GOULBURN VALLEY WATER

**Goulburn Valley Region Water Authority**

ABN 84 578 076 056

104-110 Fryers Street,
Shepparton, Victoria 3630

**P.O. Box 185,
Shepparton 3632
DX 63036 Shepparton**

Our Ref.: 010/031/16(LJG:jc)
Direct Dial: 5832 0443

15 February 2007

Mr Sean Crees
Acting Director Regulation (Water)
Essential Services Commission
Level 2
35 Spring Street
MELBOURNE 3000

Dear Sean

RESPONSE TO ESSENTIAL SERVICES COMMISSION –
*"2008 WATER PRICE REVIEW CONSULTATION PAPER"* DECEMBER 2006

Further to our meeting with staff of the Essential Services Commission (ESC) on 5 February 2007 and subsequent discussions with yourself, Goulburn Valley Water is pleased to provide the following comments in respect of the abovementioned discussion paper on the proposed framework and approach to the preparation of the next Water Plan.

The ESC's initiative in developing the discussion paper outlining the proposed framework and approach to the Water Plan is commendable. However a much earlier release of the document would have been appreciated by the water industry. It may now be too late to investigate initiatives raised in the paper for the 2008-2013 Water Plan.

Goulburn Valley Water is supportive of the overall content of the paper as it provides a structured approach to the development of Water Plans.

Goulburn Valley Water has raised the following issues in discussions with Commission staff and now takes this opportunity to formalise our views:

- Length of regulatory period and dealing with uncertainty
- Service Standards
- Restrictions
- Guaranteed Services Levels (GSLs)
- Assessing Expenditure/Incentive Mechanisms
- Tariff Structures
- New Customer Contributions (NCCs)

**Tel: (03) 5832 0400**
Fax: (03) 5831 1467

mail@gvwater.vic.gov.au
**www.gvwater.vic.gov.au**

## *Length of Regulatory Period and Managing Uncertainty*

Goulburn Valley Water supports a five year regulatory period rather than a three year period, in order to avoid the administrative burden and substantial costs associated with the Commission's process as such costs are eventually passed on to customers through higher water prices.

The Commission must acknowledge that given the severe drought situation now existing in Victoria, forward planning of water availability, revenue forecasts and cost estimates carries a high degree of risk and uncertainty.

This will require a greater degree of flexibility on the part of the Commission in respect of carryover of unforeseen costs and the need to possibly review price determinations during the regulatory period in certain circumstances, if we are to avoid a greater degree of conservative forecasting and budget estimates by water businesses in the preparation of the 2008-2013 Water Plan.

The dire water resource situation in Victoria cannot simply be dismissed by the Commission in the interest of expediency. Of particular concern is the Commission's cavalier response to the current severe water resource situation and its associated impacts on water businesses both now and into the future.

> *"Managing the demand and supply balance is a core business activity for urban water authorities and this is reflected in the Statement of Obligations requirement to develop demand and supply strategies"*[1]

There is no disagreement that managing supply through long term water supply demand strategies is a core responsibility of the Authority. However, unlike other resource dependant businesses such as power (coal) we cannot simply create more water – we are heavily reliant on nature and good average rainfall in our catchments. The potential long term impact of this drought continuing over the period of the 2008-2013 Water Plan cannot simply be dismissed as a business as usual issue.

The current drought has decreased revenue streams due to severe water restrictions in many systems, with correspondingly increased costs in the management of these water restrictions and shortages.

## *Service Standards*

Goulburn Valley Water supports the proposal that service standards should be consistent with available historic performance, subject to adjustment based on reliable data obtained over the past two years. The customer consultative committee will be consulted on any proposed changes to existing service standards.

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[1] ESC Framework and Approach, 2008 Water Price Review, Page 15

### *Restrictions*

Goulburn Valley Water notes with concern the Commission's comments *(Page 25)* concerning its monitoring of Victorian water businesses in the area of restrictions.

Non payment of water bills does not in itself establish genuine hardship or inability of the customer to pay a water account. In our experience, there are two types of non-payers – those who genuinely cannot afford to pay and those who simply prefer not to pay.

The management of a fair and transparent restriction policy is an effective, low cost debt collection strategy for both the customer and the water business.

Whilst the Commission may have found that a higher use of restrictions and legal actions against customers for non payment exists in regional Victoria, it should consider this practice in the context of overall business efficiency in revenue collection ie. the percentage of revenue raised actually collected across each business. This is an area of business performance currently not being monitored and should be of interest to the Commission.

The take up of the Utility Relief Grants Scheme administered by the Department of Human Services, is a matter for individual customers. It is up to the customers to apply for the grant once having been made aware of the scheme and provided with the application forms.

Goulburn Valley Water supports the Commission's view that authorities outline their restriction and debt collection policies in their Water Plan.

### *Guaranteed Service Levels (GSLs)*

We note that the Commission is not proposing to require businesses to adopt GSL scenarios in the 2008 Water Plan.

The feedback Goulburn Valley Water received from customers during the consultation period for the current Water Plan did not support the introduction of GSLs, strongly preferring that the focus of effort and expenditure should be directed at fixing any systemic problems.

Goulburn Valley Water does not support the view that the introduction of a GSL scheme will provide the appropriate incentive for a business to address the incidence of poor service performance. We will continue to consult with customers on this matter, but at this stage we do not plan to introduce a GSL scheme.

### *Assessing Expenditure/Incentive Mechanisms*

An important issue not addressed in the discussion paper is that of new Government imposed policy initiatives on water businesses, post the 2005/08 Water Plan and ESC price decision.

The requirement of the Department of Sustainability and Environment for the Authority to undertake the development of a Water Supply Demand Strategy at a cost of some $400,000 is a good example of this type of impost on business costs.

The challenge going forward is to have Government and its various regulatory agencies working within the business framework it has created for the operation of the Victorian water sector.

The principle of an efficiency carryover mechanism is supported in principle. However, the Commission's simplistic approach to the identification and quantification of efficiency improvements to business as usual expenditure, is of concern. The current drought situation, and its associated increasing expenditure in managing water restriction rules, drives up costs and reduces units of production (water sales) cancelling out productivity gains measured in the normal business environment of say manufacturing, ie. selling more units of production whilst holding or reducing costs of doing business.

Goulburn Valley Water seeks more specific guidance from the Commission on how it sees business efficiency improvements being realistically measured and captured in the current operating environment.

Goulburn Valley Water supports the view that businesses continually pursue productivity improvements via smarter work practices, better technology and innovation. However, this may not be reflected in cost reductions. Customer service outcomes maybe improved, but the impact of larger than CPI price rises for key input costs, and additional costs associated with events such as managing the current extensive drought conditions will disguise and may exceed productivity savings.

Goulburn Valley Water therefore does not support the Commissions position of imposing an arbitrary 1% per annum productivity improvement on water businesses. Consideration will need to be given to levels of service, additional costs driven by current drought conditions and regulation (over and above what was estimated in the 2005 Water Plan) and actual cost movements for key inputs in the current market place.

### *Tariff Structures*

We note that the Commission in its discussion paper, *Framework and Approach 2008 Water Price Review*, does not advocate an industry wide adoption of rising block water tariffs. Goulburn Valley Water have consulted with customers over the past two years regarding rising block tariffs and two-part sewerage tariffs for residential customers. Customers have been against the introduction of either of these pricing methods. Consultation will continue as part of the 2008-2013 Water Plan consultation process.

Goulburn Valley Water does not plan to introduce tiered water tariffs on the basis that water consumption is relatively inelastic and such tariffs are confusing for customers. There can also be serious equity issues with inclining block tariffs particularly for large families and vulnerable customers with higher non-discretionary use and/or low income groups. For more affluent consumers increasing the price of water (even substantially) will not necessarily result in reduced water usage as they will be willing to pay higher prices to maintain their lifestyle.

The Authority is also of the view that all customers residential and non-residential, should pay the same price for water supplied from the same system.

Our approach to water conservation is to pursue water use efficiency through voluntary demand management programs and education, coupled with an appropriate two part water tariff. Goulburn Valley Water has had significant success over the past decade through education, water audits, cleaner production and technology initiatives. These initiatives will continue to drive our water conservation program and water supply/demand management strategies.

### Sewerage Tariffs – Volumetric Charges

The cost of providing sewage services for residential customers is predominately fixed and not driven by flows. Sewerage flows from residential properties cannot be efficiently metered and therefore discharges must be estimated based on water entering the property measured via the water meter. This is an extremely arbitrary calculation open to challenge, disputation and is extremely confusing to customers.

The Authority therefore intends to continue with its policy of a fixed sewerage fee for residential properties and a two-part tariff for non-residential properties.

### Conclusion

Goulburn Valley Water has resolved to continue with current tariff structures for the 2008-2013 Water Plan period unless customers indicate a strong preference for change via either step pricing for volumetric water charges or volumetric sewerage charges for residential customers. In developing water tariff structures for 2008-2013 additional revenue requirements will, in the main, be realised from the variable component, rather than the fixed tariff component.

## *New Customer Contributions (NCCs)*

The Framework and Approach 2008 Water Price Review paper suggests increasing the current cap from $500 to $1,000 per lot/per service. The new cap to be accompanied by a principle that contributions reflect the per lot cost of shared infrastructure associated with the development, but only if shared assets are provided by the water authority.

The Authority welcomes the proposed increase in NCC per lot, but disagrees strongly with the accompanying proposed principle associated with its application.

Such a proposed principle would further skew infrastructure costs away from the development industry and on to existing customers including low income and other vulnerable customers. Such a transfer of costs is, in our view, inequitable and maybe contrary to the legislative intent of Section 268 and 270 of the Water Act 1989.

In introducing such a principle, the Commission may also be acting contrary to the intent of Clause 14(VII) of the WIRO – *"taking into account the interests of customers of the regulated entity, including low income and vulnerable customers"*.

The Water Industry believes there are opportunities to improve on the current arrangements, particularly in relation to incentives for Water Sensitive Urban Design (WSUD) developments. Currently the consequences are that larger more water-intensive developments face the same charge as higher-density more water efficient developments. Therefore, to be more consistent with the WIRO principle of signaling and providing appropriate incentives for sustainable water use, the Water Industry suggest that NCCs should send a stronger message to encourage and reward more water sensitive developments.

Current arrangements do not recognise the effect of development decisions on existing regional water customers, where development is designed to attract more people to regional centres resulting in large water intensive developments. Incremental developments will, collectively and over time, generate the need for additional investment in upstream capacity. The WIRO requires tariffs to be designed having regard to the interests of customers, consequently the NCC level should be considered in terms of what is an appropriate balance to strike between full upfront funding or funding over time.

Goulburn Valley Water has been involved in the development of an alternative water industry policy position on NCCs which proposes an upfront contribution, reducing the financial impact on the total customer base and reflects an equitable sharing of funding for growth assets between the two different groups of customers. These NCCs, combined with incentives for water sensitive urban design, will discourage inefficient development decisions, promote sustainable development and will be in the interests of the broader customer base, particularly in regional Victoria.

The full details of the Victorian Water Industry's alternative approach to NCC is outlined in Attachment A to this submission.

Thank you for the opportunity to respond and provide feedback on the 2008 Water Price Review Consultation Paper.

Should you wish to discuss any aspect of this submission, please contact either myself or our Director-Finance, Graeme Jolly.

Yours sincerely

Laurie J Gleeson
CHIEF EXECUTIVE OFFICER

**Attachment A**

# 2008 Water Price Review

# Consultation Paper

# Framework and Approach

## VICTORIAN WATER INDUSTRY SUBMISSION

## NEW CUSTOMER CONTRIBUTIONS

**FEBRUARY 2007**

VICTORIAN WATER
INDUSTRY ASSOCIATION INC.
"Innovation, Cooperation and Sustainability"

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| VICTORIAN WATER INDUSTRY ASSOCIATION INC "Innovation, Cooperation and Sustainability" | **Victorian Water Industry Submission New Customer Contributions** <br> **February 2007** |

## Background

Customer contributions are a cost levied by water businesses on customers (developers) for the provision of water and sewerage infrastructure to service land.

The Water Act 1989 and The Water Industry Act 1994 provide water businesses with the ability to require new customers to make an upfront contribution to the costs of connecting to the existing water and sewerage networks. Existing non-serviced property owners are also required to make upfront contributions for the cost of connection.

The Essential Services Commission (the Commission) has the power to regulate standards, conditions of service and supply and price under clause 6 of the Water Industry Regulatory Order (WIRO) for both a declared and a prescribed service. The WIRO outlines a number of regulatory principles that the Commission must be satisfied have been met before it can either approve the proposed customer contributions or the method. Clause 14 of the WIRO outlines these regulatory principles. The principles are broad and include:

- Prices must provide for a sustainable revenue stream to the business that nonetheless does not reflect monopoly rents and/or inefficient expenditure by the business.
- Prices must provide incentives for the sustainable use of Victoria's water resources by providing appropriate signals to water users about:
  - the costs of providing services including costs associated with future supplies
  - periods of peak demands and/or restricted supply
  - choices regarding alternative supplies for different purposes
- Prices must provide businesses with incentives to pursue efficiency improvements and to promote the sustainable use of Victoria's water resources.
- Prices must enable customers or potential customers of the regulated entity to readily understand the prices charged by the regulated entity for prescribed services, or the manner in which such prices are to be calculated or otherwise determined.

## Current 2005 Regulatory Period Arrangements

The key aspects of the current arrangements for new customer contributions (NCC's) are:

- New customers are responsible for providing assets to be installed specifically to service their property or development.
- The maximum NCC was set at $500 per lot per service for water and sewerage (total $1,000 per lot). Water businesses may charge a per lot charge up to the scheduled charge for each new property connected.

- Water businesses are responsible for infrastructure assets that are generally provided to service more than one development.
- Water businesses may apply to the Commission to levy a NCC above the scheduled charge where shared assets must be constructed ahead of schedule to service a new property or development. In these cases and subject to approval by the Commission, the water business may recover the capital financing costs that are attributable to bringing forward construction of the shared assets.
- Reticulated assets are defined as the infrastructure assets that are explicitly provided in relation to prescribed services for one development and are not required to be upsized to support other future developments, and may include a pipeline, a water storage tank, a local treatment plant, pumping station, rising main, sewerage flow control facilities, local booster disinfection plant and/or a local sewage pre-treatment system. A water main that is 150 mm or less in diameter and a sewerage main that is 225 mm or less in diameter, and all associated assets that relate to those sized assets are generally considered to be reticulation assets, although there may be some situations where these sizes are inappropriate.
- Shared distribution assets are defined as infrastructure assets that are generally provided in relation to prescribed services for more than one development and do not include reticulation assets, headworks and tailworks.

## Basis for the Current 2005 Regulatory Period Arrangements

The Commission's review during the 2005 determination found the industries approach to setting NCC's to be inconsistent and incompatible with the principles of the WIRO. The Commission's decision reflected the view that NCC's should:

- reflect incremental costs (at a minimum should not include the costs associated with sunk costs, shared assets, headworks or tailworks costs)
- provide locational signals to encourage new customers to connect where there is existing infrastructure and reflect a higher cost associated with out of sequence developments

The Commissions' basis for the final decision of a flat fee of $500 for each service was adopted in the interest of simplicity and ease of understanding.

Some businesses had proposed NCC's lower than $500 and these were also adopted by the Commission.

## Water Industry Proposed Approach to New Customer Contributions for the 2008 Regulatory Period

The 2008 Water Price Review consultation paper, issued by the Commission in December 2006 suggests moving to a cap of $1,000 per service. This proposed cap would be accompanied by a principle that contributions reflect the per lot costs of shared infrastructure associated with the development, but only if shared assets are provided by the water authority.

In the paper the Commission has acknowledged that an upfront contribution for water infrastructure has little bearing in providing locational signals relative to other factors. "In a 1999 report for IPART, PricewaterhouseCoopers found that upfront developer contributions have no broad impact on urban planning."

In terms of tariff structures more generally, the paper notes the importance of designing tariff structures in a way that contributes to the achievement of broader demand-supply objectives which include providing appropriate signals to water users about the cost of services, future supplies, periods of peak demand and times of restrictions. We must also be cognisant of who the customer is. NCC's are usually levied on the developer (who embeds the price in land/development prices) and the end user (who bears the ongoing usage based tariffs).

The Water Industry believes there are opportunities to improve on the current arrangements, particularly in relation to incentives for Water Sensitive Urban Design (WSUD) developments. Currently the consequences are that larger more water-intensive developments face the same charge as higher-density more water efficient developments. Therefore, to be more consistent with the WIRO principle of signalling and providing appropriate incentives for sustainable water use, the Water Industry suggests that NCC's should send a stronger message to encourage and reward more water sensitive developments.

Current arrangements do not recognise the effect of development decisions on existing regional water customers, where development is designed to attract more people to regional centres resulting in large water intensive developments. Incremental developments will, collectively and over time, generate the need for additional investment in upstream capacity. The WIRO requires tariffs to be designed having regard to the interests of all customers, consequently the NCC level should be considered in terms of what is an appropriate balance to strike between full upfront funding or funding over time.

The Water Industry's proposal allows for an upfront contribution thereby reducing the financial impact on the total customer base. This reflects an equitable sharing of funding for growth assets between the two different groups of customers. These charges, coupled with incentives for WSUD, will discourage inefficient development decisions; are in the interests of the broader customer base (particularly smaller regional communities); are consistent with the provisions of The Water Act 1989 and The Water Industry Act 1994 and can be structured in a way that avoids undue complexity.

## Proposal

With these considerations in mind, the water industry proposes the following amendments as the approach to be followed in the preparation of the 1st of May 2007 draft Water Plans, which are to be released for public comment prior to formally submitting them to the Commission in September.

1. A standard schedule of charges, detailed below, to be determined and scaled according to the water-sensitivity of particular developments and the demand for future infrastructure. (The categories a), b), and c) will need definitions developed according to planning regulations etc.):

   a) Where a New Customer Contribution is to be applied, a minimum charge of $500 per lot per service for water and sewerage (total $1,000 per lot) for developments which are designed in a manner that will have minimal impact on future water resource demands, and can be catered for without additional investment within the medium-term distribution capacity. For example: a two lot subdivision that will not require system augmentation capital expenditure beyond 2013;

   b) $1,000 per lot per service for water and sewerage (total $2,000 per lot) for water sensitive urban developments which will require further investment in infrastructure within a six year period to serve these developments,

      or,

      where shared assets must be constructed ahead of schedule to service a new property or development, and the calculated 'bring-forward' costs, as per the current NCC guideline is greater than $1,000 (per lot for water and sewerage), the calculated charge shall apply;

c) $2,000 per lot per service for water and sewerage (total $4,000 per lot) for developments designed in such a way that properties will create demand for water resources over and above high-density, water efficient homes e.g., standard quarter acre block with large outside water-use, no recycled water, no water tank etc, and which will influence near term investment in infrastructure decisions.

2. A business would have the discretion to charge zero if it is believed that the short and long term incremental costs were negligible.

3. The schedule should not apply to developments where the application would result in a higher contribution than that which is allowed under the provisions of the current water legislation.

4. Proceeds from developer charges are to be offset from future revenue in a manner that does not impact on the compliance of usage tariffs within the requirements of the WIRO (i.e. not to distort usage charges such that they no longer provide appropriate incentives for sustainable water use to end customers).

5. In the event of disputes over the categorisation of a particular development or the substantiation of particular costs where the schedule does not apply, the relevant developer can lodge a dispute with the Commission, which will make a binding decision on the matter.

6. Charges are maximums (ie caps) except for a) where a minimum charge has been set, and b) where the calculated 'bring-forward' costs as per the current developer contribution guideline is greater than $1,000 (per lot for water and sewerage), the calculated charge shall apply.

7. Current arrangements to apply with respect to applying forecast contributions to the overall revenue requirement of the water authority (as an offset to capital expenditure).

8. The Water Industry proposal is dependant on new customers continuing to be responsible for providing reticulated assets to be installed specifically to service their property or development. The definition of reticulated assets should continue to include the 150mm water main and 225mm diameter sewer main on the basis that this criterion provides a clear process to ensure developers and water authorities know when a main of this size must be funded by the developer and not by the water business. In line with the current definition, the industry reserves the right to treat some assets above this size as reticulation assets. In particular, when they are specifically required to service a single development.

9. Developers in dual pipe areas will also be required to install the additional reticulation assets for the recycled water. An upfront charge may also be levied that reflects the principles contained above.

The above approach is designed to:

- Provide appropriate incentives for WSUD, without distorting location decisions (as it applies generally and is independent of location).
- In the interests of existing customers, generate a contribution from developers towards future investment in infrastructure, as is envisaged in water legislation, while not impacting on the design of usage tariffs to provide price signals for both new and existing customers reflecting the costs of increasing demand at that location and the ability of usage tariffs to also provide incentives for sustainable water use of Victoria's water resources.
- Provide price signals to developers where they decide to develop land in a location and in a way that allotment sizes etc. require the 'bringing-forward' of significant infrastructure investment (i.e. over and above $1,000).