

**[REDACTED] (SLP1) and Affinity
Water Limited**

Final determination of a dispute determined under sections 51C and 30A of the Water Industry Act 1991

Complaint against Affinity Water Limited about the calculation of asset value payments

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Summary of our final decision

This is a final determination of a dispute between [REDACTED] (SLP1) and Affinity Water Limited over the calculation of the asset value payments for works, provided under self-lay agreements, to lay new water supply connections for a site named [REDACTED]. It was referred to us for determination under sections 51C and 30A of the Water Industry Act 1991.

In summary, we determine that Affinity Water Limited's calculation of the asset value payments associated with the [REDACTED] site must include excavation, reinstatement and non-contestable costs. We also determine that reasonably incurred non-contestable costs can be deducted from the asset value payment.

Our final decision is summarised in [Chapter 6](#) of the document.

1. Introduction

A. The complaint

- 1.1 This determination concerns a dispute referred to the Water Services Regulation Authority (**Ofwat**) by [REDACTED] (SLP1) (**the Complainant**), about Affinity Water Limited (**Affinity Water**), on 24 August 2018, for determination under section 51C and section 30A of the Water Industry Act 1991 (**the Act**).
- 1.2 The dispute is about Affinity Water's calculation of the net asset value payments¹ for a development site [REDACTED] (**the Site**). The Complainant disputes the exclusion of excavation and reinstatement costs from the asset value payment calculation. The Complainant also disputes that non-contestable costs incurred by Affinity Water, are being passed on to the Complainant.
- 1.3 This determination focuses specifically on the asset value payment made by Affinity Water under a self-lay agreement dated 15 May 2016. This agreement was in relation to phase 1 of the Site. We have focused on this as it was the first phase of the Site and, as such, the phase that formed the basis of the Complainant's complaint. There were three other phases at the Site, with three separate self-lay agreements. Our understanding is that Affinity Water applied the same calculation methodology for these other self-lay agreements and, as such, our findings will apply to the calculation of asset value payments for all four of the self-lay agreements relating to the Site.

B. Overview of our decision

- 1.4 Our determination and our reasoning for it are set out in full in [Chapter 6](#) of this document, but an overview of our determination is set out below.
- 1.5 In light of the legal framework of the Act, and the evidence we have gathered from the parties to the dispute, we determine that Affinity Water's calculation of the asset value payments associated with the Site must include excavation, reinstatement and non-contestable costs. We also determine that reasonably incurred non-contestable costs can be deducted from the asset value payment.

¹ A payment made to a self-lay provider in respect of the part of a new main used to supply water for domestic purposes the self-lay provider has constructed, once it is vested in the undertaker by means of an agreement made under section 51A of the Act.

2. Background

A. The parties

Complainant

- 2.1 The Complainant is a self-lay provider (**SLP**), working on residential and commercial developments across the South East, South West and Midlands.
- 2.2 The Complainant was contracted by a developer to lay and commission the required new water mains and services for the Site.

Company

- 2.2 Affinity Water is appointed under the Act to provide water to customers in areas of Greater London and the Home Counties, as well as some areas on the South East Coast and Essex, [REDACTED]
[REDACTED]

B. The Site

- 2.3 The Site, [REDACTED]
is a new residential development [REDACTED]
- 2.4 The Site is split into four phases with Phase 1 consisting of [REDACTED]
[REDACTED]
[REDACTED]

C. The request for a water supply connection

Application and initial offer

- 2.5 On 5 February 2016, Affinity Water received a self-lay application from the Complainant in relation to Phase 1 of the Site and, on 8 February 2016, Affinity Water confirmed its acceptance of the application.
- 2.6 On 1 March 2016, Affinity Water issued its offer letter to the Complainant. In doing so, Affinity Water set out to the Complainant that, in respect of the works associated with Phase 1 of the Site, which was laying approximately 238m of 90mm pipe main, there were three payment options that applied, namely:

- A relevant deficit payment;
- A commuted sum; or
- A payment under the self-lay provisions of the Act².

2.7 Affinity Water estimated the relevant deficit to be £[REDACTED], the commuted sum to be £[REDACTED] and the asset value payment to [REDACTED]. Affinity Water noted that the estimated asset value payment was also subject to non-contestable costs.

2.8 Each of the four phases of the Site has a separate self-lay agreement between Affinity Water and the Complainant.

2.9 Following receipt of Affinity Water’s offer letter, the self-lay agreements for the separate phases associated with the Site were signed. The self-lay agreement for the first phase was signed on 15 May 2016 and the self-lay agreement for the final phase (phase 4) was signed on 19 September 2017. The table below sets out the different phases and the dates on which the associated self-lay agreements were signed.

Table 1: Self-lay agreement dates for the Site phases

Phase number	Agreement date
Phase 1	15 May 2016
Phase 2	10 November 2016
Phase 3	12 September 2017
Phase 4	19 September 2017

The works and final payments

2.10 On 15 May 2016, the mains were laid for phase 1 of the Site and, on 24 September 2018, these mains were subsequently vested in the Company.

2.11 Of the 238m of 90mm pipe mains laid, 232m were laid by the Complainant on site, and 6m were laid by Affinity Water in order to connect the Site to the

² We note that whilst the Complainant submitted a self-lay application Affinity Water responded setting out all the options for the developer. As such, it provided the Complainant with estimates for both the requisition route and the self-lay route for providing the new mains.

³ Note the figure of £[REDACTED] differs from the final asset value payment, set out in Table 2 below.

incumbent's existing network. It is the 6m of works laid by Affinity Water that accounts for Affinity Water's off-site contractor costs below.

- 2.12 To determine the final asset value payment, Affinity Water used the total scheme costs set out in the table below. These are based on the costs that Affinity Water considered would have been incurred if it had carried out all of the works itself.

Table 2: Breakdown of the estimated total scheme costs for phase 1 of the Site

Total scheme cost	Amount
On-site water mains – Affinity Water's contractor's costs	██████████
On-site water mains – Affinity Water's costs	██████████
Off-site water mains – Affinity Water's contractor's costs	██████████
Off-site water mains – Affinity Water's costs	██████████
Total	██████████

- 2.13 Affinity Water also confirmed that there were two assumptions behind the total scheme costs it had used for the calculation:

- a. The costs for the on-site water mains excluded excavation and reinstatement costs. Affinity Water has confirmed that these works were undertaken by the developer; and
- b. The costs for the off-site water mains included excavation and reinstatement costs. Affinity Water has confirmed that these works were undertaken by its own contractor.

- 2.14 As set out in paragraph 2.7 above, when providing its offer to the Complainant, Affinity Water set out that the asset value payment was subject to non-contestable costs. To determine the final asset value payment, Affinity Water subsequently excluded the 'non-contestable' costs incurred from the asset value payment calculation (through removing them from the total scheme costs) thereby passing these costs directly on to the Complainant. The table below sets out a breakdown of the non-contestable costs.

Table 3: Non-contestable costs for the Site

Activity	Amount
Design fee – for on-site and off-site mains.	████████
Pre-commencement site visit – prior to the off-site work commencing.	████████
Audit (while work in progress) – Affinity Water visiting the Site during construction of the self-laid on-site water mains to conduct a quality audit.	████████
Audit (after completion of works) – Affinity Water visiting the Site after construction works were completed.	████████
Total	████████

2.15 Taking the above into account, the table below sets out details of Affinity Water’s calculations for the final payments to the Complainant for the Site. As can be seen in Table 3, whilst Affinity Water included its contractor costs (for the off-site mains) in the asset value payment calculation it then also, subsequently, deducted the costs from the amount payable by Affinity Water to the Complainant. Affinity Water also deducted the non-contestable costs from the asset value amount payable by Affinity Water to the Complainant but had not included these in its calculation of the asset value payment.

Table 3: Final costs and payments for phase 1 of the Site

Payment	Amount
Asset value payment due to Complainant.	████████
Deduct costs for non-contestable work undertaken by Affinity Water.	████████
Deduct Affinity Water contractor costs for off-site mains.	████████
Net asset value payable by Affinity Water to the Complainant.	████████
Amount paid by Affinity Water to the Complainant.	████████

⁴ In an email dated 11 December 2018 from Affinity Water to the Complainant, the audit after works complete cost is stated to be £████████, totalling a cost of £████████. However, in Affinity Water’s response to Ofwat’s request for information the amount is stated to be £████████, making the total costs for non-contestable items to be £████████. We believe the second instance to be an error, accounting for the £████████ discrepancy.

⁵ This is the off-site water mains contractor’s cost (set out in Table 1) minus the contractor management fee of £████████. This cost was for work that Affinity Water actually undertook.

Balance (owed by Affinity Water)	██████████
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*Affinity Water had previously stated to the Complainant that there was a balance payable to Affinity Water of ██████████ in respect of Phase 1. In collating the response to this Complaint, Affinity Water has identified that it received a payment of £██████████ (excluding VAT) from the Complainant in respect of the design for Phase 1 an amount which was not previously accounted for. As such, Affinity Water acknowledges that there is currently a balance payable to the Complainant of £██████████.

- 2.16 On 31 January 2018, Affinity Water paid the Complainant a net asset value payment of £██████████. This was 80% of the estimated asset value (██████████) minus the design fee cost (██████████).

D. Request for a determination

- 2.17 On 6 August 2018, the Complainant notified Affinity Water that it considered the calculation of the asset value payment (see [Appendix 1](#)) unreasonable under sections 51C(11) and 30A of the Act. The Complainant set out that it considered the asset value payment should include excavation and reinstatement costs as these are required to provide a new main and are not excluded explicitly from section 43(4) of the Act, which refers to 'costs reasonably incurred'.
- 2.18 On 20 August 2018, Affinity Water responded to the Complainant setting out an explanation of its approach to excavation and reinstatement costs with respect to the calculation of the asset value payment. It explained that it does not accept that excavation and reinstatement are costs that are necessarily required to provide a new main.
- 2.19 Affinity Water stated that, in its experience, where mains are requisitioned under section 41 of the Act, it is exceptional for it to carry out the excavation and reinstatement for on-site water mains, since the developer for the site typically does this work. Affinity Water, therefore, considers that the calculation of asset value payments under section 51C of the Act, should exclude excavation and reinstatement costs.
- 2.20 The Complainant was not satisfied with Affinity Water's response in relation to the complaint and, on 24 August 2018, the Complainant referred its dispute with Affinity Water to Ofwat for determination.

E. Ofwat's investigation

- 2.21 On 24 August 2018, we received the complaint and, on 3 October 2018, we contacted Affinity Water to determine whether the complaint could be resolved informally.
- 2.22 On 16 October 2018, Affinity Water confirmed that it had attempted to resolve this matter informally but had reached a point where it would be helpful for Ofwat to determine the issue. As such, on 5 November 2018, we formally opened a case under section 51C of the Act, and notified the Complainant and Affinity Water. During December 2018 and January 2019 we issued information requests to the parties to gather further information required for us to consider and determine the dispute.
- 2.23 On 29 April 2019, we issued our draft determination for this case to the parties to the dispute to allow them opportunity to make representations on the determination we proposed to make.

3. Legal framework

3.1 This section outlines the key legislative provisions relevant to this case. As explained in [Chapter 4](#), above there have been some amendments to all of the provisions referred to below (other than section 30A of the Act). Depending on the provision, those amendments became effective on either 1 October 2017 or 1 April 2018. However, given the timing of this dispute, all the references below, are references to the provision prior to the amendments introduced by the Water Act 2014⁶.

A. Supplies for domestic purpose

- 3.2 Where an owner or occupier of premises requires a supply of water for premises in a particular locality (such as a development site) for domestic purposes:
- a. under section 41(2) of the Act, the owner or occupier of premises in that locality may requisition a water main from a water undertaker. Subject to the conditions set out in section 41 of the Act being fulfilled, the water undertaker is under a duty to provide the water main (**requisition**); or
 - b. the owner or occupier of the premises in that locality may choose to construct the required mains and/or service pipes themselves, with the person constructing them entering into an agreement under section 51A(1) of the Act for that infrastructure to be vested in the water undertaker at an agreed date if it is constructed in accordance with the terms of an adoption agreement agreed between the parties (**self-lay**).

B. Requisition charge

- 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 (a **requisition charge**).
- 3.4 Sections 42 – 43A of the Act 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 (that is, the bills paid by customers

⁶ See paragraph 4.1 below.

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. Where, in any of those 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.

- 3.5 Under section 42(2)(a) the owner or occupier of the premises can choose to pay the water undertaker the requisition charge either by way of an annual amount over each of the 12 years following the provision of the water main (the **relevant deficit**), or a single lump sum payment made following the provision of the water main. This 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.
- 3.6 The final requisition charge can only be requested once the water main has been provided, albeit a security payment towards this can be requested in advance by the water undertaker by virtue of section 42(1)(b) of the Act.

C. Self-lay adoption agreements (section 51A of the Act)

- 3.7 Section 51A of the Act provides that a water undertaker may agree with any person constructing or proposing to construct a water main or a service pipe for domestic purposes that, if the relevant infrastructure is constructed in accordance with the terms of its self-lay adoption agreement, the undertaker will, following completion of the work, at some specified date or event, declare the water main and/or service pipe be vested in them (otherwise termed as 'adopted').
- 3.8 Under section 51A(3) of the Act, a person proposing to construct a water main or a service pipe may make an application in writing to a water undertaker requesting them to enter into an adoption agreement under section 51A of the Act. This application must be accompanied by such information the water undertaker may reasonably require.
- 3.9 Section 51A(6) of the Act specifies that in deciding whether, or on what terms, to grant an application for an adoption agreement, the water undertaker shall have regard in particular to any effect or potential effect on the quality of water supplies and to any increased danger to life or health that it considers may result.

3.10 Section 51A(7) of the Act states that the terms of an adoption agreement under section 51A(1) of the Act relating to a water main may, in particular, include terms:

- a. for the provision (at the expense of the person constructing or proposing to construct the water main) by,
 - i. that person; or
 - ii. the water undertaker

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

- b. providing that, if the water main and the associated infrastructure are constructed in accordance with the terms of the agreement, the water undertaker will, in addition to declaring the water main to be vested in it, declare the associated infrastructure to be so vested;
- c. where the water undertaker considers that the proposed main is, or is likely to be, needed for the provision of water supply services in addition to those for which the person is proposing to construct the main:
 - i. requiring that person to construct the main in a manner differing, as regards materials or size of pipes, depth or otherwise, from the manner in which that person proposes, or could otherwise be required by the water undertaker, to construct it; and
 - ii. providing for the repayment by the water undertaker of any extra expense reasonably incurred by that person in complying with that requirement;
- d. for the connection of the new water main to the water undertaker's existing supply system at the point or points specified in the agreement; and
- e. for any service pipes which the person constructing or proposing to construct the new water main proposes to connect to that main to be constructed in accordance with the terms of the agreement and, subject to that, to be vested in the water undertaker at the same time as the main.

D. Self-lay conditions of compliance (section 51 of the Act)

- 3.11 Section 51C of the Act sets out the financial conditions of complying with an agreement to adopt self-laid mains (entered into or to be entered into under section 51A of the Act). The section provides for two financial transactions:
- a. Section 51C(2) and (3) of the Act provides for the water undertaker to recover certain costs it reasonably incurs in connection with the adopted main from the person constructing or proposing to construct that self-laid main. This is sometimes termed the “**developer payment**” and often relates to non-contestable works that only the water undertaker can provide. The water undertaker may, under section 51C(4) of the Act, require a security payment in relation to the developer payment; and
 - b. Section 51C(5) of the Act requires the water undertaker to pay the person constructing or proposing to construct the self-laid main the “**discounted offset amount**” at the point of the main being adopted. This payment is often called the “**asset value payment**”.
- 3.12 Subject to the terms of the adoption agreement agreed between the parties under section 51A of the Act, these payments can be made to/from the developer and/or the SLP who has constructed the adopted main on its behalf.
- 3.13 Sections 51C(6) – 51C(9) of the Act set out the approach to be used to calculate the discounted offset amount, which involves taking the sum of the “**estimated offsets**” for each of the twelve years following the vesting in the water undertaker of the water main. For each of the twelve years following the adoption of the main, the estimated offset is the lesser of:
- a. the estimated revenue that will be recovered by means of the adopted main for the year; and
 - b. the annual borrowing costs of a loan that would be required to cover the costs of providing the adopted main (based on the water undertaker’s estimated costs).

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

- 3.14 As a result of the two financial provisions set out above, with the potential for one payment (the asset value payment) to go from the water undertaker to the developer/SLP and another (the developer payment) from the developer/SLP to the water undertaker, where both payments are due it is common for the

water undertaker to net one payment off against the other, resulting in a single financial transaction taking place. This is sometimes called the **net asset value payment**, since it offsets the developer payment against the discounted offset amount (that is, the gross asset value payment value).

E. Self-lay conditions of compliance (section 51 of the Act)

- 3.15 The calculation of the asset value payment and developer payment rely on establishing the costs reasonably incurred in providing a new water main (the self-laid main to be adopted) and in incorporating the adopted main into the undertaker's supply system.
- 3.16 The provisions within section 51C of the Act cross-refer back to section 43 and 43A of the Act for the purposes of calculating the developer payment and the asset value payment respectively.
- 3.17 Section 51C(3) of the Act states that the developer payment comprises the costs referred to in section 43(4)(a) and (b) of the Act. The references to the new main in section 43(4)(a) and (b) of the Act are substituted as if they were references to the incorporation of the adopted main into the undertaker's supply system. This provides that the water undertaker shall take into account costs reasonably incurred in connection with the adopted main equivalent to:
- a. the costs reasonably incurred in providing such other water mains and such tanks, service reservoirs and pumping stations as it is necessary to provide in consequence of the incorporation of the adopted main into the undertaker's supply system; and
 - b. such proportion (if any) as is reasonable of the costs reasonably incurred in providing or procuring the provision of any such additional capacity in an earlier main as falls to be used in consequence of the incorporation of the adopted main into the undertaker's supply system.
- 3.18 As a result of this section, the water undertaker's calculation can include costs they reasonably incur as a result of them providing wider works or capacity (be that in new or existing / reinforced infrastructure) that may be physically located outside of the specific site / locality that is the subject of the self-lay (i.e. in the wider network), but which are considered necessary in consequence of the self-lay in order to provide a supply to that site / locality.
- 3.19 Section 51C(8) of the Act also refers back to section 43 (via section 43A) of the Act in stating that the costs used for establishing the annual borrowing costs for the asset value payment calculation should be the same as those

included for the calculation of the requisition charge. Equal treatment of the costs in this way means that the charges faced by the developer are equivalent, regardless of whether the infrastructure is requisitioned or self-laid. This ensures a level playing field in terms of the offer provided by the statutory water undertaker in this competitive market.

F. Disputes regarding self-lay agreements

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

4. Jurisdiction to determine the complaint

4.1 Section 51C of the Act (and a number of other relevant provisions) was amended by the Water Act 2014 and those amendments came into effect, for England and Wales, on either 1 October 2017 or 1 April 2018 (depending on the provision). The Commencement Order bringing all of these amendments into effect included transitional provisions setting out how adoption agreements entered into before 1 October 2017, should be dealt with⁷. In particular, article 15(1) and (2) of the Commencement Order provides that:

- 1) Before 1st April 2018, old section 51C of the Act continues to have effect in relation to an agreement under section 51A of the Act.
- 2) From 1st April 2018, the new charging rules do not apply and old section 51C of the Act continues to have effect, where before that date—
 - a) an agreement under section 51A of the Act has been made;
 - b) an appeal has been made to the Authority under old section 51B of the Act;
 - c) an application has been made to the Authority for an order under new section 51B(4) of the Act; or
 - d) a person and a relevant undertaker have agreed that old section 51C of the Act is to continue to be the basis for the calculation of charges and that the new charging rules are not to apply.

4.2 In this dispute, the self-lay agreements for the Site were entered into prior to 1 April 2018. We are, therefore, satisfied that we have jurisdiction to determine the dispute under the ‘old’ provisions of the Act.

4.3 Ofwat is satisfied that the dispute between the Complainant and Affinity Water is a dispute about whether the calculations made by Affinity Water in determining the net asset value payments to be paid to the Complainant included all reasonable costs, as specified under the Act. Ofwat, therefore, has jurisdiction to determine the dispute under the old section 51C, read with section 30A, of the Act.

4.4 Throughout this determination, references to section 51C of the Act are references to that section as it existed prior to 1 October 2017. Other provisions that have been amended are referred to in chapter 3 which deals with the relevant legal framework. All the provisions referred to in that chapter

⁷ Water Act 2014 (Commencement No. 9 and Transitional Provisions) Order 2017 SI 2017/462.

(other than section 30A of the Act) were amended to some extent by the Water Act 2014 and in all cases, the reference is to the old provision.

5. Draft determination

5.1 On 29 April 2019, we issued a draft determination to the parties to this dispute, to which both responded with representations.

A. Response from the Complainant

5.2 On 20 May 2019, the Complainant responded to the draft determination providing no challenge to its contents.

B. Response from Affinity Water

5.3 On 20 May 2019, Affinity Water responded to the draft determination raising a number of challenges:

Excavation and reinstatement costs

5.4 With regards to excavation and reinstatement costs, Affinity Water considers we have not applied the relevant provisions of the Act to this matter correctly.

5.5 Affinity Water acknowledges that excavation and reinstatement are a necessary part of the works required for the physical provision of a water main for a development. It does not consider it correct, however, that excavation and reinstatement are necessary under a water main requisition. It considers that section 41 of the Act requires that the water undertaker provides a water main and that, as a matter of strict law, this duty can be satisfied without excavation and/or reinstatement.

5.6 Affinity Water also notes that, as a matter of practice, for most requisitions, developers typically excavate trenches to accommodate water and other services for their development and carry out reinstatement of their multi-utility trenches once all the utility services are provided. Affinity Water considers that, where it is agreed (as between the developer and the water undertaker) that excavation and reinstatement are to be undertaken by the developer, these activities fall outside the work required for the water undertaker to meet the requisition duty under Section 41 of the Act.

5.7 In summary, Affinity Water's view is that:

- a. It is not permissible to read into Section 43(2) of the Act that costs incurred by a developer in excavating and reinstating trenches for the water main are "costs reasonably incurred in providing [the] main". It is only the costs

reasonably incurred by the water undertaker that fall within the ambit of the costs referred to in this subsection. Accordingly, it would not be permissible for a water undertaker to include these costs when calculating the relevant deficit for a requisitioned main; and

- b. Section 51C(8) of the Act is clear that the income offset must be calculated by reference to the (revenue and) costs that would have applied had the adopted water main been provided pursuant to a requisition. Accordingly, only those costs that would have been reasonably incurred by the water undertaker may be taken into account in calculating the asset payment.

- 5.8 Taking the above into account, Affinity Water has asked Ofwat to reconsider this aspect of the draft determination and find that the asset payment should not take into account excavation and reinstatement costs that would not have been incurred by Affinity Water had the developer requisitioned the water mains.

Non-contestable costs

- 5.9 Affinity Water accepts our findings with regards to non-contestable costs and provided no further representations.

Wider implications of the draft determination

- 5.10 Affinity Water recognises that jurisdiction for this dispute falls under Section 51C of the Act as in force prior to 1 April 2018. However, Affinity Water set out that it is concerned that the same issue of principle arises when applying [Ofwat's Charging Rules for New Connection Services](#), and it considers the approach taken in the draft determination is inconsistent with Rule 30 of those Charging Rules.

6. Final determination

- 6.1 We set out our final determination in this chapter. It has been informed by the legal framework, as set out in [Chapter 3](#), and the evidence and representations provided to us by both parties.
- 6.2 Our determination focuses on whether the disputed costs (i.e. the excavation, reinstatement and non-contestable costs) should be included in the calculation of the asset value payments for the Site. Our determination also looks at whether or not Affinity Water was correct to deduct its non-contestable costs from the asset value payment due to the Complainant. We are not, however, determining the level of the net asset value payment itself. We expect Affinity Water to calculate this value on the basis of the conclusions of this determination.

A. Excavation and reinstatement costs

- 6.3 As set out above, the Complainant considers that the costs for excavation and reinstatement are costs that are reasonably incurred in providing a water main and, as such, are required to be included in the asset value payment calculation.
- 6.4 Affinity Water, however, considers that the calculation of the asset value payment should not include excavation and reinstatement costs. It says that in its experience, it is wholly exceptional where mains are requisitioned under section 41 of the Act, for it to carry out the excavation and reinstatement for on-site water mains and these costs are therefore not necessarily required to provide a new main.
- 6.5 It considers that if excavation and reinstatement costs were to be included then this would have the effect of SLPs receiving value through the asset value payment for works that would not have been undertaken pursuant to a requisition. In contrast, it considers that developers requisitioning mains would not derive this value because, under section 42 of the Act, Affinity Water would be specifically precluded from including any costs that it had not incurred. Taking this into account, Affinity Water considers the principle must be for the two sections of the Act to operate in an equivalent manner, which it considers would not be the case if Affinity Water included excavation and reinstatement costs in the calculation of the asset value payment.

- 6.6 Taking the above into account, Affinity Water considers that its exclusion of the excavation and reinstatement costs from the asset value payment calculation is reasonable and lawful under the Act.
- 6.7 In its response to our draft determination Affinity Water restated its position that it does not consider excavation and reinstatement to be necessary works in the laying of water mains in all cases and that, therefore, it does not consider these reasonable costs to include in the asset value payment calculation.
- 6.8 Affinity Water has set out to us that it considers that where it is agreed that excavation and reinstatement are to be undertaken by a developer, these activities then fall outside of the work required for the water undertaker to meet its duty under the Act. That is, Affinity Water considers that the duty to provide a water main in the Act can be satisfied without excavation and/or reinstatement.
- 6.9 We do not consider this position to be correct. Where excavation and reinstatement works are needed to provide a main, they can be provided by the developer, a SLP or the undertaker. In circumstances where a developer chooses not to carry out these activities itself (or via a SLP), the water undertaker would be obliged to do so in order to fulfil its obligations under the requisition request.
- 6.10 Affinity Water accepts the principle of equivalence, set out in paragraph 3.19 above, that is, that in order to establish a level playing field, the charges faced by the developer are equivalent, regardless of whether the infrastructure is requisitioned or self-laid. It argues that this equivalence is not achieved if excavation and reinstatement costs are included the calculation of the asset value payment. For the reasons that follow, we disagree with this view and consider that equivalence can only be achieved if these costs are included in the asset value payment calculation.
- 6.11 In calculating the asset value payment, there must be equivalence between the costs that would have been incurred had the undertaker provided the main under a requisition, and the costs due to the developer or SLP as an asset payment. If the undertaker had provided the main itself, it would have had to excavate and reinstate the site, unless it had entered into a commercial agreement with the developer to the contrary. The fact that there could be a commercial agreement under a requisition scenario (for a developer to carry out excavation and other works itself) is irrelevant for calculating the asset value payment. The comparator here is the undertaker carrying out all elements of a requisition.

- 6.12 We also disagree that there is no value to the developer or SLP of entering into such a commercial agreement. A developer will only enter into such an agreement if it will benefit from such an agreement, and entering into such an agreement lowers the calculation of the borrowing costs, also providing value to the developer. Excavation and reinstatement would have been necessary under a requisition, and for the purposes of the Act it does not matter whether these works are carried out by the developer or by Affinity Water. Therefore, these costs should be included in the costs reasonably incurred used for the asset value calculation.
- 6.13 Taking the above into account, we consider the costs reasonably incurred (i.e. the total scheme costs set out in Table 2) used to calculate the asset value payment should include excavation and reinstatement costs including those relating specifically to the provision of the on-site mains as these would have been incurred had the main been requisitioned.
- 6.14 We also consider that if not explicit in the agreement under section 51A of the Act, how the SLP and its developer customer choose to split the completion of excavation and reinstatement works on the site, or to share the resulting value derived through the asset value payment, is a matter for their own commercial agreement. Affinity Water has no role in this separate commercial agreement. Its role is limited to the arrangements of, and parties to, the agreement under section 51A of the Act.

B. Non-contestable costs

- 6.15 As set out above, Affinity Water has excluded certain non-contestable costs (see **Table 3**) associated with the Site from the asset value payment calculation. Affinity Water has also deducted these costs from the amount payable by Affinity Water to the Complainant and it has provided evidence, in the form of its correspondence with the Complainant in regards to another site and self-lay scheme, in support of its reasoning for this.
- 6.16 In this correspondence, Affinity Water set out that where it has carried out work to incorporate new mains into its system, including work in designing, undertaking, supervising and commissioning works, then it can recover this back from the developer under section 51C(3) of the Act – that is, that these are costs incurred to incorporate the adopted mains into Affinity Water’s network.
- 6.17 The Complainant considers, however, that the items that Affinity Water is classifying as non-contestable (design, site visit and audits) are required to

provide a new main and, therefore, fall into the definition of section 43(4)(a) of the Act and should be included within the asset value payment calculation.

- 6.18 We recognise that when water companies or SLPs provide new infrastructure their costs are not limited to construction costs, such as materials and labour. They inevitably incur additional costs that are essential to providing the works, such as costs relating to design, inspections and water sampling and other costs. Where they are reasonably incurred we consider that such costs will be part of the costs incurred in providing works.
- 6.19 As set out above, Affinity Water and the Complainant made no representations with regards to our conclusion on non-contestable costs. As such, taking the above into account, we consider the costs reasonably incurred (i.e. the total scheme costs set out in **Table 2**) used to calculate the asset value payment should include the non-contestable costs (see **Table 3**) as these should form part of (rather than being additional to) the costs Affinity Water would have incurred in providing the main, if it had been requisitioned.
- 6.20 We also consider, that these costs were reasonably incurred costs, under section 51C(3) of the Act, and Affinity Water is, therefore, correct to deduct these from the asset value payment due to the Complainant.

C. Wider implications of the draft determination

- 6.21 Our jurisdiction in this case, as set out above (see **Chapter 4**), falls under Section 51C of the Act as it existed prior to the amendments introduced to the Act by the Water Act 2014. The amendments introduced by the Water Act 2014 provide that Ofwat may issue charging rules in connection with adoption agreements (see section 51CD). Ofwat issued charging rules under this provision and those rules came into effect on 1 April 2018 (Ofwat's Charging Rules for New Connection Services).
- 6.22 In its response to the draft determination, Affinity Water stated its concern that the approach taken in the draft determination is inconsistent with Rule 30 of the Charging Rules⁸. Affinity Water's concern is that the methodology for calculating the income offset and asset payment would not meet the requirements of Rule 30 where the developer carries out the excavation and reinstatement, which it believes to be in the majority of cases.
- 6.23 Affinity Water appears to make a distinction between the asset value payment made if the work is done by the developer as opposed to an SLP. The Act

⁸ Rule 30 of the charging rules for new connection services sets out the methodology for the calculation of income offsetting arrangements. See link [here](#) to the charging rules.

does not recognise that distinction. The relationship between the developer and the SLP is a commercial relationship and has no impact on the application of the legislation in determining appropriate asset value payments.

- 6.24 This determination has looked specifically at the complaint referred to Ofwat on 24 August 2018. Our determination is limited to the facts of this case and because it has been made under the legal regime that existed prior to April 2018. As this regime was more prescriptive than the current arrangements, it is unlikely to have a lot of relevance for the determination of future disputes. However, what will remain relevant is the principle set out in the Charging Rules that “Charges (including any Income Offsets), any Asset Payments and arrangements for when they are each payable must be set in accordance with the principle that they should promote effective competition for Contestable Work.”

D. Conclusion

- 6.25 Taking the above into account, we conclude that, in relation to phase 1 of the Site, Affinity Water’s calculation of the asset value payment must include reasonably incurred excavation, reinstatement and non-contestable costs.
- 6.26 We also consider that, in relation to phase 1 of the Site, Affinity Water is permitted, under section 51C(3) of the Act, to deduct its contractor costs (for the off-site water mains), and its reasonably incurred non-contestable costs, from the asset value payment payable by Affinity Water to the Complainant.
- 6.27 Within 20 working days of our final determination, Affinity Water should provide the Complainant with details of its final calculation of the asset value payments associated with all four phases for the Site, clearly reflecting the inclusion of the costs referred to above and make any resulting adjustments in payment due to the Complainant.

Appendix 1 – Asset value payment calculation

Total scheme cost (inc Network Reinforcement)	
Number of properties	
Average income per property	
Interest rate for borrowing	
Discount rate	
Long term annual inflation	
Number of applicable years	
Annuity Factor	
Annual Repayment (total scheme cost/annuity factor)	
Year	Connection Rate (As Per Application)
	1
	2
	3
	4
	5
	6
	7
	8
	9
	10
	11
	12



Site Location							
Scheme Number							
Developer's Name							
Mains Laying Start Date							
Forecast Completion Date							
					Option 1 Payment over 12 years	Option 2 Statutory Commuted Sum	Option 3 Self-Lay
Year	Projected Future Revenue	Annual borrowing Costs	Income Allowance	Discount Factor	Projected Relevant Deficit payable by developer	Projected statutory commuted sum payable by developer	Projected Asset Payment by Affinity
	A	B	C	E	D	F	G
			Lesser of A & B	Prescribed by OFWAT	B - C	D x E	C x E
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
Total							

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