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19 February 2007

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

Dear Sean

**RESPONSE TO COMMISSION'S "2008 WATER PRICE REVIEW CONSULTATION –
FRAMEWORKS AND APPROACH, DECEMBER."**

Please find attached Wannon Water's consideration of the Commission's paper. Should you have any query or comment, I would welcome the opportunity to further respond.

Yours sincerely

Damian O'Doherty
General Manager Finance and Regulation

**Wannon Water Response
to the Essential Services Commission's
2008 Water Price Review, Consultation Paper, Framework and Approach - December 2006**

Commission's Consultation on Specific Issues

The Essential Services Commission (the Commission) has identified a number of issues for consultation including:-

- The length of the regulatory period and dealing with uncertainty
- Service Standards and Guaranteed Service Levels
- Assessing Expenditure
- Incentive mechanisms
- Tariff Structure including Miscellaneous Charges
- New Customer Contributions

Wannon Water would also like to comment on the following:-

- The form of Price Control, and
- Classification of prescribed and non-prescribed services.

Chapter 2 – Length of the Regulatory Period and Dealing with Uncertainty

Questions posed by the Commission are:

- a) Are there other challenges to moving to longer regulatory periods?
- b) What events during the first regulatory period have had a significant impact on the businesses' cost?
- c) What should be included in any adjustment mechanism for the second regulatory period?
- d) Do businesses expect to meet the materiality threshold for end of period adjustments associated with new obligations? What would be an appropriate materiality threshold for the second regulatory period?

2.1 The length of the regulatory period

Wannon Water considers that the surety of a five year plan is now appropriate for both this Authority, and the majority of the Victorian Water industry. Most Water Authorities are now mid term in their first three year determination and have an understanding of the requirements of the Commission. The expense of developing a Water Plan is considerable and there seems little point in repeating the exercise every three years. A significant issue is that Water Authorities have commenced to develop their second term Water Plan – and yet have only eighteen months experience within the first determination. Better Water Plans will be developed with longer lead times and more opportunity to scrutinize performance within the confines of an existing determination.

There may however be a case for some Water Authorities to have a three year determination due to events beyond their control. There is already evidence of some Authorities three year water plans being completely obsolete due to the drought and the additional major capital expenditure required to provide service due to the changed climatic conditions. However, this situation could also be managed through the unforeseen events capability.

An issue for the Commission is maybe the pragmatic one of workload. It may be sensible to have a rolling approach with all Authorities on a five year plan eventually, but with staggered starting dates. It would also mean that the industry could avail themselves of the same consultants, if one or several were standout performers.

2.2 Events occurring during the Initial Determination

Wannon Water has experienced several significant events during the first eighteen months of the determination.

2.2.1 Formation of Wannon Water

The most significant has been that Wannon Water did not exist when the initial determinations were made and currently works within the confines of three determinations which apply to Authorities that no longer exist. The primary impact is that Wannon Water is now operating on a scale and delivering a level of performance including compliance issues that was not envisaged when the original determinations were made.

2.2.2 Major Capital Works Issues

Originally Peterborough Sewerage Scheme was to be a fully funded customer scheme contributions and during the life of the current determination, the scheme became a capped scheme under the Country Towns Water Supply and Sewerage Program. Wannon Water is now obliged to fund an additional \$4.2M of the scheme.

Another significant issue has been the change in standards for Arsenic in drinking water with the introduction of the 2005 Safe Drinking Water Regulations, and the resultant declaration of Macarthur water supply as a Regulated Supply. To return Macarthur water to a non regulated supply, requires the construction of an iron absorption plant to manage the arsenic levels to the proscribed standard.

2.2.3 Applicability of specific events for adjustment mechanisms.

The Commission's discussion paper goes to some length to define events which might cause a reopening of a determination.

Rather than focusing on specific types of events and materialities as a set number, a more appropriate response is to consider the impact of the event upon the customer both now and in the future.

Regional Water Authorities have traditionally been community service providers, and are "not for profit" businesses. Consequently, there has not been a focus on raising revenue to return to the shareholder by way of dividend. As a result, there is not the capacity to absorb significant shocks by varying the returns to the shareholder that there is in other regulated businesses.

With this background, the crux of the issue is the ability of the Water Authority to financially manage the calamity (whatever it might be) within the existing price determination. If it can be managed within the current price determination by the adjustment to capital projects and service standards in consultation with customers – then this reasonable outcome and has been the time honoured process. Price adjustments to finance the calamity have been incorporated in subsequent price settings. The difference is that previously it has been a one year determination, presently a three year determination, and in the future, potentially a five year determination. The point is that subsequent pricing determinations should take account of events out of the ordinary which otherwise would have a permanent impact on the viability of the Authority in the future.

Secondly the increase in the pricing determination period however has its own inherent issues. Depending upon the timing of the calamity (whatever it might be) , there is an increased risk that notwithstanding adjustments to works programmes, borrowing regimes, and acceptable alterations to the customer standards, that the Water Authority remains either insolvent or will become insolvent before the end of the current regulatory period.

Often a small injection of funds early in the period on a continuous basis may arrest a declining situation – which over a longer period with no remedial action may become a major financial impost for customers of an Authority. Consequently, the determining factor for the reopening of a determination should not be set on a specified amount, but rather on the potential impacts on the Authority, and ultimately the Authority's customers whom we are all here to serve.

An arbitrary material amount set for the industry based on Melbourne Metropolitan companies would be an impossible hurdle for a smaller regional authority to reach. Common sense should prevail; it is not in any ones interest for a regulatory failure to occur, particularly through arbitrary limits.

The discussion paper asks what events should be included and again – there is little point in attempting to define such events, as surely the one that occurs will not be specified. The focus should be on the calamity's effect on the Authority's financial sustainability and its subsequent potential impact on customers. The best result for the customer, not withstanding the cost and the inconvenience to the ESC and the Authority of a mid term pricing determination should be the guiding criteria.

2.4 Materiality criteria

There is an argument that regional urban businesses are in a similar position to rural authorities as the initial RAV's were set at quite a low level. There is little or no margin in most regional businesses to cope with a calamitous event. The one size fits all thresholds of \$1 million or 2.5%, whichever is the greater, is inequitable. In Wannon Water's case \$1 million equates to 2.8% of gross revenue.

However, the revenue stream is not really the proper focus, but rather what is available after running the day to day activities of the business. Apart from the current financial year, Wannon Water is projected to make accounting losses until 2013, and incur a threefold increase in the level of debt during this period. These outcomes are subject of course to some assumptions about the level of tariff increases – but assuming modest real increases, this is the outcome.

So again, there should not be an arbitrary materiality threshold set. It is a given that a mid period examination of a price determination is expensive, and that customers like surety. However, the impacts of the calamitous event should be carefully considered on the Authority and the eventual flow through effect to the customer. The aim should be to minimise the customer impacts over time.

Chapter 3 – Service Standards

The Commission has posed four questions:

- a) Are there other factors the commission should consider in assessing proposed service standard targets?
- b) Do the core sets identified by the Commission in its initial guidance remain appropriate?
- c) Is there scope for service standards to be harmonised across businesses?
- d) How is the delivery of the Water plan outcomes best monitored?

3.1 Proposed Service Standards

The current process of the Commission determining current performance targets for Water Authorities based on historical three year performances for a core set of Commission determined standards has worked well. Wannon Water supports the Commissions position that performance must at least be consistent with the average performance of the last three years. Future targets are to be informed through customer consultation and in particular customer surveys. This means that the customers' views are being heard and implemented – which is a satisfactory position.

3.2 Appropriate Core Standards

The current suite of core standards is satisfactory. No additional issues are being raised through customer surveys that indicate any further service standards should be implemented.

3.3 Scope for better alignment of service standards across the State

Whilst not denying that there is an opportunity to have a similar service standard across the state, this concept does call into question some clear principles that the Commission has already established. The primary one is customer preference or requirements, and the second one is user pays.

Water Authorities have not been created equals. Each is differently resourced and operates within its own unique environment. In turn this means that Authorities are not facing necessarily the same issues or if they do, to the same degree. For all Authorities to perform identically to a homogenous standard, would require vastly different cost inputs, and hence reference to the customer.

Presently, Water Authorities do not have a mandate to ramp up (or down) standards to achieve a homogeneous state wide outcome.

In many instances, if customers are required to pay for a service delivery to a state-wide standard, a different choice might be espoused by customers as to the level of service they are prepared to receive (and pay for). If the Commission believes common standards should be met across the state, then a different model for the payment of the service delivery to a common standard will need to be implemented, otherwise the Commission is neglecting the very people it is supposed to be representing.

3.4 Monitoring of the Delivery of Water Plans

The Commission has elected to monitor performance in the implementation of water plans by reviewing an Authority's performance in delivering specific outcomes – primarily key capital projects, but also some key maintenance outcomes. These are two components of the Water Plan, but the Commission's real focus should be on a Water Authority's core functions, the delivery of water and sewerage services to its customers. The other issue that is worthwhile considering is the solvency of Authorities – particularly if determinations are to be every five years and the scope for reopening determinations is limited.

3.5 Guaranteed Service Levels

Wannon Water considers that the introduction of Guaranteed Services Levels (GSL's) and the provision of small payments to customers for failure to achieve specific standards are a good internal mechanism to ensure focus by Authority staff on priority customer specific issues.

However, to be meaningful, the number of standards subject to GSL's should be small and therefore direct attention to those issues which most concern customers. Wannon Water would advocate that GSL's should only apply to multiple service interruptions to the same customer for either water or sewerage services.

Wannon Water has consulted with its Customer Engagement Committee, who supports the concept. An issue for Wannon Water is the implementation of the systems to actually record breaches of proposed GSL's and the consequent estimation of costs of the proposed system.

In respect to the industry, GSL's are a management tool to encourage particular behaviours within the Authority. They are not about compensating customers for inconvenience etc. although that is a side outcome. The decision to implement such a system should therefore be left to individual water authorities as a component of how they manage their customer relations.

Chapter 4 – Assessing Expenditure

The Commission has sought comment on:-

Operating expenditure

- a) are there any other factors the Commission should take into account when assessing the businesses forecasts of operating expenditure?
- b) Are there water benchmarking studies that the Commission should consider when assessing the businesses' forecasts of operating expenditure?
- c) What factors should the Commission consider when assessing the potential for productivity improvements?

Capital Expenditure

- d) Other factors the Commission should take into account in assessing forecasts of capital expenditure?
- e) Potential for Asset management to deliver productivity improvements?

4.1 Factors to be considered in assessing businesses forecasts of operating expenditure

In Wannon Water's case, as a new Authority, it is operating on a different plane to that of its predecessor Authorities, particularly in the areas of EPA, DHS and Occupational Health and Safety compliance. Consequently, the Commission does need to consider whether the proposed operating expenditure levels are sufficient to achieve an acceptable standard of operation in terms of compliance with other regulators. Productivity gains are not necessarily a reduction in operating expenses, but can also be an increase in performance delivery to provide compliant standards of operation. In the formative years of Wannon Water this is certainly the case.

The Commission should consider issues that impact operating expenditure above historical levels. For example the impacts of drought, climate change, and Government policies to be implemented by Water Authorities, need to be given due consideration.

4.2 Benchmarking Studies

Nothing further to add.

4.3 Productivity Improvements

Wannon Water agrees with the principle that Water Authorities should deliver productivity improvements over time. Given that there will be two completed years of history for Wannon Water by the time the Commission makes its determination for the 2008-13 period, there will certainly be better knowledge about what it does cost to run an efficient compliant organisation.

The Commission should give consideration to the maturity of the business it is examining. Allowance needs to be made for businesses which are very much in a development phase, compared to businesses which are mature and have a solid operational base to work from.

4.4 Capital Expenditure

Setting capital expenditure programmes based on historical needs is not relevant to future capital expenditure requirements of a Water Authority. The Commission should review the drivers for the proposed Capital expenditure program for each Water Authority along with its capability to deliver the proposed program.

Chapter 5 – Efficiency Carryover Mechanisms

The Commission has sought comment on:

- a) should efficiency carryover mechanisms be applied for the 2008 regulatory period? and,
- b) If so, how should the efficiency mechanism be designed ?
- c) "S" factor mechanism

5.1 Efficiency Mechanism Carry Over

Wannon Water would concur with the Commission's view that applying an efficiency carryover to the first regulatory period may have limited value, particularly for Wannon Water which is a business formed after the first determination was made. The circumstances of the initial determination no longer exist and application of any efficiency carryover mechanism would little relevance.

Perhaps there is a bigger question – in that Water Authorities are "not for profit" bodies and have traditionally returned profit to their customers by way of lower charges. The concept of efficiency carryovers really only works where there is active shareholder participation seeking a dividend stream, and there is a consequent sharing of the efficiencies made.

Wannon Water would also agree with the comment that “businesses should have a continuous incentive to achieve efficiency gains irrespective of when they arise during the regulatory period. Also, incentives should reflect efficiencies achieved within the control of management.”

5.2 “S” factor mechanism

Wannon Water notes the Commission intention to not apply an “S” factor approach. The principle attribute of an “S” factor is the alteration of prices to reflect performance against clearly defined average reliability targets. This usage of prices in the Water Industry could clash with the conservation/environmental messages that pricing is also used for.

Again this type of thinking is based on the premise that the profit motive and a return to a shareholder is driving Regional Water Authorities, and as previously discussed, this is not the case.

Chapter 6 – Tariff Structures

The Commission seeks on comment on the following:

Water Tariffs

- a) Impact of inclining block on consumption in the first regulatory period,
- b) Comments from metropolitan retailers on the impact of inclining blocks in the first regulatory period,
- c) Impact on large families,
- d) Use of targets and incentive pricing satisfy WIRO requirements.

Recycled Water

- e) Are there any new obligations which will impact on directly on recycled water pricing?
- f) Is annual approval of prices appropriate for third pipe schemes where groups of customers receive homogeneous product?
- g) Are pricing principles appropriate for large non domestic customers?
- h) What pricing principles should be applied?
- i) How should recycled water tariffs be structured?

Miscellaneous Services

- j) The uncertainty of the nature of the services being offered?
- k) Should businesses be more comprehensively define their miscellaneous service?
- l) Best practise pricing and consistency across businesses?
- m) Concern about “actual cost” pricing being applied?
- n) Any benefits in adopting a common approach to determining “actual cost”?
- o) Should businesses be required to provide an estimate of costs prior to the service being provided?
- p) Is it necessary to maintain the ability for new miscellaneous services to be introduced during the regulatory period?
- q) Should the introduction of new miscellaneous services be restricted to the commencement of each regulatory period?

6.1 Water Tariffs (Questions a to d)

The Government’s policy document – “Our Water, Our Future” in section six describes the introduction of a three part tariff for Melbourne customers and states that “Government will require regional urban authorities to introduce pricing structures that provide incentives for water conservation from 1 July 2005.” (Page 128).

In Wannon Water's case, one outcome of the merger of its founding Authority members is the inheritance of three quite different tariff structures for both water and sewerage. The current awareness of water issues by the community makes this a good time to consult with customers and implement a new tariff structure which better reflects the environmental and economic circumstances.

Given that Wannon Water has two part water tariffs in all communities, but some with a three tiered inclining block, some with a two tiered inclining block and a third group with a flat volume charge, there is scope to introduce a common pricing structure, but not necessarily a common price.

In Portland and Warrnambool where inclined block tariffs have been introduced, lower average household water consumptions are evidenced, than in Hamilton where a flat tariff per kilolitre of water applies.

Given the perceived success of the Melbourne three tiered tariff structure, Government support for this concept, and Wannon Water's own experience to date with tiered tariffs, Wannon Water supports the introduction of tiered tariffs for residential customers.

In order for the process to be equitable, the end of the middle tier will be structured around average water use – which means that 50% of residential users will receive their water at a price equating to long run marginal cost – high end users will pay a premium for utilising discretionary water, and conservative water users in the first tier will receive a discount as a reward for their frugality.

The issue of the large family, or more properly the larger domestic users of water, is manageable through a variety of mechanisms. It can be dealt with by assisting those users with in-home improvements to lower the quantity of water used, hardship provisions and providing contacts for government agencies which specialise in assistance.

6.2 Recycled Water (Questions e-i)

The Commission's paper correctly identifies two very different types of recycled water schemes which require very different treatments. Type one are mandated third pipe reticulation schemes to a homogeneous group of customers. The second type could be described as negotiated arrangements with individual customers who have the option to accept or reject the proposition.

In the circumstances where there is a third pipe scheme proposed – then it is acceptable that the Commission determines the price due to the nature of the monopoly transaction. As the timing of third pipe schemes are dependent upon developers commercial assessments of the viability of particular sub-divisions, and the cost will vary with each proposition, then the Commission needs to be flexible in making itself available to match commercial realities. The Commission is suggesting that there be an annual appraisal of such schemes. This may be too limiting.

Although a Water Authority has the ability to mandate third pipe schemes, they will not be mandated at any cost. A Water Authority must evaluate the cost of provision of recycled water, the portion of the cost recovery component, and other tangible benefits (i.e. substitution for potable water etc.) Consequently, if the schemes are not to be regulated through determined principles, so that there is some surety about what will and what won't be permitted by the Commission, then the Commission is going to have to be involved in each scheme as they are developed. In this way a proper assessment will be made by all parties as to the potential outcomes and decisions to proceed or not will be made with full knowledge of the potential outcomes. Subsequent movements in price for recycled water under these conditions can be set on annual basis perhaps up to the next determination. However, once the system has matured, and the costs and benefits are readily identifiable, then there is no reason why these mature schemes could not be determined in the same manner as other regulated prices.

It is noted that that the Commission is considering establishing a set of standard tariffs for recycled water to apply in typical residential subdivisions. While this may provide a simple solution to the Commission, the prices selected will not reflect local conditions and issues. There is the potential for communities to trade future potable supply and security options with intelligent provision of recycled water schemes and consequently true costs (meaning price to the customer) of all options must be known and understood. As the Commission would be setting prices on the basis of one size fits all, an incorrect decision is likely to be made.

In respect to negotiated provision of recycled water where there is an element of competition (i.e. a choice for the end user of alternative supplies) the Commission is proposing a continuation of the present arrangements and this is acceptable to Wannon Water.

6.3 Miscellaneous Charges (Questions j-q)

The majority of miscellaneous charges types are common to all Authorities. In the case of those charges which are likely to be paid by service users from both within and outside of an Authority's operational region – there is some merit in these charges being common across Authorities. The best example is the fee for information statements, and conveyancing staff in general would appreciate a standard or common fee across authorities.

However, as pointed out earlier, not all Authorities are created equal and different circumstances apply within each Authority which will give rise to different cost structures. So there should be a focus on miscellaneous charges being cost reflective of the service provider, rather than common across the industry. It is important that the user of the service pays for it, and the function is not cross subsidised by the general tariffs.

In respect to the actual questions asked:

- j) Wannon Water would contend that there is no uncertainty about the nature of the miscellaneous services being offered any given Authority. There may be an issue when comparing similarly named services between Authorities where different outcomes are delivered. However, it would be unusual for a customer of both Authorities to require the same miscellaneous service and for that person not to get a similar result from both Authorities.
- k) Should businesses be required to more comprehensively define their miscellaneous services? The answer is to what end? If the definition is sufficient within the Authority to ensure a constant quantum of service to all purchasing customers from the Authority –then this should be sufficient. The only value a common definition across all Authorities is if a common price is to be established across all Authorities, and a common price across Authorities will result in under and over recoveries depending on local cost structures and efficiencies.
- l) What is the best way to ensure that miscellaneous service prices are priced appropriately and consistently across all businesses? It is important that the service given is the one that is required by the customer in that location – if the definition of this service happens to coincide with the definition of a similar service in another Authority up the other end of the state- well that is nice – but not very relevant to the customer. Miscellaneous charges are precisely that – miscellaneous things that the customers require to be done in a specific locality which suits local needs and issues. In respect to being priced appropriately, the price should be a fair approximation of the direct cost plus a contribution to the indirect costs.
- m) Wannon Water is a recent amalgam of three authorities with three very different pricing structures including miscellaneous prices. Each former Authority supposedly based its miscellaneous charges on some form of cost – yet very different answers were obtained. The only real concern is when the same Authority has three different charges for the same

service – and the location of the service provision determines the fee paid. Customers however accept that the current situation is a piece of bureaucratic nonsense and hence there does not appear to be any real customer concern about the price or more importantly the underlying costing that gave rise to the miscellaneous charge price in the first instance. Given the experience to date – there does not appear to be any significant benefit for uniform costing apart from the Commission’s desire of general well being.

n) Provision of an estimate of costs before the provision of the service. In those instances where a miscellaneous service is being provided on the basis of cost – then the customer must have the opportunity to evaluate the value of the service and therefore whether or not they would wish to continue. Wannon Water would propose that all services provided based on “cost” should have a proper estimate completed and the customer advised.

o) & q) Ability to introduce new miscellaneous services during the period.

Notwithstanding that it might be expensive and inconvenient to the Commission to assess a new miscellaneous service price – it may be a service that customers are seeking. Water Authorities are community service organisations and the ability to provide services at a reasonable cost to its customers should not be strangled by bureaucratic red tape. It will always be necessary to maintain the ability for new miscellaneous services to be introduced during the regulatory period. Who knows what technology might make available by way of opportunity in the future.

Chapter 7 – Customer Contributions

Wannon Water is pleased to support the VicWater submission in its entirety and this submission is attached as an appendix.

Other Issues of Concern

8.1 The Form of Price Control

Wannon Water does not believe that a Revenue Cap price control mechanism can be made to effectively work in the Water Industry when there is also such a heavy emphasis on both social and environmental considerations. Pricing of water is also used to deliver conservation messages and significant fluctuations in the price of water both up and down can be an outcome of revenue cap. These movements could be at cross purposes with the other criteria that Water Authorities must abide by.

However, it is noted that the rural authorities with significant irrigation components do have a revenue cap arrangement – and the learning’s from this experience should be reviewed for application to rural urban Authorities.

Price Cap has been the traditional mechanism for Water Authorities to derive their revenue which means that the shareholder is the one at risk if insufficient revenue is raised rather than the customer in a following year. As Water Authorities are classified as “not for profit” and there is not the emphasis on dividends but rather social and environmental good, this is appropriate.

However, In Wannon Water’s case – as it is a recent amalgam of three water authorities which had quite different philosophies in tariff structures – there needs to be some flexibility in the way in which the price cap is applied. This is to allow for anomalies to be corrected and also to allow for the alignment of tariff structures. Experience in the current determination has demonstrated a very inflexible attitude by the Commission to the introduction of tariff structural changes during the regulatory period even with a tariff basket in place. (Alteration of tier blocks sizes in the former Portland Coast Region Water Authority)

This attitude means that changing tariffs for innovative ideas and correction purposes can happen only at each determination and on a five year cycle this is far too inflexible and will actual stifle progressive thinking. Wannon Water would expect that the option of tariff baskets be made available to all. However, some greater flexibility than the existing tariff baskets rebalancing constraints needs to be built in to allow some progressive thinking to be implemented whilst protecting the customer from undue price shocks.

8.2 Classification of prescribed and non-prescribed services

For the majority of Water Authorities, the distinction between prescribed and non-prescribed services is fairly clear cut. The issue of principle concern is the one of farming activities on sewerage treatment plant sites. Often the use of third party farmers to manage and run irrigation systems is a least cost solution to one aspect of the sewerage treatment plant – namely the disposal of a by-product from the sewerage treatment plant and as such should be considered a prescribed service.

Wannon Water would be interested in further examining this aspect to ensure that correct allocations are made.

**2008 Water Price Review
Consultation Paper
Framework and Approach**

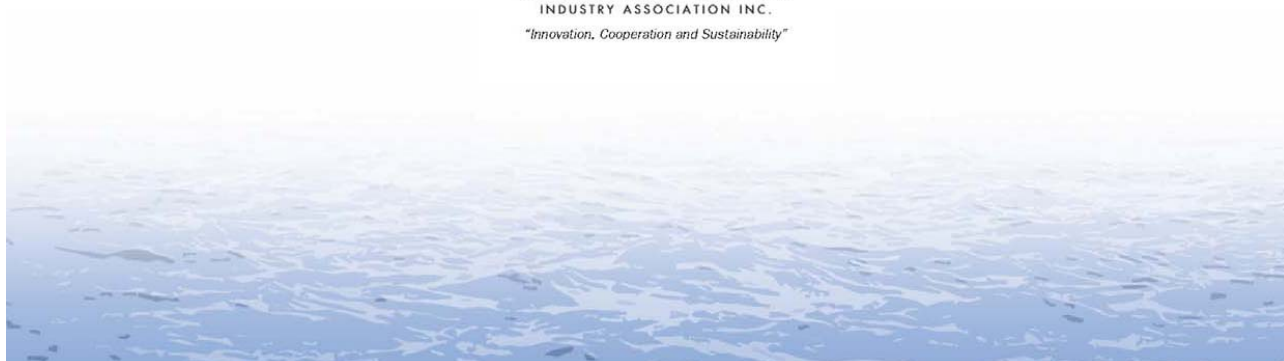
**VICTORIAN WATER INDUSTRY
SUBMISSION**

NEW CUSTOMER CONTRIBUTIONS

FEBRUARY 2007



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



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).