

July 2017

Trust in water

Exel Construction Limited and Southern Water

Final determination of a dispute under section 45(6A) and 30A of the Water Industry Act 1991

Complaint against Southern Water about the reasonableness of connection costs

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Summary of our decision

This is a final determination on a dispute between Southern Water and Exel Construction Limited over the expenses that Southern Water reasonably incurred in providing new connections between two blocks of flats and the public water network.

Overall, we determined that costs Southern Water had claimed to have incurred in undertaking the physical work to connect the blocks of flats were mostly reasonable. However, we did not find that Southern Water had provided adequate evidence to justify the costs it claimed to have incurred in providing the administrative work that was necessary in order to provide the connections.

1. Introduction

A. The complaint

- 1.1 This is the final determination of a dispute referred to the Water Services Regulation Authority (“**Ofwat**”) for determination under sections 45(6A) and 30A of the Water Industry Act 1991 (“**the Act**”).
- 1.2 The dispute is between Exel Construction Limited (“**the Complainant**”) and Southern Water Services Limited (“**Southern Water**”) (together “**the Parties**”) and is about the expenses reasonably incurred by Southern Water in connecting 67 properties at Block A, Fairfield House, West Green Drive, Crawley, West Sussex, RH11 7DL and connecting 27 properties at Block B at the same address (together “**the Connections**”).
- 1.3 Before reaching this final determination, on 17 March 2017, we issued a draft determination and we provided the Parties with the opportunity to make representations to us on that draft determination. We received comments from the Parties and we have taken those comments into account in finalising this determination.

B. Overview of our final determination

- 1.6 Our determination, and our reasons for it, are set out in full in sections 2 to 6, but an overview is set out below.
- 1.7 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:
- The total expenses Southern Water can reasonably recover from the Complainant for making the connection to Block A are £13,895.62. Southern Water must therefore return £4,081.73 to the Complainant;
 - The total expenses Southern Water can reasonably recover from the Complainant for making the connection to Block B are £5,914.74. Southern Water must therefore return £1,781.96 to the Complainant; and
 - In line with our guidance on interest rates set out in [Ofwat’s Information Notice 11/05](#), Southern Water must calculate the interest due to the Complainant, and reissue a final invoice to the Complainant within 20 working days of our final determination.

2. Background

A. The Parties

Complainant

2.1 Exel Construction Limited is the Complainant and the owner of the properties.

Company

2.2 Southern Water is appointed under the Act to provide water to customers in parts of the south of England.

B. The property

2.3 The dispute concerns the expenses reasonably incurred by Southern Water in connecting 67 properties at Block A, Fairfield House, West Green Drive, Crawley, West Sussex, RH11 7DL and connecting 27 properties at Block B at the same address.

2.4 For each of the two blocks, the Complainant installed the pipework between the individual flats and installed part of the communication pipe up to a point agreed between the Parties.

2.5 The work that Southern Water was asked to carry out on Block A was to connect the communication pipe from the agreed point to the existing water main running next to West Green Drive and to provide and install 67 internal meters.

2.6 The work that Southern Water was asked to carry out on Block B was to connect the communication pipe from the agreed point to the existing water main running next to Sunnymead, a nearby road, and to provide and install 27 internal meters.

C. The request for and making of the Connections

2.7 On 8 September 2015, Southern Water provided a quotation of £65,450 for the connections at Block A and, on 9 November 2015, it provided a quotation of £26,863.18 for the connections at Block B (together “**the Quotations**”). The Quotations were inclusive of infrastructure charges and VAT. Additionally, the Complainant requested a quotation for a diversion of an existing water main serving the existing properties on Sunnymead, a nearby road, under section

185 of the Act (“**the Diversion**”). On 24 August 2015, Southern Water provided a quotation of £11,528 (plus VAT) for the Diversion. The costs reasonably incurred by Southern Water for diverting this water main are not within the scope of this determination as the Complainant has not asked us to make a determination on these costs and we do not have powers to determine the costs reasonably incurred by an undertaker for undertaking a pipe diversion requested under section 185 of the Act.

- 2.8 Block B was ultimately connected to the diverted water main. As a result, the point at which the communication pipe from Block B was connected to Southern Water’s water main was moved by several metres compared to the original connection point agreed under the Quotations.
- 2.9 On 17 November 2015, the Complainant paid the estimated connection charges to Southern Water to provide the connection to the properties at Block A. On 12-15 August 2016, the work to provide the connection to the properties at Block A was carried out. The table below sets out a breakdown of the payments requested and paid for, for the connection to Block A. The infrastructure charges were paid by the Complainant on 1 September 2016.

Table 1: Breakdown of the estimate for Block A

Description	Cost
Water connection costs	£17,977.35
66 Water infrastructure charges	£23,356.08
66 Wastewater infrastructure charges	£23,356.08
Water capacity charge (due to the Landlord supply) ¹	£353.88
Wastewater capacity charge (due to the Landlord supply)	£353.88
Total VAT	£53.57
Total Charge	£65,450.84

- 2.10 On 17 November 2015, the Complainant paid the connection charges to Southern Water to provide the connections to the properties at Block B. On 21 September 2016, the work to provide the connections to the properties at Block B was carried out. The table below sets out a breakdown of the payments requested and paid for, for the connections to Block B. The infrastructure charges were paid by the Complainant on 7 October 2016.

¹ The Landlord supply is the supply to one of the connected flats which is the Landlord’s residence. It has a capacity charge for the water and wastewater supplies rather than an infrastructure charge due to the Landlord supply being a non-household rather than a household supply.

Table 2: Breakdown of the estimate for Block B

Description	Cost
Water connection costs	£7,696.70
26 Water infrastructure charges	£9,200.88
26 Wastewater infrastructure charges	£9,200.88
Water capacity charge (due to the Landlord supply)	£353.88
Wastewater capacity charge (due to the Landlord supply)	£353.88
Total VAT	£56.96
Total Charge	£26,863.18

- 2.11 After the work had been completed, the Complainant raised a complaint with Southern Water stating that it thought the actual work that was undertaken was less complex than the work that was anticipated in the Quotations. One specific issue raised by the Complainant is that it believes that the quotation for Block B was based on connecting that block to an existing water main rather than to the diverted water main. It considers that connecting to the diverted water main was less complex than making the connection to the water main at its original location would have been.
- 2.12 In response to the complaint, Southern Water undertook a review of the charges required for providing the Connections to both Blocks and concluded that the work that was carried out matched the work that was predicted in the Quotations. As a result, Southern Water decided that the charges set out in the Quotations were correct.
- 2.13 The Complainant was not satisfied by Southern Water's review of its charges and referred the dispute to us on 26 October 2016. The Complainant considered that the cost quoted by Southern Water was excessive given its view that the work carried out by Southern Water was simpler than the work that was quoted for.
- 2.14 The infrastructure charges and water capacity charges associated with these requests for new connections are not disputed and are not within the scope of this determination.

D. Requests for information

- 2.15 On 1 December 2016, we issued a request for information to Southern Water and the Complainant. We asked the Parties to provide detailed information on

the work that was undertaken to provide the Connections and the actual costs incurred in undertaking that work including supporting evidence. We also asked the Parties to provide copies of any correspondence between them.

- 2.16 The Complainant responded to the request for information on 14 December 2016. Southern Water responded to the request for information on 16 December 2016. We summarise the responses we received below.

Response from the Complainant

- 2.17 The Complainant told us that it, rather than Southern Water, dug the trenches in which the communication pipes were laid. The Complainant also undertook the work to reinstate these trenches once the pipes had been laid. The Complainant also confirmed that there was no traffic management involved in the work by Southern Water and that Southern Water supplied and fitted the internal water meters.
- 2.18 The Complainant confirmed the dates on which the work was carried out: 12-15 August 2016 for Block A and 21 September 2016 for Block B.

Response from Southern Water

- 2.19 In Southern Water's response, it stated that it was required to excavate 2 trenches in order to connect its water main to the part of the communication pipes that the Complainant laid to the premises. Southern Water states that it was required to excavate a one metre long, three metre wide trench to lay 1.5m of a 90mm communication pipe in order to connect Block A with the public water main, and a one metre long, two metre wide trench to lay 1.5m of a 63mm communication pipe in order to connect Block B with the public water main. This is different from the information provided by the Complainant, who stated that Southern Water undertook no excavation work.
- 2.20 Southern Water also confirmed that no traffic management was required and that as the land was either a grass verge or unmade ground², the only reinstatement work carried out was to back-fill the trenches with soil and turf. As a result, no reinstatement costs were incurred, or included, in the charges to the Complainant.

² Unmade ground is ground that does not have a surface such as road, pavement or gardens that would require Southern Water to incur a material cost to reinstate once the work had been completed.

Further information request to Southern Water

- 2.21 On 11 January 2017, we raised some further questions with Southern Water in a telephone call and by email. On 26 January 2017, Southern Water responded to these questions. Below we set out the issues that we asked Southern Water for more information on:
- a. Why there was a 23.87% uplift on the costs incurred by the contractor that undertook the engineering works that Southern Water included in the costs to the Complainant? Southern Water confirmed this was to cover the costs of various activities undertaken by its developer services team;
 - b. A more detailed breakdown of the costs incurred in providing the Connections, including separating out the material and labour costs and separating the metering costs and the costs associated with making the Connections. This is provided in Tables 3 and 4;
 - c. A description of what was meant by the water and wastewater capacity charges. Southern Water confirmed that these are effectively infrastructure charges which are levied on non-domestic supplies;
 - d. Evidence to show whether the point of connection for Block B altered between the Quotations and the actual connection work and how any change impacted the costs of providing this connection compared to the Quotations. This is discussed in detail in sections 6.15 to 6.17; and
 - e. Evidence to demonstrate that Southern Water undertook the trench excavation work that was included in the final costs to the customer. Southern Water confirmed that the Complainant dug and back filled the trench that was required to make the connection between the properties and the existing Southern Water main.

Table 3: Breakdown of the actual costs incurred by Southern Water for Block A

Description	Cost
Trench inspection fee	£82
Construction admin fee (first plot)	£48.84
Construction admin fee (additional 66 plots)	£2,462.46
Communication pipe cost	£5.44
Communication pipe installation cost	£1,115.81
Water meter cost	£6,296.66
Water meter installation cost	£5,006.91

23.87% uplift on the direct costs of undertaking the work to cover the developer team's overhead costs.	£2,965.80
66 Water infrastructure charges	£23,356.08
66 Wastewater infrastructure charges	£23,356.08
Water capacity charge (due to the Landlord supply)	£353.88
Wastewater capacity charge (due to the Landlord supply)	£353.88
Total VAT	£53.57
Total Charge	£65,450.84³

Table 4: Breakdown of the actual costs incurred by Southern Water for Block B

Description	Cost
Trench inspection fee	£82
Construction admin fee (first plot)	£48.84
Construction admin fee (additional 26 plots)	£970.06
Communication pipe cost ⁴	£3.70
Communication pipe installation cost	£769.56
Water meter cost	£2,537.46
Water meter installation cost	£2,017.71
23.87% uplift on the direct costs of undertaking the work to cover the developer team's overhead costs.	£1,271.90
66 Water infrastructure charges	£9,200.88
66 Wastewater infrastructure charges	£9,200.88
Water capacity charge (due to the Landlord supply)	£353.88
Wastewater capacity charge (due to the Landlord supply)	£353.88
Total VAT	£56.96
Total Charge	£26,863.18⁵

2.22 Further detail about this response is set out in section 6.

³ The sum of all of the values in the table is £65,457.41 and is based on the information provided by Southern Water in its responses to our requests for information. The total charge presented in this table is the total charge that Southern Water calculated. It appears that the slight difference between these two calculations comes from the calculation of the 23.87% uplift to the costs incurred by the developer.

⁴ Southern Water did not include this cost in their calculation of the cost to provide the connections to Block B

⁵ The total cost calculated using the values in the table is £26,867.71 compared to a total cost of £26,863.18 reported by Southern Water. This is due to the inclusion of the communication pipe material cost which was missing in Southern Water's calculation as well as an £0.83 difference which is assumed to be due to rounding errors.

3. Legal framework

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

4. Jurisdiction to determine the complaint

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

- a. The Complainant required Southern Water to make the Connections;
- b. Southern Water treated this as a request for new connections under section 45 of the Act; and
- c. The charge raised by Southern Water is disputed as being excessive by the Complainant.

5. Draft determination

- 5.1 On 17 March 2017, we issued a draft determination to the Parties. The determination considered:
- a. The reasonableness of the total amount the Complainant was required to pay to Southern Water for the works involved in making the Connections; and
 - b. The reasonableness of the amount the Complainant was required to pay to Southern Water for administrative costs associated with providing the Connections, which included construction administration costs as well as costs associated with the overhead costs incurred by the developer services team;
- 5.2 We considered these costs against the benchmark costs in the Hyder report⁶ and the Review of Section 45 Costs Report⁷ to assess their reasonableness.
- 5.3 After considering the evidence provided to us by the Parties, and the conclusions from the two benchmarking reports, we provisionally determined that:
- The total expenses Southern Water can reasonably recover from the Complainant for making the connections to Block A are £13,895.62. Southern Water must therefore return £4,081.73 to the Complainant;
 - The total expenses Southern Water can reasonably recover from the Complainant for making the connections to Block B are £5,914.74. Southern Water must therefore return £1,781.96 to the Complainant; and
 - In line with our guidance on interest rates set out in [Ofwat's Information Notice 11/05](#), Southern Water must calculate the interest due to the Complainant, and reissue a final invoice to the Complainant within 20 working days of our final determination.

⁶ The Hyder Report - A Comparative Study: Cost of new water supply connections work (24 March 2010) <http://www.ofwat.gov.uk/publication/comparative-study-cost-new-water-supply-connections-work-final-report/>

⁷ Review of Section 45 costs – Independent review on behalf of the Water Services Regulation Authority (Ofwat) by MW Barber Associates - http://www.ofwat.gov.uk/wp-content/uploads/2015/10/rpt_com201404s45costs.pdf

A. Complainant's representation

5.4 The Complainant responded on 7 April 2017 and raised the following concerns:

- It believes that the Hyder report is an inappropriate benchmark for assessing the costs of installing internal meters. It believes that the cost of installing an internal meter is significantly lower than the cost of installing an external meter and that the costs in the Hyder report refer to externally installed meters only. As the meters for the Connections were all internal meters, it believes that the metering costs should be lower;
- It highlighted the fact that it, rather than Southern Water, installed the meter carriers⁸ to the internal pipework within Blocks A and B. Southern Water only installed the meters;
- It believes that it took two people around 10 hours to install the 94 water meters at the two blocks, which it believes suggests an hourly charge of £702 for two people to carry out this work, which it believes is excessive;
- It raised concerns that it had requested to install the meters itself rather than the installation being carried out by Southern Water. The Complainant believes that it could have saved money by carrying out this work itself; and
- It believes that the charge for each meter is significantly above the price at which the meters can be purchased.

5.5 The Complainant also raised concerns that the 23.87% uplift was included in the charges for the Diversion which it had previously requested Southern Water to undertake. However this is not within the scope of this determination.

B. Southern Water's representation

5.6 Southern Water welcomed the conclusions of the draft determination regarding the cost for the works involved in making the Connections.

⁸ Meter carriers are devices that allow a water meter to be attached to a water pipe.

- 5.7 Southern Water challenged the conclusions of the draft determination with regard to the administration fees and the developer services team overheads. Southern Water questioned how the costs of £33.16 for the first connection and £20.54 for subsequent connections were derived from the Review of Section 45 Costs report. It also challenged our use of the conclusions of this report as a fixed figure with which all companies are required to comply rather than as guidance.
- 5.8 Southern Water also raised concerns that the administrative costs allowed in the draft determination are insufficient to cover the costs of funding the range of developer services activities which Southern Water carries out. Southern Water does not accept that these costs should be borne entirely by the generality of its domestic and non-household customers who do not benefit directly from new connections.

C. Further request for information

- 5.9 In order to address the concerns raised by the Parties in their responses to the draft determination, on 27 April 2017, we issued a further request for information to Southern Water.
- 5.10 In the request for information, we asked Southern Water to provide more evidence regarding the costs incurred in purchasing and installing the meters. We also asked for more evidence to support the construction administration fee and the developer services overhead fee that Southern Water had originally charged to the Complainant. Southern Water responded to the request for information on 12 May 2017.
- 5.11 Regarding the costs of supplying and installing the meters, Southern Water said that it uses a competitively tendered framework agreement to find a delivery partner to carry out the work. As a result, it believes that the prices it charges should reflect the market rate for both the work undertaken and the cost of the meters. Southern Water also provided evidence to show that the installation of the meters had taken 29 person-hours to complete, including off-site activities such as travel time and loading and unloading of equipment.
- 5.12 Southern Water did not challenge the Complainant's assertion that the Complainant installed the water meter carriers rather than Southern Water. However, Southern Water said that no costs associated with the installation of the carriers were included in the charges to the Complainant.

5.13 Southern Water divides the administrative costs it incurs when undertaking new connections work into two general categories, construction administration fees and developer services team overheads.

5.14 The construction administration fee of £48.84 for the first connection and £37.31 for each subsequent connection is calculated as a proportion of the costs incurred in providing the following services:

- initial processing of requests;
- liaison with the contractor and customer and any additional enquiries the customer or developer may have; and
- required updates to Southern Water's developer services system such as its New Connections Database that tracks the work and the actions required.

5.15 The developer services overheads fee, which is not tailored to specific sites nor specific project types, is a percentage fee which is charged as a 23.87% increase in the construction costs based on the average time dedicated to delivering the following activities:

- Management of contractor contracts;
- Distribution County Engineers (inspection before connections are made);
- Staff costs of Developer Services Team assigned specifically to new water connections;
- Data Reporting Team, which comprises of updating billing systems, such as adding the new premise and meter details to the system for billing purposes; and
- Developer services work pack which comprises ensuring the quotation and relevant documentation relating to the development has been progressed through its life cycle.

D. Our response to the representations

Metering costs

- 5.16 We consider that, on the basis of the information provided by Southern Water, the costs associated with providing the water meters and installing them at the Site are reasonable. As we set out in the draft determination, 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. From the additional information provided by Southern Water on the number of hours taken to carry out this work, and our own assessment of the costs of providing the new connection using the Hyder Report as a basis, we do not consider that there is compelling evidence to demonstrate that the costs associated with procuring and installing the meters is excessive.
- 5.17 The Complainant has questioned whether the Hyder Report is an appropriate benchmark to use for internally installed meters. The Hyder Report does not specify that it is only applicable for cases that involve externally installed meters. In many new connections there will be factors that will increase or decrease the actual cost of providing the new connections. The report is designed to give a benchmark against which the costs in a specific case can be compared to determine whether the costs presented appear to be excessive. As a result, we do not consider the report to be an inappropriate benchmark to use for assessing the costs of the Connections.

Construction administration fee

- 5.18 In the draft determination we provisionally determined that the construction administration fee should be £33.16 for the first connection and £20.54 for subsequent connections, based on the Review of Section 45 Costs report. The report recommends that the acceptable overall administration cost for a first new connection should be £105.30 and £64.29 for each subsequent connection. It also sets out that of this overall administration cost, the application fee should be £72.14 for the first connection and £43.75 for each subsequent connection. The appropriate construction administration fee is, therefore, calculated as the overall fee less the application fee for each connection.
- 5.19 Southern Water's view was that it could not provide a full representation on this aspect of the draft determination without understanding how these values were derived. However, we consider that this should not have prevented

Southern Water providing any available evidence it had to demonstrate what administrative costs it incurred in providing the Connections. It did not do this.

5.20 While Southern Water has indicated that the construction administration fee covers activities including “Initial processing of requests”, we note that Southern Water also requires that anyone requesting a new connection pays a separate application fee which is assumed will cover the initial processing of the request.

5.21 As a result, we do not consider that Southern Water has provided compelling evidence to demonstrate why the construction administration fee should be greater than £33.16 for the first connection and £20.54 for subsequent connections, as derived from the Review of Section 45 Costs report.

Developer services team overheads

5.22 Southern Water has stated that it believes that a reasonable share of the costs associated with the overheads incurred by its developer services team should be borne by developers rather than being borne by the generality of its customers (entirely by domestic and non-household customers who do not benefit directly from new connections.)

5.23 We agree that section 45 of the Act does not prevent costs such as these from being included in the charges for new connections. However, to justify including such costs in the charges for new connections, we would require compelling evidence to demonstrate:

- The costs incurred by the water company;
- Why these activities were necessary in order to provide the customer with the new connection; and
- How any costs that were not clearly incurred as a direct result of a specific requested new connection were allocated across the various activities undertaken by the developer services team and turned into a specific cost that relates to the specific new connection request.

5.24 In this case, Southern Water has not provided compelling evidence to demonstrate why these costs should be included in the charges for the Connections.

5.25 We note that the 23.87% uplift that Southern Water includes in its charges for new connections has not been included in several previous determinations we have made due to a lack of compelling evidence to include these costs.

6. Final determination

- 6.1 In determining the reasonableness of the costs associated with the Connections, we have considered the reasonableness of the costs charged by Southern Water, as set out in tables 3 and 4.
- 6.2 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.
- 6.3 In order to assess the reasonableness of costs incurred in disputes of this nature, we use two benchmark reports:
- the ‘Hyder Report’, which sets out reasonable costs of making connections in different scenarios;⁹ and
 - the ‘Review of Section 45 Costs’ which looks at reasonable administration/overhead fees.¹⁰

A. The works

- 6.4 We have considered whether the actual costs of the works incurred by Southern Water (£65,450.84 for Block A and £26,863.18 for Block B) reflect expenses reasonably incurred. To do this, we used the Hyder Report as guidance.
- 6.5 The Hyder Report is an independent report we commissioned 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:
- a. to obtain an understanding and explanation of the variance in charges between water companies;

⁹ The Hyder Report - A Comparative Study: Cost of new water supply connections work (24 March 2010) <http://www.ofwat.gov.uk/publication/comparative-study-cost-new-water-supply-connections-work-final-report/>

¹⁰ Review of Section 45 costs – Independent review on behalf of the Water Services Regulation Authority (Ofwat) by MW Barber Associates - http://www.ofwat.gov.uk/wp-content/uploads/2015/10/rpt_com201404s45costs.pdf

- b. to compare water company contractor rates for new water connections; and
 - c. thereby, to obtain an understanding of what are reasonable costs/charges for materials (e.g. pipework, meters, etc.) and for labour.
- 6.6 The majority of new connection disputes we determine involve one single new connection and we assess the cost of physically making the connection against the benchmarking costs set out in the Hyder report. For this determination, however, we have adopted a slightly different approach. This is because, while there were 67 premises and 27 premises connected to the public water main at Block A and Block B respectively, Southern Water was only required to make one connection at each Block in order to connect all of these premises. Furthermore, the connections were significantly larger than a typical connection, and would, therefore, be more costly to provide than a typical single connection.
- 6.7 We have, therefore, assessed the connection costs for the two Blocks in two ways:
- a. Firstly, we have assessed whether the total average cost claimed per connection, including the material and installation costs of the meter and the cost of the connection of the communication pipe, is reasonable; and
 - b. Secondly, as a sense check, we have assessed whether the cost that Southern Water has claimed for the work and materials associated specifically with the connection of the communication pipe to the water main is reasonable.
- 6.8 We consider that assessing the Connections in this way is reasonable as the Connections are different from those we typically assess and this method is a better way of benchmarking the costs.

B. Block A

- 6.9 For the connection to Block A, the total cost of the connections was £12,424.82¹¹. This included:

¹¹ This value is taken from the information provided in Southern Water's response on 26 January 2017 as this is the latest and most accurate value.

- a. A 1.5m connection of 90mm communication pipe to a 6" water main in unmade ground which cost £1,115.81, plus £5.44 for the material costs of the pipe; and
 - b. The installation of 67 water meters to meter the individual flats within Block A. Southern Water charged £93.98 per meter for the material costs of the meter and carrier, plus £74.73 per meter for the costs to deliver, install and set up each meter.
- 6.10 As the amount of connections made was 67, the total average cost of each single connection was £185.45. The Hyder report only provides costs for connection lengths of 2m, 4m and 9m connections. As this connection was 1.5m, we have used 75% of the costs of a single 2m connection as an estimation of the appropriate cost. The average cost per connection is within the range we would anticipate on the basis of 75% of the costs set out in the Hyder report of between £108.03 and £205.88 per connection. Based on this, we conclude that the connection costs charged by Southern Water for the connections to Block A were reasonable.
- 6.11 We also note that Southern Water made a larger than usual connection to its water main. As this connection was 1.5m, we have used 75% of the costs of a single 2m connection as an estimation of the appropriate cost. The maximum charge for a similar single connection based on this calculation of the value given in the Hyder report is £573.75, however, the Hyder report only considers making connections that are sufficient to provide a supply to a single property. Due to the additional complexity required to make a 90mm connection to a 6" water main, we are satisfied that the actual costs incurred by Southern Water in making this connection were reasonable.
- 6.12 Southern Water also included a single trench inspection fee of £82 for the connection to Block A. We note that a similar trench inspection was included in a previous determination, which concluded that £82 was a reasonable cost for a trench inspection fee.¹² We, therefore, conclude that this cost should be included in the charges made to the Complainant.

¹² Mr O'Connor and Southern Water: Final determination of dispute determined under sections 45(6A) and 30A of the Water Industry Act 1991. <http://www.ofwat.gov.uk/publication/mr-oconnor-southern-water-final-determination-dispute-determined-sections-456a-30a-water-industry-act-1991-/>

C. Block B

- 6.13 For the connection to Block B, the total cost of the connections was £5,406.73¹³. This included:
- a. A 2m connection of 63mm communication pipe to a 3" water main in unmade ground which cost £769.56¹⁴, plus £3.70 for the material costs of the pipe¹⁵; and
 - b. The installation of 27 water meters to meter the individual flats within Block B. Southern Water charged £93.98 per meter for the material costs of the meter and carrier, plus £74.73 per meter for the costs to deliver, install and set up each meter.
- 6.14 The Complainant challenged Southern Water's assertion that the contractors dug and reinstated the trench that was required to make the connection to Southern Water's water main. On 26 January 2017, as set out in paragraph 2.12, Southern Water confirmed that the contractors did not dig or back fill this trench; this work was carried out by the Complainant. As a result, we are removing the £62.89 charge for this work from the costs to make the connection to Block B. This makes the actual connection costs incurred by Southern Water £710.37 including the material costs of the communication pipe that was not previously included in the charges set by Southern Water.
- 6.15 The Complainant also challenged why the actual costs for the connection to Block B were not different from the costs set out in the Quotations, despite the fact that the connection was made several metres closer than was set out in the Quotations.
- 6.16 We would expect changing the location of the connection point to result in a change in costs if:
- the length of the trench that had to be dug changed;
 - the length of the pipe that had to be installed changed; or

¹³ This value is taken from the information provided in Southern Water's response on 26 January 2017 as this is the latest and most accurate value. This value includes the material cost of the communications pipe and excludes the costs of the trench excavation and reinstatement that were previously included in Southern Water's costs.

¹⁴ This value is taken from the information provided in Southern Water's response on 26 January 2017 as this is the latest and most accurate value.

¹⁵ We note that Southern Water did not include the material costs of the communication pipe in the original quotation for the connections to Block B. However, we do not see a reason for not including this cost. As a result, we have added this to the costs of providing the connections to Block B.

- the change in location resulted in a different type of surface having to be reinstated.

- 6.17 Having reviewed the information provided by Southern Water, there is no indication that changing the location of the connection point resulted in a change to the reinstatement costs as the surface types at the original and revised connection locations were similar, both areas being unmade ground. Additionally, as stated in section 7.14, we have taken into account that Southern Water did not include the material costs of the pipe in the Quotations, and has now agreed that it did not incur any trench excavation costs. Taken as a whole, we consider that any change in the length of the connection pipe installed by Southern Water should not impact the total costs of this work.
- 6.18 Overall, as the amount of connections made was 27, the total average cost of each single connection was £195.02. This is within the range we would anticipate on the basis of the costs set out in the Hyder report of between £144.04 and £274.50 per connection. Based on this, we conclude that the connection costs charged by Southern Water for the connections to Block B were reasonable.
- 6.19 We also note that Southern Water made a larger than usual connection to its water main. The maximum charge for single connection given in the Hyder report is £765.00 for a 2m connection. However, the Hyder report only considers making connections that are sufficient to provide a supply to a single property. Due to the additional complexity required to make a 63mm connection to a 3" water main, we are satisfied that the actual costs incurred by Southern Water in making this connection are reasonable.
- 6.20 Southern Water also included a single trench inspection fee of £82 for the connection to Block B. We note that a similar trench inspection was included in previous determination, which concluded that £82 was a reasonable cost for a trench inspection fee.¹⁶ We conclude, therefore, that this cost should be included in the charges made to the Complainant.

D. Construction administration fees and developer services team overheads

- 6.21 Southern Water states that it incurred costs in making the Connections associated with "on or off site construction administration" of £48.84 for the

¹⁶ Mr O'Connor and Southern Water: Final determination of dispute determined under sections 45(6A) and 30A of the Water Industry Act 1991. <http://www.ofwat.gov.uk/publication/mr-oconnor-southern-water-final-determination-dispute-determined-sections-456a-30a-water-industry-act-1991-/>

- first connection to each of the two Blocks and a further cost of £37.31 for each of the subsequent connections to each of the blocks. The activities covered by this cost are set out in section 5.14, and broadly cover the direct processing of the requisition request and liaison with the customer.
- 6.22 Southern Water also added 23.87% to the direct costs incurred by the contractor in making the Connections. The activities covered by this cost are set out in section 5.15 above.
- 6.23 We have considered the reasonableness of the costs set out in paragraphs 6.21 and 6.22 using the 'Review of Section 45 Costs' report as guidance. This independent report was commissioned by Ofwat in 2013 and involved surveying five water only companies and five water and sewerage companies. Its purpose was to arrive at an average figure for overheads and administration fees charged in the context of new connections.
- 6.24 As set out in paragraph 5.188, the report recommends that the total acceptable administration cost for a new connection under section 45 of the Act should be £105.30 for the first new connection and £64.29 for any subsequent connections, both of which are inclusive of the initial application fee. The report recommends that the administration costs outside of the initial application fee should be £33.16 for the first new connection and £20.54 for any subsequent new connections.
- 6.25 Having regard to the Review of Section 45 Costs report, we conclude that Southern Water's construction administration fees of £48.84 for first connections and £37.31 for subsequent connections, plus 23.87% uplift on the contractors' costs of providing the new connections, were too high. Instead, we consider that £33.16 for the first connection and £20.54 for each subsequent connection is a reasonable charge.
- 6.26 Taking the above into account, we determine that Southern Water should charge £1,388.80 for the total administration costs to provide the new connections at Block A and £567.20 for the total administration costs to provide the new connections at Block B. Although we may allow water companies to charge above £33.16 for one connection and above £20.54 for any subsequent connections if the facts justify us doing so, we do not consider that Southern Water has made a case for why we should depart from the amounts recommended in the 'Review of Section 45 Costs' report in this case.

6.27 This approach is consistent with a previous decision made by Ofwat in relation to Southern Water's approach of adding 23.87% uplift to direct construction costs.¹⁷

E. Conclusion

6.28 After reviewing the information provided by both Parties, and using the guidance available to us, we determine that Southern Water is seeking to recover more than is reasonable for the making of the Connections. We determine, therefore, that the reasonable recoverable costs for making the connection to Block A is £13,895.62 and the reasonable recoverable costs for making the connection to Block B is £5,914.74. Our determination is summarised in Tables 5 and 6.

Table 5: Difference between the costs claimed by Southern Water and our determined reasonable charge for block A

Description	Costs claimed by Southern Water	Determined Reasonable charge	Difference
1. Trench inspection fee	£82	£82	£0
2. Construction admin fee (first plot)	£48.84	£33.16	£15.68
3. Construction admin fee (additional 66 plots)	£2,462.46	£1,355.64	£1,106.82
4. Communication pipe material and installation costs	£1,121.25	£1,121.25	£0
5. Metering material and installation costs	£11,303.57	£11,303.57	£0
6. 23.87% uplift on the costs of undertaking the work to cover the developer team's overhead costs.	£2,965.80	£0	£2,965.80
Total	£17,983.92	£13,895.62	
Difference	-	-	£4,088.30

¹⁷ <http://www.ofwat.gov.uk/complaint-southern-water-reasonableness-connection-costs/>

Table 6: Difference between the costs claimed by Southern Water and our determined reasonable charge for block B

Description	Costs claimed by Southern Water	Determined Reasonable charge	Difference
1. Trench inspection fee	£82	£82	£0
2. Construction admin fee (first plot)	£48.84	£33.16	£15.68
3. Construction admin fee (additional 66 plots)	£970.06	£534.04	£436.02
4. Communication pipe material and installation costs	£769.56	£710.37	£59.19
5. Metering material and installation costs	£4,555.17	£4,555.17	£0
6. 23.87% uplift on the costs of undertaking the work to cover the developer team's overhead costs.	£1,271.01	£0	£1,271.01
Total	£7,696.64	£5,914.74	
Difference	-	-	£1,781.90

6.29 Tables 7 and 8 reflect the amounts that the Complainant paid as a security for the works on the basis of the Quotations compared to our determination of the costs reasonably incurred in providing the works and the total amount to be refunded following our determination. We determine, therefore, that Southern Water should refund the Complainant £5,863.69 (plus interest) in total, reflecting our calculation of the amounts that are reasonably recoverable.

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

Table 7: Total refund to be paid to Complainant by Southern Water for the connections to Block A

Description	Sub-total
1. Amount paid by Complainant	£17,977.35
2. Determined amount	£13,895.62
Total refund (excluding VAT)	£4,081.73

Table 8: Total refund to be paid to Complainant by Southern Water for the connections to Block B

Description	Sub-total
3. Amount paid by Complainant	£7,696.70
4. Determined amount	£5,914.74
Total refund (excluding VAT)	£1,781.96

Appendix 1 - Guidance regarding section 48 of the Water Industry Act 1991

Tables 9 and 10 set out Ofwat's view regarding the amounts and time periods that will be relevant if a Court is asked to resolve a dispute about interest in this case.

Table 9: Interest payable to Complainant for Block A

Amounts on which interest is payable	Time periods during which interest is payable on this amount
£13,895.50 i.e. the reasonable cost of connection works as determined by Ofwat, rounded down to the nearest 50p in accordance with section 48 of the Act	From: 17 November 2015 when the Complainant made the payment for the Connections To: the date on which the supply was considered provided and money held by the company became payment rather than security but in terms of whole 3 month periods in accordance with section 48 of the Act
£4,081.50 i.e. the amount of the security deposit less the reasonable cost of works as determined by Ofwat, rounded down to the nearest 50p in accordance with section 48 of the Act	From: 17 November 2015 when the Complainant made the payment for the Connections To: the date on which £4,081.50 is returned to the customer, in terms of whole 3 month periods in accordance with section 48 of the Act

Table 10: Interest payable to Complainant for Block B

Amounts on which interest is payable	Time periods during which interest is payable on this amount
<p>£5,914.50</p> <p>i.e. the reasonable cost of connection works as determined by Ofwat, rounded down to the nearest 50p in accordance with section 48 of the Act</p>	<p>From: 17 November 2015 when the Complainant made the payment for the Connections</p> <p>To: the date on which the supply was considered provided and money held by the company became payment rather than security but in terms of whole 3 month periods in accordance with section 48 of the Act</p>
<p>£1,781.50</p> <p>i.e. the amount of the security deposit less the reasonable cost of works as determined by Ofwat, rounded down to the nearest 50p in accordance with section 48 of the Act</p>	<p>From: 17 November 2015 when the Complainant made the payment for the Connections</p> <p>To: the date on which £1,781.50 is returned to the customer, in terms of whole 3 month periods in accordance with section 48 of the Act</p>