14 November 2024

The Water Team
Essential Services Commission, Victoria
(via Email: water@esc.vic.gov.au)

A submission to your **Review of New Customer Contributions (NCCs)**

Dear Marcus and the Water Team

Thank you for the opportunity to comment on your consultation paper. This submission responds to your request for perspectives on the issues raised as well as any other information you might like to consider.

I look forward to your critical assessment of my personal views together with any counter views of others.

In summary my suggestions are:

- Create a “Water Industry Standard – NCCs” to provide a sounder benchmark for communicating expectations. This will also be a basis for auditing, dispute resolution and enforcement
- Introduce an auditing, monitoring and public comparative reporting regime for all the component parts of NCCs and how they are being applied. That could include:
    - Cost allocation models
    - Development servicing plans
    - Accuracy of capex and timing estimates
    - Per lot incremental operating costs applied in NCC calculations
    - Per lot incremental revenues applied in NCCs
    - Number of standard NCC zones
    - Number of negotiated NCC cases
    - Number of disputed cases referred to a higher level in the water corporation
    - Number of disputed cases referred to an independent arbiter
    - Number of Victorian Civil and Administrative Tribunal (VCAT) cases
    - Cumulative income over multiple pricing periods from NCCs compared to price submission estimates
    - Performance statistics such as processing time and timeliness of infrastructure provision
- To create a sounder basis for consulting on a review of NCCs, commence audits etc for the first comparative report in early 2025 and use the report to identify issues, quantify differences, identify improvement opportunities and focus the content of explanatory sessions.
- Examine the distortionary effects of opening Regulated Asset Base (RABs) and corporation-wide tariffs
- Examine the “per lot” definition and its application in multi-unit developments and non-residential developments
- Examine the definition of reticulation assets, connection works and offsite works, in particular scalability of those definitions
- Develop case studies like those that existed pre-2013, but aligned with the pricing principles
- Initiate discussions with Department of Energy Environment and Climate Action (DEECA) to clarify the development co-ordination role of water corporations, through

perhaps legislation and/or subordinate instruments like the Statement of Obligations (SoO) or Letter of Expectations (LoE), as well as clarify the policy intent for beneficiaries (all customers/existing customer/new customers) of opening RABs, bulk water entitlement conversions and previous government subsidies
- Improve explanations in your final decisions

The remainder of this submission is organised to align with the questions in Box 2.1 of your Consultation Paper.

Q.1 Implementation issues

Q.1.1 Cost attribution – clarity of final decisions

1. The FTI Consulting report referenced in your Consultation Paper reflects badly on those water corporations and is sufficient justification for a move from light handed regulation to something more prescriptive. The challenge for the Commission will be to find the ‘Goldilocks’ degree of prescription.
2. The ‘additional information’ that was provided by those water corporations to the Commission in response to the FTI Consulting report is not clear and its impact not discernible. Does that mean the water corporations fluked their calculations of standard NCCs despite having no documented pre-determined methodology?
3. Also, it is not clear in your Consultation Paper if you approved or rejected the submissions from businesses which included headworks, sunk costs etc.
4. I recommend greater clarity in your next price review final decisions so that readers can be satisfied the Commission has achieved its objectives.

Q.1.1 Cost attribution – cost allocation models

1. The example of Cost Allocation Models (CAMs) being approved by the regulator in electricity networks (Table A.1 of your Consultation Paper) is commendable and is only a modest increase in regulation.
2. Water corporations will already have CAMs for allocating shared costs between services, although presumably this will be on an *average* cost basis. Importantly, under the NCC pricing principles, it is *incremental* not *average* costs that are to be allocated to new customers. The CAMs will need to accommodate both types of costs.
3. There needs to be sufficient clarity and exposure for developers and their technical consultants to hold the water corporation to account for their CAM, at a more localised level than possible by the Commission alone.
4. Therefore, it will be important to have each CAM publicly available (as well as approved by the Commission) and for the impact of items with less discernible connection to a development (like more remote headworks) to be shown as a separate component in calculated standard and negotiated NCCs.
5. It is also important for CAMs to identify all drivers, not only the primary driver, of the investment.

Q.1.1 Cost attribution – accuracy of costs

6. Water Corporations have the unenviable task of predicting future costs when projects are tendered and predicting when development will proceed.

7. If they under-estimate costs, and development has already proceeded, the water corporation will carry more debt, and existing customers will pay more.
8. The same applies if they build too early.
9. These two prospects together with greater internal scrutiny of requests for increased project approvals (and congratulations when projects are completed under-budget) means there is an incentive for proponents be conservative.
10. If projects are at the initiation (first gateway) stage of project approval, cost estimates will be quite generic, maybe in some cases the final cost might be 100 per cent higher.
11. While overall capex in the revenue determination uses 50th percentile cost estimates, any error exists only for the remainder of the pricing period, after which actual costs are incorporated in the RAB.
12. The overall capex estimates might have under-budget projects compensating to some degree over-budget projects (the essence of 50th percentile estimates).
13. However, for NCCs, there will be less projects to compensate one for another. This is important because existing customers will bear the under-estimates of costs and over-optimistic timing. There is the additional element of the water corporation not being in total control of timing - timing is in the hands of developers who in turn are responding to market demand and competitors. Annual updates of development servicing plans might lessen this problem.
14. I suggest the Commission could annually audit and monitor the performance of each water corporation and issue a public comparative report on growth projects (and any projects with a component attributed to growth) to identify best industry practice and any systemic biases/trends in cumulative cost and time accuracy.
15. The Commission could have some sort of escalation process, like:
    a. Use the report to improve its guidance and education sessions
    b. Reward best practice
    c. Draft a ‘Water Industry Standard – New Customer Contributions’ to enable enforceable undertakings

Q.1.2 Standard pricing - preference

16. Your Consultation Paper raises the issue of water corporations showing a preference for standard NCCs. I agree this is misaligned with the intentions of the 2013 principled based framework.
17. The Commission might consider prescriptively limiting the application of standard NCCs to small developments. Here is one possible example, and includes a change of onus and transparency:

<table>
<tr><td colspan="3">Subdivision with no external works</td></tr>
<tr><td><10 lots</td><td>10-100 lots</td><td>>100 lots</td></tr>
<tr><td>standard</td><td>negotiated</td><td>Negotiated only</td></tr>
<tr><td>Developer may make a case for negotiated NCC based on unfairness. Reasons for water corp decision published.</td><td>Water Corp may make a case for standard based on unreasonable admin effort. Reasons for water corp decision published and reported to ESC.</td><td></td></tr>
<tr><td colspan="3">Subdivision with external developer funded works</td></tr>
<tr><td colspan="2">Negotiated only.</td><td></td></tr>
<tr><td colspan="3">Subdivision with developer funded internal works – larger pipes; pump stations; other?</td></tr>
<tr><td colspan="2">Negotiated only.</td><td></td></tr>
</table>

18. An issue to consider is how a water corporation will estimate its overall revenue from NCCs for input into its price submission. It will somehow need to estimate the future revenue from negotiated NCCs and the number of lots. That will introduce some uncertainty initially, and it will be interesting to see how significant this will be relative to the uncertainties associated with construction cost estimation and timing of works.

Q.1.2 Standard pricing – cost reflectivity

19. Another point about cost reflectivity, identified in your Consultation Paper, is the large areas over which standard charges are applied and therefore the lack of location-based price signals.
20. Perhaps the Commission should prescribe that, unless demonstrated to be insignificantly different, separate standard NCCs are to be calculated for:
    a. Standalone systems
    b. Interconnected systems where there is bulk charge in place
    c. Infill/brown field areas
21. This might remove what currently appears to be well-intentioned but arbitrary nature of discounts for infill/brownfield areas.
22. My comment about the apparent arbitrary discounts could also apply to other works but would be unnecessary if the example in the table above is applied – that is, standard NCCs do not apply.

Q.1.3 Negotiating frameworks

23. Your Consultation Paper presents a disappointing list of shortcomings in water corporation negotiation frameworks.
24. My suggestion is before the next price review, the Commission should produce a publicly available comparative report on negotiating frameworks, with each requirement/expectation identified for compliance with the Guidance Paper.
25. In addition, the best water corporation for each element, where it exceeds the requirements of the Guidance Paper, should be identified.
26. As well, adherence to a water corporation’s Negotiating Framework is crucial. This might best be revealed by an audit of each water corporation and the policies, procedures and practices used by it to assure it adheres to the framework. The results of the audit should be published on the Commission’s website.
27. A presentation to the water industry and the development industry participants might stimulate more ideas for improvement.
28. These reports will be valuable during dispute resolution processes, whether that be for internal reviewers at a higher level in a water corporation, independent arbiters and VCAT.
29. The Commission should also consider producing a Water Industry Standard – NCCs which I understand may introduce a reserve power to enter into an enforceable undertaking should there be a persistently non-complying water corporation.

Q.1.4 Engagement

30. This section of your Consultation Paper is good and my only suggestion for water corporation engagement is to:
    a. stress to existing customer forums that NCCs are paid by new customers (passed-on by the developer in the price of land)
    b. the perhaps small impact on annual bills if NCCs were not applied (I recall seeing one transition plan where the impact on existing customers was quite small)

c. the benefits as well as the costs of servicing new development

Q.1.5 Incremental cost approach

31. I am perplexed by the average cost methodology that was proposed by some water corporations. In the Commission's final decision there was a statement to the effect that the new methodology was 'capable' of taking into account incremental revenues. I have no idea what 'capable' means and my confusion was compounded by a failure by its proponents to release the technical report justifying the superiority of the new methodology. Informed peer review is an ally of all regulators.
32. Equally I am perplexed by how a methodology labelled *average* cost can satisfy the pricing principles in the Guidance Paper which state *incremental* costs.
33. I suggest the Commission can improve its explanations in future and given that transparency is one of the three objectives of this NCC framework, the Commission should in future reject any new/alternate methodology that is not described in the public domain.

Q.1.6 Gifted and reticulation assets

34. This section of your Consultation Paper is good, but I wonder if water corporation development servicing plans clearly differentiate which assets are to be funded by the water corporation (and recovered through NCCs) of gifted by the developer or financed by the developer if their development is not in sequence?
35. I also wonder if there is clarity between requiring a developer to *construct* an asset (and thereby streamline construction co-ordination issues) and requiring a developer to *construct and fund* an asset?
36. I think there is an inconsistency with the NCC pricing principles for those water corporations defining reticulation pipes as those up to and including 150mm nominal diameter (water) and 225mm nominal diameter (sewerage). My recollection is that this was applied prior to 2013 (when there was a fixed $500 per lot NCC) on the basis that the incremental cost between 100 and 150 mm (water) and 150 and 225 (sewerage) was minimal – basically just the extra material cost.
37. However, the benefit of this small/negligible incremental cost is given to the water corporation, whereas the NCC pricing principles are based on the new customer/developer paying the incremental cost. If correct, the water corporation should be paying nearly 100 per cent, not zero percent, of the cost of 150 (water) / 225 (sewerage) pipe sizes.
38. This would require water corporation development servicing plans to extend to the level of detail of those pipe sizes, where the alignment will be yet unknown – it will be dictated by the layout of the new subdivision. This will only be a problem for standard NCCs.

Q.1.7 Development servicing plans

39. This section of your Consultation Paper is good, but I wonder if as well as asking respondents about any issues they have encountered, the Commission should engage an auditor to look across all water corporation plans and link them to the calculations of standard NCCs. I suggest this because of the comments in the FTI Consulting report referred to earlier, in which they commented about some lack of confidence in some projects and costings.
40. I wonder if the development servicing plans might somehow be layered to reflect asset management planning and budgeting. One layer could be a 50-year strategic/concept plan with little detail, a 10-year plan with more detail on expected costs and timing, and a 5-year business plan with refined costings and timing?

Q.1.8 Commission's guidance

41. As mentioned above, I suggest the Commission should consider a Water Industry Standard – New Customer Contributions, somewhat akin to the standard for trade waste customers.
42. Based on your Consultation Paper, and subject to your intended engagements and auditing, more prescription seems warranted. Acknowledging the Commission's ambitions to be a light-handed regulator, this new standard could be slightly more prescriptive than the current Guidelines and Explanatory Note, with a view to further prescription should it be identified as needed through ongoing performance monitoring, reporting, engagement and enforcement.

Q.2 Commission's guidance

Q.2.1 Level of prescription

43. See #42

Q.2.2 Framework objectives

44. The first objective about sending signals should perhaps use the words 'net costs' or 'costs and benefits' instead of 'costs'.
45. I suggest the three objectives should be supplemented with a fourth objective along the lines of sharing net costs fairly between developments, to reflect the role of the water corporation in development co-ordination.

Q.3 Engagement support

46. I believe the suggestions above on a) a water industry standard, b) auditing performance monitoring and reporting, c) enforcement, and d) more frequent use of negotiated NCCs in place of standard NCCs will provide improved support for engagement between developers and water corporations.
47. That said, a key will be the availability/transparency of calculations that comprise estimates of both standard and negotiated NCCs. Despite the findings of the FTI Consulting report, this should not be an unreasonable expectation.

Q.4 Other policy, industry or community issues

48. Figure 2.1 page 8 in your Consultation Paper outlines the framework within which the Commission operates, and it would be useful to expand it to reflect that water corporations, developers and VCAT operate in a broader framework. My understandings are:
    a. Planning subdivision legislation are important for water corporations as referral authorities to specify conditions of connection. These conditions may overlap at times with NCC calculations in that a water corporation may require substantial offsite works that would otherwise be included in NCC calculations.
    b. Water corporations play an important role in development coordination. It is unclear to me where this role is specified, other than through custom and practice, and perhaps self-interest in terms of a water corporation wanting gifted disparate systems to be of good quality and efficient to operate. It would be in all parties' interest for this to be documented. As roles and responsibilities are a policy issue perhaps DEECA might approached to clarify this through an amendment to the Water Act 1989 or its Statement of Obligations 2015. Performance standards like processing times and

timeliness of provision of connections would need to be specified in the SoO or by the Commission.

c. VCAT's role in dispute resolution is established in the Water Act 1989 insofar as fair and reasonable contributions to the cost of works are concerned, and planning legislation for terms and conditions of connection. Given the infrequent number of disputes in this area heard by VCAT, and the desire to avoid the costs and time involved for all parties to a dispute, it could be beneficial to more formally document in a "Water Industry Standard – New Customer Contributions" (not too dissimilar to that for Trade Waste Customers) requirements the Commission expects, including but not limited to those in the Guidance Paper which is released prior to each price review. I suggest this for several reasons:
    i. It would provide greater specificity for the arbiters of the internal water corporation dispute resolution processes
    ii. It would give the Commission the ability to require an enforceable undertaking from a water corporation that is breaching its expectations
    iii. It would give the VCAT member(s) hearing a dispute a clearer idea of what the Commission expects of water corporations

Q.5 Terminology NCCs /developer charges

49. A change to 'developer charges' would be a retrograde step.
50. Developers (like supermarkets and banks that we love to hate but cannot live without) don't attract much empathy, but they do operate in a competitive market, which presumably is more or less effective depending on location. Developers are also a critical partner/participant in the delivery of expanded networks.
51. The current terminology of 'new customer contributions' makes it clear that it is new customers who end up paying these charges/contributions that are levied on developers.
52. Keeping a focus on customers is the Commission's purpose, particularly minority groups like hardship, family violence, and those receiving less than average service standards. My view is that new customers at perhaps 4 percent or less of a water corporation's customers are a minority group. They are certainly a group not well represented in customer forums.
53. The word 'negotiated' implies cut and thrust bargaining, whereas the intent as I understand it is really to be more cost reflective and more transparent. Maybe 'bespoke' or 'tailored' would be more apt.
54. While administrative simplicity and certainty were behind the word 'standard', perhaps a better word might be 'default'.doc

Q.6 Other matters

Q.6.1 Tax

55. While the building block model for allowable revenue contains a component for tax based on a *benchmark* rather than actual tax liability, I wonder if the calculation of NCCs needs to reflect *actual* tax payments by the water corporation to then fairly share the net tax costs between new customers and existing customers?
56. For those water corporations not yet in a tax paying position, the part attributable to NCCs might be the bring-forward costs of the water corporation reaching a tax paying position.

Q.6.2 Possible distortionary issues

57. If a water corporation has applied uniform prices across its region, the calculated NCC for a specific system will be smaller than otherwise in situations where a system specific price would have been higher than the uniform price, based on say higher operating costs. The converse will also apply.
58. The opening RAB for water corporations was generally set to avoid price increases at the time of transition to economic regulation. It is generally less than the balance sheet net assets. The RAB is expected to grow over time, but in the meantime the value of gifted and funded assets is excluded from the RAB but included in the balance sheet, thereby prolonging that gap.
59. The conversion of water licences to bulk water entitlements was at no cost to the water corporation, but future entitlements will need to be purchased on the water market, or more expensive desalinated water produced. Was it the policy intent that only existing customers were the beneficiaries of this ‘free’ water?
60. If future net revenues (second NCC pricing principle) are calculated assuming average operating costs for the water corporation, that will not reflect the cheaper costs of operating and maintaining newer assets which will have less repairs and contribute less to wet weather sewer flows.
61. I have no suggestions for the quantum or significance of these issues, but they would be worth examining and discussing.

Q.6.3 Clarity

62. On page 4 of your Consultation Paper, you have listed 4 dot points relating to NCCs proposed by ‘many’ water corporations which did not support the objectives of the framework. It is unclear to me if all these issues were addressed after the Draft Decision and resubmitted prior to the Commission’s authorisation of the proposed NCCs in the Final Decision.

Q.6.4 Performance monitoring and reporting

63. A lesson from the key implementation issues listed in your Consultation Paper is that regulation of the principles-based approach to NCCs was too light handed. I think with the wisdom of hindsight, it should have been accompanied by a performance monitoring regime and a publication of comparative performance. This may have alerted the Commission and other parties earlier to issues.
    a. Such a report could be the basis of an annual meeting with say an Institute of Water Administration Special Interest Group on NCCs, with representatives from each water corporation.
    b. A comparative report might complement and help target the Commission’s intended training, which I expect will need to be ongoing given the specialist nature of the topic and staff turnover in water corporations.
    c. Discussions, consultations and training should also be offered to developers and their advisors in planning and engineering. It may also be of interest to some arbiters involved in dispute resolution and legal practitioners involved in VCAT hearings.

Q.6.3 What are “reticulation” assets

64. Earlier in this submission I mentioned a definition of “reticulation” (used by some water corporations?) as pipe sizes up to and including 150mm nominal diameter (water) and 225mm nominal diameter (sewerage).

65. I don't have a suggestion other than there needs to be a pragmatic approach based on some agreed and reputable design standards (for example, how do the WSAA (metro Melb) standards describe reticulation?).
66. The other point to make is that the definition needs to accommodate different size developments such that a developer is not incentivised to artificially split one large development into multiple smaller ones.
67. What about ancillary items like valves, pump stations, monitoring equipment etc.? Some water corporations include these items if they are within a pipe network of reticulation size, others include them at a discount.
68. Perhaps ancillary items need to be assessed in terms of benefits to other developments than the one within which they are located. For example, an optimised sewer system will use pump stations to reduce the depth of pipework or enable cross-catchment boundary transfers. How widespread are the beneficiaries?

Q.6.4 VCAT principles for connection conditions

69. VCAT has established principles of **need**, **nexus**, **equity** and **accountability**. In short I understand, the *need* must be generated by the development (and not be existing backlog demand); there must be a *nexus* between the delivery of the assets and the development (the assets serve the demand from the development; and not using the funds collected to provide assets elsewhere); there must be an *equitable sharing of the cost* of the assets commensurate with the proportion of demand generated by the development; and there must be a level of *accountability*, which is taken to mean that the funds collected are held on trust for the purpose for which they have been collected and are only spent on the assets which form the basis of the contributions.
70. These principles interface to a degree with the Commission's role in setting prices for NCCs, so some recognition in your documentation would be beneficial, with legal input of course.

Q.6.5 Densification of developments

71. Perhaps consultation with water corporations, developers and their consultants is needed to identify if there are any issues with the increasing occurrence of high density developments. Examples or case studies might be needed, particularly as in brown field areas where it may involve upsizing/bring-forward of asset renewals.

Q.6.6 Atypical lots

72. Applying a standard NCC to atypical lots such as non-residential, high water-use or even the build to rent market would not be cost reflective. The guidance materials, standards or case studies will need to clarify what the Commission thinks is fair.
73. Again, consultation with water corporations, developers and their consultants will help.

Q.6.7 Pre-investments in growth assets

74. Current guidance is that only sunk assets specifically identified by a water corporation can be included in NCC calculations. I presume the value of these sunk assets is added to the water corporations' RAB until it is later reduced by the value of NCC revenue collected.
75. A Commission audit and performance monitoring report as mentioned earlier in this submission, could identify the quantum of sunk assets that have been specifically identified and ensure that existing customers are not bearing an unfair financial impost.

I trust I have been helpful in offering feedback on your issues (some without suggested solutions for which I apologise).

Yours sincerely

David Heeps
Interested customer