

New Customer Contributions

South East Water supplementary submission to the Essential Services Commission
2013 Water Plan– New Customer Contributions



South East Water welcomes the opportunity to provide a supplementary submission to the Essential Services Commission (the Commission) *2013 Water Plan*. This submission sets out South East Water's approach to the New Customer Contributions (NCC) framework, charges, negotiation protocol and revised regulatory asset base for the 2013 regulatory period.

South East Water's NCC submission has been prepared with reference to ensuring compliance with requirements of the *Water Act 1989*, *Water Industry Regulatory Order 2012 (WIRO)*, The Victorian Government's *Living Melbourne Living Victoria Roadmap Recommendations* and guidance issued by the Commission. As per the Commission's guidance, South East Water is proposing a framework and model that demonstrates unequivocal alignment with legal, policy and regulatory frameworks¹.

South East Water considers that NCCs play an important role in sending price signals to developers to develop land where it is most efficient to connect to South East Water's water, sewer and recycled water networks. South East Water also believes it is reasonable to fund a proportion of network expansion costs via NCCs funded from new customers.

South East Water's Proposed NCC Framework

South East Water's proposal for the 2013 regulatory period is to calculate NCCs consistent with approaches taken by the Economic Regulation Authority of Western Australia (ERA) NCC Model and Melbourne Water's (MW) Drainage NCC model for calculating NCCs, which both use only capital costs.

The ERA Model for calculating NCCs can broadly be described as water businesses distribution (or "shared") asset expenditure divided by the forecast number of lots, over a set time period. MW's Drainage NCC model as South East Water understands, takes the expected drainage asset expenditure for a drainage scheme divided by the number of developable hectares within the scheme over its life. South East Water believes these approaches provide strong coverage of *Water Act* requirements, the WIRO pricing principles, Victorian Governments *Living Melbourne Living Victoria Roadmap Recommendations*, and Guidance issued by the Commission, including:

- Efficiency – provides cost reflective price signals
- Fair and reasonable – contribution to capital costs
- Equity – provides equity between developments and existing and new customers
- Consistency – provides a single model for water businesses to calculate NCCs
- Transparency and Accountability – ease of understanding to show costs and service received
- Administrative Ease – simple model to apply and calculate NCCs (for each service)
- Aligns with MAC recommendations – geographic and cost reflective developer charges, and consistent with the MW drainage model and Local Government Capital Contributions model
- Legislative compliance – complies with *Water Act* requirements to only use capital costs

Based on application of the above principles to the ERA and MW model for calculating NCCs, South East Water proposes a hybrid capital NCC model over a 15 year period (5 years back and 10 years forward). This would reduce potential large price movements between regulatory periods. South East Water proposes for the 2013 regulatory period, to use a 4 year historical period, consistent with South East Water's 2009 Price Determination term.

The high level outline of South East Water's hybrid ERA model is summarised below.

$$NCC = \frac{NPV(\text{Sum (15 [past 5 years and forward 10 years] year Distribution Capex)}) \times IGF}{\text{Lot Growth (past 5 years actuals and 10 year forecasts)}}$$

South East Water's approach at a high level is for the above to be applied for each service (water, sewerage and recycled water). South East Water believes an Intergenerational Equity Factor (IGF), needs to be applied to our

¹ Essential Services Commission 2012, *Guidance Paper – New Customer Contributions*, August 2012, P V

NCC model due to the long lived nature of the assets South East Water builds and operates. A proportion of these costs should be funded by future customers receiving benefit, through ongoing tariffs and charges – South East Water considers the appropriate IGF to recover 70% of “shared” asset costs upfront with the remainder collected over time.

Based on the hybrid capital model, South East Water proposes three geographic based sets of NCCs, to best match legal, policy and regulatory requirements, as follows.

- Officer – Pakenham (or Cardinia) growth corridor
- Cranbourne (Casey) growth corridor
- Infill area (covering all other areas, excluding backlog sewer lots)

The basis of South East Water’s justification for setting three geographic areas for NCC per service include:

- 1) Geographically distinct growth areas
- 2) Level of integrated network investment to service growth
- 3) Adjustment for developments seeking alternative levels of service
- 4) The level of administrative simplicity

South East Water’s lot growth forecasts are consistent with our 2013 Water Plan submission which relies on Victoria in Future 2012 to forecast lot growth. South East Water’s lot growth for the Officer-Pakenham and Cranbourne corridors is based on the respective Shire of Cardinia and City of Casey Victoria in Future 2012 lot growth forecasts.

South East Water proposes that the below NCCs are set for each service per lot in 2013/14 (2012/13 Dollars), with an annual CPI adjustment.

| NCC per Lot | Water | Sewer | Recycled Water | Total Per Lot Charge |
|---------------------------------------|---------|---------|----------------|----------------------|
| Officer – Pakenham | \$1,324 | \$2,632 | \$1,991 | \$5,947 |
| Cranbourne | \$821 | \$1,785 | \$2,023 | \$4,630 |
| Infill (excluding backlog sewer lots) | \$401 | \$727 | N/A | \$1,129 |

South East Water customer contributions as a result of our NCC framework proposal are expected to change as follows:

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 |
|----------------------------|-----------|----------|----------|----------|----------|
| 2013 Water Plan Submission | \$ 22.39M | \$27.96M | \$27.65M | \$22.41M | \$22.35M |
| Revised NCC submission | \$32.76M | \$38.41M | \$38.22M | \$32.41 | \$32.48M |

Commission Guidance Paper August 2012

South East Water has adopted an alternative approach, to the proposed approach in the Commission’s August 2012 Guidance Paper. South East Water believes its proposal better reflects:

- *Water Act 1989* requirements (capital cost recovery – discussed latter);
- Ministerial Advisory Council *Living Melbourne Living Victoria Roadmap Recommendations*; and
- WIRO requirements, including providing incentives and signals for the costs of serving new development.

In the Commission's August 2012 *Guidance Paper: New Customer Contributions*, the Commission raised a number of key comments against the proposed approach by South East Water, these issues are addressed individually as follows.

"the ...model would not be permissible, as it does not take into account benefits that accrue to new and existing customers as a result of the connection"

South East Water strongly opposes this contention by the Commission, as when ongoing tariffs are set, South East Water recognises and accrues the benefits of customer growth to new and existing customers. That is ongoing tariffs (fixed and variable prices) are lower than they would otherwise be, as part of the regulatory 'building blocks model'. The inclusion of expected growth in customer numbers over a regulatory period, results in benefits to all customers (new and existing).

"the model SEW proposes would not meet the Ministerial Advisory Council's objective of allowing innovations in connection solutions and Integrated Water Cycle Management"

South East Water disagrees with the Commission's statement that South East Water's proposed NCC model does not meet the Ministerial Advisory Council's objective of allowing innovations in connection solutions and Integrated Water Cycle Management (IWCM). As discussed within South East Water's submission, our NCC model and framework proposal allows reassessment (or discount) of an individual developments NCC charges, where an innovative connection or IWCM solution lead to a substantive material change in the distribution (or 'shared') assets (individual services) required to service a development.

"the statutory requirements of the Water Act do not contemplate limiting recoverable connection costs to distribution costs"

South East Water contends that its Hybrid Capital NCC model complies with the Section 268 (1) and similar sections Section 269 (1) and Section 270 (1) of the *Water Act*, in that they provide for the recovery of a contribution for the direct or indirect costs associated with connecting a new customer to South East Water's network(s). This is that:

An Authority that intends to provide services which will benefit a property may, by notice in writing require the owner of the property to meet or contribute to the present day costs of any works that are used or will be able to be used directly or indirectly for the provision of those services, and any fireplugs attached to those works.²

Further to Sections 268 (1), 269 (1) and 270 (1), the *Water Act 1989* provides special meaning to the definition of 'works', in Section 3 'definitions' rather than a common meaning, which describes 'works' as:

Works includes –

- (a) Reservoirs, dams, bores, channels, sewers, drains, pipes, conduits, fire plugs, machinery, equipment and apparatus, whether on, above, or under land; and
- (b) Works described in section 10, whether on, above or under land; and
- (c) Fencing;

Section 10 Rights to construct or operate works

- (1) An Authority or any other person may, in accordance with this Act, construct or operate works for, or which may result in –
 - (a) The drainage of land; or
 - (b) The collection, storage, taking, use or distribution of any water; or
 - (c) The obstruction or deflection of the flow of any water.

² *Water Act 1989 Section 268 (1)*

South East Water proposes to continue the current approach of applying 'bring forward' charges at the Water Authority level, where the criteria for applying a 'bring forward' charge is met. Where developers dispute the timing of a 'bring forward' charge applied by South East Water, they will continue to have the right to seek the Commission's arbitration of the 'bring forward' charge.

Transition

South East Water proposes that the new charges will take effect on 1 July 2013 for each of the geographic areas. Where South East Water has existing developments deeds on offer to customers, the NCC charges contained within them will be honoured until the 3 month expiry of the development deed offer.

South East Water believes a transition period for its new NCC charges would create perverse incentives for developers to "bring forward" standard developments applications to avoid changes in charges.

Appeals

As noted in previous submissions to the Commission, we opposed the Commission's proposal to "step back" from direct involvement and oversight of the NCC area, with the Commission's current role to be replaced by a set of negotiating principles with recourse by developers to appeal prices directly to the Victorian Civil and Administrative Tribunal (VCAT). South East Water does not believe that the Commission can absolve itself from adjudicating on its own Price Determinations and Decisions, prior to developers having the right to seek recourse at VCAT. South East Water will continue to seek the Commission's direction as to South East Water's ongoing compliance with obligations contained in our Price Determination, including developer charges.

Negotiation Protocol

South East Water proposes that the standard developer charge conditions and standard NCCs will apply in all cases, except where South East Water assesses that a non standard charge is more appropriate for a specific development or development area eg extensions to South East Water's urban growth boundaries or major redevelopment of existing areas (eg Fishermans Bend) or the inclusion of innovative connection solutions and/or IWCM, that materially change South East Waters distribution infrastructure requirements.

Attachment 1 outlines South East Water's negotiation protocol.

South East Water considers that the words '*contribution to works*', when read in conjunction with the *Water Act's* definition of '*works*' gives rise to an explicit legislative requirement that Water Authorities collect the present day cost of only capital works (direct or indirect), and thereby explicitly excluding the inclusion of operation costs and tariff revenue associated with a new connection.

South East Water accordingly considers that the *Water Act*, enables the recovery of headworks and tailworks costs, in addition to distribution costs, without inclusion or consideration of operational costs and revenue – as proposed by the Commission. However South East Water is not at his time proposing to include headworks and tailworks costs in its NCC calculations.

Asset definition

There is currently a distinction between the assets funded by South East Water and those funded by developers. We propose to retain the long term industry practice of developers paying for all water (potable and recycled water) and associated assets less than 150 mm in diameter, and all sewer and associated assets less than 225mm in diameter (reticulation size). South East Water believes that this approach is clear, reasonable and easy to administrate. South East Water will fund the larger "shared" water, sewer and recycled water assets and associated assets. This is consistent with South East Water's October 2012 Water Plan submission to the Commission.

'Brought forward' charges

A 'brought forward' charge is applied when a customer seeks to bring forward the construction of assets earlier than when South East Water had planned to construct them, within our published Development Servicing Plans (DSP). The customer is charged the cost associated with building the asset earlier to ensure the remainder of the customer base is not disadvantaged. This charge is based on the cost of South East Water borrowing the money to fund the necessary works.

At present, these charges are calculated based on the number of years the asset construction is ahead of schedule. There are three categories:

- less than five years
- six to 15 years
- greater than 16 years

This approach was introduced at the last price review and our experience is that rather than simplifying the negotiation process with developers, it actually complicates the process. South East Water's experience with the current approach is that it creates a number of perverse outcomes and does not provide the appropriate price signals to both the development industry or South East Water.

South East Water is proposing that the charge be based on the exact number of years that the development is ahead of schedule, based on the published DSP timing. This is consistent with South East Water's existing practice for 'bring forward charges' for the backlog program and the methodology used in the 2005 – 08 Price Determination. This ensures that customers whose developments are near the transition points in the above ranges (for example, six years) do not pay more than necessary. This approach provides both water businesses and the development industry with transparency as the DSPs are developed in consultation with the land development industry, other government authorities and local government. It will also facilitate development at least community cost, while providing appropriate price signals.

South East Water also proposes that where a 'bring forward' on an individual asset(s) is charged, this will be payable in addition to the standard NCCs for the development area. This approach ensures that existing customers are no worse off as a result of financing the additional costs of constructing an asset earlier than planned and developers contribute towards the costs of shared assets which benefit (directly or indirectly) their development.

DRAFT SOUTH EAST WATER NCC NEGOTIATING FRAMEWORK

1. Application of Negotiating Framework

This Negotiating Framework forms a part of South East Water's 2013 Price Determination for the 2013-2018 regulatory period.

1.1 Purpose

This Negotiating Framework sets out procedural and information requirements relevant to services to which developer charges (New Customer Contributions) apply, as defined in the Water Industry Regulatory Order (WIRO). New Customer Contributions (NCC) are levied when new connections are made to the water corporations water, sewerage and recycled water networks. The framework requires South East Water and any Connection Applicant to negotiate in good faith to agree the price (where the scheduled NCC charge does not apply), standards and conditions of services to be provided. It also provides for transparent information to enable the Connection Applicant to understand the reasons for decisions made by South East Water.

The requirements set out in this negotiating framework are in addition to any requirements or obligations contained in or imposed under the *Water Act 1989*, the *Planning & Environment Act 1987* (including under any planning scheme or permission), the *Subdivision Act 1988*, subordinate regulation under the described legislation as well as South East Water's *2013 Price Determination*.

In the case of inconsistency between South East Water's *2013 Price Determination* and this negotiating framework, the relevant *2013 Price Determination* will prevail.

This Negotiating Framework does not alter the rights of a Connection Applicant to seek a review of a South East Water decision by the Victorian Civil and Administrative Tribunal (VCAT).

1.2 Who this negotiating framework applies to

This Negotiating Framework applies to South East Water in dealing with any property owner - generally a property developer – that is a Connection Applicant who requests connection to South East Water's works in accordance with section 145 of the *Water Act 1989* ("Application"). This Negotiation Framework also applies to any Connection Applicant requesting connection to South East Water's work.

It also applies to South East Water in responding to such requests from a Connection Applicant.

1.3 No obligation to provide service, good faith obligation

Nothing in this negotiating framework imposes an obligation on South East Water to allow the Connection Applicant to connect to South East Water's works or provide services to the Connection Applicant.

South East Water can refuse its consent, consent, or consent subject to any terms and conditions that South East Water thinks fit, as provided under section 145(3) of the *Water Act*.

However, South East Water and the Connection Applicant must negotiate in good faith the price (where the scheduled NCC charge does not apply), terms and conditions for services sought by the Connection Applicant.

2. Timeframes

South East Water and the Connection Applicant will use their reasonable endeavours to achieve the following timeframes:

- (a) Agree the milestones, information requirements and any other relevant issues within fifteen [15] business days of South East Water's receipt of an Application. An Application, under Section 145 of the *Water Act* 1989, for connection means a servicing request made to South East Water, the details of which are provided in Section 2 of the *Land Development Manual*;
- (b) Respond to the Application giving details of the terms and conditions of the Offer to allow connection:
 - within one hundred and twenty (120) business days where a Standardised or Negotiated NCC Charge applies.
- (c) Adhere to any timetable established for negotiations and progress negotiations in an expeditious manner; and
- (d) Finalise negotiations within one hundred and twenty (120) business days of the initial Application.

2.1 Commencing, progressing and finalising negotiations

Table 1 below provides an indicative timeframe regarding the process of NCC negotiations. As mentioned above, dependant on the location and specific requirements of the development, either a standardised or a negotiated NCC will be applicable. The timeframes for these two charges will differ. It is likely that a Standardised NCC Charge which requires limited design and modelling to be undertaken by South East Water and/or the Connection Applicant may taken a shorter period of time than more complex applications made by the Connection Applicant. The timeline is presented below.

table 1 – Indicative timeframes for negotiating connection

| Step | Actions | Timing NCC Charge (less complex or complex) (Business Days from Application date) |
|------|---|---|
| 1 | Application (Section 145) for service requirements and costings of connection Application fee paid | Application date |

| Step | Actions | Timing NCC Charge (less complex or complex) (Business Days from Application date) |
|------|---|---|
| 2 | <p>Negotiation Meeting</p> <p>Parties discuss:</p> <ul style="list-style-type: none"> the nature of the services required; any additional information to be provided by the Connection Applicant; and notification and consultation with other persons potentially affected <p>Parties agree to timeframes for negotiation and consultation and milestones if different to these indicative timeframes;</p> | + 15 |
| 3 | <p>Applicant provides additional information</p> <p>Connection Applicant provides additional information to South East Water if requested</p> <p>This includes:</p> <ul style="list-style-type: none"> Original completed application; Additional information (if required); | Up to 35 |
| 4 | <p>South East Water Investigation completed</p> <p>This could include:</p> <ul style="list-style-type: none"> Where required, C=consultation with others potentially affected. Additional designs & modelling | Up to 90 |
| 5 | <p>Offer</p> <p>South East Water makes offer, including:</p> <ul style="list-style-type: none"> terms and conditions of connection; NCC (ie developer charge) to apply; and such Offer will (unless otherwise specified) expire 12 months from being made. | Up to 120 |

3. Provision of information by Connection Applicant

The Connection Applicant must provide sufficient information to enable South East Water to assess the Application and determine the service requirements and costings for the development. The information generally required by South East Water is detailed in Section 2.3 of the *Land Development Manual*.

The level of information required by South East Water, and the detail of it's response, will vary depending on the complexity and size of the development. As stated above, additional information may be sought by South East Water in the event of a Non Standardise NCC being sought.

4. Provision of information by South East Water

After consideration of servicing requests South East Water may provide an offer, via letter, draft development deed and/or notice ("Offer"). The Offer will include specific requirements for the particular development and also include various standard conditions and other information including charges and fees to achieve connection to South East Water's assets. This includes New Customer Contributions.

The information relating to the Offer is detailed in Section X of the *Land Development Manual*.

The Offer is provided by South East Water pursuant to the *South East Water 2013 Price Determination*.

5. Pricing Principles

South East Water's NCC charges will:

- (a) have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection;
- (b) Innovative connection solutions or Integrated Water Cycle Management solutions that cause substantive material changes in South East Water's distribution infrastructure requirements; and
- (c) be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

In setting charges, South East Water will also comply with:

- (a) the regulatory principles set out in clause 14 of the Water Industry Regulation Order (WIRO); and
- (b) Specific pricing principles approved by the Essential Services Commission as part of South East Water's *2013 Price Determination* applying at the relevant time.

6. Consultation with affected parties

If South East Water considers that persons other than the Connection Applicant may be affected by proposed connection services, then:

- subject to legal confidentiality requirements, South East Water will share any necessary information with others potentially affected to assess impacts
- parties will allow sufficient time for reasonable consultation with affected parties to occur.

7. Payment of South East Water's Costs

All developments of land requiring new or upgraded connection to South East Water's system will incur associated fees and charges payable to South East Water.

Fees and charges levied by South East Water are subject to approval processes under the *Water Act 1989* and/or as approved by the Essential Services Commission. Details about the fees and charges can be found in Section X of the *Land Development Manual*, titled "South East Water Fees and Charges".

Should the particular Application require a Negotiated NCC Charge, rather than the Standardised NCC this will arise from the relevant negotiation, subject to the Regulatory Instruments in place at the time.

8. Termination of negotiations

The Connection Applicant may elect not to continue with its Application and may end the negotiations by giving South East Water written notice of its decision to do so.

South East Water may terminate a negotiation under this Negotiating Framework by giving the Connection Applicant written notice of its decision to do so where:

1. South East Water believes on reasonable grounds that the Connection Applicant is not conducting the negotiation in good faith;
2. South East Water reasonably believes that the Connection Applicant and the particular development will not be able to receive a service from South East Water;
3. Where the Connection Applicant has provided false or misleading information to South East Water; or
4. An act of insolvency occurs in relation to the Connection Applicant.

9. Dispute resolution

In the event of a dispute between parties, South East Water will continue attempts to resolve the matter by negotiation.

After South East Water provides its Offer, if the Connection Applicant does not accept the Offer, generally the Connection Applicant has particular rights to seek a review in the Victorian Civil and Administrative Tribunal ("VCAT") of the terms and conditions of connection and the NCC charge applied. These VCAT review rights, including various time lines, rights and process are set out in the *Water Act 1989* and the *VCAT Act 1998*.

10. Giving notices

The address for correspondence and notices to South East Water is:

South East Water Corporation
Locked Bag 1
Moorabbin, Vic, 3189

A notice must be:

- (a) in writing and signed by a person duly authorised by the sender;
- (b) hand delivered or sent by prepaid post or facsimile to the recipient's address for Notices specified in the Information Table, as varied by any Notice given by the recipient to the sender; and
- (c) if given or received under any Regulatory Instruments or other statute of regulation must be given under the requirements of that relevant instrument, or other statute or regulation.

11. Terms and abbreviations

Applicant – The servicing request to South East Water for connection pursuant to Section 145 of the *Water Act 1989*;

South East Water – A water corporation established pursuant to Part 6 of the *Water Act 1989*;

Connection Applicant – The person making application to connect to the South East Water system.

Land Development Manual – South East Water's Land Development Manual, which outlines policies and guidelines for customers to connect to water and sewerage services, available at www.southeastwater.com.au

Standardised NCC Charge – This is the standardised charge for Connection Applicants wishing to connect to the South East Water network(s)

Negotiated NCC Charge – This charge, derived from the NCC principles developed by South East Water will apply where the Standardised NCC Charge is not applicable due to the nature and/or locality of the development or where a innovative connection solution or Integrated Water Cycle Management solution leads to substantive material change in South East Water's distribution infrastructure requirements with the Connection Applicant.