



NEW CUSTOMER CONTRIBUTIONS: EXPLANATORY NOTE

December 2013

An appropriate citation for this paper is:

Essential Services Commission 2013, *New Customer Contributions: Explanatory Note*, December.

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AMENDMENT RECORD

Issue No.	Date	Nature of amendment
1	1 October 2013	1 st draft
2	4 December 2013	Final

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1 OVERVIEW

This explanatory note is intended to assist staff in water businesses as well as those in the development industry to apply the new principle-based approach to new customer contributions (NCC). It collates and summarizes the Commission's 2013 decisions. If there is any inconsistency, the Commission's Final decisions and Determinations will take precedence.

This explanatory note applies during the third regulatory period from 1 July 2013 to 30 June 2018.

1.1 WHAT ARE NEW CUSTOMER CONTRIBUTIONS?

NCC, also known as developer charges, are a one-off, upfront charge that a water business may levy when a new connection is made to its water, sewerage or recycled water network. These charges apply in a range of situations. Generally, they are paid by developers who are subdividing land on the urban fringe or redeveloping sites within built up areas. They may also be levied when an existing property owner decides to connect to a service for the first time.

The relevant regulated services are 'services to which developer charges apply', being services provided by water businesses under Division 6 of Part 13 of the *Water Act 1989 (Vic)* (the Water Act). That Division refers to:¹

- services that will benefit a property, and
- works used directly or indirectly for the provision of those services, and any fireplugs associated with those works.

¹ See for example section 268, 269 and 270 of the Water Act.

1.2 THE LEGAL AND REGULATORY FRAMEWORK

The Water Act governs water businesses' rights and obligations in relation to new connections. The Water Industry Regulatory Order (WIRO) provides the Commission with the power to regulate charges for NCC.²

Appendix A shows an overview of the regulatory framework that relates to NCC.

The Commission introduced a principles-based NCC charging framework on 1 July 2013. This NCC framework aims to:

- send signals to developers about the costs of developing in different locations
- share the costs and benefits of growth between new and existing customers
- administer NCC in a transparent way.

Water businesses must use approved pricing principles (Box 1) to calculate the net incremental cost of connections. NCC will be either Standard NCC (approved by the Commission in each water business's Determination), or Negotiated NCC (agreed between a developer and water business).

BOX 1 NCC PRICING PRINCIPLES

Standard and Negotiated NCC charges will:

- have regard to the incremental infrastructure and associated costs in one or more of the statutory cost categories attributable to a given connection³
- have regard to the incremental future revenues that will be earned from customers at that connection
- be greater than the avoidable cost of that connection and less than the standalone cost of that connection.

Guidance on interpreting these principles is set out in section 2 of this explanatory note.

² That is the Water Industry Regulatory Order (WIRO) made by the Governor in Council under section 4D of the *Water Industry Act 1994 (Vic)*. Appendix A is a diagram depicting the regulatory framework for NCC.

³ Statutory cost categories means costs for works imposed under Division 6 of Part 13 of the Water Act 1989.

1.3 TYPES OF NCC – STANDARD OR NEGOTIATED

Standard NCC

For most water businesses, the Commission approved Standard NCC that will apply for connections in areas where infrastructure requirements and growth rates are relatively well known. The purpose of Standard NCC is to reduce the administrative burden as well as improve the timeliness and predictability of costs faced by developers.

Each water business publishes on its website details of its current approved Standard NCC, together with underpinning assumptions (such as timing, infrastructure provision, meter size), and maps showing where they apply.⁴

Negotiated NCC

In situations where Standard NCCs are not fair and reasonable or where a new connection is outside the areas designated as eligible for Standard NCCs, the NCC framework allows water businesses and developers to negotiate site-specific arrangements that reflect the NCC pricing principles (Box 1).

1.4 DISPUTE RESOLUTION

If there is a dispute between a developer and a water business (whether in relation to a Standard NCC or Negotiated NCC), developers may use the dispute resolution offered by a water business as part of its NCC framework. In addition, developers may follow the Water Act process to object and seek internal review by the water business, and to pursue unresolved matters through the Victorian Civil Administrative Tribunal (VCAT).

1.5 WATER BUSINESS COMMUNICATION

Reasonable industry practice will see water businesses prepare and publish:

- Development servicing plans (updated from time to time) that show the water business's forecast timing and sequencing of infrastructure that will be required to service new customers

⁴ Standard NCC charges approved in 2013 will apply until apply until 30 June 2018.

- Negotiation protocols (including references to the pricing principles and dispute resolution details)
- Explanations of where and when Standard NCCs apply, and circumstances in which a developer or water business may introduce a Negotiated NCC.

1.6 WHICH WATER BUSINESSES?

This explanatory note applies to:

- all Victorian metropolitan and regional urban water businesses⁵
- any connection applicant seeking services to which developer charges apply.⁶

Appendix B lists the relevant water businesses and links for information on their connection processes, NCC charges and negotiation arrangements.

1.7 FINAL DECISIONS AND DETERMINATIONS

This explanatory note reflects the following Commission Determinations and Decisions:

- **2013-18 Water price review determinations** for metropolitan and regional water businesses, dated June 2013, specifically determinations for:
 - Barwon Water, Central Highlands Water, City West Water, Coliban Water, East Gippsland Water, Gippsland Water, Goulburn Valley Water, GWMWater, Lower Murray Water, North East Water, South Gippsland Water, South East Water ,Wannon Water, Western Water, Westernport Water and Yarra Valley Water
- Essential Services Commission 2013, Price Review 2013: *Greater Metropolitan Water Businesses — final decision*, June
- Essential Services Commission 2013, Price Review 2013: *Regional Urban Water Businesses — final decision*, June.

⁵ This explanatory note does not apply to Melbourne Water, Southern Rural Water and Goulburn-Murray Water. Only rural water businesses which have an urban component are covered by the NCC framework.

⁶ Developer charges are defined in the Water Industry Regulatory Order.

2 INTERPRETING THE PRINCIPLES

The following descriptions provide practical examples and guidance to help interpret the pricing principles set out in (Box 1) on page 6.

2.1 INCREMENTAL COSTS

Incremental costs are costs that the business would not have incurred in serving the existing customer base, or at least not to the same scale. They may include capital, operating and financing costs associated with constructing an asset sooner than planned and taxation costs attributable to the connection.

Where the connection arrangement requires assets to be gifted, the value of gifted assets will be excluded for the purposes of calculating net incremental costs.

Incremental costs should be calculated over a period that aligns with the business's growth planning and asset use horizons. For operating costs, this period should be the same as the revenue assessment period.

Incremental cost can include an allocation of costs of assets that the business had prudently built in expectation of future growth. If such costs are included, they should be explicitly revealed.

2.2 INCREMENTAL BENEFITS

Incremental benefits are those benefits that accrue to the water business as a result of the connection. At a minimum, they include the additional revenue that the water business will earn from the new services being provided (water, sewerage or recycled water) by virtue of that new connection. They may also arise when a given connection facilitates the deferral of previously planned works — for example, a connection to recycled water services may defer the augmentation of potable water infrastructure.

2.3 AVOIDABLE AND STANDALONE COSTS

The pricing principle that charges must be greater than the avoidable cost of that connection and less than the standalone cost of the connection will ensure existing customers are not subsidising new connections. It will also ensure connection applicants are not charged more than it would cost to build the assets to service them alone.

Avoidable cost represents the cost that would be avoided if the water business did not provide services to that new customer or group of new customers. Incremental cost, as defined here for NCC calculation, can be expected to be higher than avoidable cost.⁷ Avoidable cost is forward looking only.

Standalone cost is the least cost, technically efficient servicing solution (the optimised cost). It 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, and
- estimating an entirely new servicing solution that is independent of the existing network.

2.4 CALCULATING INCREMENTAL FINANCING COSTS

In cases where a development requires an asset sooner than planned, the water business may recover any incremental financing costs that it incurs.

Water businesses should calculate incremental financing costs (IFC) using this formula:

$$\text{IFC} = (1 - [1 / (1+r)^n]) \times \text{cost of capital being provided sooner than planned}$$

where:

r = estimated pre-tax WACC (see Table 1 Annexure A of each Determination)

n = the number of years the asset is required sooner than planned.

Incremental financing costs are negotiated and may apply in addition to a Standard NCC. Of course, these additional costs may be offset against revenues earned earlier than expected, consistent with the pricing principles.

⁷ Incremental costs can include an allocation of historical costs that a water business has prudently prebuilt in expectation of future growth.

Water businesses should demonstrate that their proposed charges are fair and reasonable in the given circumstances, and that the charges satisfy the pricing principles.

Water businesses should be able to recover incremental financing costs whenever an asset is provided sooner than planned, regardless of whether development is in an area covered by a precinct structure plan.⁸

2.5 CHARGING BASIS AND UNITS

Standard NCC are applied on a per lot basis, and may be levied on any connection of a new customer that is separately titled or is, or can be, individually metered.

For the metropolitan water businesses and Western Water the Standard NCC applies for connection with a 20 mm meter. When a larger meter is required the NCC should be negotiated in accordance with the water business's negotiation protocol.

The Commission did not determine the NCC charging units to be used by the regional water businesses, but notes that the metropolitan approach would also be appropriate for regional businesses.

2.6 DISPUTE RESOLUTION

Under the Water Act, each water business's connection arrangements must be fair and reasonable. The Commission's determinations also require water businesses to negotiate in good faith to arrive at NCCs and conditions for a new connection that satisfy the pricing principles.

The arrangements for NCC negotiation must be clear and transparent, and consistent with the statutory rights, obligations and procedures under the Water Act. Information on negotiating arrangements should be presented in a way that is meaningful and helpful for potential connection applicants.

⁸ Essential Services Commission 2013, *Price review 2013: Greater metropolitan water businesses—final decision*, June; Growth Areas Authority 2013, *Precinct Structure Planning Guidelines Part One – Overview of Planning New Communities*.

Where negotiations between a water business and developer fail to reach agreement, arrangements should provide for the concerned developer or connection applicant to:

- Seek an internal review by the water business
- Request independent commercial dispute resolution.

The Water Act also provides for developers to apply to the Victorian Civil Administrative Tribunal (VCAT) for resolution.

Importantly, dispute resolution under a negotiating framework is separate and in addition to – not a substitute for – the VCAT process. This alternate dispute resolution would be followed where the parties agreed to the process, to minimise the likelihood of recourse to VCAT. If the parties fail to reach resolution under the informal mechanism, the parties continue to have access to VCAT for resolution.

In its final decisions, the Commission also indicated its willingness to provide non-binding guidance on NCC matters during the Water Plan 3 regulatory period. However, the Commission strongly encourages water businesses and developers to reach agreement through the steps outlined above.

The Commission would, of course, become involved if a water business failed to comply with its determination.

3 APPLYING NCCS - SUGGESTIONS

The NCC framework aligns economic regulation with the policy intent of the Water Act.

Within the framework stakeholders have the opportunity to develop additional detail – or standardised practices – in areas that the industry considers important. This section of the explanatory note outlines matters identified through consultation as potential topics for further industry-led development.

The Commission has provided some initial thoughts on these matters. However, these observations are not part of the existing determinations, and are not binding on the water businesses.

Where hurdles arise, the relevant statutory objectives and pricing principles should guide resolution.⁹ Where matters cannot be progressed or resolved, the Commission will consider providing further regulatory guidance for Water Plan 4 - the next regulatory period.

3.1 NEGOTIATION PROTOCOLS

The Commission encourages all water businesses to publish a negotiation protocol – in a form that is useful and meaningful to developers – that references the core pricing principles (Box 1).

⁹ Depending on the area of concern relevant objectives may be the Water Act ‘fair and reasonable’ requirements, the WIRO requirement for locational signals or other relevant instruments and objectives. See Appendix A for an overview of the regulatory framework and instruments that apply to NCC.

Indicative matters for negotiation may include agreement on:

- which assets are to be constructed and gifted by the developer to the water business
- the charging units that are fit for purpose. Ideally the charging unit should reflect the service capacity in the connection design. Historically charging units (such as equivalent tenements, number of cisterns, or fixtures) may be characterised as proxies for the amount of capacity needed to service the connection.

3.2 CALCULATIONS

The Commission (with input from the water industry) developed a tool to calculate NCC in accordance with the pricing principles. While the Commission does not mandate its use, water businesses may find it useful to calculate Negotiated NCC during the third regulatory period. The tool and guidance on its use can be found on the Commission's website.

3.3 GIFTED ASSETS

Water businesses have the discretion to determine which assets are to be gifted (provided their actions are fair and reasonable), and to characterise the gifting as a condition of connection to the water business's works. If disputed, developers may seek internal review by the water business, agree to independent dispute resolution, or seek a review by VCAT as outlined in section 271 of the Water Act.

Standard NCC reflect certain assumptions about assets that will be constructed and gifted by the developer. For Negotiated NCC, these assumptions may be different to those used in calculating the Standard NCC.

Water businesses should:

- make clear to potential developers which assets a developer will be responsible for providing and gifting, and which will be provided by the water business;
- for Negotiated NCC, the negotiation should be undertaken in accordance with the water business's published negotiating protocols; and
- where the connection arrangement requires assets to be gifted, excludes the value of gifted assets for the purposes of calculating net incremental costs.

3.4 DEVELOPMENT SERVICING PLANS

Some water businesses used development servicing plans (also sometimes called infrastructure sequencing plans) as a basis for developing their Standard NCCs. The plans are *not* regulated instruments and are not formally approved by the Commission.

Though terminology differs across the businesses, the concept is a publicly available plan prepared by a water business that:

- describes the water business's expected timing and sequencing of developments and infrastructure provision – at a point in time
- can be used as a basis for deriving standard NCC during price reviews
- can be used by a water business to communicate and describe assumptions underpinning its Standard NCCs
- if kept up to date, may help inform the calculation of incremental financing costs (see section 2.4 above).

By showing the timing of a logically-sequenced expansion of a business's water, sewerage and recycled water networks, these plans can help the businesses to explain NCC to developers, and to those involved in resolving disputes.

The accuracy and usefulness of the plans will be enhanced through effective consultation: ideally water businesses will consult on and make these plans publicly available.

Though not expressly required, it would be reasonable practice for any water business to consult with stakeholders and review its plans regularly. Updating development servicing plans annually would not affect approved Standard NCC which are set for the regulatory period.

3.5 ADDRESS PIONEER DEVELOPER ISSUES

Pioneer developer issues arise when a developer pays incremental financing costs to bring forward an asset earlier than planned and then other developers connect to the asset soon after without contributing to the financing costs.

Under the NCC framework, the developer who makes the incremental financing cost payment may negotiate with the water business to be reimbursed (a portion of the financing costs) when other developers connect (to the asset that was brought forward).

The principal requirement is that arrangements are fair and reasonable, as required by the Water Act.

While arrangements that are simple to administer will be preferred, the water business must be able to demonstrate to all developers (not only the pioneer developer) that the arrangement is fair and reasonable.

Publishing these arrangements will assist all developers (current and future) to understand whether a water business is being fair and reasonable.

3.6 INCREASED CAPACITY

The Commission's view is that a developer is only required to pay for the minimum servicing solution for its development.

However, there may be situations where a water business requires a developer to provide assets that have excess capacity to service future developments. This is capacity in excess of the minimum servicing solution. If so, the water business needs to arrive at fair and reasonable arrangements for allocating the costs associated with any increased capacity between developments.

The water business has two options to ensure that the developer providing the asset with excess capacity only pays for its share of the asset's capacity.

These are:¹⁰

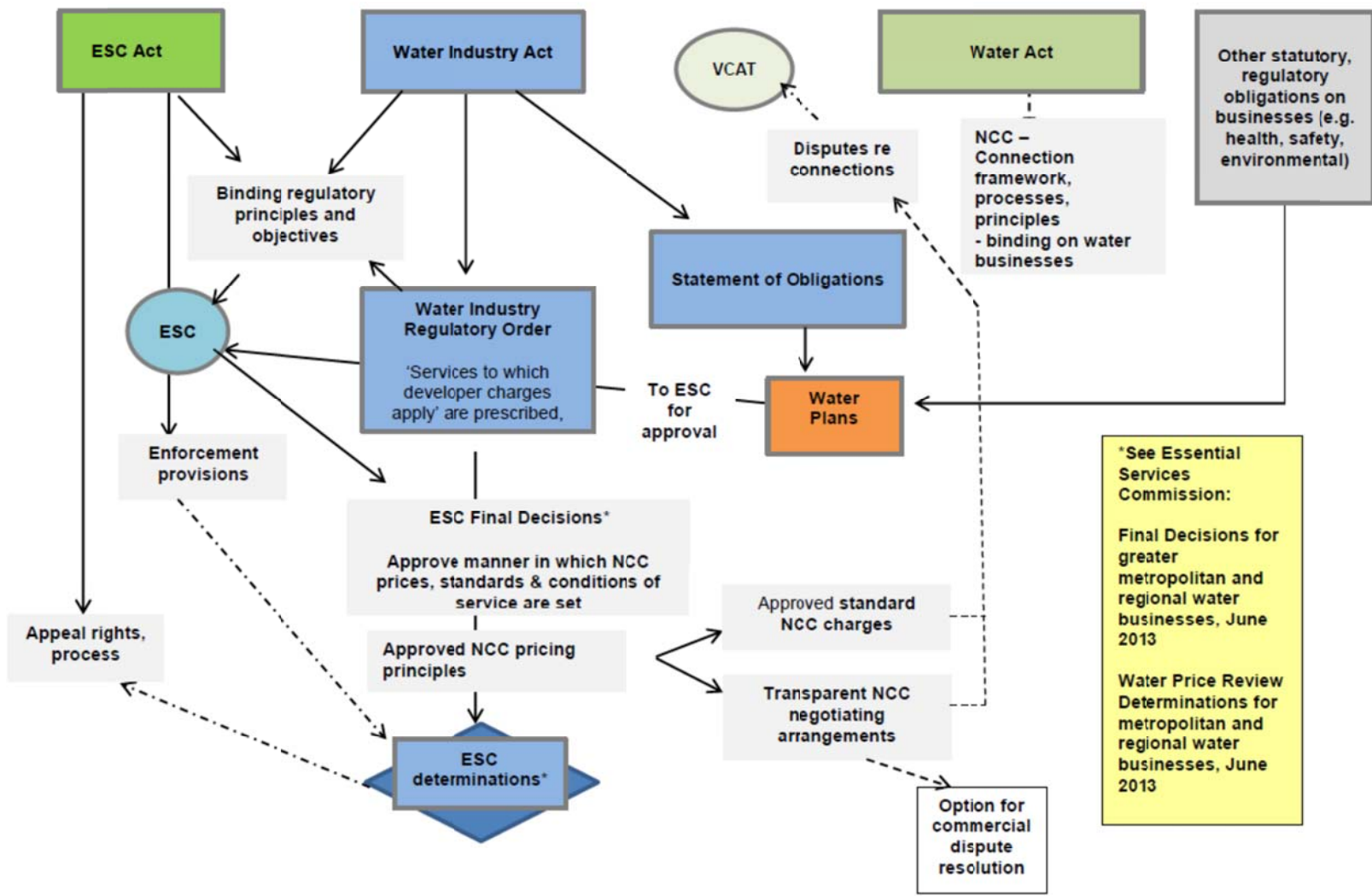
- Option 1, where the developer provides the asset, with provision to be reimbursed when subsequent connections start to use the asset
- Option 2, where the developer pays their required capacity share, and the remaining share of the assets' costs is paid for by the water business.

If the water business chooses option 2, it may then recover the remaining share of the asset's costs through the overall price process or include the value of the excess capacity in the next reset of Standard NCCs or any future Negotiated NCC.

¹⁰ These options are explained more fully at page 185 of Essential Services Commission 2013, Price Review 2013: *Regional Urban Water Businesses — final decision*, June; and page 202 of Essential Services Commission 2013, Price Review 2013: *Greater Metropolitan Water Businesses — final decision*, June

APPENDIX A – NCC REGULATORY FRAMEWORK

The diagram below shows the regulatory framework that applies to NCC.



APPENDIX B

TABLE B.1 LINKS TO WATER BUSINESS NCC INFORMATION

Water Business	Link to further information on NCC
Barwon Water	http://www.barwonwater.vic.gov.au/business/land-development
Central Highlands Water	http://www.chw.net.au/development
City West Water	http://www.citywestwater.com.au/plumbers_and_developers/land_development_manual.aspx
Coliban Water	http://www.coliban.com.au/site/root/customer_services/building_renovating/index.html
East Gippsland Water	http://www.egwater.vic.gov.au/CustomerInfo/LandDevelopmentandSubdivisions/tabid/213/Default.aspx
Gippsland Water	http://www.gippswater.com.au/GWServices/LandDevelopment.aspx http://www.gippswater.com.au/Portals/0/Gippsland%20Water%20-%20Final%20NCC%20Negotiating%20Framework%20(8%20May%202013).pdf
Goulburn Valley Water	http://www.gvwater.vic.gov.au/business/developers/2013625257195.asp
GWMWater (urban)	http://www.gwmwater.org.au/information/publications/ground-and-surface-water/west-wimmera-gma/doc_download/1956-new-customer-contribution-negotiating-framework
Lower Murray Water (urban)	http://www.lmw.vic.gov.au/About-us/Water-and-Sewerage/Property-Connections.aspx#New_Customer_Contributions
North East Water	http://www.nerwa.vic.gov.au/business-development/

South East Water	http://southeastwater.com.au/Building/Pages/BuildingDevelopment.aspx
South Gippsland Water	http://www.sgwater.com.au/Customer_Service/PDF/Tariffs%202013-2014.pdf
Wannon Water	http://www.wannonwater.com.au/ldm/policy/financial/contributions/contributions.html
Western Water	http://www.westernwater.com.au/customerservice/Pages/Propertydevelopment.aspx
Westernport Water	http://www.westernportwater.com.au/CommercialCustomers/
Yarra Valley Water	https://www.yvw.com.au/home