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GUIDANCE PAPER

NEW CUSTOMER CONTRIBUTIONS

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FOREWORD

Over the past two regulatory periods water corporations and developers have made numerous calls for the Commission to review and amend the existing “new customer contributions” (NCC) regime.

The requests were triggered by the many disputes that resulted from the existing uniform or “one size fits all” rules and charges based framework. Most have disputes centred on whether the framework allocated the cost of new connections to those who benefit in a way that could be considered fair.

The Commission responded to this complex and emotive issue by committing to undertake a project to develop a principles based NCC regime that would address the problems with the existing framework in a way that is consistent with the relevant regulatory and legislative instruments. Some of the key features of the new framework are:

- NCC are based on incremental costs , this improves cost reflectivity
- NCC take into account the benefits existing customers receive when new customers connect
- greater transparency is promoted in relation to how developer charges are calculated
- water corporations may set standard charges for catchments. This should give developers some certainty about expected charges
- water corporations and developers have the ability to negotiate charges in accordance with pricing principles
- consistent with the legislation that VCAT will hear disputes in relation to NCC.

The Commission believes that the new NCC regime is better aligned with the regulatory and legislative frameworks and the recommendations of the Ministerial Advisory Council in relation to NCC than the existing framework. Key participants

during the consultation have also indicated support for the framework. On that basis, we would not expect water corporations to propose an alternative unless they can unequivocally demonstrate a better alignment with the policy and regulatory frameworks.

During this project Commission staff have regularly sought input from key stakeholders such as the water industry (coordinated through VicWater), the Urban Development Institute of Australia the Property Council of Australia, the Growth Areas Authority, The Department of Sustainability and Environment and the Office of Living Victoria. This feedback has supported the development of a framework that is principled and flexible. As a result, the new NCC regime will be applicable across the many development scenarios that can arise.

This guidance paper puts forward the Commission's expectations in relation to NCC and water plan 3. Importantly, the Commission expects upfront consultation between water corporations and developers about the costs and timing of assets required to service new areas. Early investment in this activity by both parties will improve transparency and lessen the likelihood of unanticipated outcomes and disputes.

I thank VicWater for its financial contribution toward the NCC estimator. This tool should make the calculation of NCC more transparent. This valuable tool will be made available to all stakeholders at the same time this paper is released.

Dr Ron Ben-David

Chairperson

The table below contains a summary of the key features of the framework and the guidance paper.

Background

Water corporations levy New Customer Contributions (NCC) when new connections are made to the water, sewerage and recycled networks. Currently NCC are set at uniform levels across Victoria. To date, developers and water corporations have approached the Commission on numerous NCC disputes centred on the opaqueness of the current regime. They have also consistently conveyed the need to reform the regime.

We have consulted extensively with the industry over 2011-12 and developed an alternative principled-based NCC framework. This new framework is to be adopted by the water corporations so that it comes into effect 1 July 2013, coinciding with the start of the next regulatory period.

New NCC framework

The new NCC framework will return to a more flexible arbitrate and negotiate connection regime as envisaged by legislation. The existing state wide scheduled charges and prescriptive rules will be replaced by pricing principles. This will enable NCC to be applied consistently across the many different developments in Victoria.

Under this framework each of the key participant's roles is clarified. The Commission will assess and approve the pricing principles, any standardised charges and negotiation framework of each water corporation. Water corporations are required to negotiate NCC in accordance with the approved pricing principles and negotiating frameworks. Developers will negotiate with water corporations and have recourse to the Victorian Civil and Administrative Tribunal (VCAT) for dispute resolution.

The negotiating framework will explain connection applicants' rights and obligations, the service charging model, applicable pricing principles, the negotiating process and recourse to arbitration. We also see merit in having the negotiation framework proposed by water corporations including information that is aligned with all grounds for appeal to VCAT – this will help to inform the decision of VCAT should a dispute eventuate.

The pricing principles proposed by water corporations must include the minimum pricing principles set out in this paper. The pricing principles require developers to meet the incremental costs that they impose on the water business when they connect to the water, sewerage or recycled water networks less the incremental revenues earned from the new customers. This approach ensures that NCC are cost reflective and that the benefits of new connections are shared between new and existing customers.

During the transition period, in the interests of minimising formal disputes before VCAT, the Commission could (upon request from a water business or developer) provide an opinion about whether the proposed NCC charge is consistent with the approved pricing principles. This informal role will be reviewed prior to the end of the next regulatory period.

We believe that the new framework will result in increased transparency and efficiency in the way that connections services are provided and how NCC are calculated and applied. It will also support the user pays principle when it comes to different connection types across the state.

Guidance to Water Corporations

Water corporations are expected to:

- Commence consulting with their new connection customers (developers, Urban Development Institute of Australia, Property Council of Australia) on how they are proposing to apply the new NCC framework both individually and via VicWater
- Provide to us estimates of growth capital, gifted assets and forecast NCC revenue based on the current regime, and the negotiating framework, as a minimum, as part of its individual final water plan by 28 September 2012. Some water corporations can also include NCC revenue based on the new framework, any standardised NCC and a transition plan (for circumstances where the proposed NCC are materially higher than those applying in the current regulatory period) if they are in the position to do so when they submit their final water plan in September 2012. At the very latest, all water corporations must provide all of the above by 7 December 2012.
- Further consult with new connection customers (developers, UDIA, PCA) following their submission to us, particularly in providing greater certainty about the magnitudes of the NCC proposed in “brownfield and greenfield” developments and catchments where a standardised NCC is proposed.

NCC Estimator

The Commission has developed an NCC estimator to assist water businesses calculate NCC in accordance with the pricing principles. This illustrative calculator will be made available to all interested stakeholders.

1.1 Purpose

The purpose of this paper is to provide guidance to water corporations and developers on a range of matters relating to the New Customer Contribution framework. It clarifies the Commission's position on elements of the framework that were proposed and consulted on in the May 2012 New Customer Contributions – Staff framework and approach paper (the Staff Paper).

Water corporations should refer to this guidance when preparing their final water plan 3. This is a guidance paper for the purposes of the Commission's review of water corporations' water plans in accordance with the Water Industry Regulatory Order (WIRO). It is not a guideline of the form provided for in section 13 of the Essential Services Commission Act 2001 (Vic) (ESC Act).

1.2 Introduction

New customer contributions are levied when new connections are made to the water corporation's water, sewerage and recycled water networks.

Over the course of the first and second water plan periods, developers and water corporations have made numerous requests to the Commission to resolve disputes and provide guidance on applying NCC. The disputes have been about:

- lack of clarity around what the scheduled charge pays for
- complex definitions relating to bring forward charges and reticulation assets
- lack of consistency between water corporations in the way NCC are applied.

During the development of the current NCC guideline, Commission staff suggested a move to a principled framework for the next water plan period.

The Staff Paper proposed a framework that confirms water corporations' ability to negotiate NCC in accordance with defined pricing principles. Stakeholders were asked their views on a number of matters contained within the paper. Refer to appendix A for the Commission's responses to the submissions on the paper.

The NCC pricing principles require developers to pay the incremental costs of connection less the incremental revenues that will be earned by the water corporation from the new customers.

This approach recognises that new connections can impose costs on water corporations and that existing customers benefit when new customers connect. This benefit arises because fixed costs are spread over a larger customer base.

The principled approach will allow NCC to be levied in a consistent way across the multitude of different development connection situations that eventuate. The NCC pricing principles and confirmed negotiating flexibility will also better enable the Victorian water industry to accommodate policy developments to be implemented by the newly formed Office of Living Victoria.

The Commission recognises that a consequence of this approach is that NCC may be different between water corporations as well as between different catchments within a water corporation (where the underlying cost structures are materially different).

1.2.1 Consultation

The Commission has consulted extensively with key stakeholders throughout the development of the new framework. These stakeholders include the water industry (coordinated through VicWater), the Urban Development Institute of Australia the Property Council of Australia, the Growth Areas Authority, The Department of Sustainability and Environment and the Office of Living Victoria.

A detailed listing of this consultation is included in appendix E

1.2.2 Terminology used in this paper

The terms new customer contributions and developer charge are used throughout this paper – for the purposes of this paper they are interchangeable (unless otherwise identified) and they relate to charges paid for NCC services. As set out in the Staff Paper, NCC services can be defined as set out in box 2 page 12. Note this guidance paper does not cover drainage charges. Section 2.2.2 sets out the statutory requirements for when a NCC is applicable and what it can recover.

1.2.3 When does the framework come into effect

The Commission proposes that the NCC framework will not come into effect until the commencement of the new regulatory period on 1 July 2013. Until this time, the current determinations and May 2011 guideline will continue to apply.

1.2.4 Contact details

Should stakeholders require further clarification on any information provided in this guidance paper they should contact:

Andrew Chow – Director Water on (+613) 9651 0229

Or

Merryn Wilson – Project Manager on (+613) 9651 0269

1.2.5 Structure of this paper

The paper is structured as follows:

Chapter 2 – outlines the legal and regulatory framework for water service connections and NCC and explains how this has informed the Commission's development of the NCC framework for water plan 3.

Chapter 3 – sets out the proposed NCC framework for water plan 3, including the minimum pricing principles, NCC calculation parameters and the key requirements of a negotiating framework.

Chapter 4 – shows what the Commission expects water corporations will deliver and when in relation to the NCC component of water plans for regulatory period 3.

Appendix A – documents the Commission's response to stakeholder submissions on the Staff Paper and other Commission advice.

Appendix B – provides a pro forma negotiating framework that water corporations may choose to adopt in their water plans for regulatory period 3.

Appendix C – provides notes on the variables that are used to calculate NCC

Appendix D – shows legislative framework for negotiations between water corporations and property owners developing land.

Appendix E – lists the consultation undertaken by the Commission in the development of the NCC framework.

This chapter outlines the legal and regulatory framework for new customer contributions (NCC) and proposed negotiating frameworks, and explains how this has informed the Commission's development of the NCC framework for water plan 3. It highlights relevant changes to the Water Act 1989 (Vic) (the Water Act) that have come into effect since the Staff Paper.

It covers:

- the nature of, and rationale for, changes
- the broad statutory framework that now applies to water corporations and developers (being a sub-set of property owners) in relation to new or modified connections
- the Commission's powers to require and approve water corporation negotiating frameworks for NCC
- interaction between decisions under an approved negotiating framework, and dispute resolution under the Water Act.

2.1 Nature of and rationale for changes

The statutory regime for connections creates a default minimum regulated connection process. It entails a 'negotiate and arbitrate' regime with the following characteristics:

Legislated starting point

Under the statutory framework created by the Water Act:

- there is no universal connection obligation for water corporations
- however if a property owner requests, a water corporation must consider its application to connect
- the water corporation has a wide discretion to refuse, or to connect on terms and conditions that water corporation thinks fit
- prices must be fair and reasonable
- dispute resolution is via the Victorian Civil and Administrative Tribunal (VCAT) under the Water Act.

Regulatory overlay

The Commission is required by the WIRO to regulate prices or price setting methods for, amongst other things, services to which developer charges apply. Such services are both prescribed and declared under the WIRO.

In the past, this price regulation has been effected through a fixed schedule of charges that has proved problematic for its lack of flexibility, uncertain interpretation, and frequent disputes.

Legal effect of the changes

In a legal framework sense, the guidance provided in this paper clarifies the connection process by:

- requiring each water corporation to develop and publish a negotiating framework (approved by the Commission as part of its water plan 3), and
- establishing principles to help interpret ‘fair and reasonable’.

The process followed and information made available during connection negotiations should better inform, and minimise the costs of, any connection disputes. The arrangements also recognise that there are both standard and tailored connection circumstances, and provide flexibility to accommodate both.

The proposed framework for NCC is consistent with the Commission’s broad discretions, the regulatory principles under clause 14(1) of the WIRO, the procedural requirements under clause 13 of the Water Industry Regulatory Order (WIRO), and with the objectives of the Commission under section 4C of the Water Industry Act 1994 (Vic).

The following sections outline some key provisions.

2.2 Recent statutory changes affecting New Customer Contributions

Statutory changes that came into effect from 1 July 2012 align customer connection processes for metropolitan and regional water corporations, with both now covered by section 145 of the Water Act.

2.2.1 Nature of connection obligation

There is no universal service obligation¹ for any water corporation. Instead, there is a statutory prohibition on any persons (including developers) connecting to or using a water corporation's works without consent²; and a wide discretion with water corporations to decide whether or not to connect, and if so, to determine the terms and condition for that connection³. A water corporation's connection decision is reviewable by the VCAT⁴ (with review provisions described more fully in section 2.4 below).

BOX 1 RELEVANT PROVISIONS FROM THE WATER ACT

Water Act 1989 Section 145 - Control over connections

- (1) A person must not, without an Authority's consent, cause or permit—
 - (a) any works to be connected to the works of the Authority; or
 - (b) the alteration or removal of any works that are connected to the works of the Authority; or
 - (c) anything to be discharged into the works of the Authority.

[Penalties are listed, subsections 1(c) and (d)]
- (2) An application for the Authority's consent must be made in the manner determined by the Authority, and must be accompanied by any fee fixed by by-law and any plans and other information that the Authority requires.
- (3) The Authority may—
 - (a) refuse its consent; or
 - (b) consent; or

¹ Universal service obligation' is a term used in regulated industries to describe the practice of requiring a service provider to deliver a baseline level of services to every resident in a given area.

² Section 145(1) of the Water Act

³ Section 145(1) of the Water Act

⁴ Under Section 145(3A) of the Water Act

(c) consent subject to any terms and conditions it thinks fit.

(3A) A person may apply to VCAT for review of a decision by an Authority under subsection (3).

(3B) An application for review under subsection (3A) must be lodged with VCAT within 28 days after—

(a) notice of the decision was given; or

(b) if, under section 45 of the Victorian Civil and Administrative Tribunal Act 1998, the person requests a statement of reasons for the decision, the day on which the statement of reasons is given to the person or the person is informed under section 46(5) of that Act that a statement of reasons will not be given.

(4) A person who causes or permits anything referred to in subsection (1) to be done must make sure that it is done in accordance with any terms and conditions subject to which the Authority gave its consent.

[Penalties listed, subsections 4(a) and (b)]

(5) Terms and conditions subject to which the Authority consents are binding on the successors in title of the person who applied for that consent

2.2.2 Charging New Customer Contributions

Water corporations have broad powers to charge property owners (including developers where applicable) for their infrastructure, services and customer usage under Divisions 5 and 6 of Part 13 of the Water Act.

A developer can be a property owner liable for payments under the water regulatory regime. The concept of developer charges has been used historically in the Victorian water industry, and appears as a defined term in the Water Industry Regulatory Order⁵ (**WIRO**), though not in the Acts. In Schedule 1 of the WIRO, developer charges means:

⁵ That is, an Order made under section 4D of the *Water Industry Act 1994* (Vic)

- Contributions to the costs of works imposed under Division 6 of Part 13 of the Water Act⁶ (which deals with property owner finance, requirements for payments and costs for increased services); or
- Contributions to the costs of works imposed under sections 196 and 197 of the Water Act (which deals with charges associated with waterway management).

Under the WIRO, “services to which developer charges apply” are:

- declared services in respect of which the Commission has the power to regulate standards and conditions of service and supply; and
- prescribed services in respect of which the Commission has the power to regulate prices.

The two key constraints on charges associated with new connections arise through:

- **WIRO requirements and determinations of the Commission** – Charges must be set in accordance with the procedural requirements and regulatory principles of the WIRO⁷, and determinations made by the Commission under the WIRO, in accordance with the enabling Water Industry Act and Essential Services Commission Act 2001 (Vic) (the ESC Act).
- **General and specific charging provisions in the Water Act** - Charges imposed should be assessed by the water corporation as fair and reasonable, taking into account the benefit to each affected property.

The legislative framework for negotiations between water corporations and property owners developing land is depicted in appendix D.

2.3 Commission powers to require and approve negotiating frameworks

A negotiating framework for NCC would be an instrument developed by a regulated water corporation and submitted to the Commission for approval as part of the water corporation’s water plan 3.

The negotiating framework is essentially a guide for connection applicants and sets out how the water corporation will engage with the applicant to arrive at, and communicate, an appropriate price, terms and conditions for connection.

⁶ Though the definition of *developer charges* in the WIRO also refers to contributions to the costs of works imposed under sections 27, 28 and 29 of the *Water Industry Act 1994*, those sections were repealed with effect from 1 July 2012.

⁷ See clause 13 of the WIRO for procedural requirements, and clause 14 for regulatory principles.

The Commission derives its general powers in relation to NCC from:

- The ESC Act which enables the Commission to regulate the prices, standards and conditions of service of goods and services that are prescribed and declared in an empowering instrument;
- Part 1A of the Water Industry Act which deals with regulation of the regulated water industry, and in particular:
 - section 4B which makes Part 1A relevant legislation, and defined water corporations⁸ a regulated industry, for the purposes of the ESC Act;
 - section 4C which set out the objectives of the Commission in relation to the regulated water industry;
 - section 4D which creates the head of power for a WIRO⁹ ;
- The WIRO which makes 'services to which developer charges apply' declared and prescribed services in respect of which the Commission has the power to regulate prices, standards and conditions of service and supply.

Clause 8 of the WIRO empowers the Commission to approve or specify prices for prescribed services, or the manner in which prices are calculated or otherwise determined, in water plans for regulated entities. With the Commission's decision being a determination for the purposes of the ESC Act.

A decision to require water corporations' water plans to include a negotiating framework for NCC would be consistent with:

- the Commission's broad discretions
- the regulatory principles under clause 14(1) of the WIRO
- the procedural requirements under clause 13 of the WIRO and
- the objectives of the Commission under section 4C of the Water Industry Act.

2.4 Interaction between negotiating framework and VCAT process

This section explains how a dispute resolution mechanism under a negotiating framework could operate effectively in parallel with recourse to VCAT under the Water Act. Importantly, dispute resolution under a negotiating framework would be separate and in addition to – not in substitution for – the VCAT process. It would occur where the parties mutually agreed to the process to minimise the likelihood of going to VCAT.

⁸ *Regulated water industry* means the water industry as constituted by the Melbourne Water Corporation, metropolitan water corporations, Regional Urban Water Authorities and Rural Water Authorities.

⁹ Section 4AA of the Water Industry Act provides that if there is any inconsistency between a provision of Part 1A – Regulation of the Regulated Water Industry – and the ESC Act or Water Act, then the provisions of Part 1 A prevail to the extent of that inconsistency.

2.4.1 Negotiating framework content on dispute resolution

As a minimum, an approved negotiating framework will set out clearly the connection applicant's right and process to challenge a water corporation's decision through VCAT. As an optional matter, the negotiating framework may also offer an alternative dispute resolution process that the parties (water corporation and connection applicant) may agree to use—for example, agreeing to appoint an independent arbiter.

The statutory framework provides for review of a water corporation's charging decisions as set out in appendix D. It is envisaged that a Commission-approved negotiating framework will highlight the VCAT process and timing (see requirements in section 3.5 of this guidance paper). It is also envisaged that the information required to be compiled and shared in the course of negotiations pursuant to an approved negotiating framework will:

- align with categories or grounds for appeal to VCAT
- improve transparency and understanding for persons seeking connection; and
- provide core information on reasons and calculations that will help inform the decisions of a dispute resolution body or VCAT.

Section 3.5 sets out relevant information requirements in more detail.

3.1 Overview

The new customer contributions (NCC) framework comprises all the elements that are necessary to manage NCC in a way that is consistent with the legislative and regulatory regimes. The key elements of the framework are:

- defining the service to which NCC applies
- a charging model
- pricing principles
- supporting tools and guidance

Each of these elements is interrelated and work together to support the framework's objective, which is:

facilitating efficient and timely connection of new customers on a fair and reasonable basis, taking into account the benefit to the new customer relative to the benefits realised by other customers.

The elements are described in more detail¹⁰ in this chapter.

Under the NCC framework:

- water corporations are required to negotiate NCC in accordance with pricing principles (section 3.4) and their approved negotiating frameworks.
- developers will negotiate with water corporations and have recourse to the Victorian Civil and Administrative Tribunal (VCAT) for dispute resolution.
- industry bodies may choose to work together to facilitate 'model' industry approaches consistent with pricing principles.
- the Commission—through the water price review and water plan process—will approve the negotiating framework, any supplementary pricing principles adopted by individual water corporations and standardised NCC submitted by the water corporations in their water plans.
- the NCC framework requires separate charges for each service – water, sewerage and recycled water.

¹⁰ Refer to the New customer contributions - Commission staff framework and approach paper May 2012 for additional information on the framework.

3.2 Defining the service

Defining the service establishes the boundaries and eligibility for the NCC service. The Commission has defined the NCC service in box 2.

BOX. 2 NCC SERVICE DEFINITION
The NCC service is defined as:
Infrastructure and associated activities to connect an un-serviced property to the water services networks
or
Infrastructure and associated activities required to increase services to a serviced property

3.3 Charging model

NCC should have regard to all the incremental costs that new connections customers impose on the water business and the incremental benefits that the water business receives from these connections. The pricing principles described in section 3.4 reflect this.

The impact of this is that NCC will be more cost reflective and will vary between water corporations. In addition NCC may also vary between catchments within a water corporation.

3.4 Minimum New Customer Contributions pricing principles

The minimum NCC pricing principles that will govern the calculation of negotiated or standardised NCC are in box 3.

Water corporations may propose additional pricing principles in their negotiating frameworks for water plan 3. These may cover additional principles that are relevant to a specific water corporation and which would further support that corporation's connection outcomes achieving the NCC framework.

Any additional pricing principles should not override the effect of the minimum pricing principles.

BOX. 3 MINIMUM NCC PRICING PRINCIPLES

NCC must:

- i. have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories¹¹ attributable to a given connection
- ii. have regard to the incremental future revenues that will be earned from customers at that connection
- iii. be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

(Any additional pricing principles should not either expressively or implicitly override the effect of the minimum pricing principles.)

Purpose of the minimum pricing principles

These minimum NCC pricing principles represent the minimum requirements that the Commission would expect to see an NCC comply with in order to confirm that the charge was fair and reasonable as required by the Water Act.

In the current absence of statutory guidance on NCC charging, the Commission understands that VCAT decisions have focussed on what constitutes fair and reasonable. This has included that charges:

- are sufficiently explained or justified by the business, being based on sound corporate policy, having regard to broader context of potential future infrastructure demands and reflecting proper cost apportionment
- are fair and reasonable in all circumstances and assess each connection on its merits.

The Commission agrees that an important part of the fair and reasonable test is the explanation of how costs and benefits have been attributed to a given connection. The requirement to have an approved negotiating framework and the information provision requirements within that framework will support this limb of the fair and reasonable test and improve transparency within the connections charging framework.

¹¹ Refer to the New customer contributions - Commission staff framework and approach paper May 2012 for more detail on the framework.

The second limb to the fair and reasonable test is that of having due regard to the costs and benefits of a given connection. The Commission considers its minimum pricing principles serve this purpose.

By specifying the use of net incremental cost of connection, the minimum pricing principles support fairness between new and existing customers, and between connection applicants in different locations and at different dates of connection.

Reasonableness requires that any costs attributed to a connection reflect the additional costs a water corporation has incurred or will incur to service that connection. Further, it may be considered unreasonable to ignore the benefits associated with connection.

The incremental cost and revenue pricing principles ensure that connections are charged for the net incremental cost that they impose on the water corporations.

The pricing principle that charges must be greater than the avoidable cost of that connection and less than standalone cost of that connection will ensure existing customers are not subsidising connections at inefficient levels, and that connection applicants are not charged more than it would cost to build the assets they require themselves. These efficient pricing bounds provide a further safeguard that NCC are:

- fair by at least covering avoidable costs
- reasonable by not exceeding costs of the connection applicant providing the service themselves.

The following sections further explain these cost concepts specified in the minimum pricing principles. Appendix C provides details of various incremental cost and benefit items and notes on their calculation.

3.4.1 Incremental costs

Incremental costs are costs that would not have been incurred to serve the existing customer base, or not incurred to the same scale¹². Incremental costs may include capital, operating, financing and tax costs attributable to the connection. The Commission's view is that, consistent with the heads of power under the Water Industry Regulatory Order (WIRO) and sections 268, 269 and 270 of the Water Act, developer charges for the present day cost of any works can encompass the above cost types.

Incremental cost should be calculated over a period that aligns with the corporations' growth planning or asset utilisation horizons, and for operating costs this should be the same as the revenue assessment period.

¹² For example the corporation may have efficiently pre-planned for growth and upsized its historical investments accordingly.

The Commission notes that incremental cost, as defined here for the purposes of NCC calculation, can be expected to be higher than avoidable cost. This is because avoidable cost is forward looking only, whereas under the above definition, incremental cost can include an allocation of historical costs that the corporation had prudently prebuilt in expectation of future growth.

Avoidable cost represents the cost that would be avoided if the water corporation did not provide services to that customer or group of customers.

3.4.2 Incremental benefits

Incremental benefits are those benefits that accrue to the water corporation as a result of the connection. At a minimum, they will include the additional revenue that the water corporation will earn from the relevant service (water, sewerage or recycled water) at the connection.

Additional benefits may arise from deferred system augmentation where a given connection facilitates the deferral of previously planned works.

3.4.3 Efficient pricing bounds

Standalone cost represents the least cost technically efficient servicing solution (optimised cost). Standalone cost will be the cheaper option out of:

- Working out the share of existing assets and new connection assets required to service just that connection or group of connections
- Estimating an entirely new servicing solution that is independent of the existing network (if this is lower cost).

3.4.4 Ongoing certainty

The Commission considers that minimum pricing principles contained within an approved negotiating framework constitute a price setting method for the purposes of the WIRO.

The Commission notes that these minimum pricing principles forming part of the approved price setting method can give rise to connection cost recovery over multiple pricing periods. Therefore, the Commission anticipates that the minimum pricing principles will be included in the water corporations' water plans on an ongoing basis.

3.5 Supporting tools - negotiating framework

The negotiating framework is the primary form of guidance to support the implementation of the NCC framework. The purpose of a negotiating framework is to facilitate efficient and timely connection of new customers on a fair and reasonable basis, taking into account the benefit to the new customer relative to benefits realised by other customers.

The minimum requirements for a negotiating framework, includes information to explain:

- the role and rights of water corporations, developers, VCAT, and the Commission;
- the legal and regulatory framework as it applies to connection negotiations and determination of charges and terms and conditions;
- the process for negotiation and arbitration (including minimum information provision and arrangements for managing confidential information);
- approved NCC pricing principles (i.e. minimum NCC pricing principles plus any additional principles proposed in the corporation's water plan);
- the eligibility/threshold for any standardised charges, if these have been proposed by a water corporation and approved by the Commission.

The negotiating framework should incorporate the statutory requirements in section 268(4) of the Water Act which stipulates that where a water corporation requires payment or contribution for services that will benefit a property, it must issue the owner of the property a notice which specifies:

- the amount of the payment required;
- the reason why the payment is required;
- any works or services that have been or will be provided;
- the property in relation to which payment is required;
- if payments are required in relation to a group of properties, the amounts required in relation to each property;
- the right of the owner to object and apply for a review under section 271; and
- in the case of a notice under subsection 268(1) that details of the proposed services and the costs are available for inspection, free of charge, at the Authority's office during normal corporation hours.

In addition, it is envisaged that the information required to be compiled and shared in the course of negotiations pursuant to an approved negotiating framework will include information that may support the allowable grounds for appeal to VCAT that is, information that enables the connection applicant to determine whether:

- the amount is excessive
- where there are several properties that will benefit:

- that the owner should not be required to make payment;
- that another owner should also be required to contribute; or
- the distribution of the cost between the properties is unreasonable;
- that the payment was not set in accordance with a WIRO or the Essential Services Commission Act;
- for section 269, that the use of the services has not, or will not, increase;
- for a charge under section 268, that the property will not benefit from the services; or
- for a charge under s 268(1), any other grounds (section 271).

3.5.1 Template negotiating framework

A pro-forma negotiating framework is set out in appendix B. This template NCC negotiating framework covers the following matters:

- application and purpose of negotiating framework
- timeframes for negotiation
- provision of information by connection applicant
- provision of information by water corporation
- pricing principles
- standardised charges and eligibility criteria for these charges—where a given corporation has elected to propose any standardised charges in its water plan
- consultation with affected parties
- payment of water corporation’s costs
- termination of negotiations
- dispute resolution
- contacts for notices
- terms and abbreviations

3.6 Common New Customer Contributions calculation parameters

This section outlines the Commission's views on a number of parameters that will be common to most NCC calculations.

3.6.1 Assessment period for incremental operating costs and revenues

When calculating NCC, incremental operating costs and revenues should be measured over the same period. For the purpose of water plan 3, the default assessment period should be 30 years. This is because:

- most assets have a long service life and will generate an income stream for many years
- this time frame is also consistent with; IPART's water approach, electricity distribution connection charges and with the period for electricity transmission connection agreements.

The Commission acknowledges that in some cases (where it is clear that the life of the connection will be shorter) it may be more appropriate to negotiate that revenues and operating costs be measured over a shorter timeframe.

This period should also be used when assessing any other incremental benefits such as avoided system augmentation costs.

If a water corporation wishes to submit proposed standardised NCC charges in its water plan that rely on a shorter assessment period, it must also submit a version of the equivalent charge based on a 30 year period. This will allow the Commission to consult on the reasonableness of adopting a shorter period and for stakeholders to appreciate the impact of this difference on the magnitude of NCC charges.

3.6.2 Weighted average cost of capital (WACC)

When calculating NCC, the post-tax nominal Weighted Average Cost of Capital will be a relevant input for:

- assessing financing costs
- discounting costs and cash flows to their present value.

Water corporations should use the post-tax nominal WACC that aligns to post-tax real WACC and inflation assumptions used for the building block calculations in their water plans.

3.6.3 Accounting for inflation

All costs used in the NCC calculation should be stated in nominal terms.

3.6.4 Other issues

Charging units

Water corporations shall have the flexibility to choose the charging units for NCC (for example the charging parameter or unit of billing).

A guiding principle for connections is that they seek to provide a given amount of service capacity in the connection design. Historically the charging parameters used for NCC (such as lots, equivalent tenements, cistern, or fixtures) may be characterised as proxies for the amount of capacity needed to service the connection.

Water corporations should use charging units that are fit for purpose for each service and connection type.

Bring forward calculations

Financing costs relating to bring forward connections should be calculated as financing costs on the connection capital expenditure for the number of years that the expenditure is brought forward. That is, the product of capital expenditure, the post-tax nominal WACC and the number of years. This is a change from the practice in water plan 2 whereby bring forward charges were determined as 0, 40 per cent and 70 per cent of construction costs depending on the bring forward category.

The Commission requires that water corporations intending to levy bring forward charges will have prepared up to date Development Servicing Plans that show the timing of when assets were otherwise expected to be constructed. This is because it is necessary that a water corporation be able to provide evidence that the expenditure was not otherwise planned for in the current water plan period.

Zero charges

The charge for a given service in a given location may be calculated to be zero if that is the outcome of applying the NCC pricing principles to that connection.

Interaction with the RAB

Corporations will continue to add gross capital to and net contributions off the regulatory asset base (RAB). NCC costs and revenue will be assessed as part of total water plan proposal on forecast basis with actuals used in RAB roll-forward at the next water plan.

Initially water corporations may add an amount of net growth capital to the RAB. However, over time, this amount will be reduced by NCC revenue associated with this capital. This means that over the life of the growth asset existing customers will not be worse off as a result of growth.

To the extent material error in the forecasting of standardised charges transpires, and the water corporation cannot use case by case NCC to recover its required costs, then the corporation may consider relying upon the unforeseen event provisions to re-open its water plan.

While the NCC pricing principles mean NCC costs and revenues should move in line with each other during water plan 3, to the extent any over recovery of NCC revenues does occur, the RAB roll forward will lower the remaining RAB, and all customers will benefit from lower prices.

4.1 Water plan 3 – New Customer Contributions

The Commission expects water corporations to commence consultation with their new connection customers (developers, UDIA, PCA) on how they propose to apply the new NCC framework both individually and facilitated by VicWater. Among other things, this should include the setting of standard NCC and indicative NCC for major growth areas. The Commission expects that the consultation process for standard NCC may continue until March 2013. While negotiation for non-standard NCC will take place at the time connection is requested, water corporations should provide indicative NCC for non-standard developments prior to 1 July 2013.

The NCC component of each water corporation's water plan will include:

- a proposed negotiating framework
- forecast growth capital expenditure and gifted assets
- forecast NCC revenues for water plan 3
- any proposed standardised NCC and associated eligibility criteria for these charges.

During the transition to the new NCC framework some corporations may require additional time to formulate their proposed NCC arrangements. The following sections set out the Commission's timetable for submissions, including minimum and preferred submission content at each date.

Water corporations have two options relating to their NCC submission.

Option 1 – complete submission in September/October 2012

Option 2 – a staged submission (minimum requirement in September 2012/October 2012 and complete submission by December 2012)

These options are detailed below.

4.1.1 Option 1 – Complete submission in Final Water Plan 3

Complete submission content

- forecast growth capital expenditure and gifted assets
- NCC revenue forecasts based on the water plan 3 NCC framework and pricing principles
- any standardised charges and evidence of their compliance with the pricing principles
- negotiating framework based on the pro forma in appendix B
- transition plan (if required for a given catchment).

4.1.2 Option 2 – Staged submission

Final Water Plan submission

When water corporations submit their final water plans, they must include as a minimum:

- forecast growth capital expenditure and gifted assets based on the existing framework
- NCC revenue forecasts based on the existing framework
- the default negotiating framework based on the pro-forma in appendix B.

Water corporations should wait to consult on any proposed standardised NCC until they have been calculated using the minimum pricing principles (between September and December 2012).

December 2012 submission

Corporations will be have an opportunity to submit supplementary information on NCC by 7 December 2012 this will comprise:

- forecast growth capital expenditure and gifted assets
- revised NCC revenue forecasts based on the water plan 3 NCC framework and pricing principles
- any standardised charges and evidence of their compliance with the pricing principles
- negotiating framework based on the pro forma in appendix B
- transition plan (if required for a given catchment).
- if necessary any adjustments to tariffs for other services as a consequence of NCC calculated under the framework.

4.1.3 Transition plans

Transition plans should be included in submissions in the event that NCC calculated under the new regime are materially higher than those that would have been calculated under the existing framework. These plans would need to include a glide path for NCC.

Under a glide path approach the value of the NCC increases (smoothly) from the value it would have been under the existing framework in 2013-14 to the total value the NCC would be if it were calculated under the new framework for the year 2017-18.

For comparison purposes the scheduled NCC in 2013/14 would be assumed to be the scheduled NCC in 2012/13 adjusted for the Consumer Price Index.

4.2 Commission's water plan decision process

The Commission's water plan review process includes the following milestones:

- February 2013 – Draft decision on NCC elements of water plans released for final consultation
- May 2013 – Final decision on NCC elements of water plans released in water plan determination.

APPENDIX A | RESPONSES TO SUBMISSIONS

The May 2012 Staff Paper sought stakeholder responses to a number of consultation questions relating to the proposed NCC framework. The Commission received submissions from:

- Victorian Water Industry Association (VicWater)
- East Gippsland Water (EGW)
- South East Water (SEW)

Table 1 sets out stakeholder responses to the consultation questions and the Commission's response to these.

Table 1

<i>Question</i>	<i>Stakeholder response</i>	<i>Commission's view</i>
a) How effective is the proposed framework in achieving its objective?	<p>VicWater commented that it supported the pricing principles, on the condition that the Commission provided further detail on how they would work in practice.</p> <p>EGW responded that the proposed framework reflected the fair and reasonable provisions of the Water Act, and was flexible enough to apply to different business cases as opposed to the current prescriptive approach. EGW added that the prescriptive nature of the current approach was a major drawback.</p>	<p>The Commission's view is that the proposed framework meets its objective. It also aligns with the relevant legislative and regulatory frameworks, reflects good regulatory practice and is now supported by the illustrative examples and template negotiating framework provided with this guidance paper.</p>
b) How effective is the proposed framework in addressing water corporation and developer issues?	<p>SEW stated that water corporations and developers want long term certainty as to which assets they are responsible for providing. SEW added that such certainty cannot be provided by a negotiation framework.</p>	<p>The Commission's view is that while the current "one size" fits all prescriptive approach may provide some certainty (but only) in relation to the state wide scheduled charge, it does not allocate costs between water corporations and developers in a way that is consistent with the Water Act – namely in a fair and reasonable way, taking into account the benefit of that property relative to other properties.</p> <p>The Commission also notes that equivalent negotiated connection arrangements already apply efficiently in Australia's electricity, gas and telecommunications industries.</p> <p>The Commission considers that it is important to ensure consistency of the pricing principles beyond the next regulatory period See section 3.4.4.</p>

<i>Question</i>	<i>Stakeholder response</i>	<i>Commission's view</i>
	<p>SEW asked two questions that it saw as necessary for the Commission to address before adopting principles for NCC. These questions are:</p> <ul style="list-style-type: none"> • What party or parties are responsible for providing assets to expand water corporations networks? • How should the costs for expansion of water corporations' networks be recovered: upfront, overtime, or combination of both? 	<p>The Commission believes that the NCC pricing principles answer these questions. The pricing principles state that developers are responsible for paying the net incremental costs of expanding the network.</p> <p>The pricing principles allow for the costs of development to be recovered upfront and overtime. The NCC paid is the net cost of connection, the balance equivalent to the incremental revenue earned from the connection is paid over time. The regulatory mechanism for achieving this is the addition of net capital expenditure to the RAB, which is then recovered through regulated retail charges over the life of the assets.</p>
	<p>SEW added that NCC played an important role in sending price signals to developers about where it is most efficient to develop land closest to South East Water's water, recycled water and sewerage network.</p>	<p>The Commission considers that the flexibility achieved through the new NCC framework will improve price signalling to developers.</p> <p>Under the new framework NCC will be based on the net incremental costs of providing infrastructure and associated activities to serve land in different locations. This will enable developers to make decisions as to where it is most cost effective to develop. The existing framework only achieves this by reference to gifted reticulation assets and to a lesser extent through existing bring forward charging arrangements.</p> <p>The proposed framework will allow signalling for all supply chain costs and for this to be fit for purpose for a given connection situation.</p>

<i>Question</i>	<i>Stakeholder response</i>	<i>Commission's view</i>
c) What guidance is needed to facilitate transition into the next regulatory period and who is best placed to develop this guidance?	SEW stated that any NCC model will continue to obligate the Commission to define shared and reticulation assets.	<p>The Commission's view is that it should not define shared or reticulation assets. This is because the pricing principles require all incremental connection costs to be included in the calculation. This is regardless of the asset type.</p> <p>Further our view is prescriptive State-wide asset definitions would limit any NCC framework's flexibility to be applied in a principled way over the wide range of possible development situations.</p> <p>The Commission encourages water corporations and developers to work together to prepare industry standards where they may be useful. Such standards also provide a more flexible approach than any guideline or determination made by the Commission (i.e. if required, it is less administratively costly and more timely to adjust an industry standard).</p>

<i>Question</i>	<i>Stakeholder response</i>	<i>Commission's view</i>
d) Over what length of time should future incremental revenues and operating costs be measured?	VicWater stated that revenues should be measured over 20 years and capital expenditure over one or more water plans.	<p>The Commission's view is that incremental operating costs and revenues should be measured over 30 years this is because:</p> <ul style="list-style-type: none"> • assets have a long service life and will generate an income stream for many years • this time frame is consistent with IPART's approach <p>The Commission acknowledges that in some cases (where it is clear that the life of the connection will be shorter) it may be more appropriate to negotiate that revenues and operating costs be measured over a shorter timeframe.</p> <p>The Commission's view is that capital expenditure that facilitates multiple forecast connections over more than one water plan period should be considered in NCC charges across all the periods for which it is facilitating connections. This is a change from the Staff Paper which proposed constraining capital to a 5 year period.</p>
e) Is there merit in standardising capacity measures for NCC charging for each NCC service type, or is it preferable to allow flexibility?	Stakeholders did not answer this question.	<p>The Commission's view is that water corporations should have the flexibility to be able to choose the charging basis for NCC. A standardised charging basis may not result in comparable charges between developments and other connections that impose similar incremental costs on the water corporation.</p>

<i>Question</i>	<i>Stakeholder response</i>	<i>Commission's view</i>
f) Should the Commission retain an informal role in the transition by providing opinions on whether a given NCC charge reflects proper application of the NCC pricing principles?	Stakeholders did not respond to this question directly. But they indicated that they would like the Commission to provide further guidance on the application of the proposed framework before 1 July 2013.	<p>During the transition period the Commission could (upon request from a water corporation or connection applicant) provide an opinion whether the proposed NCC charge accords with the approved pricing principles. This is to assist in promoting greater clarity in the interpretation of the pricing principles. We also propose to review this informal role prior to the end of the next regulatory period. The Commission could comment on only one of the several possible grounds for appeal, being compliance with the WIRO and ESC Act (see s 271(1)(ea) of the Water Act).</p> <p>The Commission notes that nothing can be done by the water corporations or the Commission to 'stop the clock' on the VCAT process described in appendix D. Any Commission process would impinge on these timeframes, and could only be addressed by the water corporation in its notice of charges. Specifically, a water corporation can specify in its notice of charges a longer period than 1 month to allow objections by property owners (s 271(1) of the Water Act).</p>
g) Any illustrative case studies showing how the new pricing principles would work in practice	Stakeholders provided examples that could be used to show how the pricing principles would work in practice.	

Table 2

<i>Stakeholder response</i>	<i>Commission's view</i>
<p>VicWater's submission stated the NCC pricing principles proposed are, in a number of cases inconsistent with the provisions of the Water Act and Water Industry Act.</p> <p>VicWater subsequently provided legal advice that:</p> <ul style="list-style-type: none">• questioned whether operating costs could be considered "works" for the purposes of s268 of the Water Act. VicWater also advised that revenue offsets are not contemplated in any way under s268 of the Water Act.• outlined perceived inconsistencies between the Water Act and the proposed NCC framework objective.	<p>The Commission's view is that there are no impediments to implementing the framework. Further the proposed framework is more closely aligned with the regulatory framework than the existing framework.</p> <p>The Commission's view relating to operating costs and revenue offsets is:</p> <ul style="list-style-type: none">• consistent with the heads of power under the WIRO and sections 268, 269 and 270 of the Water Act, developer charges for the present day cost of any works can encompass operating costs• there is no expressed or implied prohibition against offsetting works charges by the revenue expected to be received from the new customer in the way of usage charges <p>The framework's objective is derived from the statutory requirements of the Water Industry Act and Water Act. The objective promotes efficient pricing and is consistent with the requirements¹³ of the Water Act and Water Industry Act in relation to the provision of services that benefit property, namely:</p> <p>Charging principle in WIA s.27(3) guides negotiation: 'the amount of any payment must be assessed by the licensee to be fair and reasonable, taking into account the benefit to that property relative to the benefit to other properties'</p>

¹³ Refer to the New customer contributions - Commission staff framework and approach paper May 2012 for more detail on the framework.

<i>Stakeholder response</i>	<i>Commission's view</i>
<p>SEW noted that water corporations (particularly the Melbourne Licensees) do not have the power to “walk away” from negotiations. Ultimately they are obligated to connect a customer requesting connection.</p>	<p>The Commission’s view confirms there is no obligation on Water Corporations to connect a customer. A person that wishes to connect must apply for Water Corporation consent. The Water Corporation may:</p> <ul style="list-style-type: none"> • refuse to consent • consent or • consent subject to any terms and conditions it thinks fit (s145). <p>The nature of water corporations’ connection obligation is discussed further in [chapter 2].</p>
<p>SEW’s preferred NCC model was a hybrid of the Economic Regulation Authority of Western Australia (ERA) Model. SEW noted the model had strong coverage of, Water Act requirements, the WIRO pricing principles and proposed NCC principles, including:</p> <ul style="list-style-type: none"> • 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 corporations to calculate NCCs • Transparency and Accountability – ease of understanding to show costs and service received • Administrative Ease – simple model to apply and calculate NCCs • Aligns with MAC recommendations for geographic and cost reflective developer charges 	<p>Commission has now reviewed the applicable statutory framework for water plan 3. This review shows that the ERA 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. Further, even if permissible, the model SEW propose would not meet the Ministerial Advisory Council’s (MAC’s) objective of allowing innovations in connection solutions and Integrated Water Cycle Management (IWCM). Any model that calculates a cost reflective charge for the various connection situations that may transpire is by nature reasonably complex. Based on this it is difficult to see how the model proposed by SEW would be much more simple to administer than the model proposed by the Commission.</p>

Stakeholder response

SEW contended that the proposed approach was at odds with the current principles of the regulatory building blocks model (via the inclusion of operating costs and expected revenue, which are key components of the building blocks model inputs) approach for setting ongoing tariffs.

Commission's view

The Commission's view is that the proposed approach is consistent with the building blocks model. This is evidenced by its prescribed use in regulated gas and electricity networks whose rules also prescribe use of the building block cost of service approach to regulation.

The net incremental cost approach recognises that an on-going revenue stream (based on the building block prices) will be earned from new connections, and that those connections should only pay an upfront charge where the on-going regulated revenue stream (over a reasonable period) is insufficient to cover the connection costs.

On this basis, some growth capital expenditure (i.e., total growth capital expenditure net of NCC's) should be added to the RAB and recovered through on-going regulated building block charges. This is because it is possible to add connection related costs to the RAB up to the point where the present value of connection costs is equal to the present value of additional revenues that would be earned from the connection. This ensures existing customers are no worse off.

By adding net capital expenditure to the RAB, and accounting for incremental revenue when setting the NCC revenue (i.e. which is used to determine net capital expenditure), the model allows the building block charges (derived from the RAB and operating expenditure) to adjust as new customers' demand is taken into account at each reset such that existing customers will be better off or no worse off from the new connections and the costs associated with those connections.

Stakeholder response

SEW stated that NCCs represent a contribution by the customer to the costs of providing the distribution network to a new customer. The Commission's proposal to use retail tariffs significantly over estimates the tariff revenue collected from new customers, as it includes both bulk costs and retail costs (bulk costs currently represent over 50% of South East Water costs. SEW added that electricity NCC model uses distribution tariffs to calculate an NCC charge.

Commission's view

The Commission's view is that the proposed approach is consistent with the building blocks model. This is evidenced by its prescribed use in regulated gas and electricity networks whose rules also prescribe use of the building block cost of service approach to regulation.

The net incremental cost approach recognises that an on-going revenue stream (based on the building block prices) will be earned from new connections, and that those connections should only pay an upfront charge where the on-going regulated revenue stream (over a reasonable period) is insufficient to cover the connection costs.

On this basis, some growth capital expenditure (i.e., total growth capital expenditure net of NCC's) should be added to the RAB and recovered through on-going regulated building block charges. This is because it is possible to add connection related costs to the RAB up to the point where the present value of connection costs is equal to the present value of additional revenues that would be earned from the connection. This ensures existing customers are no worse off.

By adding net capital expenditure to the RAB, and accounting for incremental revenue when setting the NCC revenue (i.e. which is used to determine net capital expenditure), the model allows the building block charges (derived from the RAB and operating expenditure) to adjust as new customers' demand is taken into account at each reset such that existing customers will be better off or no worse off from the new connections and the costs associated with those connections.

Stakeholder response

SEW stated that NCCs represent a contribution by the customer to the costs of providing the distribution network to a new customer. The Commission's proposal to use retail tariffs significantly over estimates the tariff revenue collected from new customers, as it includes both bulk costs and retail costs (bulk costs currently represent over 50% of South East Water costs. SEW added that electricity NCC model uses distribution tariffs to calculate an NCC charge.

SEW noted that that the current electricity negotiation Rules and associated Guidelines for the electricity industry, run in excess of 100 pages, compared with the equivalent Commission Rules and Guideline totalling 9 pages – it is questionable whether this meets the Water Industry Regulatory Order (WIRO) requirements for prices (or the manner in which prices are calculated) to be readily understandable by customers.

SEW argued that the inclusion of operational costs in the NCC calculation will lead to significant regulatory complexities in future regulatory periods, for the Commission (and Water Corporations) when approving efficient operating costs for Water Corporations' Water Plans, as there will be a need to develop adjustment mechanisms to account for already collected operational costs (preventing the potential for Water Corporations to double dip, for operation cost recovery).

Commission's view

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

The Commission's view is that incremental costs attributed to new connections (i.e. capital expenditure and operating expenditure) should be the total supply chain costs not just distribution/retail.

The difference between electricity distributors and water retailers is the distributors are not liable for other supply chain costs, whereas water retailers are.

- A total supply chain method of connection cost attribution will best support achieving the policy objectives of the MAC.
- Further bulk charges are captured in both operating costs and revenues so therefore they should generally net out.

The current 'Connection charge guidelines for electricity retail customers' is 29 pages. <http://www.aer.gov.au/node/7258>.

Further, the Commission has provided a simple pro-forma negotiating framework as appendix B to this guidance paper.

Generally speaking, average incremental operating expenditure will be netted out by average incremental revenue.

Where incremental operating expenditure is > average, the resulting higher NCC charge will be netted off the RAB. Thus, when a water corporation forecasts its operating expenditure for future regulatory period inclusive of notionally contributed operating expenditure and the Commission approves building block prices based on these forecasts, there will be no over-recovery because the corporation's RAB return will be commensurately lower.

<i>Stakeholder response</i>	<i>Commission's view</i>
<p>SEW raised a number of other issues more generally in relation to NCC. These were:</p> <p>Out of Sequence Charging – return to the year on year finance cost model of bring forward charges.</p> <p>Greenfield and Infill Development Costs - needs to be addressed through geographic charges.</p> <p>Development Servicing Plans – South East Water continues to strongly support development servicing plans.</p> <p>Transition – ensuring risks for “winners” and “losers” in the transition process are adequately considered.</p> <p>Appeals – amendments of Water Act/Water Industry Act to remove VCAT from the process</p>	<p>The Commission’s response to these issues is:</p> <ul style="list-style-type: none"> • The proposed framework allows incremental financing costs to be calculated on a year on year basis. • The proposed framework better facilitates geographic charging. • The preparation of Development Servicing Plans continues to be strongly encouraged by the Commission. • The Staff Paper explains how ‘winners/losers’ are accounted for in the transition and foreshadowed flexibility for water corporations amid the transition. • Amending the Water Act or Water Industry Act is not within the Commission’s scope.
<p>VicWater^a in a subsequent submission requested further clarification on where and when developer charges are applicable.</p>	<p>Section 2.2.2 of this paper clarifies where and when NCC may be charges and section 3.4 and appendix C discuss what costs are recoverable and how these are calculated.</p>
<p>VicWater in a subsequent submission sought further explanation for how capital costs are reconciled between the NCC charges and corporations’ RABs over time.</p>	<p>Corporations will continue to add gross capital to and net contributions off the RAB. NCC costs and revenue are assessed as part of total water plan proposal on forecast basis with actuals used in RAB roll-forward at next water plan.</p> <p>While this means that in an initial water plan period a net amount of growth capital may be added to the RAB, over successive water plan periods subsequent NCC associated with that capital will be deducted from the RAB.</p>
<p>VicWater in a subsequent submission identified that the Water Act could be interpreted as allowing recovery of past and present costs associated with providing services to a connection.</p>	<p>The Commission has amended its definition of incremental costs to allow for historical costs that were incurred for the purpose of servicing forecast customer growth. See appendix C.</p> <p>Historical costs should be considered net of any contribution already received toward that costs and based on the written down residual value of those costs.</p>

Stakeholder response

VicWater in a subsequent submission requested the Commission explain why it adopted pricing principles that biased NCC towards avoidable cost, and in what circumstances the Commission would expect to see NCC pricing close to the upper bound of standalone cost.

Commission's view

The Commission notes that incremental cost, as defined section 3.4.1, can be expected to be higher than avoidable cost. This is because avoidable is forward looking only, whereas incremental cost can include an allocation of historical costs that the corporation had prudently prebuilt in expectation of future growth. Given the strong network characteristics of water services, the Commission would only expect to see NCC reflecting standalone cost if the least cost technically efficient servicing solution for a given connection request would not involve using any of the water corporation' existing infrastructure.

VicWater in a subsequent submission requested the Commission explain why it has decided on the minimum pricing principles.

The Staff Paper provided extensive explanation for the proposed pricing principles. Section 3.4 of this paper explains that the Commission considers the minimum pricing principles represent the minimum requirements that the Commission would expect to see an NCC charge comply with in order to confirm that the charge was fair and reasonable as required by the Water Act.

Interplay of developer charges and development charges

S.259 of the Water Act provides that a water corporation may impose a development tariff on the owner of unserviced properties within its district. The Commission understands that this form of prefunding ahead of connection is no longer commonly practiced by water corporations. Such practice would be somewhat inconsistent with the NCC pricing principles under the new NCC framework. To ensure no over recovery of connection costs, the Commission will require water corporations to report revenues from any development charges levied under s.259 so that these can be deducted from the costs that would otherwise be recoverable in NCC.

^a this submission followed the water industry workshop held in July 2012.

APPENDIX B | SAMPLE NEGOTIATING FRAMEWORK

The Commission has developed negotiating framework form that water corporations could consider submitting as a part of their Final Water Plans. An example of the form is displayed below.

1. Application of Negotiating Framework

This Negotiating Framework forms a part of (WATER BUSINESS NAME's) approved water plan for the 2013- 2018 water plan period.

1.1 Purpose

This Negotiating Framework sets out procedural and information requirements relevant to **services to which developer charges apply**, as defined in the WIRO. It requires Water Business and any Connection Applicant to negotiate in good faith to agree the price, 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 the Water Business.

The requirements set out in this negotiating framework are in addition to any requirements or obligations contained in the [list regulatory instruments].

In the case of inconsistency between the [Regulatory Instrument] and this negotiating framework, the relevant [Regulatory Instrument] will prevail.

This Negotiating Framework does not alter the rights of a Connection Applicant to seek a review of a Water Business's decision by the Victorian Civil and Administrative Tribunal.

1.2 Who this negotiating framework applies to

This Negotiating Framework applies to (WATER BUSINESS NAME) and to any property owner - generally a property developer – that is a Connection Applicant who requests connection to Water Business's works in accordance with section 145 of the *Water Act 1989* (Vic).

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

1.3 No obligation to provide service, good faith obligation

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

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

However, Water Business and Connection Applicant must negotiate in good faith the price, terms and conditions for services sought by the Connection Applicant.

2. Timeframes

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

- (a) Agree the milestones, information requirements and any other relevant issues within [5] days of Water Business's receipt of an application;
- (b) Adhere to any timetable established for negotiations, and progress negotiations in an expeditious manner; and
- (c) Finalise negotiations within [120] business days of the initial application.

2.1 Commencing, progressing and finalising negotiations

[table 1 below should be modified by the Water Business to reflect water industry practice, and reasonable expectations]

table 1 – Indicative timeframes for negotiating connection

Step	Actions	Timing
1	Receipt of written application for connection	X
2	Parties discuss: <ul style="list-style-type: none">• the nature of the services required;• any information to be provided by the Connection Applicant; and• notification and consultation with other persons potentially affected	X + 5 Business Days

Step	Actions	Timing
	Parties agree: <ul style="list-style-type: none"> timeframes for negotiation and consultation; and milestones. Connection Applicant pays application fee.	
3	Connection Applicant provides information to Water Business [Water business may request additional information]	X + [20] Business Days [Additional 20 Business Days]
4	Where required, Water Business consults with others potentially affected	X + [40] Business Days
5	All necessary information is received by Water Business, including: <ul style="list-style-type: none"> the completed application; the Connection Applicant's information; and consultation feedback where required. 	Y
6	(WATER BUSINESS NAME's) provides Commercial Information and makes offer (in form of Notice).	Y + [20] Business Days
7	Parties finalise negotiations	Y + [80] Business Days

3. Provision of information by Connection Applicant

[this section should deal with the Connection Applicant's obligations to provide sufficient information to enable the Water Business to assess needs and its obligation to provide additional commercial information if requested by the Water Business.]

[Add reasonable confidentiality requirements]

4. Provision of information by Water Business

[this section should detail the obligations of the Water Business to provide information (including cost information) to the Connection Applicant.

It should list information:

- that must be provided by the Water Business under the Water Act
- that is reasonably required by a Connection Applicant in order to satisfy the grounds for review by VCAT under the Water Act.

Add reasonable confidentiality requirements

5. Pricing Principles

The Water Business's charges will:

- have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection;
- have regard to the incremental future revenues that will be earned from customers at that connection; and
- be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

In setting charges, Water Business will also comply with:

- the regulatory principles set out in clause 14 of the WIRO; and
- [Incorporate here any specific pricing principles approved by the Essential Services Commission as part of in Water Business's water plan]

6. Consultation with affected parties

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

- subject to reasonable confidentiality requirements, Water Business 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 Water Business's Costs

8. Termination of negotiations

The Connection Applicant may elect not to continue with its application for a service to which a developer charge applies, and may terminate the negotiations by giving Water Business written notice of its decision to do so.

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

1. water business believes on reasonable grounds that the Connection Applicant is not conducting the negotiation under this negotiating framework in good faith;
2. water business reasonably believes that the Connection Applicant will not acquire any Negotiated Distribution Service; or
3. an act of insolvency occurs in relation to the Connection Applicant.

9. Dispute resolution

[Set out the VCAT process, timing – perhaps a flow chart?]

[OPTIONAL - Offer alternate dispute resolution process – make clear that this does not remove rights to seek review by VCAT under the Water Act]

[Highlight that the information required of the Water Business under this Negotiating Framework should enable the Connection Applicant to assess its grounds for appeal]

10. Giving notices

Address for notices

Time notice is given

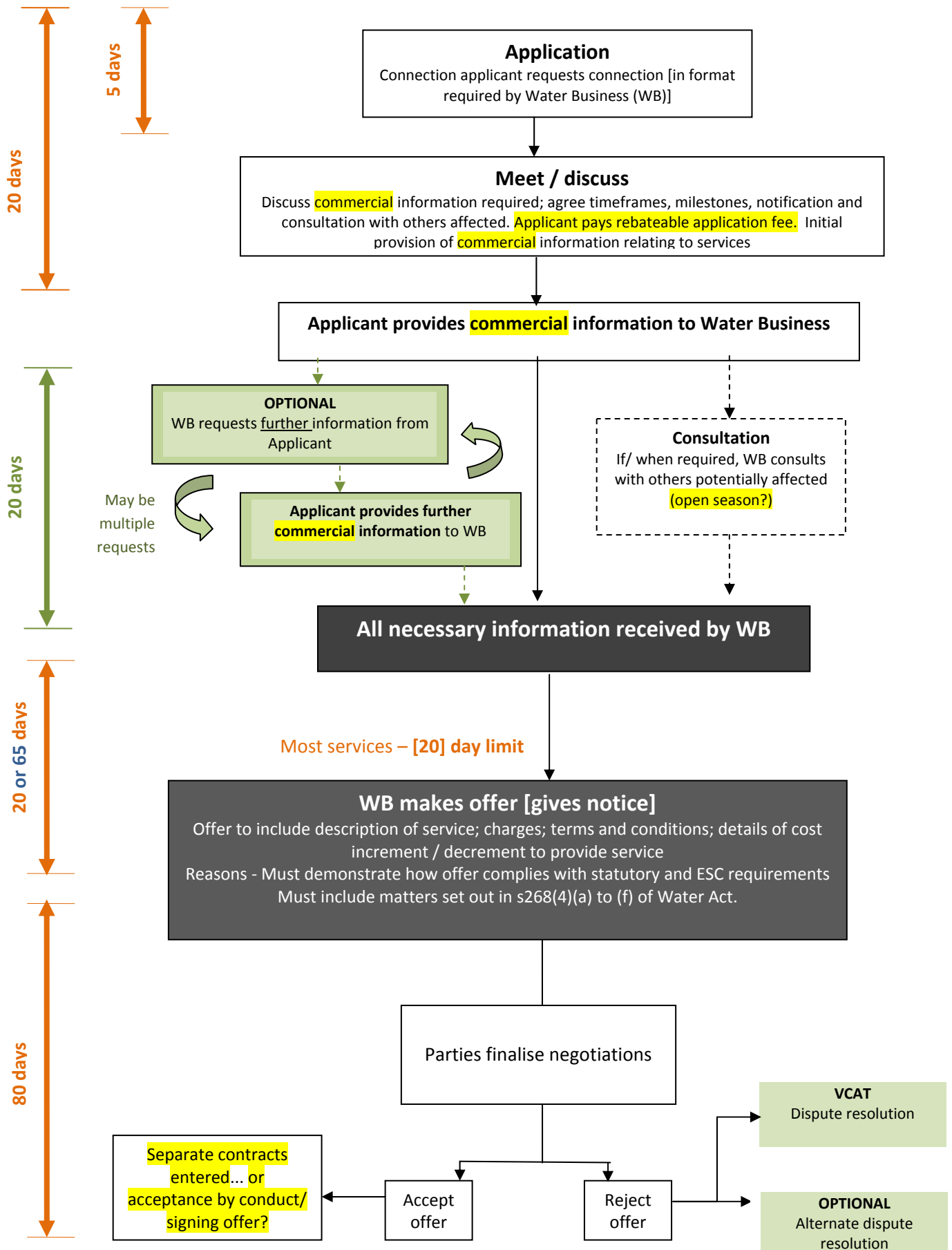
11. Terms and abbreviations

Definitions

Interpretation

NEGOTIATING FRAMEWORK FOR NEW CUSTOMER CONTRIBUTIONS

INDICATIVE TIMELINES FOR NEGOTIATING FRAMEWORK



APPENDIX C | NEW CUSTOMER CONTRIBUTIONS CALCULATION NOTES

<i>Incremental cost variable</i>	<i>Calculation notes</i>
<p>Capital expenditure by water corporation.</p> <p>This is incremental expenditure required to service growth. For the calculation of a standardised charge the next regulatory period’s capital should be included.</p> <p>Case by case situations should only include the incremental capital required to service the development in question.</p>	<p>A portion of assets that were constructed in water plan 2 to service growth in water plan 2 and beyond may be included in the calculation of an NCC. Water corporations must satisfy the Commission that the cost of these assets has not been recovered through previous contributions.</p> <p>Water corporations must provide strong justification for the inclusion of these assets in their water plan 3 NCC charges.</p> <p>In cases where an asset planned for water plan 3 serves both new and existing customers the portion allocated for new customers can only be included in the charge. The methodology used to apportion costs should be transparent and be consistent with the incremental cost principle</p> <p>Some assets may have capacity to serve customers over more than one regulatory period. The cost of these assets should be prorated across future periods by working out the portion of total capacity that is used in the relevant future period.</p>
<p>Incremental operating costs</p> <p>These are costs that the water corporation would avoid if these new customers did not connect.</p>	<p>Incremental operating costs should be calculated over 30 years.</p> <p>To calculate the total incremental operating cost, annual operating costs for the regulatory period or development must be estimated over 30 years.</p> <p>A present value analysis is then undertaken on these estimates using a discount factor of the regulatory post-tax nominal Weighted Average Cost of Capital.</p> <p>Incremental operating costs are total system costs and include headworks and tailworks.</p>

<i>Incremental cost variable</i>	<i>Calculation notes</i>
<p>Financing costs</p> <p>These costs are the costs a water corporation faces when a developer requires an asset to be constructed sooner than planned.</p>	<p>In principle, financing costs are calculated as follows:</p> <p>Financing costs _(bring forward) = Asset construction costs* multiplied by the number of years the asset is being brought forward multiplied by the regulatory post-tax nominal WACC</p> <p>^ in the case of pipelines, construction costs include the cost of bringing the asset from where it is (when the application is made) to the point where it serves the development.</p> <p>In practice, because bring forward investments will change cash flows and tax liabilities, the actual bring forward cost will be calculated as financing costs on the net present value of the change in cash flows.</p>
<p>Gifted assets provided by developers</p> <p>These are assets that the water corporation has required the developer to build and gift.</p>	<p>Gifted assets are valued in accordance with water corporations accounting policies.</p>
<p>Depreciation costs</p> <p>These costs are included when calculating the incremental cost of a temporary asset using the operating cost methodology.</p>	<p>The incremental costs attributable to temporary assets can be calculated in two ways:</p> <ul style="list-style-type: none"> operating cost method capital cost method <p>Incremental cost _(temporary asset operating cost) = (depreciation cost + financing cost) multiplied by the no. of years the temporary asset is expected to be in use.</p> <p>Incremental cost _(temporary asset capital cost) = (Capital cost divided by Asset life) multiplied by the no. of years the temporary asset is expected to be in use.</p> <p>Installation and removal costs associated with the temporary asset can be added to the incremental cost.</p>
<p>Taxation</p> <p>Incremental taxation costs should be included in the NCC charge calculation.</p>	<p>Corporations should have regard to the incremental tax liability or benefit that arises from the NCC related costs and revenues when calculating NCC charges.</p>

<i>Incremental benefit variable</i>	<i>Calculation notes</i>
<p>Incremental tariff revenue</p> <p>This is revenue that the water corporation will earn from customers at the new connection.</p>	<p>Incremental revenues should be calculated over 30 years.</p> <p>To calculate the total incremental revenue, annual revenues for the regulatory period or development must be estimated over 30 years.</p> <p>A present value analysis is then undertaken on these estimates using a discount factor of the regulatory post-tax nominal WACC.</p> <p>Average tariffs for each service (and category within the service for example residential or non-residential) should be used in the calculation.</p> <p>When calculating a standardised charge water corporations could use:</p> <ul style="list-style-type: none"> • the approved tariffs in year 5 of water plan 2, or • its forecast of the relevant service tariff in water plan 3. <p>This second option is preferred.</p> <p>The current year's tariff should be used when calculating a charge on a case by case basis.</p>
<p>Other non-revenue benefits</p> <p>These are other benefits that accrue to the water corporation. These benefits may accrue when developers undertake works that defer augmentation of other assets.</p>	<p>Water corporations should assess on a case by case basis and discount to present value.</p> <p>Other benefits should be categorised in two groups.</p> <ol style="list-style-type: none"> 1. Benefits for which the benefit is treated as taxable income. For example, the development capital expenditure on a local storm water management may defer the requirement for a local government storm water system upgrade. The local government could pay the water corporation the deferment benefit. 2. Benefits for which the benefit is not treated as taxable income. For example, the development may have an environmental benefit that the water corporation wishes to value but for which it will not receive taxable income from any party.

APPENDIX D | LEGISLATIVE FRAMEWORK FOR NEGOTIATIONS BETWEEN WATER CORPORATIONS AND PROPERTY OWNERS DEVELOPING LAND

References below are to the Water Act 1989 (Vic), which regulates water corporations. The equivalent provisions in the Water Industry Act 1994 (Vic) were repealed on 1 July 2012 by the Water Amendment (Governance and Other Reforms) Act 2012 (Vic).

<i>Connection</i>	<i>Development charges</i>	<i>Dispute resolution</i>
<p>There is no obligation on water corporations to connect a customer.</p> <p>A person that wishes to connect must apply for water corporation consent. The water corporation may:</p> <ul style="list-style-type: none"> • refuse to consent • consent or • consent subject to any terms and conditions it thinks fit (s145). <p>(This is different to the pre 1 July 2012 situation under section 63(2) of the Water Industry Act, which requires a water corporation to connect a customer.) A water corporation may impose a development tariff on the owner of unserviced properties within its district (s259).</p>	<p>A water corporation may impose a development tariff on the owner of unserviced properties within its district (s259).¹⁴</p> <p>A water corporation may charge a property owner a fair and reasonable charge</p>	<p>Within 1 month, the property owner may object to the water corporation because:</p> <ul style="list-style-type: none"> • where the fee is based on valuation of the land, the land is not rateable; • the person is not liable for the tariff; • the tariff was not set in accordance with a WIRO or the ESC Act; • the water corporation did not give notice that the property is a serviced property; • the fee imposed by the water corporation is not a correct application of the tariff (s266). <p>Within 28 days, the owner may appeal the water corporation's response to the objection to VCAT.</p> <p>Within 1 month, the property owner may object to the water corporation on any of</p>

¹⁴ See Commission comment in appendix A ,table 2 regarding the interplay of development charges and NCC.

<i>Connection</i>	<i>Development charges</i>	<i>Dispute resolution</i>
	<p>to contribute to the cost of any works for the provision of services:</p> <ul style="list-style-type: none"> • that will benefit that property (s268) • to that property, if the use will increase due to development, or change in use, of the land (s269) or • to that property, where the property becomes a serviced property (s270). 	<p>the following grounds:</p> <ul style="list-style-type: none"> • the amount is excessive • where there are several properties that will benefit: • that the owner should not be required to make payment • that another owner should also be required to contribute or • the distribution of the cost between the properties is unreasonable. • that the payment was not set in accordance with a WIRO or the ESC Act • for s 269, that the use of the services has not, or will not, increase • for a charge under s 268, that the property will not benefit from the services or • for a charge under s 268(1), any other grounds (s271). <p>Within 28 days, the owner may appeal the water corporation's response to the objection to VCAT.</p>

Source: Lander & Rogers (2012)

Process for appeals

The process for appealing against both general development charges and contributions is as follows:

1. **Notice** - The clock runs from the time the water corporation **gives notice of a charge**.
2. **Objection** - Then the developer/property owner has **one month*** to object *to the water corporation* to that notice (the contents of which are specified in s268(4)(a) to (g) and 270(3) of the Water Act)

- *OPTIONAL* - The water corporation has a discretion to specify in the *notice* of charges a longer time than 1 month to allow objections (s271(1)).
3. **Decision on objection** - The water corporation has **2 months** following receipt of an *objection* to notify the developer/property owner of its decision on the objection (s271(2))
 - **Optional step under VCAT Act** - the developer/property owner can request a **statement of reasons** from the water corporation (s46 of the *Victorian Civil and Administrative Tribunal Act 1998* (Vic))
 4. **Appeal to VCAT** - After the later of the water corporation's decision on the objection, or receipt of a statement of reasons, or advice that a statement of reasons will not be given, the developer/property owner has **28 days** to appeal the water corporation's response to the objection to VCAT (s271(4)(b) of the Water Act).

APPENDIX E | CONSULTATION

The table below lists the consultations Commission staff have undertaken with stakeholders in relation to the NCC framework for the next regulatory period.

<i>Date</i>	<i>Stakeholder</i>	<i>Issue</i>
July 2011	VicWater	Initial meeting to commence consultation with the water industry on the development of a new NCC framework for the next regulatory period
July 2011	Water industry NCC working group	Meeting 1 – discuss the principles that the new NCC framework should meet
August 2011	Department of Sustainability and Environment	Met to discuss the Ministerial Advisory Councils position on developer charges
September 2011	Water industry NCC working group	Meeting 2 – discuss the principles that the new NCC framework should meet
September 2011	Urban Development Institute of Australia	Met to discuss a new NCC framework for the next regulatory period
October 2011	VicWater	Met to discuss progress of framework development
October 2011	Water industry NCC working group	Meeting 3 – discuss potential NCC framework options
October 2011	Urban Development Institute of Australia	Met to discuss progress of framework development

<i>Date</i>	<i>Stakeholder</i>	<i>Issue</i>
November 2011	Water industry NCC working group and Urban Development Institute of Australia	Meeting 4 – joint meeting to discuss the principles that the new NCC framework should meet
December 2011	Water industry NCC working group & Urban Development Institute of Australia & Property Council of Australia	Meeting 5 – joint meeting to discuss the principles that the new NCC framework should meet
December 2011	All stakeholders Released on ESC website	Release of Commission staff position paper on new customer contributions
January 2012	IPART	Met to discuss developer charge regime in NSW
April 2012	Department of Sustainability and Environment	Met to discuss the proposed NCC framework
April 2012	VicWater	Met to discuss the proposed NCC framework
April 2012	Urban Development Institute of Australia & Property Council of Australia	Met to discuss the proposed NCC framework
April 2012	Water industry NCC working group	Met to discuss the proposed NCC framework
April 2012	City West Water	Met to discuss the proposed NCC framework
April 2012	South East Water	Met to discuss the proposed NCC framework
May 2012	Urban Development Institute of Australia infrastructure committee	Met to discuss the proposed NCC framework

<i>Date</i>	<i>Stakeholder</i>	<i>Issue</i>
May 2012	All stakeholders Released on ESC website	Release of Commission staff framework and approach paper on new customer contributions
June 2012	Urban Development Institute of Australia infrastructure committee	Met to discuss the proposed NCC framework
June 2012	Growth Areas Authority	Met to discuss the proposed NCC framework
June 2012	Department of Sustainability and Environment	Met to discuss the proposed NCC framework
June 2012	Western Water	Met to discuss transition and timing issues relating to the new framework
June 2012	Water industry VicWater Finance managers conference	Present new framework
July 2012	Water industry	Two workshops to explain how the pricing principles could work in practice
August 2012	Office of Living Victoria	Met to discuss the proposed NCC framework
August 2012	Water industry NCC working group	Issues relating to further guidance on the NCC framework
August 2012	Urban Development Institute of Australia , Property Council of Australia, Growth Areas Authority and Department of Sustainability and Environment	Issues relating to further guidance on the NCC framework

