homes is therefore seeking to be reimbursed the cost it incurred in taking out a bond (the sum of £2,327.71) and it also seeks interest on that sum.

### **Thames Water's view**

- 4.8 Thames Water has stated that it does not have any record of correspondence to show why it did not accept security in the form of a bond from Millwood Homes.
- 4.9 Thames Water has also confirmed that it has not made any compensation payment to Millwood Homes but is working with a loss adjuster to assess Millwood Homes' claims and determine its liability.

### **Our determination**

- 4.10 Thames Water has been unable to provide any reasons for its refusal to accept security in the form of a bond from Millwood Homes. Millwood Homes incurred a cost in taking out this bond and the option to pay a bond was only withdrawn by Thames Water at the point at which Millwood Homes provided the bond to the company. We have therefore concluded that Thames Water acted unreasonably in respect of this issue by:
- i) initially offering Millwood Homes the option to pay a bond as security;
  - ii) withdrawing the bond option only after it was taken out and provided by Millwood Homes;
  - iii) failing to provide a reason for its refusal to accept the bond offered; and
  - iv) failing to make any compensation to Millwood Homes for the costs it incurred in taking out the bond.
- 4.11 While we note that Thames Water claims to have appointed a loss adjuster to deal with Millwood Homes' claims for losses, we have not been provided with the scope of issues being looked at by the loss adjuster nor when it is likely to reach a decision.

- 4.12 In response to our draft determination Thames Water disagreed that it had acted unreasonably in this matter but agreed to compensate Millwood Homes to the value of £2,327.71.
- 4.13 Given the above and since this matter has been referred to us by Millwood Homes for determination, we determine that Thames Water should compensate Millwood Homes for the costs it incurred in taking out the bond in question. The compensation payable by Thames Water is £2,327.71 being the cost Millwood Homes incurred in taking out the bond.
- 4.14 We have set out our determination on the interest payable in this case under section 4D (Interest payable) below.

## **B. Reasonableness of the final requisition charge for the New Main**

### **Millwood Homes' view**

- 4.15 Millwood Homes contends that the amount of security sought by Thames Water in respect of the New Main (£32,161.59) was not reasonable. It argues that:
- i) Thames Water exaggerated its estimate of the cost of the work and a cheaper alternative should have been selected. Millwood Homes suggests that it would have been satisfactory to lay a 90mm Medium-density polyethylene (MDPE main) rather than the 100mm Fuchs steel main that was actually laid. It reasons this is because although soil surveys undertaken on the Site by Thames Water revealed there was diesel contamination, there was a planning requirement that the Site be cleaned up by Millwood Homes before any development took place;
  - ii) A reasonable estimate of the cost of the 100mm Fuchs main would have been no more than £100 per metre and so the cost of the work should not have exceeded £13,000 (130 metres multiplied by £100); and
  - iii) Thames Water has failed to offset the charges revenue it will receive from premises on the Site when calculating the requisition charge security. Millwood Homes has calculated that the water charges income in the year the New Main was provided should have been £1,395 (based on the 12 properties on the Site paying charges for a period on average of 9 months in the first year). This is based on Thames Water's charge of approximately £155 per average household for metered properties for the relevant year (2008-09).

- 4.16 Millwood Homes also notes that Thames Water did not re-calculate the final charge once actual costs of the New Main were known and has failed to notify Millwood Homes of this amount in accordance with the Act.
- 4.17 In response to our draft determination Millwood Homes disagreed with our calculation of the final requisition charge for the New Main on the basis that it had excavated the trench for the New Main and had carried out reinstatement work itself. Millwood Homes therefore argues that Thames Water is incorrectly seeking to recover the costs of these activities when it did not carry them out.
- 4.18 Millwood Homes noted that as Thames Water failed to provide the New Main within the required timeframe set out in the Act, it had houses ready for occupation but without a water supply. Because of this it states that, to speed up the water supply to the houses on the Site and release the houses for occupation, it had to carry out all of the excavation and reinstatement for the New Main and for the Connections itself.
- 4.19 Millwood Homes argues that the above reason, rather than the type of pipe that was used, was the principal reason for its view that the estimated costs of the New Main were too high and that the amount of £25, 994.92 (as set out in table 1 below) provided by Thames Water, and which is purported to include excavation costs, is incorrect.
- 4.20 Given the above, Millwood Homes has noted that because it would be reasonable to apply direct costs in proportion to the cost of the work that was actually carried out, in its view Thames Water should recalculate the direct costs and overheads in addition to its contractors' labour.

### **Thames Water's view**

- 4.21 Thames Water has confirmed that its choice of material for the main it laid was Fuchs steel. It has explained that at the time the main was to be laid this material was chosen because the Site was deemed to be contaminated.
- 4.22 Thames Water has provided us with copies of its DAD calculations for both the security it recovered for the New Main (based on estimated costs) and the final requisition charge it has calculated (based on actual costs). These calculations show that:
- a. The estimated cost of the New Main was £46,153.24. This included £36,255.49 for construction costs and £9,897.75 for Thames Water's 'Direct Costs and overheads';

- b. The actual costs of the New Main amounted to £41,507.59. This included £32,606.12 for construction costs and £8,901.47 for Thames Water's 'Direct Costs and overheads' (see Table 1 below for a more detailed breakdown of the costs). Thames Water has stated that its construction costs were based on the schedule of rates valid for the term contractors at the time;
- c. Thames Water has allowed for the offset of revenue in the security payment it sought and the final requisition charge it has now calculated. Thames Water's revenue assumptions in both of its calculations were based on an amount of £154.53 per household for the year 2008-09;
- d. In both of its calculations Thames Water has assumed that revenue from all of the Site's 12 premises would be generated from year five of the DAD calculation (with revenue from less than the full 12 properties in the preceding years) but has not provided any reasons or evidence to support the use of this assumption; and
- e. Thames Water has calculated the final requisition charge to be £27,515.94. This is lower than the security amount of £32,161.59.

**Table 1 Detailed breakdown of actual costs incurred for the New Main**

<b>Activity</b>	<b>Amount</b>
Contractors labour	£25,994.92
Materials	£3,898.79
Reinstatement	£2,712.41
<b>Construction costs total</b>	<b>£32,606.12</b>
Thames Water direct costs (covering scheme designer and field engineer costs)	£4,806.79
Thames Water overheads (covering the provision of planning, scheduling, and control activities, customer liaison, billing and collection and notice serving. It also includes a portion of central support activities such as finance, customer services the provision of insurance cover and other legal costs, communication network and other corporate infrastructure needed to support Thames Water's operation.)	£4,094.68
<b>Direct costs and overheads total</b>	<b>£8,901.47</b>
<b>Total actual costs</b>	<b>£41,507.59</b>

- 4.23 Thames Water has stated to us that it is unable to establish why it did not make a refund to Millwood Homes once it had re-calculated the final requisition charge. Thames Water has confirmed that it now proposes to offer Millwood Homes a refund of £4,645.65 (i.e. the security of £32,161.59 minus the final requisition charge of £27,515.94). It proposes to make this refund following the completion of our determination (including payment of interest based on our guidance and time of the refund payment).
- 4.24 Following receipt of Millwood Homes' representations on our draft determination in respect of the actual scope of works carried out in laying the New Main, we wrote to Thames Water to ask for its views (with supporting evidence) on Millwood Homes' assertions.
- 4.25 In its response Thames Water noted that its own records did not support the suggestion that its contractors had not carried out the excavation and reinstatement works associated with the laying of the New Main. Its position

in respect of excavation and reinstatement for the Connections is set out in section C below.

- 4.26 In support of the above Thames Water provided copies of post-completion site inspections and contractor track sheets as evidence of the work carried out by its contractors and concluded that it was not appropriate to revise its costs any further.

### **Our determination**

- 4.27 Since the main for which the above referenced security was paid has now been provided by Thames Water, our determination has focused on the reasonableness of the final requisition charge Thames Water can recover (based on the actual costs it incurred in providing the New Main), rather than the security payment which was based on estimated costs.
- 4.28 Millwood Homes has made a number of points about the reasonableness of the amount of the security that was requested by Thames Water. We have, however, taken the same points to apply equally to the final requisition charge since the security was an estimate of this amount and the underlying calculations for both charges are the same.
- 4.29 In order to determine the reasonableness of the final requisition charge, we have considered: whether the works carried out were appropriate; whether the costs associated with the works were reasonably incurred; and the revenue assumptions to be used in the DAD calculation.
- 4.30 We have concluded that that it was reasonable for Thames Water to lay 130 metres of 100mm Fuchs steel main since the information available to the company at the time it was to lay the main highlighted that the Site was contaminated and therefore Fuchs steel was the most appropriate material to use. We have not seen any evidence to suggest that Millwood Homes presented evidence to Thames Water to suggest that the land surrounding the pipe was to be decontaminated before it was laid.
- 4.31 In respect of the whether the costs associated with the laying of the main were reasonable, we have considered both the construction costs and direct costs and overheads set out by Thames Water that together made up the total costs.
- 4.32 In terms of the construction costs, we note that these were based on a schedule of rates set out by Thames Water's term contractor. Our understanding is that the term contractor was chosen via a competitive

selection process in which we would expect the schedule of rates put forward to be have been a key part of the process.

- 4.33 Where a company has used a contractor selected following a competitive tender process, we will generally accept that the amount paid to the contractor for the work represents the costs reasonably incurred. We will, however, query those costs where they appear to be substantially higher than might be expected given the nature of work carried out and the material used.
- 4.34 As noted above, following representations from Millwood Homes we sought additional information from Thames Water in respect of its actual costs. Thames Water provided provided copies of post-completion site inspections and contractor track sheets as evidence of the work carried out by its contractors.
- 4.35 After reviewing this additional information and in the absence of robust evidence to the contrary, we are satisfied that Thames Water did carry out excavation and reinstatement work associated with the provision of the New Main and that the costs set out in table 1 above reflect the work carried out.
- 4.36 We do not consider that the costs in this case were substantially higher than might be expected given the nature of work carried out and the material used. On this basis we are satisfied that the construction costs for the New Main in this case were reasonable.
- 4.37 In respect of the direct costs and overheads we do not consider that these were unreasonable either since they appear to be proportionate to the amount of construction costs incurred.
- 4.38 On the basis of the above we have concluded that the amount of £41,507.59 set out by Thames Water was reasonably incurred.
- 4.39 In respect of the income that should be offset against the actual costs incurred by Thames Water, we consider that this should be higher than the amount that Thames Water has provided for in its calculations. We consider that Thames Water's assumption of revenue of £154.53 is reasonable since it reflects Thames Water's average household bill for the charging year 2008-09. However we consider that the timing of the occupancy assumptions within the DAD calculation are incorrect.
- 4.40 Thames Water has confirmed to us that the 12 properties on the Site were connected in the space of two months between 21 February 2009 and 14 April

2009. This included eight properties connected in February 2009 and four properties connected in April 2009.

- 4.41 We are of the view that Thames Water should have allowed for receipt of one year's full charges income from the eight properties connected in February 2009. It should then have allowed for receipt of 10 months charges income from the remaining four properties that were connected in April 2009.
- 4.42 Appendix 1 to this determination sets out in more detail our view on how the charges income should have been calculated for the purposes of arriving at the final requisition (DAD) charge for the New Main.
- 4.43 The effect of the above is that we consider the total income that Thames Water could have expected to receive for each year following the provision of the main until year five should be higher than that calculated by Thames Water. The total income offset should amount to £25,478.90 which is greater than the income offset amount of £21,461.12 that Thames Water has provided for in its own calculation of the final charge for the New Main.
- 4.44 Re-calculating the DAD calculation to reflect our conclusion of costs reasonably incurred and revenue assumptions, we determine that the final requisition charge that Thames Water can recover from Millwood Homes is £24,034.38. Appendix 1 shows our determined calculation of the final requisition charge.
- 4.45 As a result of our determination a refund of £8,127.21 is due to Millwood Homes on the security payment it made (i.e. £32,161.59 minus £24,034.38).

## **C. Reasonableness of expenses incurred in making the Connections**

### **Millwood Homes' view**

- 4.46 Millwood Homes considers that the estimated costs set out by Thames Water to make the Connections were too high and an exaggeration of the actual costs. Millwood Homes is seeking a determination on the reasonable cost of the work which in its view should not include any costs for excavation or backfilling work, which it states were carried out by itself rather than Thames Water.

### **Thames Water's view**

- 4.47 Thames Water has explained that it had not completed its internal review of the actual costs it incurred in making the Connections against the costs paid

by Millwood Homes in advance of the Connections, when this dispute was referred to us for determination.

4.48 Thames Water has now provided us with a breakdown of the actual costs it incurred in making the Connections at the Site. This is set out in Table 2 below. The total cost (£4,972.22) incurred by Thames Water excludes costs for excavation work. While these costs were not originally excluded Thames Water has subsequently explained that its original costs were based on details it received from its contractor. Unlike the costs of the New Main set out in table 1 above, Thames Water has been unable to provide evidence to show that it carried out the excavation work associated with the Connections and as a result calculated the cost of the Connections being delivered so that it did not include excavation, rather than contest this issue, as detailed below:

**Table 2 Breakdown of actual costs incurred in making the Connections**

<b>Activity</b>	<b>Amount</b>
Contractors labour (excluding excavation)	£1,443.80
Materials	£1,076.94
Thames Water direct costs (covering scheme designer and field engineer costs)	£1,870.80
Thames Water overheads (covering the provision of planning, scheduling, and control activities, customer liaison, billing and collection and notice serving. It also includes a portion of central support activities such as finance, customer services the provision of insurance cover and other legal costs, communication network and other corporate infrastructure needed to support Thames Water's operation)	£580.68
<b>Total actual costs</b>	<b>£4,972.22</b>

4.49 The actual costs incurred amount is lower than the estimated costs of £9,596 which was recovered from Millwood Homes prior to the works taking place. Based on the above Thames Water believes that a refund of £4,623.78 is due to Millwood Homes.

## Our determination

- 4.50 In determining the reasonableness of the costs associated with the Connections we have separated the costs into two categories:
- (i) **Construction costs** – This includes the total cost of the making the Connections (the physical pipe laying and actual connection of pipe to main) including labour, materials and reinstatement; and
  - (ii) **Administration fees and overhead costs** – This includes the administration fees and overheads incurred in providing a single new connection.
- 4.51 As noted in our determination of costs reasonably incurred for the New Main, where a company has used a contractor selected following a competitive tender process, we will generally accept that the amount paid to the contractor for the work represents the expenses reasonably incurred. We will, however, query those costs where they appear to be substantially higher than might be expected having regard to other information available to us.

## Construction costs

- 4.52 We have considered whether the construction costs incurred by Thames Water can be considered reasonably incurred. To do this we have used the Hyder Report<sup>6</sup> as guidance.
- 4.53 The Hyder Report is an independent report commissioned by us which involved the surveying of a number of water companies to understand the breakdown of charges made by those companies for work undertaken in connecting new water supplies, and:
- to obtain an understanding and explanation of the variance in charges between water companies;
  - to compare water company contractor rates for new water connections; and
  - thereby, to obtain an understanding of what are reasonable costs/charges for materials (e.g. pipework, meters, etc.) and for labour.

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<sup>6</sup> The Hyder Report - A Comparative Study: Cost of new water supply connections work (24 March 2010) [http://www.ofwat.gov.uk/publications/commissioned/rpt\\_com\\_20100928s45hyder.pdf](http://www.ofwat.gov.uk/publications/commissioned/rpt_com_20100928s45hyder.pdf)

4.54 In this case the average cost of one connection can be calculated by dividing the total construction cost for the Connections by the number of connections that were made. This gives an amount of £210.06 (i.e. £2,520.74 / 12). We have concluded that this is not inconsistent with the median or maximum range of costs set out in the Hyder Report as being reasonable for making one connection, as per Table 3 below.

**Table 3 Range of contractor charges**

Surface	Verge			Footway			Carriageway		
Service length	2m	4m	9m	2m	4m	9m	2m	4m	9m
<b>Median</b>	£274.50	£312.14	£476.08	£394.79	£531.52	£765.00	£449.89	£587.00	£977.00
<b>Maximum</b>	£765.00	£765.00	£815.33	£925.78	£1229.00	£1987.05	£1469.35	£1885.45	£2925.70
<b>Minimum</b>	£144.04	£144.04	£193.92	£203.92	£203.92	£278.42	£246.62	£246.62	£331.18

### Administration fees and overhead costs

4.55 We have also considered the reasonableness of the administration and overhead costs incurred by Thames Water. To do this we have used an independent review of section 45 administration fee and overhead costs<sup>7</sup>.

4.56 This independent review was commissioned by Ofwat in 2013 and involved surveying five water only companies and five water and sewerage companies to arrive at an average figure for overheads and administration fees.

4.57 This review concluded that as well as costs directly associated with the making a new connection (direct on-costs), some companies seek to recover an additional payment that contributes to the cost of operating the company (company on-costs). Since companies experience these company on-costs whether or not new connections are requested they cannot be directly attributed to a specific new connection.

4.58 Based on the above, the review recommended that the acceptable overall direct on-cost for a section 45 new connection is £105.30. The review also recommended that when a developer requests two or more connections at the

<sup>7</sup> [http://www.ofwat.gov.uk/publications/commissioned/prs\\_web201404s45costs](http://www.ofwat.gov.uk/publications/commissioned/prs_web201404s45costs)

same location the full direct on-costs for the second and subsequent connections should be reduced to £64.29 to reflect the savings the company makes from technical tasks in the process.

- 4.59 In line with the recommendations described above, we consider that, for a standard single service connection, administration and overhead costs<sup>8</sup> should not generally exceed £105.30 and that subsequent connections should not generally exceed £64.29. Since in this case 12 connections were made we consider that the administration and overhead costs for the remaining 11 connections should amount to £707.19. Therefore we have determined that the total direct and overhead cost that Thames Water can recover from Millwood Homes is £812.49.
- 4.60 In this case Thames Water's own total direct and overhead cost calculation for the Connections amounts to £2,451.48. This is £1,638.99 higher than we would expect.
- 4.61 Based on the above we have determined that the total expenses (including construction and overhead costs) that Thames Water can reasonably recover from Millwood Homes for the making of the Connections amounts to £3,333.23.
- 4.62 It follows that because the actual cost we have determined for the Connections is lower than the amount Thames Water recovered as security, a refund of £6,262.77 (£9,596 minus £3,333.23) to Millwood Homes is due. This is greater than the refund amount of £4,623.78 that Thames Water itself was proposing to make.

## **D. Interest payable**

### **Millwood Homes' view**

- 4.63 Millwood Homes is seeking interest to be paid on:
- a) the security amount of £32,161.59 paid for the New Main – from the date that this was received by Thames Water up to the date that Millwood Homes receives a refund from Thames Water for any overpayment (resulting from the difference between the final requisition charge and security amount);

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<sup>8</sup> This includes fees to process applications and other administrative and technical activities carried out after a water company has accepted a quote.

- b) the cost of the bond (£2,327.71) that was taken out initially to provide security for the New Main – from the date the bond was received by Millwood Homes from the bondsman (19 July 2008) until the date on which Thames Water makes the requested refund of the bond amount;
- c) the payment of £9,596 made to Thames Water for the making of the Connections – from the date this was received by Thames Water up to the date when the Connections were made.
- d) any overpayment made for the Connections based on the difference between the actual and estimated costs of the work – from the date the Connections were made to the date on which Thames Water provides a refund on any overpayment; and
- e) the infrastructure charges payment of £6,912 which was paid together with the Connections payment referred to above – from the date of payment until the date the Connections were made. Millwood Homes argues that infrastructure charges are not due until properties are connected and it was wrong for Thames Water to have sought payment in advance.

4.64 In response to our draft determination Millwood Homes noted that in our final determination there should be a requirement on Thames Water to calculate the interest due and submit its calculations to Millwood Homes within 28 days of the date of the final determination. It added that subject to Millwood Homes' agreement of Thames Water's calculations, Thames Water should be required to pay the total sum due within 14 days of the date of Millwood Homes' written acceptance of the amount.

### **Thames Water's view**

4.65 Thames Water has not made any interest payments to Millwood Homes to date. It has however confirmed to us that it would calculate interest on the security it recovered for the New Main based on our guidance and time of refund payment.

4.66 Thames Water does not accept that the advance payment it recovered for the Connections can be considered as security and therefore should attract interest.

4.67 In response to our draft determination Thames Water reiterated its view that it does not accept that the advance payments it requests for connection applications amount to security and, as such, it does not accept that the payment made by the customer attracts any interest. However it added that

rather than take issue on this particular point in this case, it would agree to pay interest at a rate based on our guidance and in line with the time of refund payment in an effort to resolve this matter.

- 4.68 In respect of the recovery of infrastructure charges Thames Water has stated that it does not demand infrastructure charges in advance, since these become payable once a connection is completed.

### **Our determination**

- 4.69 Section 42(4) states that where any sums have been deposited with a water undertaker by way of security for the discharge its obligations under section 42, the undertaker shall pay interest at such rate as may be determined either by the undertaker with Ofwat's approval or as determined by Ofwat. Interest is payable on every sum of 50p deposited for every three months during which it remains in the hands of the undertaker.
- 4.70 Section 48 of the Act provides that where for the purposes of section 47(2)(a) of the Act, any sums have been deposited with a water undertaker by way of security, the undertaker shall pay interest at either a rate determined by the undertaker and approved by Ofwat, or as determined by Ofwat, on every sum of 50p deposited for every three months during which it remains in the hands of the undertaker.
- 4.71 We note that Thames Water does not dispute the fact that it must pay interest on the security it has held for the New Main and that it will calculate this in accordance with our guidance.
- 4.72 We disagree, however, with Thames Water that the amount paid by Millwood Homes in advance of the Connections being provided should not be classed as security and therefore should not attract any interest. We consider the amount of £9,596 to fall under section 47 of the Act.
- 4.73 We consider that the Act is clear; where for the purposes of section 47(2)(a) of the Act, any sums have been deposited with a water undertaker by way of security, the undertaker shall pay interest at either a rate determined by the undertaker and approved by Ofwat, or as determined by Ofwat, on every sum of 50p deposited for every three months during which it remains in the hands of the undertaker and hence be subject to interest.
- 4.74 In line with the provisions of the Act and our determination of charges and refund set out above, we consider that interest is payable by Thames Water to Millwood Homes on:

- a. the security amount of £32,161.59 it recovered for the New Main (from the date the security was paid on 22 October 2008 until the date the New Main was provided 25 February 2009);
- b. the £8,127.21 refund due for the New Main (from the date the New Main was provided on 25 February 2009 until the date the refund is paid);
- c. the security of £9,596 that Thames Water recovered in advance of making the Connections (from the date the security was paid on 18 November 2008 until the date the last connection was made on 14 April 2009); and
- d. the £6,262.77 refund due on the Connections (from the date the Connections were provided on 14 April 2009 until the date the refund is paid).

4.75 We also consider that Thames Water should pay the refunds and interests due to Millwood Homes as set out in this determination within 20 working days of the date of this determination.

4.76 We do not consider that interest is payable on sums which were not deposited with Thames Water. Therefore we consider that no interest is payable on the costs of £2,327.71 that Millwood Homes incurred in taking out a bond as security for the New Main. Section 42(4) of the Act allows interest only where sums have been deposited with the undertaker.

4.77 In respect of the infrastructure charges received by Thames Water, the Act does not provide for interest to be payable on this amount. There is no provision in the Act for interest to be payable on sums advanced in payment of infrastructure charges under section 146 (2)<sup>9</sup>, or for us to make determinations on this point.

4.78 In any event, it appears from the correspondence that we have reviewed that Thames Water did not demand upfront payment of infrastructure charges. Instead Millwood Homes was given the option of paying in advance which it duly did. The amount of the infrastructure charges are the same now that the Connections have been made and therefore no overpayment was made by Millwood Homes.

4.79 For the amounts where we consider that interest is payable, Thames Water should apply interest rate(s) in accordance with [Ofwat's Information Notice on interest rates](#). This anticipates the approach we think a Court is likely to take in making such a determination for this particular dispute. The amount of any

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<sup>9</sup> i.e. there is no equivalent of section 42(4) or section 48 (1) in relation to requisition or new connections payments.

interest payable is for the Courts to determine, if Thames Water and Millwood Homes are unable to agree this amount.

## 5. Conclusion

- 5.1 We have concluded that Thames Water acted unreasonably by initially offering Millwood Homes the option to pay security in the form of a bond only to later withdraw this option (after Millwood Homes had taken out the bond) and request a cash security only payment instead. Thames Water should therefore compensate Millwood Homes for the costs it incurred in taking out a bond for payment of security. This amounts to £2,327.71.
- 5.2 We have determined that the final requisition charge that Thames Water can recover from Millwood Homes for the provision of the New Main is £24,034.38. We have determined the amount of the final requisition charge by concluding that the actual costs incurred by Thames Water in providing the New Main were reasonably incurred. We have however concluded that the amount of charges revenue that should be offset against those costs should be greater than Thames Water has allowed for in its own calculations.
- 5.3 We have determined that the expenses that were reasonably incurred by Thames Water (and thus payable by Millwood Homes) in making the Connections amounts to £3,333.23. This is because some of the expenses associated with the direct costs and overheads incurred by Thames were unreasonably high and thus should not be charged to Millwood Homes.
- 5.4 We consider that interest is payable by Thames Water to Millwood Homes on the:
- a. security amount of £32,161.59 it recovered for the New Main;
  - b. refund of £8,127.21 due for the New Main;
  - c. security of £9,596 Thames Water recovered in advance of making the Connections; and
  - d. refund of £6,262.77 due on the Connections.

Thames Water should apply interest rate(s) in accordance with Ofwat's Information Notice on interest rates. Where the parties are unable to agree on the amount of interest payable, this is for the Courts to determine.

- 5.5 Thames Water should pay the refund amounts set out in the above paragraph within 20 working days of the date of this final determination. We consider that any interest payable on these amounts should also be paid within 20 working days of the date of this final determination.