



MG Estates PL

ESC Coliban Water Pricing Draft Decision Submission

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11 May 2023

 **Currie & Brown**

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Kate Symons
Chairperson,
Essential Services Commission
Level 8
570 Bourke Street
MELBOURNE VICTORIA 3000

(Via Engage Victoria website)

Dear Commissioners

DRAFT DECISION FOR COLIBAN WATER - MG ESTATES PTY LTD SUBMISSION

Thank you for the opportunity to comment on your draft decision for Coliban Water. Our comments are in relation to New Customer Contributions (NCCs) and should be read in the context of our detailed submission to you on 1 December 2022 and Coliban Water's response dated 12 January 2023, both of which are on your website.

To recap, MG Estates is developing 1,380 lots with maximum infrastructure efficiency on one site in Maiden Gully, Bendigo to be released over the next 10 years. MG Estates is asked to contribute over \$20m on infrastructure to be gifted to Coliban Water and in addition is requested by Coliban Water to pay over \$7m in NCC charges based on the proposed prices. In excess of \$7m of the MG Estates \$20m infrastructure expenditure will be creating new connection upgrades outside the site to allow for new customers to connect to the network. This clearly lacks parity with proposed NCC charging in other growth areas and is inconsistent with Essential Services Commission (ESC) guidelines particularly in relation to negotiation of NCCs and accepted practice for the provision of developer contributions including the ability to provide external infrastructure to connect new customers. Despite the scale of investment and the quantum of the increase in NCC prices, Coliban Water has not explained its input assumptions or its new calculation methodology.

In line with the ESC guidelines, MG Estates for some time has been seeking a negotiated NCC agreement with Coliban Water. To date Coliban Water have refused to participate in a negotiation process. It is our belief that a negotiated outcome for a site of this scale is more appropriate under the ESC guidelines than the application of a standard NCC.

In your final decision, we recommend that you:

- a. Reject Coliban Water's proposed methodology for calculating new customer contributions because it fails to meet the requirements of your Guidance Paper, as Coliban Water is unable to demonstrate it has "*had regard to*" incremental future revenues.
- b. Reconsider your assessment of "advanced" for the engagement component within the PREMO framework because of Coliban Water's poor engagement on NCC processes, regardless of the quality of the engagement on other aspects of its submission.

- c. If Coliban Water does respond to your draft decision with the required explanations and new estimates of NCCs, you should assess if Coliban Water has had sufficient time and invested sufficient genuine effort to explain its approach and expose its assumptions to those developers in a position to review, test and if necessary, challenge them.

We also suggest that you commit to a Commission led, industry-wide review of the NCC framework, commencing soon after your final decision, considering amongst other things:

- i. an assessment of the methodology for calculating new customer contributions which some water corporations have proposed, and the resultant loss of consistency across the water sector.
- ii. the use and application of standard NCCs at the expense of negotiated NCCs and the resultant loss of cost reflectivity.
- iii. principles used by water corporations for deciding what conditions are placed on subdivisions, and principles used by water corporations for deciding what infrastructure is the responsibility of a developer, within the context of impact on the calculation of NCCs. This should include how decisions are made on how and when developers are reimbursed for works built by developers on behalf of a water corporation.
- iv. expanding your performance monitoring and reporting to include and expose the choices made by water corporations in administering the discretionary elements within the NCC framework.
- v. where policy clarity and coherence might assist the Commission and water corporations.

Each of the points above are elaborated upon in the rest of this submission.

We believe there are broader failings than the proposed method for calculating NCCs. It has been hastily developed and creates inconsistency and uncertainty and appears to be a process to reallocate funds to the existing customers at the expense of new customers for whom affordability challenges are likely to be material. Additionally, there is no established transparent nexus to new development in designated growth locations.

[a. Proposed method for calculating NCCs](#)

1. Coliban Water has proposed a method different to the one offered by the Commission. The differences appear to be that there is no provision for net revenue to reduce NCCs, and there is no residual value assigned to infrastructure that might serve new customers beyond the planning period. It is unclear if it is the method or the input assumptions that have resulted in 76 per cent increase in the standard NCCs for water, and a 149 per cent increase for sewerage.
2. Your analysis in the draft decision focusses on numerical inconsistencies and 'potential' for the proposed NCC methodology to comply with the Water Act. We believe the Commission should be assessing compliance with the Guidance Paper.
3. Our understanding is:
 - 3.1. The Water Act gives water corporations the *power to charge* fair and reasonable NCCs.

- 3.2. The Water Industry Act via the Water Industry Regulatory Order (WIRO) gives the Commission *power to regulate the price* of NCCs charged by water corporations.
 - 3.3. The WIRO requires the Commission to issue a Guidance Paper prior to a price review, after consultation, and to make a price determination which is *consistent with the Guidance Paper*.
 - 3.4. The Guidance Paper requires water corporations to use three pricing principles, which *together* the Commission has decided demonstrate prices are fair and reasonable.
 - 3.5. The second listed principle is “have regard to the incremental future revenues that will be earned from customers at that connection.”
4. Coliban Water’s spreadsheet for applying the proposed methodology to calculate NCCs appears to have no provision for including incremental future revenues. This is evidence that Coliban Water is unable to demonstrate it has “*had regard to*” those revenues at that connection. While “have regard to” allows Coliban Water to decide not to include an allowance for future revenues, it should only do so after considering the circumstances of each case. Coliban Water, by omitting any provision for these revenues, is applying it in all circumstances, thereby not being fair and reasonable.
 5. It is missing the point if the new methodology interpretation is that regard does not have to be made for incremental future revenue because Coliban Water’s allowable revenue calculated in the building block formula does not change much because no gifted or funded assets are included in the regulatory asset base. The point is not about Coliban Water’s total revenue allowance; it is about how the revenue is collected from existing customers relative to new customers. On the one hand, new customers will increase the tax burden on Coliban Water as a result of paying tax on the value of gifted assets and the revenue from NCCs. On the other hand, new customers will have new infrastructure that will have much lower maintenance and operating costs than the typical aged infrastructure in the existing system. These are the issues that Coliban Water needs to have regard to.
 6. Your draft decision references a March 2022 negotiating framework proposed by Coliban Water. In section 7 page 6 of that framework, Coliban Water states that in most cases negotiated NCCs apply *in addition to* standard NCCs, whereas your guidance requires that a standard NCC applies *or* a negotiated NCC applies. Also, the Coliban Water framework is silent on the option of a developer instigating a negotiated NCC. The responses of the Coliban Water at the ESC forum on 1 May 2023 demonstrates that this issue requires a clear direction from the ESC in relation to its guidelines.
 7. We believe Coliban Water’s proposed methodology for calculating NCCs is inconsistent with the Guidance Paper and should be rejected by the Commission. While this may appear problematic for Coliban Water, we have proposed a possible interim solution (see paragraphs #23-25 later in this submission).

b. PREMO assessment (engagement component)

8. The Commission’s five key principles for good customer engagement have not been met by Coliban Water. Our assessment against each principle is:

- 8.1. The form of customer engagement was not tailored to the introduction of significant price increases for new customers.
 - 8.2. Developers were not given appropriate instruction and information, considering the introduction of a new methodology, reassignment of infrastructure previously the responsibility of Coliban Water to now be a developer responsibility, and significant increases in capital expenditure assigned to growth.
 - 8.3. Reasonable consideration was not given to developers who pay NCCs on behalf of new customers given the services provided and prices proposed to be charged by Coliban Water. The engagement has not been commensurate with the level of infrastructure partnership that exists. In fact, it has exposed a lack of trust and understanding in the development sector from Coliban Water which has driven the poor-quality engagement.
 - 8.4. Coliban Water did not start engagement with developers early in its planning for a new methodology, engagement has not been ongoing, and Coliban Water has sought to deflect negotiations until after the draft decision.
 - 8.5. Coliban Water, as mentioned in the draft decision, has not taken into account the views of developers.
9. Your reasoning in the draft decision in relation to engagement is somewhat difficult to understand.
 - 9.1. You have recognised that Coliban Water has engaged poorly with developers who pay NCCs on behalf of new customers.
 - 9.2. You have recognised that Coliban Water engaged extensively and well in other aspects and with other customer segments.
 - 9.3. How has one negated the other and led to an 'advanced' rating?
 10. If your decision was weighted based on customer numbers, it would mean that new customer issues could not be heard. Given the Commission's focus on minority groups of customers we can assume this was not your intention.
 11. If your decision was to be weighted based on price impacts, then the overall negotiation rating would be more closely aligned to what has happened with developers, leading to a 'basic' rating (the lowest rating possible).
 12. We contend that assessing the PREMO rating based on the significance of the issues or price changes is a better incentive for water corporations to engage on the important issues, and it better assists the Commission to effectively regulate while being light handed.
 13. We encourage the Commission to reconsider the "advanced" rating for the engagement component within the PREMO framework given to Coliban Water in the draft decision, and to clarify the basis for the assessment to provide the broader industry with clarity on your approach.

c. Insufficient time to amend and engage

14. In your draft decision you require Coliban Water to a) explain its new methodology, align its cost input assumptions with those in the price submission template and revise its

prices; or b) adopt the methodology referred to in the Guidance Paper and produce new prices, also with aligned input assumptions.

15. We cannot see how Coliban Water could pursue path a) and have this accepted by the ESC within the timeframe, given the extent of the uncertainty and range of issues that require clarification. For example, we are uncertain if it is the methodology or the inputs that are creating the significant uplift in NCCs. If it is increased growth expenditure because of deferred expenditure in the past, has this expenditure not been recovered already from NCCs? If it is increased growth expenditure reflecting accelerated rates of development, isn't this offset by the increased number of new customers?
16. If it is the methodology creating the significant uplift in NCCs, is it due to the lack of regard for net revenues? Or is it due to lack of regard for residual capacity beyond the planning horizon? There is a lot of explaining to do.
17. Even if the only issue to be resolved was the methodology, there is very little time for Coliban Water to document its methodology, explain it to developers and allow sufficient time for them to comment. Following that engagement, Coliban Water would need time to consider any feedback from developers and amend its price submission. The Commission themselves need time to review the documentation, engagement process and changes, and still have time to issue a determination before 1 July 2023. Coliban Water has belatedly commenced a process of consultation with individual developers and consultants while maintaining its current methodology, however it lacks rigour in relation to the following:
 - 17.1. A review of each growth area and infill areas including rates of potential future development and population growth. For example, in the Maiden Gully Area the MG Estates project has a permit and is currently undergoing detailed design demonstrating delivery within the proposed pricing period. The Council's MGNE growth area is still in the planning stages and due to the need to resolve bushfire and vegetation issues is unlikely to receive rezoning approval and therefore a need for servicing within the next five (5) years.
 - 17.2. The infrastructure projects required by catchment to support the projected growth.
 - 17.3. The cost estimate for each project.
 - 17.4. How costs are allocated between future and current customers, including provision for incremental future revenues.
18. However, the methodology is not the only issue to be resolved. Coliban Water has not produced, or has chosen not to share, much of the material that developers need to review and become confident that Coliban Water is being fair and reasonable. This included an interview on 5 May during which an outline of four (4) models was provided and a request made for responses to two questions. Given the volume of information provided detailed responses to the questions could not be provided in the 30-minute engagement. We were informed that further information from Coliban Water would be emailed by COB 5 May. This information is yet to be received. That transparency and the review by developers with an intimate knowledge of regional development is an essential input for the Commission to be confident in its determination of prices.

It appears that Coliban Water are confused between parity and protection for existing customers at the expense of new customers and see the development sector not as an

enabling infrastructure partner for new customers but somehow as an apparent detractor from existing customers. We note that it is Coliban Water's responsibility for the balance between existing and new customers produced by the NCC pricing model and not the development sector. However, the lack of transparency has the development sector concerned about cost shifting for ageing asset replacement, climate change adaptation, regulatory compliance and inter-generational investment into the NCC calculations. Coliban Water has not demonstrated through engagement that this has not occurred.

- 19 It is apparent from Coliban Water's approach to the ESC consultation process that Coliban Water see New Customer Contributions as a developer charge not a future client cost. Coliban Water in their submission have had most regard to current clients and little regard to future clients on price parity, nexus and future income.
- 20 The material referred to in paragraph #17 is referenced in your NCC Explanatory Note, and includes:
 - 20.1 Incremental costs.
 - 20.2 Incremental benefits.
 - 20.3 Bring-forward financing costs and rate of development assumptions.
 - 20.4 What, if any, existing assets are being included.
 - 20.5 Assets to be provided by developers rather than Coliban Water, and why it is so?
 - 20.6 Development servicing plans for each system or sub-system, to demonstrate cost reflectivity.
 - 20.7 Treatment of pioneer developers.
 - 20.8 Provision of increased capacity and how shares in the costs are calculated.
- 21 If Coliban Water accepts your offer to submit explanations and new estimates of NCCs, the Commission should consider if Coliban Water had sufficient time to explain its approach, expose its assumptions to those in a position to challenge them, and consult meaningfully, compounding the already inadequate engagement process.
- 22 It seems neither path (a) nor path (b) in paragraph #14 above is achievable, consequently we have taken the liberty of offering a possible interim solution.

[d.A possible interim solution](#)

- 23 If Coliban Water cannot realistically and appropriately deliver on the Commission's offer for the reasons described in the previous paragraphs, it begs the question about what can be done and by when.
- 24 We suggest the Commission considers using its powers under the WIRO to substitute prices for standard NCCs with prices as at 30 June 2023, and that they remain frozen until the Commission undertakes a longer-term review (see next section) and Coliban Water has had time to implement any changes, after meaningful engagement.

25 This is not as harsh as it sounds because Coliban Water will still have the option of applying negotiated NCCs. It will give them the incentive to put in place the information necessary for the calculation of negotiated NCCs and good faith negotiations.

e.Recommended longer-term solution

26 The NCC methodology, guidance and explanatory material date back to 2013, so a review is warranted. It is also timely to record the differences between water corporations in how they applied the discretionary elements of the NCC framework, to identify systemic difficulties and opportunities for improvement in the explanatory material.

27 A goal should be to identify best practice water corporations and improvements that can be made across the industry.

28 We suggest the Commission commits to leading a review of the NCC framework, commencing soon after the final decision, considering amongst other things:

- 28.1 the new methodology proposed by Coliban Water (and some other water corporations, we believe).
- 28.2 the use and application of standard NCCs at the expense of negotiated NCCs and the resultant loss of cost reflectivity.
- 28.3 the minimum level of information required to support a standard NCC and to be provided in negotiations for a negotiated NCC.
- 28.4 principles used by water corporations for deciding what conditions are placed on subdivisions¹, and principles used by water corporations for deciding what infrastructure is the responsibility of a developer, within the context of impact on the calculation of NCCs.
- 28.5 the fairness of reimbursement arrangements for water corporation assets which the developer has agreed to construct on behalf of a water corporation.
- 28.6 developing further clarity around the preconditions for inclusion of sunk costs from previous pricing periods.
- 28.7 expanding your performance monitoring and reporting during the pricing period to include and expose the choices made by water corporations in administering the discretionary elements within the NCC framework (to allow early identification and remediation of issues).
- 28.8 where policy clarity and coherence might assist the Commission and water corporations.
- 28.9 Other matters determined by the Commission through your own initiative or at the suggestion of others.

¹ VCAT has established several principles which have been upheld by the courts and also applied in guidelines by successive state government Ministers over the past 30 years. These principles are **need**, **nexus**, **equity** and **accountability**. In short, the *need* must be generated by the development (and not be existing backlog demand); there must be a *nexus* between the delivery of the assets and the development (the assets serve the demand from the development; and not using the funds collected to provide assets elsewhere); there must be an *equitable sharing of the cost* of the assets commensurate with the proportion of demand generated by the development; and there must be a level of *accountability*, which is taken to mean that the funds collected are held on trust for the purpose for which they have been collected and are only spent on the assets which form the basis of the contributions.

f.Request summary

- 29 Overall, it is our contention that it is implausible for the ESC to accept Coliban Water's current method and proposed increases in NCCs because it does not and cannot comply with the Guidance Paper nor meet even basic standards of customer engagement based on the missing information on method and inputs.
- 30 In our view the Commission has a pragmatic alternative which is to revert to the previously approved default NCCs, and we note that this doesn't negatively affect Coliban Water as they still have the opportunity to apply negotiated NCCs, something which MG Estates has been consistently seeking to do provided it is with open and transparent explanations and supporting material.

Yours sincerely



Mr Gerard Gilfedder
Currie & Brown (Australia) (acting for MG Estates)