



# Issues paper

## Inquiry into regulatory arrangements for small-scale water, sewerage and energy services

August 2016

## Request for submissions

The Essential Services Commission (**Commission**) invites written submissions on this paper. Written comments should be provided by **Friday, 30 September 2016**.

It is the Commission's policy to make all submissions publicly available via its website ([www.escosa.sa.gov.au](http://www.escosa.sa.gov.au)), except where a submission either wholly or partly contains confidential or commercially sensitive information provided on a confidential basis and appropriate prior notice has been given.

The Commission may also exercise its discretion not to publish any submission based on length or content (for example containing material that is defamatory, offensive or in breach of any law).

Responses to this paper should be directed to: **Inquiry into regulatory arrangements for small-scale water, sewerage and energy services**

It is preferred that submissions are sent electronically to: [escosa@escosa.sa.gov.au](mailto:escosa@escosa.sa.gov.au)

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- ▶ The Commission is conducting an Inquiry to inform itself on the best way to regulate small-scale water, sewerage, electricity and reticulated liquid petroleum gas services in South Australia, to ensure the long-term interests of consumers of those services are protected.<sup>1</sup>
- ▶ The purpose of this Issues Paper is to gather evidence from people currently providing and consuming these services, people who may want to provide these services in the future, and other interested parties.
- ▶ Submissions and responses addressing the matters raised in this Issues Paper, or any other matters relevant to the Inquiry, are due by **Friday, 30 September 2016**.

## Purpose of the Inquiry

Our primary objective under the Essential Services Commission Act 2002 (**ESC Act**) is to protect the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.<sup>2</sup> The scope of our role in various essential service markets is set out in industry regulation acts.<sup>3</sup>

This Inquiry will seek to determine the most appropriate future regulatory framework for small-scale water, sewerage, electricity and reticulated liquid petroleum gas (**LPG**) utility services (**small-scale utility services**). It will include consideration of other matters and reviews that may impact the overall context in which we make our decisions.<sup>4</sup>

## Why are we reviewing our regulatory framework now?

We consider that a review of our various regulatory frameworks for small-scale utility services is necessary and appropriate at this time, for the following reasons:

- ▶ Our current framework regulatory determination for small-scale water and sewerage retailers is due to expire on 30 June 2017. While the frameworks for electricity and LPG do not have a formal expiry date, it is timely to review how well each of our current frameworks are assisting suppliers to become more efficient and deliver positive outcomes for consumers.
- ▶ Recent and emerging technological, operational and environmental and other developments could have significant impacts on the provision of electricity in regional and remote areas, as well as having the potential for new 'off-grid' developments to emerge within and on the edge of the current electricity network. New business models are likely to expand customer choice in this market, but are also likely to introduce new risks which we need to assess.

We consider that our market rules should be flexible enough to allow any new business models that are in the interests of consumers to operate. We want to explore whether the regulatory outcomes we are seeking from these markets are similar enough to allow us to establish high-level principles that are generally applicable to each market. This approach would allow us to develop a more

<sup>1</sup> The Inquiry does not extend to electricity and natural gas services provided under the National Electricity Law, National Gas Law and National Energy Retail Law. It also does not cover the water and sewerage retail services provided by SA Water.

<sup>2</sup> Essential Services Commission Act 2002, section 6(a).

<sup>3</sup> Our industry specific functions are set out in section 6A of the Electricity Act 1996 and Gas Act 1997 and section 7 of the Water Industry Act 2012.

<sup>4</sup> For example, the work being undertaken by the [COAG Energy Council](#) on the regulation of standalone and non-interconnected energy systems under the national energy frameworks. Refer also to [Energy Market Transformation Bulletin No.1](#).

flexible regulatory framework that would work across all industries now and into the future.

## The current markets

While there are differences between current suppliers, the markets for small-scale utility services have some similar characteristics:

- ▶ a single supplier that operates one or more geographically isolated networks and bills customers for those services
- ▶ low customer numbers, and
- ▶ limited choice for customers.

Recognising the difference in the scale and nature of the services provided, our current frameworks are targeted and proportionate to the risks they present for customers.

A summary of the small-scale utility service markets we currently regulate follows.

## The water and sewerage markets

We currently regulate 63 entities providing water (drinking and non-drinking) and sewerage retail services to around 166,000 customers in South Australia.<sup>5</sup> The majority of these services are provided by local councils, with several private companies also providing services to local communities through standalone networks.

However, we are aware that some local communities are receiving services through long-standing and less formal arrangements, such as operations run by community organisations. By their very nature, such arrangements are difficult for us to identify.

When our role as the economic regulator of the water and sewerage sector began in 2012, these entities were already providing water and sewerage services to local communities.

Our focus during the first four year regulatory period has been on introducing greater transparency around suppliers' current practices and understanding their existing practices and procedures.

## The energy market

We currently regulate eight suppliers providing electricity services to around 5,000 customers through a series of standalone electricity networks.<sup>6</sup> These services are provided by three broad categories of suppliers:

- ▶ those who operate systems owned by the South Australian Government who are funded through the Remote Areas Energy Supplies Scheme<sup>7</sup>
- ▶ those who hold generation, distribution and retail licences, own the relevant assets themselves and receive a subsidy through the Remote Areas Energy Supplies Scheme, and
- ▶ those who own the relevant generation and/or distribution assets themselves and provide a bundled retail service to customers.

We last reviewed these licences in 2007-08 prior to the expiry of the original licences that had been issued by the Technical Regulator in 1999.

We also currently regulate three privately-owned suppliers providing reticulated LPG services to around 3,000 customers in eight standalone networks.

<sup>5</sup> Details of individual water retail licences can be found using the following links: [intermediate](#) and [minor](#), and [exemptions](#).

<sup>6</sup> The networks are located in regional and remote areas of the State that are not connected to the National Electricity

Market, so they are not regulated under the National Electricity Law.

<sup>7</sup> Refer <https://www.sa.gov.au/topics/water-energy-and-environment/energy/energy-supply-and-sources/remote-areas-energy-supplies-scheme>.

We last reviewed our regulatory framework for reticulated LPG suppliers in 2012-13, following the South Australian Government's decision that types of gas other than natural gas would continue to be regulated by the Commission once the National Energy Customer Framework commenced operation in South Australia.

### Limited customer choice

While the Commission has not granted exclusive rights for only one supplier to operate in each geographic area, customers' choice is currently limited to being part of that network or by being self-sufficient.

In some instances, customers in small-scale networks may purchase water, sewerage, electricity and gas from separate suppliers.

### Changing markets

The market for the supply of electricity services to customers is changing. New business models have the potential to provide customers with greater choices and improve business efficiencies.

However, it is also possible that new risks may emerge through new business models. For example, there may be greater uncertainty about the continuity of supply or the reliability of services that can be achieved through various new and emerging technological solutions. It is important that customers understand these risks when they are making their choices between supply options.

The ownership arrangements that emerge are also likely to be different to the traditional centrally-controlled approach to providing utility services. This could include:

- ▶ existing privately-owned suppliers expanding their business offerings to compete in new and emerging markets
- ▶ individual councils or groups of councils working together to deliver services across council boundaries
- ▶ community-owned or strata corporations providing utility services to property owners or tenants, or
- ▶ land and property developers, potentially in partnership with existing suppliers or other third parties.

Some business models will require careful consideration of the current legislative framework.

For example, it is possible that electricity micro-grids may emerge where the primary source of energy is supplied locally but a connection to the National Electricity Market is maintained. While licensing of the retail operations falls outside of our jurisdiction if a connection to the National Electricity Market is maintained,<sup>8</sup> we are responsible for licensing some generation, distribution and transmission operations, whether they form part of the National Electricity Market or are standalone operations.<sup>9</sup>

It is also possible that the additional choices in the electricity market could have implications for the reticulated LPG market in the future as customers consider their new supply options.

Finally, the recent commencement of the water industry third party access regime<sup>10</sup> may encourage alternative suppliers to enter the market for water and sewerage services and potentially expand customer choice in this market.

<sup>8</sup> These functions are performed by the Australian Energy Regulator. Refer [www.aer.gov.au](http://www.aer.gov.au).

<sup>9</sup> A person carrying on electricity or gas operations can seek an exemption from the requirement to be licensed in the particular circumstances set out in regulation 15 of the Electricity (General) Regulations 2012 and regulation 7 of the Gas Regulations 2012. Statutory exemptions are not

provided for a person retailing water under the Water Industry Act 2012.

<sup>10</sup> For further details on the water industry third party access regime refer to the Commission's website at <http://www.escosa.sa.gov.au/water-overview/third-party-access.aspx>.

## Our role in promoting a well-functioning market for small-scale utility services

Meeting our legislated objectives<sup>11</sup> in regulating small-scale utility services requires us to put in place arrangements to promote a well-functioning market for these services. We consider a well-functioning market is underpinned by two overarching principles:

- ▶ suppliers understand the long-term costs of doing business that reflects what customers value and suppliers price accordingly to recover those costs, and
- ▶ customers have confidence that the market will respond to and meet their needs, and that they have access to information on services and prices to be able to make informed decisions.

As such, an effective market is characterised by satisfied customers who are able to purchase products and services they value.

In assessing the best way to promote a well-functioning essential service market, we need to have regard to the need to:

- ▶ promote competitive and fair market conduct
- ▶ prevent misuse of monopoly or market power
- ▶ facilitate entry into relevant markets
- ▶ promote economic efficiency
- ▶ ensure consumers benefit from competition and efficiency
- ▶ facilitate maintenance of the financial viability of regulated industries and the incentive for long-term investment, and

- ▶ promote consistency in regulation with other jurisdictions.<sup>12</sup>

We also want to ensure that:

- ▶ any regulatory arrangements that we develop or administer are targeted and proportionate
- ▶ wherever possible, the costs of regulation do not exceed the benefits, and
- ▶ our decisions take into account and clearly articulate any trade-off between costs and service standards.<sup>13</sup>

Having regard to these requirements, we aim to ensure that:

- ▶ there are markets for such services (whether monopoly or competitive)
- ▶ those markets operate efficiently and effectively, and
- ▶ suppliers are responsive to customers' service needs and requirements.

We understand that customers expect a regulatory framework to deliver the services they value at an efficient price. We also understand they expect there to be appropriate consumer protections in place, such as the provision of relevant information and complaint handling mechanisms to assist them if something goes wrong.

We understand that suppliers (existing and new entrants) expect a regulatory framework that establishes clear and efficient market rules, creates minimal duplication of effort and provides certainty about their rights and obligations in the future.

We consider it is reasonable for all stakeholders to expect us to establish, monitor and enforce market rules that are proportionate to the risks of meeting clearly defined regulatory objectives.

<sup>11</sup> ESC Act sections 6(a) and 6(b).

<sup>12</sup> Essential Services Commission Act 2002, section 6(b).

<sup>13</sup> Essential Services Commission Act 2002, section 25(5).

This approach will impose the lowest possible regulatory costs for the greatest benefits for all market participants.

In developing our market rules, we need to consider whether it is necessary to:

- ▶ establish minimum requirements or service standards
- ▶ prohibit certain actions
- ▶ ensure appropriate information is provided, and
- ▶ regulate prices, conditions relating to prices or price-fixing factors.

We should only intervene in a market to address market failure. While not an exhaustive list, this market failure could include:

- ▶ provision of complex information or incomplete information to customers that makes it difficult for customers to make decisions about their use of services
- ▶ provision of services that customers do not value or delivery of services at an inefficient cost, and
- ▶ restriction or disconnection of services without prior warning, valid reasons or where a customer is willing but unable to pay for the use of those services.

Our role is to promote an efficient and effective market where customers are satisfied and able to purchase products and services they value. We do this by monitoring the market and responding to supplier behaviour that represents the greatest risks to the market. But we should only intervene if we can demonstrate that by doing so leads to a net benefit for the community.

For example, there are various ways that customers can purchase water, sewerage, electricity and gas services.<sup>14</sup> Where those

services are provided through a shared network, the ability for suppliers to tailor service offerings to individual customers may be limited. This limitation may suggest that suppliers should be required to provide at least a minimum level of service to all customers who wish to receive that service.

Further, the costs associated with the service should be identified and recovered by the suppliers if they are going to continue to offer services in those markets.

This Inquiry primarily focuses on markets where services are provided by only one supplier (monopoly services). In such markets, it is possible that a failure to take a long-term view of the costs of providing services could lead to future bill shocks (that is, an unexpected significant increase in the cost of the customer's bill) and/or loss of the service for customers (market exit).

## Our current regulatory frameworks for small-scale utility services

### Water and sewerage market

A person must not provide a retail service in the water market unless they hold a licence authorising those services, operations or activities.<sup>15</sup> The retail service does not separate the elements of the supply chain. Consequently, in the water industry, we license the bundled retail service.<sup>16</sup>

Our powers for regulating water and sewerage services includes industry licensing, the ability to make industry codes, rules and guidelines regulating supplier behaviour, regulating the prices of those services and monitoring supplier performance.<sup>17</sup>

<sup>14</sup> Some people may choose to be self-sufficient and take responsibility for meeting their own essential service needs.

<sup>15</sup> Section 18(1) of the Water Industry Act 2012.

<sup>16</sup> Part 4 of the Water Industry Act 2012.

<sup>17</sup> Our specific functions are set out in section 7 of the Water Industry Act 2012.

Recognising that there are differences in scale and scope of retail operations provided by retailers throughout the State,<sup>18</sup> we have tailored our approach by establishing different requirements for retailers providing services to less than 50,000 customers (**minor and intermediate retailers**).

Our consumer protection framework for minor and intermediate retailers, set out in the Water Retail Code – Minor and Intermediate Retailers,<sup>19</sup> establishes requirements around:

- ▶ standard form customer contracts that suppliers can use to ensure that there are clear and legally enforceable rights in the sale and supply of water and sewerage services
- ▶ a Customer Charter to provide customers with a summary of their rights and responsibilities
- ▶ minimum requirements around billing, billing disputes, payment terms and methods to ensure that customers receive accurate billing information in a timely manner
- ▶ limitations on the grounds on which suppliers can restrict or disconnect customers and requirements to ensure that customers can have their supply restored quickly, and
- ▶ procedures for dealing with customer enquiries, complaints and the resolution of disputes between the customer and the business.

We made our first price determination to apply to minor and intermediate retailers in June 2013.<sup>20</sup> This determination is a combination of pricing principles and a price monitoring framework.

Under this form of regulation, minor and intermediate retailers retain the responsibility for determining their own prices. However, we have sought to introduce a greater level of transparency into the price setting process by requiring minor and intermediate retailers to take certain principles into account in determining their costs and developing their prices, and demonstrate to us that they have done so.<sup>21</sup>

This approach to regulating minor and intermediate retailers' prices covers the period from 1 July 2013 to 30 June 2017.<sup>22</sup>

We monitor minor and intermediate water suppliers' performance by requiring them to report annually on:

- ▶ service complaints, supply interruptions and sewerage overflows
- ▶ the length of the network and changes in customer numbers
- ▶ total consumption, sales and revenue
- ▶ an itemised pricing schedule and a pricing policy statement
- ▶ an assessment of how they have determined the costs of providing their services
- ▶ the number of customers participating in a financial hardship program

<sup>18</sup> Section 25(2) of the Water Industry Act 2012 requires us to have regard to the scale and nature of a water retailer's operations in determining the licence conditions that should apply to that entity.

<sup>19</sup> For a copy of the current Code, refer to [Water Retail Code- Minor and Intermediate Retailers, WRC-MIR/02](#), released in March 2015.

<sup>20</sup> For a copy of the price determination, refer to [2013-2017 Price Determination for Minor and Intermediate Retailers](#) (1 July 2013, as varied on 23 July 2015).

<sup>21</sup> These principles were drawn from the National Water Initiative Pricing Principles (**NWI Pricing Principles**), as

required under a Pricing Order issued under section 35(3) of the WI Act. The NWI Pricing Principles relate to cost recovery, pricing and transparency of drinking water, recycled water and stormwater services. The pricing order excluded the Principles for Recovering the Costs of Water Planning and Management Activities. While the NWI Pricing Principles do not apply to sewerage services, we decided that they could be drawn upon and adapted to cover these services, including Community Wastewater Management Systems (**CWMS**).

<sup>22</sup> Part 3 of the ESC Act 2002 and division 3 of the Water Industry Act 2012 set out our price regulation functions.

- ▶ customers who have their supply restricted as a result of not paying their bills, and
- ▶ the number of customers where a supplier is undertaking legal action to recover debts owed.<sup>23</sup>

## The national energy market

The final stage of introducing the national energy regulatory framework in South Australia occurred in February 2013, when the primary responsibility for regulating South Australia's retail energy market transferred to the Australian Energy Regulator (AER). The AER is now responsible for electricity and gas network price regulation, retail consumer protection and monitoring the performance of suppliers in the national energy market.<sup>24</sup>

However, the Commission has retained responsibility for regulating electricity and gas suppliers that are not regulated by the AER under the national energy regulatory framework. This includes:

- ▶ suppliers providing electricity in standalone networks that are not connected to the National Electricity Market, and
- ▶ suppliers providing LPG in standalone networks.

While the Commission has not granted exclusive rights for only one supplier to operate in each geographic area, customers' choice is currently limited to being part of that network or by being self-sufficient to meet their electricity and/or gas needs on their own.

Our powers in these markets include industry licensing, making industry codes to regulate supplier behaviour, regulating the prices of those services, and monitoring supplier performance.<sup>25</sup>

## Off-grid electricity market

A person must not carry on operations in the electricity market unless they hold a licence authorising those operations.<sup>26</sup> This includes the separate elements of the supply chain, including the generation, transmission, distribution, retailing of electricity, and the system control over a power system.

In the energy industry, we license the generation, network and retail service functions within the supply chain.<sup>27</sup>

The Commission has established consumer protections around key elements of the relationship between a customer and their supplier.<sup>28</sup> This includes:

- ▶ standard form customer contracts that suppliers can use to ensure that there are clear and legally enforceable rights in the sale and supply of electricity services
- ▶ minimum requirements around billing, billing disputes, payment terms and methods to ensure that customers receive accurate billing information in a timely manner
- ▶ limitations on the grounds on which suppliers can disconnect customers and requirements to ensure that customers can have their supply reconnected quickly, and

<sup>23</sup> For a copy of the current information guideline, refer to [Water Regulatory Information Requirements for Minor and Intermediate Retailers, Water Industry Guideline No.3 \(WG3/04\)](#), released in July 2015. Also available is an accompanying [Explanatory Memorandum](#).

<sup>24</sup> The national energy regulatory framework is set out in the National Electricity Law, National Gas Law, National Energy Retail Law and rules made under those laws. Further

details on the AER's operations are available at [www.aer.gov.au](http://www.aer.gov.au).

<sup>25</sup> Our industry specific functions are set out in section 6A of the Electricity Act 1996 and section 6A of the Gas Act 1997. Section 15 of the Electricity Act 1996.

<sup>26</sup> Part 3 of the Electricity Act 1996 and Gas Act 1997.

<sup>28</sup> These requirements are established as licence conditions for suppliers. Details can be found using the following links [generation](#), [distribution](#) and [retail](#) licences, and [exemptions](#).

- ▶ procedures for dealing with customer enquiries, complaints and the resolution of disputes between the customer and the business.

We do not currently regulate the prices, or the way that suppliers set their prices, for off-grid suppliers.<sup>29</sup>

We monitor off-grid suppliers' performance by requiring them to report annually on:

- ▶ supply interruptions and complaints about service quality
- ▶ the total length and capacity of the network
- ▶ customer growth
- ▶ total consumption and revenue, and
- ▶ customers disconnected as a result of not paying their bills.<sup>30</sup>

### LPG market

A person must not carry on operations in the gas market unless they hold a licence authorising those operations.<sup>31</sup> This includes the separate elements of the supply chain, including the distribution and retailing of gas, including LPG.

Our consumer protection framework for LPG suppliers, set out in the LPG Industry Code,<sup>32</sup> establishes requirements around:

- ▶ standard form customer contracts that suppliers can use to ensure that there are clear and legally enforceable rights in the sale and supply of LPG services

- ▶ minimum requirements around billing, billing disputes, payment terms and methods to ensure that customers receive accurate billing information in a timely manner

- ▶ limitations on the grounds on which suppliers can disconnect customers and requirements to ensure that customers can have their supply reconnected quickly, and

- ▶ procedures for dealing with customer enquiries, complaints and the resolution of disputes between the customer and the business.

We do not currently regulate the prices, or the way that suppliers set their prices, for LPG suppliers.<sup>33</sup>

We monitor LPG suppliers' performance by requiring them to report annually on:

- ▶ supply interruptions and complaints about service quality
- ▶ the total length and capacity of the network
- ▶ customer growth
- ▶ total consumption and revenue, and
- ▶ customers disconnected as a result of not paying their bills.<sup>34</sup>

<sup>29</sup> Part 3 of the ESC Act 2002 and division 2A of the Electricity Act 1996 set out our price regulation functions.

<sup>30</sup> Off-grid licensees' annual reporting requirements are not set out in a regulatory instrument but mirror the requirements of LPG suppliers.

<sup>31</sup> Section 19 of the Gas Act 1997.

<sup>32</sup> The details can be found using the following links current [Reticulated LPG Industry Code, RLIC/01](#) and [LPG distribution](#) and [retail](#) licences.

<sup>33</sup> Part 3 of the ESC Act 2002 and division 2 of the Gas Act 1997 set out our price regulation functions.

<sup>34</sup> Clause 2.1 of the Reticulated LPG Industry Code sets out annual reporting requirements.

## Our understanding of how well the current markets are functioning

To evaluate how well the current small-scale utility services markets are working, we have assessed the data we have collected from suppliers in three key areas:

- ▶ How well do suppliers understand the long-term costs of doing business?
- ▶ Are suppliers pricing services to recover their long-term costs?
- ▶ How satisfied are customers?

However, as the data we currently have is limited, we are asking stakeholders to assist us by providing further data, information and insights on these indicators. While we have focused on particular areas, information that is of broader relevance to this Inquiry would also be appreciated.

### How well do suppliers understand the long-term costs of doing business?

We consider that it is important for a supplier to understand the long-term costs of managing its business. Given that these services are generally not provided in a competitive market, a lack of understanding of costs risks the viability of the supplier and hence loss of services to customers.

However, not all suppliers have direct control over all of the functions within the supply chain.

Some suppliers provide a bundled service to customers covering the generation or production, transmission or distribution and retail functions. Other suppliers do not own or operate the network required for them to provide a utility service to customers. As

such, the long-term costs of doing business will vary between business models.

For example, if the supplier is the network owner and/or operator, knowledge of the condition of its infrastructure assets is important. An up-to-date asset management plan can be an indicator of how well the supplier understands its assets and is planning for the maintenance and replacement of those assets.

While we do not currently require suppliers to have an asset management plan,<sup>35</sup> we have asked water and sewerage service suppliers to inform us as to whether or not they currently manage their networks using this tool.

Only 50 percent of water suppliers have reported that they currently have an asset management plan in place. This increases to around 75 percent for sewerage suppliers.

### Are suppliers pricing services to recover their long-term costs?

We consider that assessing the extent to which a supplier is recovering enough operating income to cover their operating costs and depreciation is a reasonable proxy for whether or not that supplier is recovering the costs of service provision.

We currently require water and sewerage suppliers to demonstrate to us how they have set their prices to recover the costs of providing their services.<sup>36</sup> We have not currently set any cost recovery or pricing requirements for small-scale electricity and LPG suppliers.

In 2014-15, 58 percent of retailers reported that their operating income covered their operating costs and depreciation, with the

<sup>35</sup> Councils are required to develop and adopt long-term strategic management plans under section 122 of the Local Government Act 1999. Private businesses would also be likely to have plans to demonstrate the viability of their business to investors.

<sup>36</sup> Clause 2.1 of the [Price Determination for Minor and Intermediate Retailers 2013-2017](#) sets out the pricing principles that small water and sewerage suppliers must comply with in setting their prices.

remaining 42 percent reporting operating deficits.

Of the retailers that reported operating deficits, many are gradually adjusting their prices to limit the price shock to customers. Others are limited in their ability to recover the cost of service provision (for example, due to a small customer base and/or public benefit reasons).<sup>37</sup>

### How satisfied are customers?

An effective market requires consumers to be confident in the ability of the market to respond to and meet their needs.

While not a direct measure of customer satisfaction, we currently monitor the level of complaints received by suppliers as an indicator of the overall quality of service customers are receiving, how well customers are informed, and the appropriateness of the suppliers' responses to issues raised.

Although the number of reported complaints varies greatly, many suppliers report very low levels of complaints. Low numbers of complaints may indicate customers are satisfied with their service. However, it may also indicate that customers do not know that they can make a complaint, or the process for doing so. The limited data may also indicate that suppliers are not accurately recording complaints. As such, we can only draw limited conclusions about customer satisfaction based on this indicator.

However, we recognise that customers being satisfied is different to customers choosing not to complain.

Disengaged customers may be generally less likely to complain about service issues. Conversely, confident and engaged customers are more likely to consider their

options and take advantage of the benefits available in the market.

We consider better indicators of customer confidence, engagement and satisfaction are required in the future.

## Our future regulatory framework for small-scale utility services

We acknowledge that the information we currently have on how well the current small-scale utility services markets are performing is limited. We also recognise that new and emerging business models will impact on the current markets and the rules required to ensure those markets operate efficiently and effectively in the future.

We will be conducting further research and engaging with stakeholders to further our understanding of current and emerging issues in these markets during this initial consultation period.

In assessing the need for regulation to promote well-functioning markets for small-scale utility services in the future, we will take an outcomes and risk-based approach to:

- ▶ evaluate the data, information and insights we gather, and
- ▶ develop targeted and proportionate consumer protections to apply in the future.

### An outcomes-based approach

An outcomes-based approach means focusing on what a well-functioning market would deliver. It does not focus on prescribing business inputs or outputs. Rather, it seeks to establish broad principles against which suppliers' conduct can be judged.

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<sup>37</sup> Essential Services Commission, *Minor and Intermediate Retailers Regulatory Performance Report 2014-15*, June 2016, p.8.

For example, in looking at the bills that suppliers issue to customers, we would assess the extent to which the bills allow customers to understand how their use of the service is being charged. Under this approach, we would expect suppliers to work with their customers to understand what information is required for this to be achieved, rather than prescribing the contents of bills.

However, we also recognise that there may still be areas where prescriptive regulation is required to promote the long-term interests of consumers.

### **A risk-based approach**

A risk-based approach to regulation promotes evidence-based solutions that focus on prioritising effort to achieve the most important regulatory outcomes. It can improve productivity and efficiency. However, it does not seek to eliminate all risks. Rather, it uses a risk assessment methodology to identify risks in meeting regulatory outcomes and develop appropriate risk-mitigation strategies.

For example, to mitigate the risk of a supplier abandoning the market, we could assess the extent to which the supplier has mechanisms in place to understand the long-term costs of managing their operations, rather than being prescriptive and require the supplier to provide a range of detailed data.

## **How you can help us develop our future framework**

While not seeking to limit the issues in the small-scale utility services markets that can be raised with us, we would be assisted by receiving advice on the following matters.

## **Understanding what customers value**

Suppliers have the day-to-day relationship with customers. This allows them to identify important insights into the issues that matter most to customers.

Some customers have, or with future market developments will have, a choice of options to consider when purchasing electricity, gas, water and sewerage services. Where customers have a choice, our primary concern is to ensure that they have access to the right information to make an informed choice. They need to be able to compare the price, quality and reliability of the services they can expect to receive from the main network and alternative 'off-grid' options, such as generating their own electricity, using bottled gas or grid electricity, storing water in tanks, or installing septic tanks.

In the past, we have been prescriptive about the form and content of the information suppliers need to provide to customers. However, we consider that suppliers may benefit from a more flexible approach that would allow them to develop relevant information with their customers. This could result in more targeted information for customers and cost savings for suppliers.

Other customers may have limited practical choice in how they purchase utility services. In these instances, we consider it is important for suppliers to engage with their customers to work through the price and service package that customers want and are prepared to pay for. This approach allows suppliers to ensure they deliver the services its broader customer base values at an efficient cost.

Presently, we have limited understanding of the extent to which suppliers are seeking to engage with their customers to assist them to make decisions on their service offerings.

We want to better understand how suppliers determine what their customers value, are prepared to pay for, and how satisfied customers are with the services currently being provided.

#### Question 1:

1(a) What issues are current customers of small-scale utility services concerned about? How do you know customers are concerned about these issues?

1(b) Does our current regulatory framework allow suppliers the flexibility to respond to the issues raised by customers? What improvements to our framework are required?

1(c) Where customers are not provided with a choice of supply arrangements, what information do they need to understand the service they receive?

1(d) What are the appropriate indicators to allow us to monitor customer confidence, engagement and satisfaction in these markets?

### Improving supplier efficiency in the longer term

Providing the services that customers value comes at a cost. We want to better understand how suppliers are currently setting their prices for providing services in the small-scale utility services markets.

We want to better understand how well the current regulatory framework provides suppliers with sufficient guidance around how to efficiently meet their obligations and deliver better outcomes for customers.

We also want to understand if suppliers require greater regulatory flexibility to provide the services customers value.

We are also interested in any information suppliers have on the costs of complying with our current regulatory obligations.

#### Question 2:

2(a) Are there any difficulties for small-scale utility suppliers in setting prices to recover the long-term efficient costs of running their businesses? If so, how could our regulatory framework assist to address this issue?

2(b) Are there any concerns that suppliers are over-recovering their long-term efficient costs? If so, how could our regulatory framework assist to address this issue?

### Guidance for customers considering alternative supply options

Utility markets are in a period of change, where the traditional centrally-supplied and vertically-integrated business model is being challenged.

We want to better understand the extent to which our current regulatory framework is flexible enough allow new business models to enter the market and provide customers with utility services they value at a cost they can afford.

We do not want to limit the supply choices being offered to customers, but we do want to make sure that customers have confidence in the market to deliver these services and the information required to make informed decisions about supply options.

We also want to better understand how new suppliers will interact with customers and share the cost of managing potential new financial and service reliability risks.

**Question 3:**

3(a) Does our current regulatory framework present any issues or challenges for new entrants offering new small-scale utility services? If so, how?

3(b) Are there any new or emerging business models that will create a different relationship between suppliers and customers? If so, will this relationship create new financial, service reliability or other risks that customers need to be aware of when making their decisions?

3(c) Where customers are provided with a choice of supply arrangements, what information will they need to make informed decisions about new supply options? Who should provide this information?

**The cost of regulation and effectively managing market risks**

In addition to the consumer protections we provide through our regulatory frameworks, suppliers in small-scale utility service markets are also required to comply with various environmental, public health, safety and technical requirements. These requirements provide benefits to customers, suppliers and the broader South Australian community.

However, the cost of complying with all of these requirements comes at a cost to suppliers, and, ultimately, forms part of the prices paid by customers.

We want to understand if the risks in these markets are currently being mitigated efficiently and whether there are any emerging risks in these markets that will need to be managed in the future.

We also want to understand if there are further opportunities for us to work with other regulators to ensure risks are mitigated in a financially prudent and efficient manner.

**Question 4:**

4(a) How much does it cost for suppliers to comply with their obligations under our current regulatory framework?

4(b) Are you aware of any areas where more than one regulator is seeking to deal with the same matter (regulatory overlap)?

4(c) Are there any areas where you believe that no regulator is dealing with a matter but should be (regulatory gap)?

4(d) Are you aware of any emerging risks that we need to take into account?

**Other issues**

While we have asked for feedback on a series of particular issues, stakeholders are invited to provide any other information or evidence which may be relevant to the Inquiry's scope.

**Question 5:**

Are there any other issues that you think we should consider as part of this Inquiry?

## Next steps

We are holding metropolitan and regional public forums to enable broad discussion of the issues contained in this paper.

The first public forum will be in metropolitan Adelaide, details are as follows:

**Date: Tuesday, 13 September 2016**

**Time: 10.30 to 12.00**

**Venue: Adelaide Town Hall, Meeting Hall**

To register your attendance, please go to [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

Please refer to our website for when we will be conducting regional visits.

Our consultation on this Inquiry is not limited to these forums. We are also seeking to engage with metropolitan and regional stakeholders through meetings, presentations and workshops, including by leveraging off of existing networks. We are happy to discuss options to do this with stakeholders.

Following consideration of the issues raised through our public consultation, we will release a Draft Report, for a further period of public consultation.

The key timeframes for the upcoming stages of this Inquiry are provided below.

STAGE	TIMING
Release of this Issues Paper	August 2016
Submissions due	30 September 2016
Draft Report released	January 2017
Submissions due	March 2017
Final Report released	June 2017