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Inquiries

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

## Final Inquiry Report

February 2021

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## Glossary of terms

Commission	Essential Services Commission, established under the <i>Essential Services Commission Act 2002</i>
Commission's statutory objectives	The Commission's primary objective is contained in section 6(a) of the ESC Act, being the protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services, with section 6(b) providing additional objectives to which the Commission must have regard
Competent operation	The demonstrated ongoing provision by a licensee of a competent service as defined in Box 1
CTTG	City of Tea Tree Gully
CWMS	Community wastewater management system
DEM	Department for Energy and Mining
Draft Inquiry Report	<i>Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage And Energy Services</i> , Draft Inquiry Report, August 2020, available at <a href="https://bit.ly/2JpPaU1">https://bit.ly/2JpPaU1</a>
ESC Act	<i>Essential Services Commission Act 2002</i>
EWOSA	Energy and Water Ombudsman (SA) Limited, ACN 089 791 604
Framework and Approach paper	Small-scale networks Inquiry, <i>Framework and Approach</i> , June 2019, available at <a href="https://bit.ly/2JpPaU1">https://bit.ly/2JpPaU1</a>
Gas industry	Reticulated natural gas and LPG
Inquiry	This small-scale networks Inquiry
Licensees	Small-scale network service providers licensed by the Commission
LPG	Liquid petroleum gas
Minister	Minister responsible for the relevant Act
NWI	National Water Initiative
OTR	Office of the Technical Regulator
RAES	Remote Area Energy Supply
Regulatory framework	Economic regulatory framework administered by the Commission
Report	This Final Inquiry Report
SACOSS	South Australian Council of Social Service
Small-scale networks	Comprising, South Australian: <ul style="list-style-type: none"> <li>▶ water and sewerage (water industry) networks with 50,000 connections or less</li> <li>▶ off-grid electricity networks, and</li> <li>▶ reticulated natural gas and liquid petroleum gas (gas industry) networks</li> </ul>
Small-scale networks Inquiry	Inquiry into regulatory arrangements for small-scale network water, sewerage and energy services (see terms of reference at Appendix 1) – this Inquiry.

Technical Regulator	The position of the Technical Regulator is established under the <i>Electricity Act 1996</i> , the <i>Gas Act 1997</i> , the <i>Energy Products (Safety and Efficiency) Act 2000</i> , and the <i>Water Industry Act 2012</i> . Its primary objectives are ensuring the safety of workers, consumers and property, as well as compliance with legislation and applicable technical standards in the electricity, gas and water industries.
Treasurer	Treasurer for the South Australian Government
Trusted licensee	A licensee that demonstrates to the Commission's satisfaction that it is engaging in a competent operation
VTA approach	Verified trust and accountability approach
Water industry	Water and sewerage

## Summary

The Essential Services Commission (**Commission**) has released this Final Inquiry Report (**Report**) to explain the positions, findings and recommendations that it has reached through its Inquiry into regulatory arrangements for small-scale and off-grid water, sewerage and energy services (**Inquiry**), conducted under Part 7 of the *Essential Services Commission Act 2002*.

This Report sets out the enhancements and refinements to be made to the Commission's existing economic regulatory framework for those small-scale and off-grid water, sewerage and energy services, adopting a verified trust and accountability regulatory approach (**VTA approach**).

The VTA approach provides a targeted, flexible approach to regulation, consistent with the Commission's primary objective in designing and implementing regulatory systems. That is, protecting consumers' long-term interests with respect to the price, quality and reliability of essential services. It will incentivise service providers to pursue long-term asset and service sustainability, and to maintain genuine engagement with their customers at all times.

Competent operation will need to be demonstrated – transparently and publicly – by service providers. Where a service provider is consistently demonstrating competent operation, it is considered 'trusted' by the Commission. A trusted service provider will benefit from a lessening of its reporting requirements to the Commission. For customers, the benefits arise from enhanced confidence in their service provider.

If, however, a service provider cannot consistently demonstrate competent operation, it will not be 'trusted.' This does not imply that the licensee's operation is unsafe; rather, that it has carried out its operations in a manner that warrants stronger regulatory oversight in order to protect customers. It may face additional reporting and/or regulatory measures in order that customers' interests are adequately protected. Once trust and accountability is re-established, those additional measures will be rolled back.

The Commission will continue its provision of regulatory education and advice to assist service providers in this regard, and enhance its own data analysis techniques and practices. This will allow the Commission to better understand market outcomes and their contexts from a wider range of sources, thereby allowing it to reduce the amount of data that trusted licensees (that is, those that the Commission considers to be running competent operations) are required to report to it on a regular basis, and to take regulatory action as needed.

The VTA approach is likely to evolve with time, allowing the Commission to further reduce regulatory oversight for those service providers that consistently demonstrate competent operation of their networks.

## Context

This Inquiry is important in the wider context of the changing ways in which essential services are delivered to consumers, as well as changing community expectations of those services and of the service providers. The Commission also appreciates that regulatory regimes (such as this economic regulatory framework) should support business and economic development in South Australia.

Central to the Inquiry is the concept that small-scale networks should be regulated in ways that are appropriate to those networks and their customers. The regulatory approaches adopted for larger-scale operations, such as entities operating in the National Electricity Market or SA Water, may not represent the best approach for their small-scale counterparts.

This Inquiry relates to all licensed small-scale network services (**small-scale networks**), defined as:

- ▶ water and/or sewerage networks with 50,000 connections or less
- ▶ off-grid electricity networks, and
- ▶ reticulated natural gas and liquid petroleum gas (LPG) networks (other than those owned by Australian Gas Networks Limited).

Those networks are mostly located in outer metropolitan and regional areas across the State, serving small communities. In many cases, the networks emerged over time to meet a community need for the provision of an essential service. In total, the networks provide services to around 120,000 customers, although, in general, each serves only a small number of customers.

## Demonstrating competent operation – establishing trust

In monopoly industries (such as the industries relevant to this Inquiry), service providers do not face competition. Competition drives a strong focus on satisfying and retaining customers, seeking out more efficient and effective service delivery modes, and having in place robust long-term business plans and pricing arrangements.

As a result, the Commission, through regulatory means such as education materials, licence conditions, industry codes, pricing determinations and other regulatory action, incentivises or requires monopoly service providers to explore and implement improvements for the benefit of customers. In that sense, the Commission (as with all economic regulators) endeavours to mimic the outcomes that a competitive market would deliver.

In that overall context, under the verified trust and accountability approach (**VTA approach**), those service providers that can demonstrate a continued competent operation, will be ‘trusted’. They will:

- ▶ be customer-focused, and deliver consistent and genuine engagement and consultation with customers, to deliver the price-service-quality mix valued by customers at the lowest sustainable cost
- ▶ develop, maintain and implement sound and robust long-term financing, asset management and operational plans that underpin the delivery of services in a sustained manner
- ▶ price services in a manner that takes account of efficient costs on a sustainable basis, customer willingness to pay, minimum legislative standards and affordability, noting that there may be trade-offs within these that need to be effectively and transparently managed
- ▶ appropriately account for and comply with all legislative requirements (not just those arising under the Commission’s regulatory framework), and
- ▶ have sufficient financial strength to ensure the long-term viability of the service.

## The verified trust and accountability approach in practice

In the first instance, establishment of competent operation will lead to reduced regulatory reporting requirements for service providers. While this may mean that individual service providers may have fewer direct reporting requirements, at the same time the Commission will continue to provide education and advice to industry, and is enhancing its regulatory oversight – through obtaining, assessing and analysing a wider range of market intelligence in a more comprehensive way than it has in the past.

That includes not only operational performance reports from businesses, but extends to complaints data and evidence of systemic issues reported by the Energy and Water Ombudsman (SA) Limited (**EWOSA**), intelligence from other regulators and Government agencies, media reports, contacts from Parliamentarians, and direct customer contacts to the Commission. Overall, the Commission will have

more – rather than less – regulatory market intelligence available to it, even though businesses may be reporting less data directly to the Commission.

In that context, EWOSA scheme membership will be required for all service providers (a change from the current situation) from 1 July 2021, as scheme information will be a critical element of the revised approach. Membership of the scheme will provide all customers and service providers with access to an experienced and expert independent dispute resolution service. It will also provide the Commission with consistent and comprehensive information about emerging trends or systemic issues arising in each of the regulated industries.

The Commission acknowledges that scheme participation has a cost for service providers – but also notes that there are costs associated with any independent dispute resolution scheme, and that statutory requirements already oblige service providers to participate in a scheme of some sort. The Commission is of the view that, for the above reasons, the benefits of mandatory membership of EWOSA outweigh those costs.

Analysis of a wider range of market intelligence allows the Commission to focus strongly on understanding outturn performance across the small-scale network industries in a long-term context – particularly in relation to trends in service delivery, and asset planning, delivery and management.

The Commission will do so, however, without losing focus on the need for service providers to be compliant with regulatory obligations, which may have a more short-term focus. This is particularly relevant in relation to practices such as billing, payment and customer hardship, where there are more immediate impacts for customers if service providers do not deliver or meet regulatory requirements. That said, the Commission is aware that a short-term failure in those areas, while needing immediate correction in order to provide consumer redress, may also be indicative of longer-term issues within a service provider's business.

Using the outcomes of its analysis, the Commission will take appropriate regulatory actions – assessing and acting on regulatory performance (either individual service providers or industry-wide), in the context of the regulatory regime's intended customer outcomes. Those actions may include:

- ▶ validating, confirming or seeking further information from service providers through further questioning or audits (as required)
- ▶ provision of performance feedback to service providers (including identification of areas of concern with specific performance or in trends in performance)
- ▶ taking educative or corrective action (for example, explain the need for, or requiring a focus on, asset management to address a trend, even if there is no current 'breach'), or compliance or enforcement responses under the Commission's Enforcement Policy on an evidence-informed basis, or
- ▶ publication of performance reports identifying both trend and shorter-term issues that require or have required regulatory attention, in order that customers have the opportunity to gain independent information and advice on those matters relating to their service providers (noting that service providers should themselves be moving to publish more performance information, more regularly).

Where the Commission's analysis and subsequent regulatory action identifies that a service provider is no longer operating in a consistently competent manner, or has failed to provide accurate or timely regulatory information, and it has failed to provide evidence or argument rebutting those propositions, it will no longer be trusted to run its operations with reduced reporting requirements. It may face a range of consequences, including heightened reporting requirements, further audits, and increased reporting frequency. These will persist until the Commission is satisfied that the service provider has returned to consistent competent operation and is again being accountable to its customers in the delivery of essential services.



## Harmonisation

The Commission has considered the harmonisation/standardisation of current code and licence obligations across the small-scale industries – the harmonisation project.

For reasons of history and underpinning legislative frameworks, there are various differences between the regulatory arrangements for the water, gas and electricity industries. The Commission has identified the potential for those differences to be inefficient for licensees (particularly where a single entity provides services across those industries) and for consumers, to the extent that they might expect common issues across industries to be dealt with in a common manner, which may not always be the case at present.

At the same time, the Commission recognises that changes to existing business systems and practices will have costs, which is an important consideration in the context of potential harmonisation.

While submissions to the Draft Inquiry Report supported the underlying principle of harmonisation, the Commission acknowledges that there is potentially limited appetite to undertake a full harmonisation project in practice at this time. As a result, harmonisation efforts will occur as part of the Commission's reviews of codes, guidelines and licences, and as material evidence-based issues are identified over time.

## Indicators of success

In adopting the VTA approach, the Commission has also identified the intended outcomes that it will use to evaluate and assess the success of the approach over time. Those are that the approach:

- ▶ provides for a price-service-quality offering that meets the specific needs of the customers of a small-scale network, subject to legislative requirements
- ▶ ensures incentives and accountability are with the right parties
- ▶ minimises the regulatory cost by ensuring regulation is effective, targeted, fit-for-purpose and capable of responding to external influences, and
- ▶ creates consistency across regulatory instruments where appropriate.

## Implementation

Implementation of the VTA approach will occur in a staged manner, with multiple opportunities for stakeholder engagement and collaboration. This is to ensure that a common understanding of the approach is developed between stakeholders and the Commission.

From the release of this Report until 30 June 2022, the Commission will work with service providers to:

- ▶ develop a data baseline, drawn from market intelligence and existing performance data for each service provider
- ▶ develop an understanding of what is likely to be material in the context of performance outcomes over time, given the operational context of each service provider
- ▶ make changes to reporting guidelines and vary licence conditions where necessary
- ▶ make an assessment of which service providers will be 'trusted' (that is, that the Commission considers are likely running a competent operation) from the operational commencement of the approach on 1 July 2022, and

- identify what performance information should be published by service providers and by the Commission and how that is best done.

From 1 July 2022, the approach will be applied in practice to licensees, with those identified as competent and trusted (or otherwise) identified. The new reporting arrangements will apply for data for the 2021-22 reporting period. Since licensees do not collate data until around October, each should know months in advance their reporting obligations.

## Decisions

A consolidation of the decisions noted throughout this Report is set out below.

### VTA approach – Decision 1

- The Commission will adopt the VTA approach outlined in this Final Inquiry Report for the regulation of small-scale networks.

### VTA approach – Decision 2

- In the period from the point of publishing this Final Inquiry Report to 30 June 2022, an implementation process will be undertaken. This will comprise a number of key tasks, which will be undertaken in collaboration with licensees, to ensure a smooth transition to the VTA approach.
- The practical application of the VTA approach for licensees will formally begin 1 July 2022, with the new reporting requirements applying to data for the 2021-22 reporting period. Until that time, annual return obligations will remain as they are.
- Each licensee will be classified as a Category A or B licensee prior to 1 July 2022, with annual return obligations thereafter based on that classification – and noting that the classification may change in the future, subject to licensee performance.

### VTA approach – Decision 3

#### *For existing licensed regulated business operations*

- For the purposes of implementing the VTA approach, an existing licensed regulated business operation is one which is licenced at the point at which the VTA implementation process starts. That is, the date at which this Final Inquiry Report is published.
- The classification process for each licensee will be undertaken as summarised in Figure 5 (section 3.4.1), in the context of the definition of competent operation, as described in Box 1 (section 3.1).
- The Commission will provide a licensee assessed as Category B with a statement of reasons for this classification. The licensee will have the opportunity to provide further evidence to the Commission on that assessment. The Commission will then make a decision, communicate that (and any new or changed regulatory obligations) to the licensee, and make its decision public.

#### *For new licensees and new regulated business operations undertaken by existing licensees*

- For the purposes of implementing the VTA approach, any licensee commencing operations after the date at which this Final Inquiry Report is published will be considered a new regulated business operation.

- ▶ Entirely new licensees are likely to be classified as Category A, but the Commission will monitor operations for an initial period to confirm that position based on outturn performance.
- ▶ If a new operation is undertaken by an existing licensee, its classification will mirror that attained for its existing regulated business operations, as the Commission will have experience of the level of competency obtained by that licensee.

#### *Ongoing verification of competent operation*

- ▶ Through the ongoing verification process, if the Commission has cause to believe a Category A licensee should be reclassified as Category B, it will provide that licensee with a statement of reasons.
- ▶ The licensee will have an opportunity to provide further evidence to the Commission, if it wishes, to seek to maintain a Category A classification. The Commission will assess that evidence and make a determination, having regard to the definition of competent operation (described in Box 1). That determination, and any changed regulatory requirements (which will have immediate effect), will be communicated to the licensee and made public.
- ▶ If, through the ongoing verification process, the Commission has cause to believe a Category B licensee should be reclassified as Category A, the licensee will be informed of this and of its revised regulatory reporting obligations (which have immediate effect), and it will be removed from the Category B list on the Commission's website.

### **VTA approach – Decision 4**

#### *Category A licensees*

Category A licensees' annual reporting returns are required to be approved by the licensee's CEO (or equivalent) and comprise the following:

- ▶ a list of office holders, to assure the Commission that the licensee is a fit and proper person
- ▶ connection and customer numbers, to be used primarily for calculating Commission licence fees (water) and EWOSA membership fees respectively
- ▶ information on hardship and affordability, at least equivalent to that required prior to the VTA approach being formally implemented at 1 July 2022
- ▶ identification of any material changes to operations, and
- ▶ a statement of assurance that the licensee is complying with its obligations and engaging in a competent operation to the level contemplated in Box 1.

Category A licensees will also be required to provide immediate ('real time') information regarding any material service issue arising, the response and the outcome.

#### *Category B licensees*

Category B licensees' reporting obligations will comprise the following:

- ▶ the matters set out above, plus
- ▶ any additional specific reporting obligations required by the Commission from time to time.

### **VTA approach - Decision 5**

As part of its ongoing verification process under the VTA approach, the Commission will conduct audits of all licensees over time to:

- ▶ verify competent operation
- ▶ fill any information gaps identified in regulatory assessment processes, and
- ▶ examine whether the licensee is meeting the requirements of the Acts, licences, codes, and guidelines.

#### **VTA approach – Decision 6**

- ▶ Licensees will be required to report on their performance directly to their customers.
- ▶ The Commission will continue to publish annual performance reports. However, these will focus on systematic issues, performance trends, the outcomes of audits and major compliance or operational issues, and how licensees have responded to these in terms of issues remediation and customer redress.
- ▶ The Commission will also publish issue-specific event reports (as it currently does) where material or major issues arise.

#### **EWOSA membership – Decision 7**

- ▶ The Commission has decided that, for the purposes of the industry regulation Acts and industry licence conditions, all licensees must become members of EWOSA by 1 July 2021.

#### **Harmonisation – Decision 8**

- ▶ The Commission has decided that it will not pursue harmonisation as a single, separate project. Rather, harmonisation efforts will occur as part of the Commission's regular reviews of codes and guidelines, and as material evidence-based issues are identified.

### **Next steps**

The Commission will release a work program outlining the work and consultation process required, to the point of the implementation of the VTA approach on 1 July 2022.

# 1 Overview of the Inquiry

The Commission has conducted this Inquiry to identify the potential for enhancements and refinements to the nature and scope of its existing economic regulatory framework for small-scale and off-grid water, sewerage and energy services. In doing so, its primary objective was to protect South Australian consumers' long-term interests with respect to the price, quality and reliability of essential services.

The services relevant to the Inquiry are those provided through:

- ▶ water and sewerage (**water industry**) networks with 50,000 connections or less
- ▶ off-grid electricity networks, and
- ▶ reticulated natural gas and liquid petroleum gas (LPG) (**gas industry**) networks (other than those owned by Australian Gas Networks Limited).

These networks are collectively referred to as **small-scale networks** throughout this Report, and the service providers, who are licensed by the Commission, are referred to as **licensees**.

Of note, the Inquiry does not cover natural gas services or electricity services provided in the relevant national markets.

The Inquiry's scope is to:

- ▶ analyse the consumer protections associated with the delivery of services in small-scale networks, while ensuring regulatory arrangements are targeted, efficient and appropriate, and
- ▶ identify an appropriate economic regulatory framework that:
  - is relevant for customers, licensees and exempted entities who provide a small-scale network service, and
  - will remain relevant for new participants, business models and/or technologies which could deliver more effective and innovative outcomes for customers in the future.

The framework has to accommodate a diverse range of networks, generally situated in rural and regional South Australia, while also meeting the Commission's statutory objectives (section 1.1) and minimising the costs of regulation.

Given that context, this Final Inquiry Report outlines the approach the Commission will adopt for the economic regulation of small-scale networks.

In considering the issues raised through the Inquiry, the Commission was mindful that the benefits of any regulatory requirements need to outweigh the costs, and that the needs and views of all stakeholders need to be taken into account.

## 1.1 The Commission's functions and powers

The water, electricity and gas industries are declared to be regulated industries for the purposes of the *Essential Services Commission Act 2002* (**ESC Act**), meaning that the Commission has economic regulatory powers and functions in relation to those industries (section 2.1).

In that capacity, the Commission licenses small-scale network service providers and requires licensees, through mandatory licence conditions, to comply with Commission-made consumer protection codes. These establish the economic regulatory framework the Commission uses to monitor the performance

of regulated entities against the obligations set out in legislation, with guidelines to help providers to comply with reporting requirements to the Commission.<sup>1</sup>

The outcomes arising from the economic regulatory framework must be consistent with the industry Acts and meet the Commission's statutory objectives as set out in the ESC Act (**Commission's statutory objectives**): the primary objective being the protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.<sup>2</sup>

In developing and administering the economic regulatory framework, the Commission must also 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>3</sup>

In addition to the Commission's economic regulatory framework, licensees are also subject to regulatory schemes administered by other agencies, such as the Technical Regulator for safety and technical regulation, SA Health for public health requirements for drinking water supply, and the Environment Protection Authority for the environmental impact of businesses.<sup>4</sup> This Report deals solely with the economic regulatory framework administered by the Commission, and any reference to 'regulatory framework' or 'regulation' refers only to that administered by the Commission (unless otherwise stated).

### 1.1.1 The Commission's regulatory business model

The Commission operates a regulatory business model as shown in Figure 1 below.<sup>5</sup> That model reflects the Commission's key functions of regulatory design, market intelligence and analysis, and regulatory action. These are underpinned by evaluation of the Commission's regulatory performance and operational systems.

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<sup>1</sup> Unless the context otherwise requires, any reference to reporting requirements in this Report is a reference to reporting requirements to the Commission noting that, as outlined in this section, licensees are likely to be subject to a number of regulatory schemes administered by other agencies, each of which may have their own reporting requirements.

<sup>2</sup> Section 6(a) of the ESC Act.

<sup>3</sup> Section 6(b) of the ESC Act.

<sup>4</sup> Appendix 2 of the Framework and Approach paper to this Inquiry provides a list of entities that regulate small-scale networks and the functions they perform.

<sup>5</sup> Commission, *Strategy 2020-2023*, May 2020, pp.14-15, available at <https://www.escosa.sa.gov.au/about-us/strategic-plans>.

Figure 1: Regulatory Business Model



This Report covers the Regulatory Design phase of the business model, with Implementation to follow during 2021 and 2022.

## 1.2 Small-scale networks

There are 83 small-scale network entities licensed by the Commission, some of which provide more than one service.<sup>6</sup> The majority of licensees provide water and/or sewerage services. Table 1 provides a breakdown of licensees by industry (note: some licensees provide more than one service so the total does not add to 83).

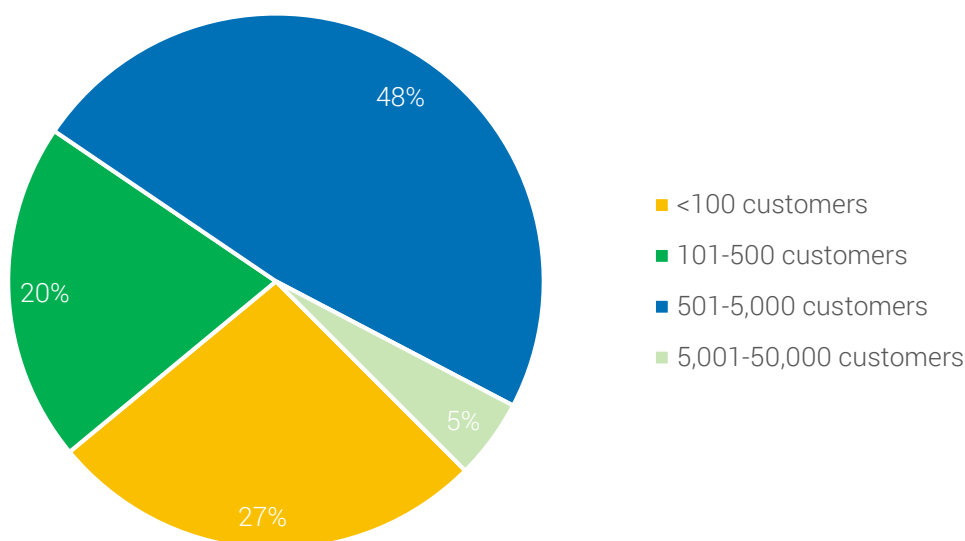
Table 1: Number of licensees by industry

Industry	Number of licensees
Water	36
Sewerage/community wastewater management system (CWMS)	50
Electricity	8
Gas	5

Licensees are diverse. They include local government, private operators, and not-for-profit organisations. The networks are mostly located in outer metropolitan and regional areas across the State, serving small communities. In many cases, the networks emerged over time to meet a community need for the provision of an essential service. In total, the networks provide services to around 120,000 customers, although, in general, each licensee has a small number of customers from which they can recover their costs. Figure 2 illustrates the percentage of networks by customer size.

<sup>6</sup> 83 licensees as at 30 June 2020. There were 72 licensees as at 30 June 2015.

Figure 2: Small-scale networks by customer size<sup>7</sup>



From a customer perspective, choice is generally limited to being part of that network or being self-sufficient. Most customers purchase different services (for example, electricity and water) from different licensees.

Overall, the Commission's small-scale network regulatory framework has to accommodate considerable diversity of networks, while also meeting the Commission's statutory objectives and minimising the costs of administering regulation with respect to those objectives.

### 1.3 The Inquiry

The Commission considered an Inquiry into the way in which it regulates small-scale networks as necessary and desirable to ensure that the regulatory framework it applies remains consistent with its primary statutory objective. It also considered the Inquiry important to ensure regulation of small-scale networks is proportionate and responsive to recent and emerging issues. Those issues can relate to changing technological, operational, environmental or other factors impacting the delivery of water and sewerage retail services, and the sale and/or supply of electricity and gas services to South Australians through small-scale networks.

Under the Inquiry's terms of reference (Appendix 1), the Commission has:

- ▶ inquired into appropriate regulatory arrangements administered by the Commission under the ESC Act (including subsidiary regulatory instruments made by the Commission such as industry codes) and price regulation arrangements for small-scale network operations
- ▶ analysed consumer protections associated with the delivery of small-scale network water, sewerage and energy services, with a view to ensuring that any regulatory arrangements it administers are targeted, efficient and appropriate, and
- ▶ identified an appropriate regulatory framework that:

<sup>7</sup> As at 30 June 2020.



- has relevance for customers, and for licensees and exempted entities currently providing small-scale network water, sewerage and energy services, and
- will be relevant in the context of new participants, business models and/or technologies which could deliver more effective and innovative outcomes for customers in the future.

Overall, the outcome sought from this Inquiry was to identify a regulatory framework covering the relevant services, that:

- ▶ provides for a price-service-quality offering that meets the specific needs of the customers of a small-scale network, subject to legislative requirements
- ▶ ensures incentives and accountability are with the right parties
- ▶ minimises the regulatory cost by ensuring regulation is effective, targeted, fit-for-purpose and capable of responding to external influences, and
- ▶ creates consistency across regulatory instruments where appropriate.

## 1.4 Consultation

This Final Inquiry Report has been informed by submissions received in response to a Draft Inquiry Report released in August 2020.<sup>8</sup> The Commission thanks respondents for their submissions and for their robust engagement in the consultation process. Twelve<sup>9</sup> submissions were received, from:<sup>10</sup>

- ▶ Licensees or industry representative bodies:
  - City of Playford
  - City of Salisbury
  - City of Tea Tree Gully (CTTG)
  - Clean Energy Council
  - Local Government Association of South Australia
  - Monarto Water Network, and
  - Origin Energy
- ▶ Customers or customer representative bodies:
  - Private individual – S Kaye
  - Private individual – Y Pierre, and
  - South Australian Council of Social Service (SACOSS).
- ▶ Government Departments:
  - Department for Energy and Mining (DEM), including the Office of the Technical Regulator (OTR).

<sup>8</sup> See the Commission's Inquiry into regulatory arrangements for small-scale and off-grid water, sewerage and energy services, available at <https://bit.ly/2JpPaU1>

<sup>9</sup> A thirteenth submission related to irrigation services and was outside of the Inquiry's scope. The Commission has referred that submission to the Department for Environment and Water for its consideration.

<sup>10</sup> Public (non-confidential) submissions to the Inquiry Terms of Reference are available at <https://bit.ly/2JpPaU1>.

- ▶ Other interested stakeholders
  - Red Energy and Lumo Energy.

The Commission also held meetings with the following stakeholders:

- ▶ Adelaide Hills Council
- ▶ Alano Water
- ▶ City of Playford
- ▶ City of Port Adelaide Enfield
- ▶ City of Port Lincoln
- ▶ City of Salisbury
- ▶ Clare and Gilbert Valleys Council
- ▶ Cowell Electric
- ▶ DEM and OTR
- ▶ District Council of Streaky Bay
- ▶ Elliston District Council
- ▶ Light Regional Council
- ▶ Local Government Association
- ▶ Port Augusta City Council
- ▶ SACOSS
- ▶ Tumby Bay District Council, and
- ▶ Yorke Peninsula Council.

The issues raised by stakeholders through consultation have been carefully considered. Where relevant, certain arguments and submissions have been mentioned in the text, either by direct quotation or by reference to themes or arguments. This is to assist stakeholders to understand the proposed positions that have been reached.

However, a failure to reference an argument or submission does not mean that it has not been taken into account in reaching the final positions. All submissions have informed the Commission's consideration of each of the relevant issues and the expressed viewpoints.

#### **1.4.1 Major issues raised in submissions to the Draft Inquiry Report**

Overall, respondents to the Draft Inquiry Report expressed general support for the proposal to implement a VTA approach (including mandating membership of the Energy and Water Ombudsman (SA) Limited scheme). There were several major themes arising from submissions, the most material of which were:

- ▶ questions as to the quality and availability of licensee performance information for customers and third parties under the VTA approach (for example, as expressed by SACOSS and the OTR)

- ▶ despite supporting the underlying principle of harmonisation, few specific examples of potentially beneficial harmonisation changes which could be put in effect, and
- ▶ the possible risk to the financial viability of some small operators, from mandating for all licensees membership of the Energy and Water Ombudsman (SA) Limited scheme.

## 1.5 Next steps

The Commission will release a work program outlining the work and consultation process required to implement the VTA approach. Overall, however, from the release of this Report until 30 June 2022, the Commission will work with service providers to:

- ▶ develop a data baseline, drawn from market intelligence and existing performance data for each service provider
- ▶ develop an understanding of what is likely to be material in the context of performance outcomes over time, given the operational context of each service provider
- ▶ make changes to reporting guidelines and vary licence conditions where necessary
- ▶ make an assessment of which service providers will be 'trusted' (that is, that the Commission considers are likely running a competent operation) from the operational commencement of the approach on 1 July 2022, and
- ▶ identify what performance information should be published by service providers and by the Commission and how that is best done.

From 1 July 2022, the approach will be applied in practice to licensees, with those identified as running competent operations (or otherwise) identified. The new reporting arrangements will apply for data for the 2021-22 reporting period. Since licensees do not collate data until around October, each should know – months in advance – what their reporting obligations will be.

Energy and Water Ombudsman (SA) Ltd scheme membership will be required for all service providers from 1 July 2021.

## 2 The current regulatory framework

This Chapter discusses the current statutory framework for the regulation of small-scale networks, and the way the Commission applies that framework. The following chapters then present the Commission's decisions for refining and enhancing this framework.

### 2.1 Statutory framework

The water, electricity and gas industries are declared to be regulated industries for the purposes of the ESC Act.<sup>11</sup> The Commission's functions for those industries are set out in section 5 of the ESC Act, and allow the Commission to regulate small-scale network service providers, to protect the long-term interest of consumers with respect to price, quality and reliability of essential services by:

- ▶ licensing service providers<sup>12</sup>
- ▶ making, monitoring the operation of, and reviewing from time to time, codes and rules relating to the conduct or operations of a regulated industry or regulated entities<sup>13</sup>
- ▶ monitoring and enforcing compliance with, and promoting improvement in, standards and conditions of service and supply, and
- ▶ regulating prices.<sup>14</sup>

The industry regulation Acts require:

- ▶ That a person providing a small-scale network service must hold a licence as follows:
  - water and sewerage: retail licence
  - off-grid electricity: generation, distribution and retail licences as applicable,<sup>15</sup> and
  - reticulated gas (natural and LPG): distribution and retail (LPG only) licences as applicable.
- ▶ The Commission to consider an application for a licence, having regard to factors specified in the industry regulation Acts, with the Commission given the power to issue or refuse to issue a licence.
- ▶ The Commission to make licences subject to conditions that it determines, such as requiring:
  - compliance with applicable codes or rules<sup>16</sup> made under the ESC Act

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<sup>11</sup> The relevant industry regulation Acts for this Inquiry are the *Water Industry Act 2012*, *Electricity Act 1996* and *Gas Act 1997*.

<sup>12</sup> *Water Industry Act 2012*, section 19, *Electricity Act 1996*, section 16, and *Gas Act 1997*, section 20.

<sup>13</sup> ESC Act, Part 4, *Water Industry Act 2012*, section 25, *Electricity Act 1996*, section 21, and *Gas Act 1997*, section 25.

<sup>14</sup> ESC Act, Part 3, *Water Industry Act 2012*, section 35, *Electricity Act 1996*, section 35A, and *Gas Act 1997*, section 33.

<sup>15</sup> Where off-grid electricity licensees provide multiple services under the *Electricity Act 1996*, the Commission has issued one licence document which contains provisions related to each service. Generally, the licences are divided into the following chapters: general, generation, distribution, connection, sale and supply (covering retailing).

<sup>16</sup> Part 4 of the ESC Act provides the Commission with broad powers to make, vary and amend industry codes or rules.

- the licensee to maintain specified accounting records and to prepare accounts according to specified principles<sup>17</sup>
- a specified process to be followed to resolve disputes between the licensee and its customers<sup>18</sup>
- the licensee to monitor and report as required by the Commission on indicators of service performance determined by the Commission,<sup>19</sup> and
- water industry entities to provide, in the manner and form determined by the Commission, such other information as the Commission may from time to time require.<sup>20</sup>

The industry regulation Acts provide the Commission with discretion in the form and manner in which regulation is implemented (for example, whether by way of licence conditions, codes and/or guidelines).<sup>21</sup> However, once the Commission adopts the form of regulation, the licensee is obliged to comply as a result of the conditions placed in its licence.

The relationship between the ESC Act and the industry regulation Acts is illustrated in Figure 3.

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<sup>17</sup> For example, s25(1)(f), *Water Industry Act 2012*.

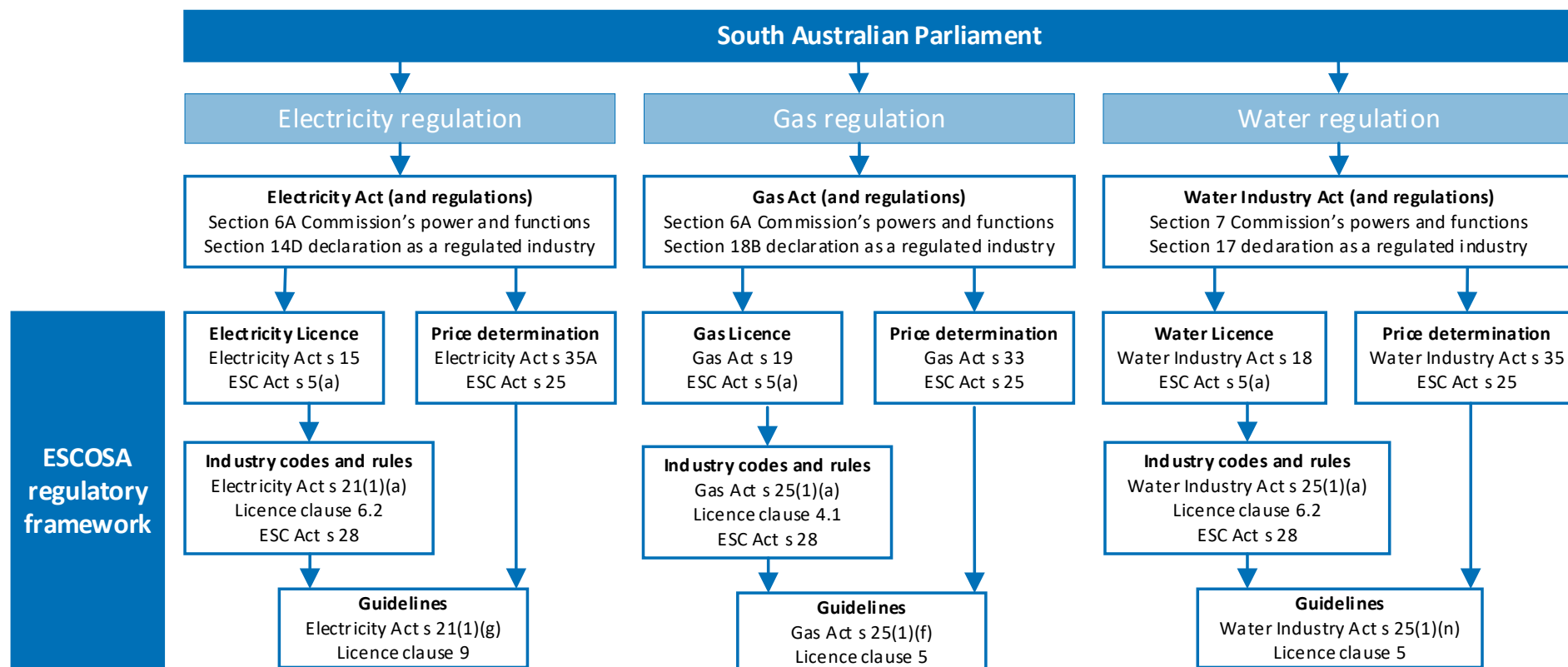
<sup>18</sup> For example, s25(1)(g), *Water Industry Act 2012*.

<sup>19</sup> For example, s25(1)(i), *Water Industry Act 2012*.

<sup>20</sup> For example, s25(1)(n), *Water Industry Act 2012*.

<sup>21</sup> In exercising that discretion, the Commission must still have regard to all relevant statutory factors such as those set out in the industry Acts and section 6 of the ESC Act.

Figure 3: The Commission's powers and functions in relation to the regulation of small-scale networks



## 2.2 How regulation is currently applied

The differences in the Commission's regulation of small-scale networks can be summarised as follows:

- ▶ For water and sewerage services, the Commission has issued:<sup>22</sup>
  - a retail code<sup>23</sup>
  - a reporting/information requirements guideline,<sup>24</sup> with an accompanying explanatory memorandum<sup>25</sup>
  - a compliance system and reporting guideline<sup>26</sup> and enforcement policy,<sup>27</sup> and
  - a price determination, which is currently in operation.<sup>28</sup>
- ▶ For off-grid electricity services:<sup>29</sup>
  - there are no retail codes or guidelines,<sup>30</sup> with all requirements (including customer protection and reporting/information requirements<sup>31</sup>) set as licence conditions

<sup>22</sup> Copies of minor and intermediate licences can be accessed from the Commission's licence/exemption register, available at <https://www.escosa.sa.gov.au/industry/water/licensing/licence-register>.

<sup>23</sup> Essential Services Commission, *Water Retail Code-Minor and Intermediate Retailers*, WRC-MIR/02, March 2015, available at <https://www.escosa.sa.gov.au/ArticleDocuments/429/20150311-Water-WaterRetailCode-MIR-02.pdf.aspx?Embed=Y>.

<sup>24</sup> Essential Services Commission, *Water Regulatory Information Requirements for Minor and Intermediate Retailers*, Water Industry Guideline No.3, WG3/04, July 2015, available at <https://www.escosa.sa.gov.au/ArticleDocuments/398/20150727-Water-InformationRequirementsGuidelineNo3-MinorInte.pdf.aspx?Embed=Y>.

<sup>25</sup> Essential Services Commission, *Water Regulatory Information Requirements for Minor and Intermediate Retailers*, Water Industry Guideline No.3, WG3/04, Explanatory Memorandum, September 2015, available at <https://www.escosa.sa.gov.au/ArticleDocuments/399/20150930-Water-GuidelineNo3-ExplanatoryMemorandum-WIG3-04.pdf.aspx?Embed=Y>.

<sup>26</sup> Essential Services Commission, *Water Industry Guideline No 1-Compliance System and Reporting*, WG1/04, July 2016, available at <https://www.escosa.sa.gov.au/ArticleDocuments/952/20160706-Water-GuidelineNo1-ComplianceSystemsReporting-WG1-04.pdf.aspx?Embed=Y>.

<sup>27</sup> Essential Services Commission, *Enforcement Policy*, version 2.5, September 2013, available at [https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy\\_V2-5.pdf.aspx?Embed=Y](https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy_V2-5.pdf.aspx?Embed=Y).

<sup>28</sup> Details of the minor and intermediate retailers price determination, available at <https://www.escosa.sa.gov.au/industry/water/retail-pricing/minor-and-intermediate-retailers-price-determination>. The price regulation provisions of the *Water Industry Act 2012* also include a framework for the Treasurer to issue Pricing Orders. Such a Pricing Order was in force, when the determination was made. It required the Commission to adopt or apply the **NWI** Pricing Principles when making a price determination. These NWI Pricing Principles relate to cost recovery, pricing and the pricing 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 not required to do so, the Commission determined to adapt and apply these Pricing Principles to the pricing of CWMS services. More recently, the Commission has released its draft regulatory determination in relation to the drinking water retail services provided by Robusto Investments Pty Ltd (19 November 2020, available at <https://www.escosa.sa.gov.au/projects-and-publications/projects/water/decision-to-make-a-price-determination-to-apply-to-robusto-investments/decision-to-make-a-price-determination-to-apply-to-robusto-investments-compass-springs>).

<sup>29</sup> Copies of off-grid licences can be accessed from the Commission's licence/exemption register, available at <https://www.escosa.sa.gov.au/industry/electricity/licensing/licence-register>.

<sup>30</sup> However, parts of the Electricity Metering Code and Electricity Distribution Code could or do apply to small-scale operations.

<sup>31</sup> For reporting/information requirements, refer to annual return obligation contained in the licence.

- the Commission has published an energy compliance guideline<sup>32</sup> and enforcement policy,<sup>33</sup> and
  - the Commission has not made a price determination.
- For reticulated gas services, the following applies in respect of LPG networks:<sup>34</sup>
- an industry code<sup>35</sup>
  - licensee reporting/information requirements provided as general obligations contained in the industry code<sup>36</sup>
  - an enforcement policy,<sup>37</sup> and
  - the Commission has not made a price determination.

## 2.2.1 Consumer protections

The consumer protections in each industry are broadly similar. However, there are some differences in the details of requirements between industries. For example, there are different requirements for the notification periods for planned interruptions to services, and the processes for estimating bills between industries.<sup>38</sup> Further, the regulatory instruments requiring licensees to provide protections for customers are different, with requirements split between licences and industry codes.

These regulatory instruments require the licensee to prepare and submit for the Commission's approval procedures for the management and resolution of customer enquiries and disputes, in accordance with AS ISO 10002-2006 (as amended from time to time).<sup>39</sup> For example, clause 3.2 of the *Water Retail Code – Minor and Intermediate Retailers* establishes the requirement for these dispute procedures to provide customers with the ability to have their enquiry or complaint escalated first within the retailer, and then subsequently to an external independent party for resolution, in the event that the complaint remains unresolved.<sup>40</sup> For this purpose, the Commission estimates the majority of local government licensees have nominated Ombudsman SA as their external dispute resolution body.<sup>41</sup> Nine water and one

<sup>32</sup> Essential Services Commission, *Compliance Systems and Reporting*, Energy Industry Guideline No.4, EG4/4, September 2013, available at [https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnergyGuidelineNo4\\_ComplianceSystemsReporting\\_G4-4.pdf.aspx?Embed=Y](https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnergyGuidelineNo4_ComplianceSystemsReporting_G4-4.pdf.aspx?Embed=Y).

<sup>33</sup> Essential Services Commission, *Enforcement Policy*, version 2.5, September 2013, available at [https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy\\_V2-5.pdf.aspx?Embed=Y](https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy_V2-5.pdf.aspx?Embed=Y).

<sup>34</sup> Copies of reticulated LPG licences can be accessed from the Commission's licence/exemption register, available at: <https://www.escosa.sa.gov.au/industry/gas/licensing/licence-register>.

<sup>35</sup> Essential Services Commission, *Reticulated LPG Industry Code*, RLIC/01, January 2014, available at [https://www.escosa.sa.gov.au/ArticleDocuments/653/130404-ReticulatedLPGIndustryCode\\_RLIC-01.pdf.aspx?Embed=Y](https://www.escosa.sa.gov.au/ArticleDocuments/653/130404-ReticulatedLPGIndustryCode_RLIC-01.pdf.aspx?Embed=Y).

<sup>36</sup> Refer clause 2.1 of the Reticulated LPG Industry Code.

<sup>37</sup> Essential Services Commission, *Enforcement Policy*, version 2.5, September 2013, available at [https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy\\_V2-5.pdf.aspx?Embed=Y](https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy_V2-5.pdf.aspx?Embed=Y).

<sup>38</sup> For example, clause 3.2.4 of the Reticulated LPG Industry Code requires a licensee to provide affected customers with at least five business days' notice of a planned outage. Whereas, clause 4.3 of the *Water Retail Code – Minor and Intermediate Retailers* requires at least four business days' notice.

<sup>39</sup> For example, section 3.2, *Water Retail Code – Minor and Intermediate Retailers*, WRC-MIR/01, July 2013, available at <https://www.escosa.sa.gov.au/ArticleDocuments/413/130627-WaterRetailCode-MinorIntermediateRetailers.pdf.aspx?Embed=Y>.

<sup>40</sup> Commission, *Water Retail Code – Minor and Intermediate Retailers*, WRC-MIR/01, *Explanatory Memorandum*, June 2013, p.4, available at <https://www.escosa.sa.gov.au/ArticleDocuments/615/130627-WaterRetailCode-MinorIntermediateRetailers-ExplanatoryMemo.pdf.aspx?Embed=Y>.

<sup>41</sup> This is based on the Commission reviewing the websites of a random sample of 20 out of 62 local government licensees (29 April 2020) for their dispute resolution procedures. All licensees in the sample nominated Ombudsman SA, with one licensee nominating Mediation SA and another the Office for Public Integrity, in



electricity licensee have joined the Energy and Water Ombudsman (SA) Limited (EWOSA) scheme.<sup>42</sup> Other licensees have chosen to rely upon private, independent bodies.<sup>43</sup>

## 2.2.2 Regulating prices

Regulating prices is about protecting customers with respect to the prices charged for services, and promoting the ongoing provision of services. In the absence of regulatory intervention, licensees' pricing strategies may under-recover or over-recover the cost of service. Ideally, licensees should make every effort to recover from their customers the full, efficient costs of providing the service at a sustainable level that customers want and are willing to pay for – with the expectation that licensees regularly invest to ensure service sustainability, rather than allowing the service to degrade.

The Commission has broad pricing powers, and is able to make determinations regulating prices, conditions relating to prices and price-fixing factors for goods and services, in any manner it considers appropriate, subject to the provisions of the relevant industry Act.<sup>44</sup> Price determinations can be an appropriate regulatory instrument, given that licensees are generally monopoly service providers within the geographic area where they operate and, as a result, do not have the benefit of competition to drive economically efficient behaviour.<sup>45</sup> Price regulation seeks to replicate the outcomes of a competitive market, constraining prices to levels reflecting the prudent and efficient costs of services valued by customers, for delivery on a sustainable basis.

### 2.2.2.1 Pricing of water and sewerage and asset sustainability

For the water industry, the Commission has made a determination pursuant to the price determination powers under Part 3 of the ESC Act, as authorised by Part 4, Division 3 of the *Water Industry Act 2012*,<sup>46</sup> and has included price disclosure requirements in the Water Retail Code – Minor and Intermediate Retailers.<sup>47</sup> This determination, which only applies to water and sewerage licensees, is a combination of a price monitoring framework and pricing principles, which are consistent with the National Water Initiative (NWI) Pricing Principles.

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addition to Ombudsman SA. Typical wording was: *'When advising a complainant of the outcome of an investigation of a complaint, Council will provide information about alternative remedies, including any rights of appeal and the right to make a complaint to an external agency such as the SA Ombudsman'*.

<sup>42</sup> EWOSA website viewed 8 April 2020, available at <https://ewosa.com.au/members/our-scheme-members>

<sup>43</sup> For example, as of the 16 April 2020, Cowell Electric Supply Pty Ltd has used a nominated person employed by the Outback Communities Authority (see <https://www.oca.sa.gov.au/>). However, the Australian Energy Regulator granted Cowell Electric an individual exemption for the sale and distribution of electricity at Iron Knob and Pimba on 26 September 2019 (see <https://www.aer.gov.au/communication/cowell-electric-supply-pty-ltd-granted-individual-exemption-for-the-sale-and-distribution-of-electricity-at-iron-knob-and-pimba>). Under the terms of these exemptions, Cowell Electric is required to seek membership of EWOSA.

<sup>44</sup> Section 25 of the ESC Act.

<sup>45</sup> This is similar to the justification the Commission uses to make a price determination that applies to SA Water – see Commission, *SA Water Regulatory Determination 2020*, Draft Determination: Statement of Reasons, March 2020, p.10, available at <https://www.escosa.sa.gov.au/ArticleDocuments/21462/20200304-Water-SAWRD20-DraftDecision-StatementOfReasons.pdf.aspx?Embed=Y>.

<sup>46</sup> Essential Services Commission, *Subsequent Determination to vary the 2013-2017 Price Determination for Minor and Intermediate Retailers*, to apply from 1 July 2017, available at <https://www.escosa.sa.gov.au/ArticleDocuments/1099/20170627-Water-SubsDeterminationVary2013-2017PDMIR-Final.pdf.aspx?Embed=Y>

<sup>47</sup> Essential Services Commission, *Water Retail Code – Minor and Intermediate Retailers (WRC-MIR/01)*, Explanatory Memorandum, June 2013, Clause 3.4, p.5, available at <https://www.escosa.sa.gov.au/ArticleDocuments/413/130627-WaterRetailCode-MinorIntermediateRetailers1.pdf.aspx?Embed=Y>. This clause establishes the requirement for licensees to publicly disclose any prices, fees and charges applicable to the provision of a retail service.

Under this form of regulation, licensees retain the responsibility for determining their own prices, but must do so in conformance with pricing and related principles set out by the Commission in the determination. This provides transparency into a licensee's price setting process by requiring it to:

- ▶ take certain principles into account in determining its costs and developing its prices, and
- ▶ demonstrate to the Commission that it has done so.

In 2018-19, 71 percent of water and sewerage licensees reported full compliance with all of the relevant NWI pricing principles.<sup>48</sup> The remaining 29 percent reported meeting some but not all of the relevant pricing principles. However, it should be noted that 'full compliance' in a particular year need not mean the licensee is fully recovering the cost of service in that year – full cost recovery occurs over time.<sup>49</sup>

Many licensees are still transitioning to full cost recovery, and are gradually adjusting prices in order to manage the overall price increase to customers. Some licensees are limited in their ability to recover the cost of service provision due to a small customer base. Others cite public benefit reasons (such as supplying schools or community areas) for not seeking to fully recover costs. Overall, this suggests customers of those networks are not being charged excessive prices, unless there is evidence indicating the cost base of any specific network is demonstrably inefficient. To date, the Commission is not aware of any such evidence.

However, while excessive pricing does not appear to be a concern, pricing in a manner that does not fully recover costs over a period of time might place longer-term sustainability at risk. As reported in the 2018-19 Minor and Intermediate Retailers Regulatory Performance Report,<sup>50</sup> the Commission does have some concerns over the long-term sustainability of the small-scale network asset stock, and notes the importance of maintaining capital investment levels over time to smooth pricing impacts and maintain service sustainability.

In circumstances where capital investment levels are not maintained, gradual asset deterioration can eventually result in the need for wholesale asset replacement in a compressed period, with customers potentially facing both a material increase in prices and unawareness of the poor state of the assets.

The Commission considers that customers should have greater transparency regarding the maintenance and renewal of the assets associated with delivering an essential service, and the consequential implications for pricing and service sustainability. This places greater emphasis on the role and responsibility of the essential service provider in managing and communicating this competently.

### 2.2.2.2 Pricing of electricity

Electricity licensees must publish prices on their website. While this provides a level of transparency for customers, it does not necessarily mean that pricing reflects the efficient costs of each off-grid network.

<sup>48</sup> Essential Services Commission, *Water: Minor and Intermediate Retailers Regulatory Performance Report 2018-19*, 2019, available at <https://www.escosa.sa.gov.au/industry/water/regulatory-reporting/regulatory-performance-reports>.

<sup>49</sup> For example, a licensee may decide to smooth price increases over time by imposing a lower price increase in initial year(s) (and hence under-recover in those year(s)).

<sup>50</sup> The minor and intermediate retailer regulatory performance report provides information on the operation of water industry licensees with 50,000 or fewer connections. The 2018-19 report is available at <https://www.escosa.sa.gov.au/industry/water/regulatory-reporting/regulatory-performance-reports>.

However, just over 50 percent of small-scale network electricity customers<sup>51</sup> are supplied electricity under the Remote Area Energy Supply (RAES) scheme.<sup>52</sup> Customers under this scheme are charged for their electricity consumption and pay tariffs which are aligned to the average of market/discount offers provided by South Australian on-grid retailers. The RAES tariffs are reviewed and set annually by the Minister for Energy and Mining.<sup>53</sup> This, combined with the transparency of published prices, limits the need for the Commission to consider making a price determination.

Anangu people living in Housing SA buildings are currently not charged for their electricity consumption. Under the South Australian Government's 'Future Sustainability' program, these customers are due to start being charged for their electricity consumption from 1 July 2021, at a rate much lower than the current RAES tariffs.<sup>54</sup>

In that overall context, the Commission is not aware of any evidence suggesting that electricity customers are being overcharged, or that there are network asset sustainability issues.<sup>55</sup>

### 2.2.2.3 Pricing of LPG

The Commission requires transparent information about LPG prices to be provided directly to customers on entering a market contract. On a regular basis thereafter, prices should be available from licensees' websites.

In addition to this form of price monitoring, reticulated LPG faces some competition from substitutes.<sup>56</sup> If substitutes are available, prices in the reticulated LPG market are unlikely to be excessive. To date, the Commission has not been presented with any evidence to suggest that prices are inefficient, that viable substitutes do not exist, or that there are network asset sustainability issues.

<sup>51</sup> Based on small-scale network customer numbers reported to the Commission and reported RAES customer numbers, as follows:

- In 2018-19, 6,420 customers were supplied through off-grid electricity networks – see Commission, *Off-Grid Energy Networks Regulatory Performance Report 2018-19*, available at:

<https://www.escosa.sa.gov.au/ArticleDocuments/539/20200313-Energy-OffgridNetworksPerformanceReport2018-19-FactSheet.pdf.aspx?Embed=Y>

- Customer numbers for the RAES State/Independent scheme (around 2,400 customers) and RAES Aboriginal Communities scheme (around 1,000 customers), as provided by the Department of Energy and Mining, available at:

[http://www.energymining.sa.gov.au/energy\\_and\\_technical\\_regulation/energy\\_resources\\_and\\_supply/remote\\_area\\_energy\\_supply/raes\\_communities](http://www.energymining.sa.gov.au/energy_and_technical_regulation/energy_resources_and_supply/remote_area_energy_supply/raes_communities) and

[http://www.energymining.sa.gov.au/energy\\_and\\_technical\\_regulation/energy\\_resources\\_and\\_supply/remote\\_area\\_energy\\_supply/raes\\_aboriginal\\_communities](http://www.energymining.sa.gov.au/energy_and_technical_regulation/energy_resources_and_supply/remote_area_energy_supply/raes_aboriginal_communities) respectively (website viewed 15 April 2020).

<sup>52</sup> The RAES scheme comprises the RAES State/Independent scheme and the RAES Aboriginal Communities (AC) scheme. Refer DEM website at <https://www.sa.gov.au/topics/energy-and-environment/energy-supply/remote-areas-energy-supplies-scheme> (website viewed 15 April 2020).

<sup>53</sup> A copy of the tariffs applying from 1 November 2019, are available at:

[http://www.energymining.sa.gov.au/\\_data/assets/pdf\\_file/0020/315443/1-RAES-Tariffs.pdf](http://www.energymining.sa.gov.au/_data/assets/pdf_file/0020/315443/1-RAES-Tariffs.pdf).

<sup>54</sup> Further information on the 'Future Sustainability' program is available at:

[https://www.energymining.sa.gov.au/energy\\_and\\_technical\\_regulation/energy\\_resources\\_and\\_supply/remote\\_area\\_energy\\_supply/future\\_sustainability](https://www.energymining.sa.gov.au/energy_and_technical_regulation/energy_resources_and_supply/remote_area_energy_supply/future_sustainability), viewed 16 December 2020).

<sup>55</sup> Noting the ability for the Government to be able to seek competitive tenders for the provision of RAES services. From 1 April 2016, the South Australian government has contracted Cowell Electricity Supply to support the RAES State and AC electricity assets and infrastructure. Source: Department for Energy and Mining, available at:

[http://www.energymining.sa.gov.au/energy\\_and\\_technical\\_regulation/energy\\_resources\\_and\\_supply/remote\\_area\\_energy\\_supply](http://www.energymining.sa.gov.au/energy_and_technical_regulation/energy_resources_and_supply/remote_area_energy_supply)

<sup>56</sup> Substitutes include bottled LPG and electricity.

### 2.2.3 Service standards

Larger service providers, such as SA Water, are required to adopt a best endeavours approach to achieving specified service standard performance targets (for example, in relation to customer service and complaint handling or field crew attendances). However, the Commission has generally not found the need to set similar standards for small-scale licensees (apart from electricity licences, which contain specified quality and interruption of supply obligations<sup>57</sup>). However, there are general service standard obligations which the Commission monitors. For example, all water and sewerage licensees must provide a reliable supply to customers, minimise the frequency and duration of interruptions, and have in place policies, practices and procedures to minimise the impact of unplanned interruptions.<sup>58</sup>

The Technical Regulator monitors compliance with legislation and applicable technical standards in the electricity, gas and water industries, aiming to ensure the safety of workers, consumers and property. There are other regulators that impose and enforce standards on licensees in relation to other matters, such as SA Health and the Environment Protection Authority (section 1.1).

There is the potential for customers to face ongoing poor service levels (including a failure to deal with complaints), where customers lack access to alternative suppliers.<sup>59</sup> That is why all licensees are required to have enquiries, complaints, and dispute resolution procedures in place that have been approved by the Commission. These procedures should clearly set out how customers can make an enquiry or complaint about the services they receive. These procedures should have escalation steps within them, including to an independent review body when a complaint cannot be resolved by the service provider.

Only a small number of licensees are responsible for the majority of water and sewerage complaints on a yearly basis. For example, in 2018-19, four licensees accounted for 79 percent of water-related complaints. In the same year, seven licensees accounted for 82 percent of sewerage-related complaints.<sup>60</sup>

There have been no reported complaints in relation to reticulated LPG network service providers since 2014-15. Also, while not all electricity licensees have to report complaint data, those that do, report a consistently low volume of complaints.<sup>61</sup>

Based on the number of customer complaints, the evidence suggests that customers generally do not appear to be expressing dissatisfaction with the service received. However, some pockets of localised concerns arise from time to time and the Commission takes appropriate regulatory action in such cases. Notwithstanding this, the Commission has some concerns over the level of understanding of the long-term sustainability of the small-scale network assets (section 2.2.2).

<sup>57</sup> For example, see clause 21 (quality of supply) and clause 22 (interruption of supply) of the Cowell Electric Supply Pty Ltd Electricity Retail, Distribution and Generation Licence, which specifies voltage performance bands and required periods of notice to customers for planned supply interruptions. A copy of the licence is available at: <https://www.escosa.sa.gov.au/ArticleDocuments/531/20191016-Electricity-RetailDistributionGenerationLicence-CowellElectricalSupply.pdf.aspx?Embed=Y> (website viewed 9 April 2020).

<sup>58</sup> Commission, *Minor and Intermediate Retailers Regulatory Framework – Information Sheet*, available at: <https://www.escosa.sa.gov.au/ArticleDocuments/547/20190522-Water-MIR-RegulatoryFramework-InformationSheet.pdf.aspx?Embed=Y>.

<sup>59</sup> As noted in section 1.2, from a customer perspective, in the case of small-scale networks, choice is generally limited to being part of that network or being self-sufficient. While there is the potential for poor service to occur even where there are alternative suppliers, a customer at least has the option to change – and this in itself may place some pressure on the licensee to perform appropriately.

<sup>60</sup> Of the licensees with the highest number of complaints (that is, the two groups mentioned) five had complaints for both water and sewerage services. Of those, none recorded a high number of complaints for both services (in other words, they only recorded a high number of complaints for one of the services they provide).

<sup>61</sup> The exception being in 2017-18, where one service provider accounted for 11 of the 13 complaints reported.

### 2.2.4 Monitoring and reporting

The Commission publicly reports each year on licensees' regulatory performance, based on the submitted annual reports.<sup>62</sup> To produce those reports, and dependent on the industry, the Commission collects information including:

- ▶ financial data such as income, expenses, operating surplus or deficit
- ▶ operational performance information, such as number of customers, complaints, restrictions, and customers on financial hardship programs
- ▶ quality and reliability data, such as planned and unplanned interruptions, and
- ▶ asset information, such as asset schedules and technical specifications.

## 2.3 The effectiveness of the current regulatory regime

As part of this Inquiry, the Commission reviewed the effectiveness of its regulation of small-scale networks. It considered whether there is evidence that licensees are behaving in a manner that has a detrimental effect on customer outcomes, based on the observations discussed in section 2.2.

While acknowledging that the evidence available is limited, the assessment suggested that, in general, licensees overall do not appear to be behaving to the detriment of their customers, when assessed against the current requirements of the codes and/or licence conditions. This may indicate that the Commission's current regulatory regime is assisting in achieving desired outcomes. However, that does not preclude changes, especially given the Inquiry's desired outcome of ensuring that any regulatory arrangements it administers remain targeted, efficient and appropriate.

In particular, the design and administration of a regulatory framework should ensure that customers have transparency regarding how the assets associated with delivering an essential service are being maintained and renewed, as well as the implications that this has for longer-term pricing and service sustainability. This places greater emphasis on the role and responsibility of the essential service provider in managing and communicating this competently.

In the Draft Inquiry Report, the Commission proposed moving toward a less-prescriptive, more-targeted model. The Commission considers this can be achieved while also accommodating the need for greater focus on long-term service sustainability. This should result in tangible benefits for consumers and licensees alike, through emphasising customer engagement and reducing reporting obligations, while also creating greater understanding and transparency of longer-term service sustainability. How this is proposed to be achieved in practice is outlined in the following chapters.

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<sup>62</sup> Refer Essential Services Commission Annual Performance Reports, available at: <https://www.escosa.sa.gov.au/industry/water/regulatory-reporting/regulatory-performance-reports> (water/sewerage) and <https://www.escosa.sa.gov.au/industry/gas/regulatory-reporting/regulatory-performance-reports> (electricity/gas).

### 3 The VTA approach

#### Summary

The Commission's decision is to adopt a verified trust and accountability (VTA) approach, to enhance the incentives for a licensee to provide a competent operation to the benefit of customers. In summary, this approach categorises licensees that are trusted (considered to be running a competent operation) as Category A and those that are not as Category B. Category A licensees benefit from reduced annual reporting requirements to the Commission. Category B licensees do not, and are subject to tailored reporting requirements.

Two key aspects of the VTA approach are that licensees pursue asset and service sustainability, and maintain proper behaviour towards customers – detail of the outcomes expected from a licensee in these two areas is set out in Box 1.

The decisions necessary to give practical effect to the VTA approach are highlighted throughout this Chapter but, in summary, from the release of this Report until 30 June 2022, the Commission will work with service providers to:

- ▶ develop a data baseline, drawn from market intelligence and existing performance data for each service provider
- ▶ develop an understanding of what is likely to be material in the context of performance outcomes over time, given the operational context of each service provider
- ▶ make changes to reporting guidelines and vary licence conditions where necessary
- ▶ make an assessment of which service providers will be 'trusted' (that is, that the Commission considers are likely running a competent operation), and thereby classified as Category A or B, from the operational commencement of the approach on 1 July 2022, and
- ▶ identify what performance information should be published by service providers and by the Commission and how that is best done.

From 1 July 2022, the approach will be applied in practice to licensees. The new reporting arrangements applicable to Category A licensees will apply for data for the 2021-22 reporting period.

Over the period from the release of this Report until 30 June 2022, the Commission's objective is to allow stakeholders to gain a greater understanding of the practical operation of the VTA approach, the categorisation process of existing licensees, and the assessment of new licensees through the licensing process.

The VTA approach will not alter existing customer protections under legislation, industry codes, and licence conditions. Also, in addition to information obtained from the annual reporting of licensees, the Commission will collect market intelligence, obtaining knowledge from a more diverse range of sources than it currently utilises. This approach should result in the Commission having a more immediate, richer source of knowledge on which to base assessments in a timely manner, thereby reducing any potential risks from the reduction in direct reporting from Category A licensees, and benefiting customers with quicker resolution of issues.

Licensees will be subject to an ongoing process of verification of competent operation, with categorisation subject to change, depending upon a licensee's behaviour in the context of the competent operation concept.

This Chapter details the VTA approach. It includes:

- ▶ the key concepts of the VTA approach
- ▶ stakeholder feedback regarding the VTA approach
- ▶ how the Commission will implement the VTA approach
- ▶ how licensees will be assessed and classified, including ongoing assessment
- ▶ changes to licensees' reporting obligations, including:
  - reporting material changes to operations
  - immediate reporting of service issues, and
  - submitting a statement of assurance
- ▶ changes to current processes such as audits and annual performance reports, and
- ▶ how the Commission will measure the success of the VTA approach.

### 3.1 Key concepts of the VTA approach

The VTA approach should enhance the incentives for a licensee to provide a competent operation for the benefit of its customers (Box 1). Two key aspects of the VTA approach are that licensees pursue asset and service sustainability, and maintain customer focus in their behaviours.

The VTA approach also formalises the Commission's ongoing assessments of competent operation more explicitly. If a licensee can demonstrate competent operation and, as a result, is trusted (**trusted licensee**), it benefits in the form of reduced reporting requirements and more flexible general oversight, based upon a constructive future regulatory relationship. This reduces the licensee's regulatory cost without reducing its obligations to customers.

Further, it also means that, even more so than in the past, the Commission will provide education and advice. The VTA approach places a strong emphasis on constantly monitoring performance, outcomes and trends, and continuously verifying and testing a licensee's trusted status. The Commission will intervene or take regulatory action as required to protect consumers' interests. This is because embedded within the VTA approach is the concept that competent operation is a continuous state. A trusted licensee should be able to demonstrate competent operation with minimal preparation at any time (section 3.5.4).



### Box 1: Concepts of the VTA approach

#### Competent operation

A licensee should be able to demonstrate to the Commission's satisfaction that it is sustainably providing essential services that customers want, at the level of quality and reliability that they value, at a price that accounts for their willingness to pay, legislative requirements and affordability. This will be defined as competent operation, and will incorporate the following licensee actions:

- ▶ customer-focused, involving consistent and genuine engagement and consultation with customers to deliver the price-service-quality mix valued by customers at the lowest sustainable cost
- ▶ develop, maintain, and implement sound and robust long-term financing, asset management, and operational plans that underpin the delivery of services in a sustained manner
- ▶ price services in a manner that takes account of efficient costs on a sustainable basis, customer willingness to pay, minimum legislative standards, and affordability, noting that there may be trade-offs within these that need to be effectively and transparently managed
- ▶ appropriately account for legislative requirements (not just those arising under the Commission's regulatory framework), and
- ▶ provide, or will provide for, sufficient financial strength to ensure the long-term viability of the services provided.

#### Demonstrating competent operation

Licensees must be *accountable* to their customers and the Commission, demonstrating competent operation on a continuous basis. Once licensees can demonstrate competent operation, the Commission will *trust* them (a trusted licensee) to operate their networks with less prescriptive reporting requirements.

In order for a licensee to demonstrate competent operation, and therefore be considered a trusted licensee, it should be able to provide evidence to the Commission's satisfaction (upon request at any time) which demonstrates, on a continuous basis, business practices that support competent operation as defined above – the *verification* process.

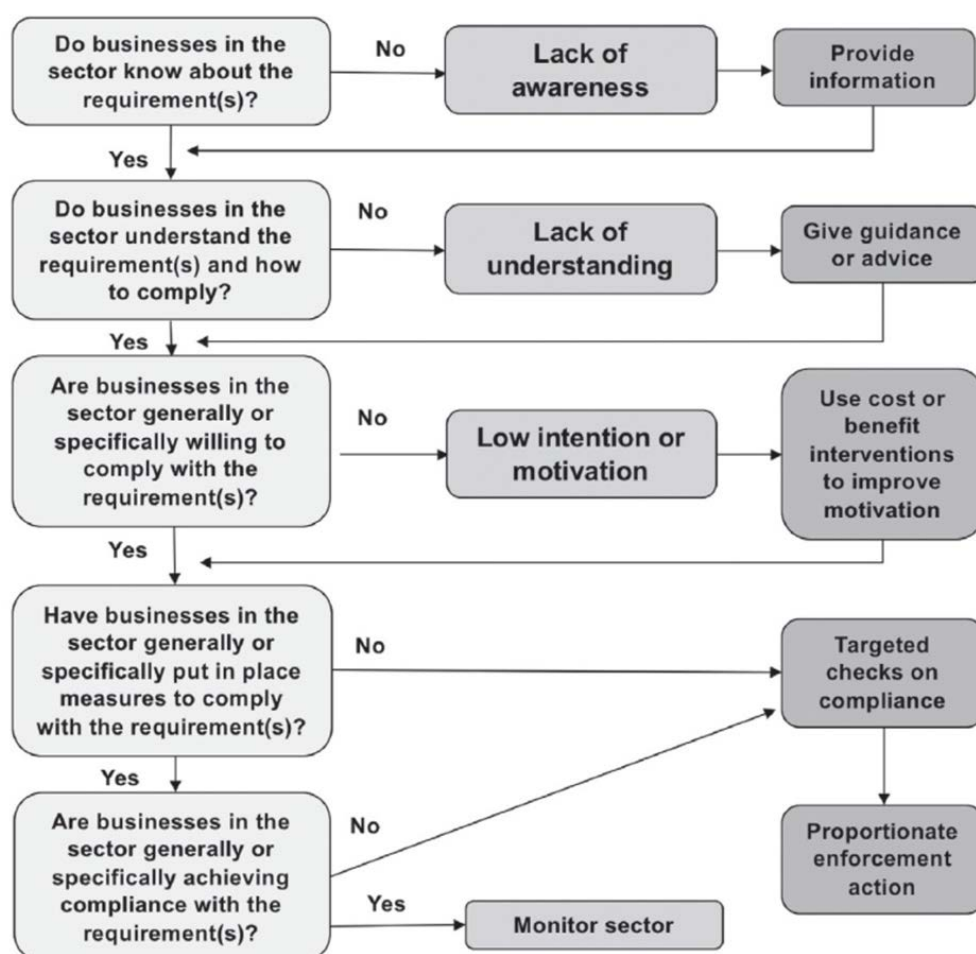
Once trust is gained, licensees are presumed to be providing a competent operation and performing appropriately, unless evidence is presented to the contrary. Licensees can provide positive evidence to support trust by proactively identifying any issues early with the Commission, then actively developing and implementing remedial actions.

The Commission will monitor licensees, and gather market intelligence regarding licensees and their operations. Monitoring in this manner means a licensee can gain and lose trust based on its own actions. A loss of trust would signal to the licensee's customers that it is not providing a competent operation (and not necessarily that its operations are unsafe in any way). The Commission's response would be directly related to the outcome of the licensee's actions.

The Commission notes that the fundamental structure of its regulatory approach (as summarised in Figure 4 below) will not change under the VTA approach. What will change is 'how' it applies that approach in practice (as explained in this Report) – with greater emphasis on licensee accountability and regulatory verification of performance outcome and long-term trends.



Figure 4: regulatory actions and interventions



Source: Russell and Hodges, Regulatory Delivery, 2019 at page 339.

### 3.2 Stakeholder feedback regarding the overarching concept of the VTA approach

The Commission is grateful for the stakeholder responses received on this issue, has considered the submissions made and has reached its decisions, as explained below.

SACOSS opposed the VTA approach, as it did not consider there to be sufficient evidence to support a reduction in reporting requirements for licensees.<sup>63</sup> From discussions with SACOSS, it is apparent that its concerns arise from its view that reduced routine reporting requirements for licensees will reduce transparency and accountability of customer issues.

In response to SACOSS and, as explained in this Chapter, the Draft Inquiry Report may not have sufficiently articulated that, under the VTA approach, there will be more information, rather than less, available to the Commission and stakeholders, within the overall system produced by its application. At the same time, the Commission will ensure that current information which is sought and valued by stakeholders – notably information on hardship performance and outcomes as identified by SACOSS – will continue to be available. The Commission will work with stakeholders to identify both the scope and presentation of that information.

<sup>63</sup> SACOSS, *Submission to ESCOSA's Draft Inquiry Report into the Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.6, available at <https://bit.ly/2JpPaU1>.

To explain the overall system more fully, Appendix 3 sets out an example, based on a hypothetical Community Wastewater Management System (CWMS). This starts at the initial point of categorising a licensee under the VTA approach, through to the end of its third year operating under it. It details how the VTA approach might operate in practice, and how this would maintain data collection integrity in the absence of prescriptive reporting requirements.

That example only represents one potential outcome of applying the VTA approach. Importantly, however, it shows that the VTA approach is not designed merely to reduce reporting to the Commission, but also creates a system where:

- ▶ licensees value and maintain a good relationship with their customers – gaining a genuine understanding (through engagement) of customer value propositions in terms of the price, quality and reliability of the services they provide, with a focus on long-term asset and service sustainability
- ▶ a more dynamic and interactive regulatory process occurs between a licensee and the Commission, allowing more ‘real time’ understanding of issues that impact on consumers – both in terms of regulatory action and public reporting on those matters
- ▶ the regulatory outcomes for an individual licensee depend on it applying the necessary diligence and attention to its customers, the delivery of its services, and its long-term planning, so as to maintain competent operation
- ▶ licensees have the opportunity to respond actively and positively to customer and regulatory issues and concerns as they arise, and before the Commission is required to intervene by taking regulatory action of some form, and
- ▶ there are no reductions in consumer protection.

The environment described above is achieved through driving licensee accountability and cultural change (in seeking to maintain or establish a trusted status), and the Commission’s approach to gathering and assessing market intelligence associated with licensees’ operations, as well as the opportunity for the provision of better information to stakeholders (from both licensees and the Commission).

However, the Commission does acknowledge the possibility that the stronger focus on asset and service sustainability within the VTA approach may bring to light the need for some licensees to reconsider existing pricing policies. If the outcome of this is price rises, this may result in affordability and hardship concerns for particular customers. The need to monitor the outcome of this is discussed in section 3.5 on reporting obligations.

In addition to SACOSS, the CTTG and Red Energy/Lumo Energy provided comments on the VTA approach in general.

The CTTG supported the VTA approach, but asked for an exemption from it until such time where there is clear direction of the future of its CWMS, including a strategy adopted by the CTTG for the transition of customers to SA Water.<sup>64</sup>

While the Commission appreciates CTTG’s position, it does not consider it appropriate to provide CTTG with an exemption. Provided that CTTG acts competently, for example by maintaining a good service through the transition to SA Water operation, and good communication with its customers, particularly

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<sup>64</sup> City of Tea Tree Gully, submission to *Draft Inquiry Report – Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, p.1, available at <https://bit.ly/2JpPaU1>. CTTG also asked that the VTA regulatory framework be implemented after consultation and implementation of the harmonisation project. The Commission’s decision regarding the harmonisation project is discussed in Chapter 5.

regarding transitional pricing, there should be no need to consider an exemption. It is for CTTG to demonstrate it is operating competently, given the circumstances it faces.

Red Energy/Lumo Energy wanted to ensure that there are no overlaps or inconsistencies between the Commission's regulatory framework and that of the Australian Energy Market Commission.<sup>65</sup> In particular, that the approach maintains existing consumer protections, reliability standards, and competitive retail market offers.

While the Commission supports the concept of consistency, there are necessary differences between economic regulatory regimes in different jurisdictions, and for different industries (often driven by the terms of the governing industry regulation Acts).

As such, it is the Commission's position that the core consumer protection concepts which are common across regimes – clear information disclosure, fair treatment of customers, business accountability, proper billing and payment options, disconnection and reconnection requirements, and provision for robust hardship provisions – should be maintained.

Where this can be achieved in a manner that delivers no overlaps or inconsistencies between national and State-based regimes, the Commission will do so. Where, for legislative or local requirement reasons it cannot, the Commission will have regard to those national practices, but develop and implement its frameworks to protect the long-term interests of South Australian consumers.

#### VTA approach – Decision 1

- The Commission will adopt the VTA approach outlined in this Final Inquiry Report for the regulation of small-scale networks.

### 3.3 The implementation process for the VTA approach

The Commission recognises that the VTA approach represents a change in its regulatory practice and, as such, there is a need for a smooth transition and implementation process. That process for the VTA approach will begin from the point of publishing this Final Inquiry Report, with its application formally starting 1 July 2022. In the intervening period, the following preparatory tasks will be undertaken:

- **Task 1:** Develop each licensee's baseline information through a collaborative process.

This involves consolidating the existing information held by the Commission (which has been provided by licensees) to form a baseline set of information. This will relate to an assessment of the sustainability of a licensee's regulated services, which is a key Commission focus going forward, as well as general compliance with the licensee's obligations. The Commission will confirm that baseline information with each licensee, in order to ensure it is an accurate reflection of their position.

- **Task 2:** Develop an understanding of what is likely to be material in the context of performance outcomes over time, given the operational context of each service provider.

In part, this is an outcome of Task 1. Through developing the baseline information for each licensee, what is material to the past and future operational performance of a licensee can be identified. Additionally, it also relates to identifying common themes across licensees. The role of materiality and the relevance of this task is discussed in sections 3.4.3 and 3.5.2.

<sup>65</sup> Red Energy-Lumo Energy, submission to *Draft Inquiry Report: Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, available at <https://bit.ly/2JpPaU1>.

- **Task 3:** Classify each licensee as Category A (competent and trusted) or Category B (not yet considered competent and trusted) for the formal commencement of the VTA approach. This is discussed further in section 3.4. This task will be informed by the outcomes of Tasks 1 and 2 and will be completed prior to 1 July 2022.

Through undertaking these tasks, it will also be possible to identify any necessary changes that need to be made to existing reporting guidelines and licence conditions. They should also assist in identifying what performance information should be published by service providers and by the Commission and how that is best done.

Until 1 July 2022, licensee's annual obligations will remain as they are. Thereafter, starting with the 2021-22 reporting period, each licensee's annual reporting obligations will be based upon its classification, noting that, under the VTA approach, classification may change depending on the licensee's performance (section 3.4 and Appendix 3).

#### VTA approach – Decision 2

- In the period from the point of publishing this Final Inquiry Report to 30 June 2022, an implementation process will be undertaken. This will comprise a number of key tasks, which will be undertaken in collaboration with licensees, to ensure a smooth transition to the VTA approach.
- The practical application of the VTA approach for licensees will formally begin on 1 July 2022, with the new reporting requirements applying for the 2021-22 reporting period. Until that time, annual return obligations will remain as they are.
- Each licensee will be classified as a Category A or B licensee prior to 1 July 2022, with annual return obligations thereafter based on that classification - and noting that the classification may change in the future, subject to licensee performance.

### 3.4 Assessing and classifying licensees

The Draft Inquiry Report identified three aspects relevant to assessing and classifying licensees, comprising:

- Assessing and classifying existing licensees' regulated business operations.
- Assessing and classifying new licensees' regulated business operations.
- Ongoing verification of competent operation and classifying licensees.

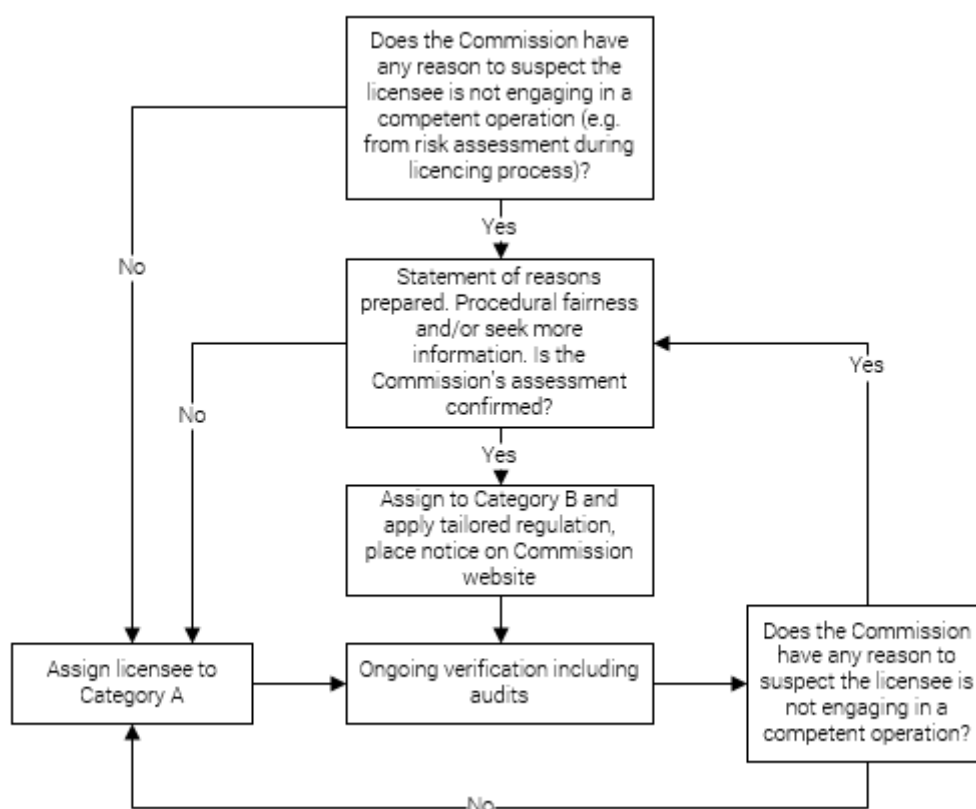
The Commission's approach to each of these is described below.

#### 3.4.1 Assessing and classifying licensees' existing regulated business operations

An existing licensed regulated business operation will be one that is licensed at the point at which the implementation process for the VTA approach starts - that is, the date at which this Final Inquiry Report is published. Licensees may have a number of licensed regulated business operations at this point.

During the implementation process summarised in section 3.3 above, the Commission will identify whether a licensee can demonstrate competent operation. The assessment and categorisation process to be used is illustrated in Figure 5.

Figure 5: Competent operation assessment



In assessing competence, the Commission will have regard to historical compliance with regulatory obligations, and levels of customer complaints. It will also undertake, from existing data reported to the Commission and other available market intelligence, an assessment of each licensee's sustainability across its licensed regulated business operations.

As outlined in Figure 5, for any licensee where there is reason to doubt its capability or capacity to be defined as a Category A licensee, the Commission will communicate those concerns with the licensee and seek further information. This will identify relevant issues, and provide an opportunity for the licensee to respond and present evidence on those matters.

If the licensee does not present sufficient evidence to provide assurance of competent operation, the licensee is likely to be assigned to Category B, and face tailored regulatory requirements until the identified concerns have been addressed.<sup>66</sup>

Where the outcome of an assessment results in a licensee being placed into Category B, this will be published on the Commission's website (see Figure 5). It is in customers' interests to have access to this information in relation to their service provider, as it provides them with an opportunity to better understand and, if they wish to, question the service provider's performance. It may also provide impetus to licensees to behave in an appropriate manner, and encourage them to gain/regain Category A status as quickly as is feasibly possible. Stakeholders provided the following specific comments on this overall approach, in their response to the Draft Inquiry Report.

<sup>66</sup> In undertaking that process, the outcome of Task 1 of the implementation process described in section 3.3 is relevant.

- ▶ The CTTG submitted it was concerned with publicly reporting whether a licensee was defined as Category B, stating that such reporting could negatively impact a licensee's reputation, as well as customers' property values.<sup>67</sup>
- ▶ The OTR questioned how the Commission would treat a licensee that was considered competent but where the infrastructure was unreliable and in poor condition.<sup>68</sup>

Regarding the CTTG's position on public reporting, the Commission cannot comment on how property values may or may not move as a result of publishing information regarding the results of a regulatory assessment. The Commission acknowledges that a licensee has an incentive to reduce the likelihood of being classified as Category B, if that results in reputational risk to the licensee. However, that is consistent with the intent of the VTA approach, where the reputational outcome suggested by the CTTG can be avoided through a licensee's own actions.

Regarding the OTR's query, the VTA approach assesses licensee performance within the context in which the licensee operates. The licensee may choose to maintain the current infrastructure until it becomes necessary to either replace it, or provide some other way of providing the essential service. How the licensee goes about this, and communicating its plan of action to its customer base, is the critical point in the context of applying the VTA approach.

In particular, under the VTA approach, there would be an expectation that licensees would have a continuing dialogue with their customers to achieve a level of service that customers were willing to pay for, while accounting for a licensee's legislated obligations. Also, if the Commission considers the asset condition of a licensee a particular risk to customer service delivery, it would liaise with the OTR, given the OTR's responsibilities and obligations.

Finally, as noted above, during the implementation period, the Commission will review the competency of licensees in dealing with asset and service sustainability (based on existing data and information), as part of the initial categorisation process. The Commission will continue to liaise with the OTR on those matters, including indicating areas of concern with asset condition, which will allow the OTR to focus on those under its regulatory regime.

### 3.4.2 Assessing and classifying new licensees' regulated business operations

For a new licensee, or an existing licensee undertaking a new regulated business operation, the assessment will take place as part of the licensing process. It is likely that most new licensees would start in Category A, subject to risk assessment through the licensing process. However, given that the Commission will not have had experience with the operation of a new licensee, the Commission will monitor their operations more closely for an initial period, irrespective of which category it is initially placed into.

If an existing licensee undertakes a new regulated business operation, its classification will be dependent upon the classification for its existing operations. This is because the Commission has experience of the level of competency attained by the licensee in practice.

### 3.4.3 Ongoing verification of competent operation and classifying licensees

The ongoing verification process is an important part of the VTA approach: a licensee can affect its assessment as a competent operation through its own actions. The VTA approach aligns both compliance and performance risks more directly with a licensee's behaviour.

<sup>67</sup> City of Tea Tree Gully, submission to *Draft Inquiry Report – Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, pp.2-3.

<sup>68</sup> Department for Energy and Mining, submission to *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, p.3, available at <https://bit.ly/2JpPaU1>.

The Commission will undertake the ongoing verification process to ensure licensees remain categorised correctly, based upon how their behaviour aligns with the competent operation concept. The Commission will gather and analyse market intelligence on licensees' operations (including reporting from licensees, complaints data from EWOSA, information from other regulators, media reports and the like), as well as from its audits of licensees.

If, through the ongoing verification process, the Commission believes a Category A licensee warrants reclassification to Category B, it will provide a statement of reasons to the licensee (section 3.4.1). The licensee will have an opportunity to respond and provide evidence in relation to those reasons. As competent operation should be a continuous state for any Category A licensee, a licensee should be able to provide comprehensive transparent information regarding any concerns raised by the Commission quickly and effectively.

The Commission will then consider that evidence and make a determination: if it is not sufficiently assured by a licensee's response, it will classify the licensee as Category B and notify it of new regulatory requirements, which have immediate effect.

Breaches of regulatory compliance will not necessarily result in a Category A licensee automatically being reclassified as Category B. The Commission understands that service issues will arise from time to time.

Having regard to the materiality or severity of any breach, and provided breaches are not persistent or systemic, it is the licensee's response – such as minimising the impact on customers, and developing risk mitigation measures against the problem reoccurring – that is important from a competent operation perspective.

From the perspective of a licensee, this means that the ongoing verification process should not be a 'check-list' of processes and procedures, but should instead relate to an understanding of the impact that a licensee's actions has had on its customers, providing customer redress and remediating its own operations to minimise further customer harm.

Licensees will remain classified as Category B until the Commission is confident the licensee can demonstrate competent operation. This may involve the Commission auditing the licensee to seek evidence of competent operation. The time needed to demonstrate competent operation may vary on a case-by-case basis, and will be dependent on a licensee's practical response to any concerns raised. Once the Commission considers the licensee to be engaging in a competent operation and performing appropriately, and will be considered a Category A licensee (unless subsequent evidence is presented to the contrary).

Appendix 3 provides an example of how this ongoing verification process might work in practice, and how it links to updating a licensee's baseline data, as discussed further in section 3.5.1.<sup>69</sup>

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<sup>69</sup> This example represents one potential outcome of applying the VTA approach, and does not necessarily reflect the approach the Commission would adopt in practice. This would depend on the specific circumstances of the case.



**VTA approach – Decision 3***For existing licensed regulated business operations*

- ▶ For the purposes of implementing the VTA approach, an existing licensed regulated business operation is one which is licenced at the point at which the VTA implementation process starts. That is, the date at which this Final Inquiry Report is published.
- ▶ The classification process for each licensee will be undertaken as summarised in Figure 5 (section 3.4.1), in the context of the definition of competent operation, as described in Box 1 (section 3.1).
- ▶ The Commission will provide a licensee assessed as Category B with a statement of reasons for this classification. The licensee will have the opportunity to provide further evidence to the Commission on that assessment. The Commission will then make a decision, communicate that (and any new or changed regulatory obligations) to the licensee, and make its decision public.

*For new licensees and new regulated business operations undertaken by existing licensees*

- ▶ For the purposes of implementing the VTA approach, any licensee commencing operations after the date at which this Final Inquiry Report is published will be considered a new regulated business operation.
- ▶ Entirely new licensees are likely to be classified as Category A, but the Commission will monitor operations for an initial period to confirm that position based on outturn performance.
- ▶ If a new operation is undertaken by an existing licensee, its classification will mirror that attained for its existing regulated business operations, as the Commission will have experience of the level of competency obtained by that licensee.

*Ongoing verification of competent operation*

- ▶ Through the ongoing verification process, if the Commission has cause to believe a Category A licensee should be reclassified as Category B, it will provide that licensee with a statement of reasons.
- ▶ The licensee will have an opportunity to provide further evidence to the Commission, if it wishes, to seek to maintain a Category A classification. The Commission will assess that evidence and make a determination, having regard to the definition of competent operation (described in Box 1). That determination, and any changed regulatory requirements (which will have immediate effect), will be communicated to the licensee and made public.
- ▶ If, through the ongoing verification process, the Commission has cause to believe a Category B licensee should be reclassified as Category A, the licensee will be informed of this and of its new regulatory reporting obligations (which have immediate effect), and it will be removed from the Category B list on the Commission's website.

**3.5 Changes to reporting obligations and the Commission's analytic approach**

From 1 July 2022, and applying to the 2021-22 reporting period, reporting requirements to the Commission for Category A licensees will be reduced, relative to the previous arrangements. For Category B licensees, reporting requirements will be at least equivalent to the previous obligations – unless there is reason to extend these for a particular licensee.



A Category A licensee's annual reporting return,<sup>70</sup> approved by the licensee's CEO (or equivalent), will be limited to the following:

- ▶ a list of office holders, to assure the Commission that the licensee is a fit and proper person
- ▶ connection and customer numbers, to be used primarily for calculating Commission licence fees (water), and EWOSA membership fees respectively
- ▶ information on hardship and affordability, at least equivalent to that required prior to the VTA approach being formally implemented at 1 July 2022
- ▶ identification of any material changes to operations, and
- ▶ a statement of assurance that the licensee is complying with its obligations and engaging in a competent operation to the level contemplated in Box 1.

Category A licensees will also be required to provide immediate ('real time') information regarding any material service or compliance issues arising, the response, and the outcome. This data, plus that received from the annual reports, will augment the Commission's current database, along with information from EWOSA, other regulators, and enhanced market monitoring.

While the Draft Inquiry Report suggested that there might be reduced reporting on hardship and affordability,<sup>71</sup> noting the concerns of SACOSS, and having considered the matter further, the Commission will maintain reporting of those metrics, to at least the current level.

The Commission notes that the VTA approach places a strong focus on asset and service sustainability. This may bring to light the need for licensees to implement price increases in order to maintain, or achieve, service sustainability, which may result in affordability and hardship concerns for particular customers.

Further, there may be a need, for a period of time, to enhance these reporting requirements, or any other reporting requirement, depending on circumstances. An example of this is the Future Sustainability program, which includes the introduction of electricity charging for some electricity customers (section 2.2.2.2). SACOSS, in its response to the Draft Inquiry Report, put the view that this program should be subject to additional reporting obligations during its rollout.<sup>72</sup> SACOSS noted that the program may result in customers self-disconnecting, as they cannot afford a full-time service, based on studies in other jurisdictions.

The Commission agrees with that submission, noting that the program represents a significant change in circumstances for both licensees, and some customers involved with the RAES scheme. The Commission will work with the relevant licensees and SACOSS to monitor the impact that such changes (and other policy-related changes) may have upon operations and customers. This may include the collection of specific additional data for a time. It could also include requiring the relevant licensees to publish specific information, or the Commission itself publishing this information on its website.

Overall, the Commission considers this represents a balanced, targeted approach to affordability and access issues. It ensures that concerns regarding affordability and hardship, in all communities, will not be 'obscured' by the implementation of the VTA approach.

<sup>70</sup> Which, in order to streamline the reporting process for Category A licensees, might end up being incorporated as part of the Annual Compliance Report.

<sup>71</sup> Commission, *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, Draft Inquiry Report, August 2020, section 3.5, p.31, available at: <https://bit.ly/2JpPaU1>.

<sup>72</sup> SACOSS, *Submission to ESCOSA's Draft Inquiry Report into the Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.15.

The OTR's submission stated that it is concerned that licensees may not collect data if they perceive they do not need to report it.<sup>73</sup> The Commission acknowledges there is the risk that, under the VTA approach, a Category A licensee could choose to interpret reduced reporting requirements as not needing to collect information. The Commission notes that this same risk exists in other regulatory reporting regimes, such as the taxation system, where full data is not required to be reported by a taxpayer each year, but records must nevertheless be maintained and produced on request – with a failure to do so potentially giving rise to an adverse outcome.

Overall, while appreciating the risk, the Commission considers that there are sufficient checks and balances within the VTA approach to appropriately manage it. These include ongoing reporting, market intelligence gathering, analysis and regulatory action by the Commission. These complement the underpinning historical data set that the Commission has, and will use to refine profiles for each licensee, in order to understand performance trends and operational issues (and which will be updated to include future performance data over time).

In terms of market intelligence gathering, the Commission will place greater emphasis on collecting data relating to licensees and their networks from sources other than licensees throughout each year, including:

- ▶ complaint data from EWOSA (see Chapter 4 for details regarding the role of EWOSA licensee membership)
- ▶ information from other regulators
- ▶ direct customer contact
- ▶ licensees' websites
- ▶ the Commission's Consumer Advisory Committee
- ▶ approaches from individual customers
- ▶ Members of Parliament
- ▶ the media, and
- ▶ other sources that the Commission may identify in the future.

Collecting this market intelligence will provide the Commission with a more diverse source of immediate knowledge than it currently receives. If the market intelligence identifies concerns that warrant further assessment, the Commission can request information from the relevant licensee, either as an ad hoc request or through an audit. This will benefit customers if it results in a quicker resolution of issues.

In totality, this approach should result in the Commission having a more immediate, richer source of knowledge on which to base assessments in a timely manner, while at the same time reducing the potential risks (identified by SACOSS and the OTR) of reduced reporting for Category A licensees.

As such, the Commission does not consider that reduced routine reporting requirements by Category A licensees to the Commission will result in a greater incidence of non-compliance, or performance issues.

Further, the credible threat of being reclassified as Category B exists if any Category A licensee chooses to interpret reduced reporting requirements as reduced compliance obligations. The Commission

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<sup>73</sup> Department for Energy and Mining, submission to *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, p.3.

considers this particularly relevant, in order to provide customers and customer representative bodies with assurance of regulatory intervention if it becomes necessary.

Overall, the objective of the VTA approach is to transition the existing system from one that is, relatively speaking, dependent on annual (routine) reporting to assess compliance and performance - often well after the event and with less emphasis on longer-term sustainability<sup>74</sup> - to one that has a relatively stronger focus on 'real time' assessment mechanisms, and the role of longer-term sustainability in relation to the circumstances of each licensee.

The issue of the longer-term sustainability of small-scale networks providing essential services is a common interest between the Commission and the OTR, given each party's legislative obligations. The Commission will continue to work collaboratively with the OTR to develop an understanding of the risks associated with licensees in this context. This should assist in the identification and management of any risks identified.

#### VTA approach – Decision 4

##### *Category A licensees*

Category A licensees' annual reporting returns are required to be approved by the licensee's CEO (or equivalent) and comprise the following:

- ▶ a list of office holders, to assure the Commission that the licensee is a fit and proper person
- ▶ connection and customer numbers, to be used primarily for calculating Commission licence fees (water), and EWOSA membership fees respectively
- ▶ information on hardship and affordability, at least equivalent to that required prior to the VTA approach being formally implemented at 1 July 2022
- ▶ identification of any material changes to operations (section 3.5.1), and
- ▶ a statement of assurance that the licensee is complying with its obligations, and engaging in a competent operation, to the level contemplated in Box 1 (section 3.5.3).

Category A licensees will also be required to provide immediate ('real time') information regarding any material service issue arising, the response, and the outcome (section 3.5.2).

##### *Category B licensees*

Category B licensees' reporting obligations will comprise the following:

- ▶ the matters set out above, plus
- ▶ any additional specific reporting obligations required by the Commission from time to time.

### 3.5.1 Material changes to operations

The Commission is including an obligation for Category A licensees to annually update the Commission on any material changes to operations, alongside the annual assurance statement.

This will allow Category A licensees to report on an exception basis, rather than need to spend time and resources merely replicating annual information that has not materially changed. The reason for this approach is that, if circumstances have not materially changed, the Commission can assume that previous information provided is a suitable proxy when updating its baseline information on the

<sup>74</sup> Any compliance or complaint issues identified or brought to the Commission's attention are investigated throughout the year.

licensee (that is, use the previous year's data, or some form of average of historical data, when no material change has been reported).

Material changes to operations will include anything that may impact consumers, such as pricing or the viability of the service. In determining if a change to operations is material, the Commission is of the view that licensees should be guided by the definition of 'material', which is: *'of substantial import or much consequence' and 'likely to influence the determination of a cause'*.<sup>75</sup>

Some examples of material changes are provided in Box 2.

#### Box 2: Examples of material changes

Licensee A provides a reticulated LPG service to two hundred customers and has expanded into a new housing development. This adds thirty new customers, as well as the necessary supporting infrastructure. Since this expansion is a significant change to operations, increasing the asset stock as well as customer numbers, the licensee determines it is a material change, and informs the Commission in its annual reporting return.

Licensee B publishes a new asset management plan for its sewerage operations, and subsequently increases prices by six percent. Since this is a significant price increase above current levels of inflation, the licensee determines it is a material change, and informs the Commission through its annual reporting return.

In the following year, Licensee B replaces 13 percent of its pipes. Although this should reduce the number of service issues it records, the licensee determines the upgrade is a material change to its asset base, and informs the Commission through its annual reporting return.

As competent operators, Category A licensees should have the capability to determine if a change is material in the context of their network and the services provided. If uncertain, a Category A licensee should discuss the matter with the Commission as early as possible, and should err on the side of caution – if uncertain then it should classify the change as material. If a licensee reports a material change(s), the Commission will liaise with the licensee to understand the implications this may have for the baseline information held about the licensee.

The Commission is not proposing to mandate the form in which information regarding material changes is provided. This is because a Category A licensee should be able to meet any such reporting requirement via using the licensee's existing business systems and processes that are required to properly manage a licensee's business. The audit process (discussed below in section 3.5.4) will present opportunities to test the robustness of this approach, from the perspective of both licensees and the Commission.

Updating the Commission of material changes annually is seen as a minimum requirement, and the Commission would encourage ongoing dialogue between it and licensees, with licensees reporting material changes as they occur when practicable.

As suggested by Origin Energy in its submission, the Commission will work with licensees to develop an understanding of what constitutes a material event - in general and (as noted above) for individual licensees as required.<sup>76</sup> This will be initiated through the implementation process.

<sup>75</sup> Macquarie Dictionary (Online), accessed 8 Jan 2020, <https://www.macquariedictionary.com.au/>

<sup>76</sup> Origin Energy, submission to *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.2, available at <https://bit.ly/2JpPaU1>.

### 3.5.2 Immediate reporting of service issues

The Commission acknowledges that operational issues occur from time to time, and that such one-off events are not themselves probative of competent operation. Rather, it is the licensee's response and subsequent actions that will inform the Commission's assessment of, and judgement on, that matter.

Given this, Category A licensees will be required to provide to the Commission relatively immediate 'real time' information regarding any material service issues (for example, major unplanned interruptions), their subsequent response to resolving those issues, and the outcome. This information should be reported to the Commission as soon as practically possible, having regard to licensees needing time to respond and resolve the issue.

This encourages the rectification of issues in a timely and efficient way. It also assists the Commission to identify, over time and across licensees, any systemic issues early, through identifying trends and patterns. It further assists in developing constructive relationships between the Commission and licensees, as well as deepening the Commission's knowledge of the operations of individual networks.

Furthermore, for the same reasons as outlined above regarding the approach to reporting material changes to operations, the Commission will not define materiality thresholds in the context of service issues. If uncertain, a licensee must communicate with the Commission, and should err on the side of caution, identifying service issues as material if uncertain as to classification. However, the Commission will monitor this approach, and will respond if it results in material service issues going unreported in relatively immediate 'real time'.

The Commission notes the Local Government Association of South Australia's submission that the proposed requirement for immediate reporting of service issues is already required under the requirements of other relevant regulators of licensees such as the Environment Protection Authority, SA Health and the OTR. The Commission acknowledges it need not be directly notified of all issues (such as environmental spills) pertaining to the jurisdiction of these regulators.<sup>77</sup> The Commission proposes to continue to work with other regulators to determine how best to share information, so licensees do not need to separately report issues to multiple regulators.

### 3.5.3 Statement of assurance

Category A licensees will also be required to provide, as part of their annual reporting return, an assurance statement that they are undertaking a competent operation, and have notified the Commission of all material changes. This will provide assurance that regulatory requirements (described in Box 1) are being met, and that the licensee will be able to provide supporting evidence and information if and as requested by the Commission.

That assurance statement will be an extension of the current compliance assurance statement, providing overall assurance on, not just regulatory compliance in a narrow sense, but also the licensee's long-term asset, financing, and delivery capabilities – which are inherent and fundamental obligations within the licence.

The Commission considers this statement an integral element of the VTA approach, particularly as it provides assurance not only to the Commission, but also to customers and customer representative bodies, of the intention and capacity of the licensee to provide a competent operation.

Further, the assurance statement serves as a risk mitigation mechanism against reduced reporting requirements being interpreted by a licensee as not needing to maintain appropriate records to underpin business operations.

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<sup>77</sup> Local Government Association of South Australia, *Feedback on Small-Scale Enquiry*, November 2020, available at <https://bit.ly/2JpPaU1>.

Under the VTA approach, a Category A licensee can maintain its business records in any manner it wishes, but must be capable of providing relevant information when requested by the Commission (for example, in response to an audit). If it cannot, the Commission may determine that the licensee's assurance no longer holds, or that it is not complying with its obligations. Depending on circumstances, this may warrant the Commission moving the licensee into Category B (as explained earlier in this Chapter).

### 3.5.4 Audits

Audits are an important component of the Commission's compliance framework and take various forms, as outlined in Table 2.

Table 2: Types of audit and their function

Audit	Function
Periodic audits	The Commission will advise each year the focus areas for audits (using a risk-based assessment), although it may not make prior announcements as to which licensees will be audited, or when.
Incident-based audits	Audits to establish facts, circumstances etc., should a material issue come to light. This might be directed at a single licensee, or group of licensees, depending on the nature of the incident.
Ad hoc audits	These are designed to continually verify the level of licensee performance. Again, the Commission may not make prior announcements as to which licensees will be audited, or when.
Assurance audits	These are designed to check that remediation actions (for example, from a non-compliance and/or loss of trust) are in place and effective. This might be directed at a single licensee, or group of licensees, depending on the nature of the incident. The Commission may not make prior announcements as to the timing of these audits.

As part of its ongoing verification process under the VTA approach, the Commission will conduct audits of all licensees over time. Auditing will verify competent operation and fill any information gaps identified in regulatory assessment processes (allowing the Commission to reach decisions on regulatory matters). It will allow the Commission to examine whether the licensee is meeting the requirements of the Acts, licences, codes, and guidelines, and if not, why not, and the remedies proposed by the licensee.

Audits will also inform the Commission as to whether the licensee:

- ▶ appropriately engages with its customers, given its operational context
- ▶ is pricing appropriately, and
- ▶ can demonstrate having a sustainable operation. This includes understanding its assets, the costs to provide a sustainable service over the long term, and the practical actions implemented that are based on those factors.

The audits will be undertaken by the Commission, or parties working for the Commission. The Commission will seek efficiencies by combining elements of the audit as appropriate. For example, if responding to a specific concern, it may use the opportunity to also review and understand broader compliance issues. The Commission will also seek to leverage audits carried out by other regulators, and might, on occasion, conduct combined audits.

The Commission notes Origin Energy's submission that audits should be used judiciously, with less emphasis on periodic audits and a focus on event-based (incident and assurance) and ad hoc audits.<sup>78</sup> While broadly agreeing that the audit program should not cause unnecessary costs or burden, the Commission considers there are good reasons for conducting an industry-wide periodic audit program. Such programs are common, and through them regulators can signal the risk-based focus areas for a year, and then conduct audits on businesses at random.<sup>79</sup> This provides the regulator with a snapshot of performance and compliance on an industry-wide basis, and publication of the findings can inform other operators of risk areas that should be addressed proactively.

The Commission will publish the results of audits. This is important in order to assure customers and consumer representative bodies that the Commission is fulfilling its legal obligations. That is, to ensure licensees are meeting their regulatory obligations and providing a competent operation. This is consistent with the Commission's primary statutory objective.

#### VTA approach - Decision 5

As part of its ongoing verification process under the VTA approach, the Commission will conduct audits of all licensees over time to:

- ▶ verify competent operation
- ▶ fill any information gaps identified in regulatory assessment processes, and
- ▶ examine whether the licensee is meeting the requirements of the Acts, licences, codes, and guidelines.

### 3.5.5 Annual performance reports

The changes to the annual reporting requirements of licensees enables a change in how licensee performance is reported to customers and other stakeholders. Currently, the Commission publishes an annual performance report, providing an overview of the performance of licensees at an aggregated level (section 2.2.4).

The information reported is at a high level, and may not provide sufficient detail for specific licensee's customers or customer representatives to understand specific or local performance. For that reason, the Commission is changing its public reporting approach:

- ▶ Licensees will be required to report on their performance directly to their customers, with form and detail being determined through customer engagement. This provides a direct line of accountability from licensees to their customers.
- ▶ The Commission will continue to publish annual performance reports, but those will focus more strongly on matters such as systematic issues, observations on performance trends (positive or negative), the outcomes of audits and major compliance or operational issues, and how licensees have responded to these in terms of issues remediation and customer redress.
- ▶ The Commission will also publish issue-specific event reports (as it currently does), where material or major issues arise.

<sup>78</sup> Origin Energy, submission to *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.2

<sup>79</sup> For example, refer to the ACCC enforcement and compliance priorities for 2020, available at <https://www.accc.gov.au/about-us/australian-competition-consumer-commission/compliance-enforcement-policy-priorities>



This approach ensures that the costs associated with reporting are directed at providing customer benefit and licensee accountability (noting that the system as a whole allows for a more prescriptive regulatory reporting regime to be implemented, depending upon an individual licensee's behaviour).

There were some concerns from stakeholders on the public reporting of data. Origin Energy questioned the value of reporting performance metrics to customers directly, stating that customers are unlikely to be concerned with performance across the network.<sup>80</sup> The OTR stated that smaller licensees might find it challenging to report on their performance directly to customers, due to limited resources.<sup>81</sup> SACOSS raised the concern that affordability and access issues, particularly in regional and remote communities, would be obscured.<sup>82</sup>

Given a fundamental aspect of the VTA approach is customer engagement, the Commission believes that public reporting should not prove a material resourcing issue for licensees operating competently. Through engagement processes, customers can make clear to licensees what information and level of detail they want available, and licensees should respond appropriately. If they do not, the Commission may intervene and impose direct regulatory obligations - either individual or industry-wide.

Regarding SACOSS' concern, the proposed approach may include the publication of performance reports identifying both trends and shorter-term issues that require, or have required, regulatory attention. Through this, customers have the opportunity to gain independent information and advice on those matters relating to their service providers (noting that service providers should themselves be moving to publish more performance information, more regularly). Also, the Commission already requires additional reporting from a licensee where it considers it necessary, and will continue to do so under the VTA approach.

#### VTA approach – Decision 6

- ▶ Licensees will be required to report on their performance directly to their customers.
- ▶ The Commission will continue to publish annual performance reports. However, these will focus on systematic issues, performance trends, the outcomes of audits and major compliance or operational issues, and how licensees have responded to these in terms of issues remediation and customer redress.
- ▶ The Commission will also publish issue-specific event reports (as it currently does) where material or major issues arise.

### 3.6 Measuring success

It is important to establish measures of success for the VTA approach, and to monitor actual performance against these measures. This supports both future reviews of the effectiveness of the VTA approach, as well as allowing it to evolve as experience with its implementation increases. Setting such measures is consistent with the Commission's business model (section 1.1.1).<sup>83</sup>

<sup>80</sup> Origin Energy, submission to *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.2.

<sup>81</sup> Department for Energy and Mining, submission to *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, p.3.

<sup>82</sup> SACOSS, *Submission to ESCOSA's Draft Inquiry Report into the Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.17.

<sup>83</sup> Commission, *Strategy 2020-2023*, May 2020, pp.8-11 and pp.14-15, available at <https://www.escosa.sa.gov.au/about-us/strategic-plans>.



1. **Intended outcome:** The VTA approach:

- ▶ provides for a price-service-quality offering that meets the specific needs of the customers of a small-scale network, subject to legislative requirements
- ▶ ensures incentives and accountability are with the right parties
- ▶ minimises the regulatory cost by ensuring regulation is effective, targeted, fit-for-purpose, and capable of responding to external influences, and
- ▶ creates consistency across regulatory instruments, where appropriate.

2. **Measures of success:** Under the VTA approach in practice:

- ▶ most, if not all, licensees classified as competent operators, demonstrated through:
  - no material or systemic issues being identified through ad hoc audits, indicating that licensees are accepting that competent operation must be achieved on a continuous basis, and
  - limited need for follow up on any licensee reporting, indicating that licensees understand their obligations
- ▶ the Commission uses market intelligence to create evidence and undertake analysis that demonstrates the sustainability, or otherwise, of the network assets, and
- ▶ the Commission uses its verification, compliance and enforcement powers where evidence shows licensees have failed to meet regulatory requirements (or are at risk of doing so), and are not being accountable to their customers, thereby implementing a strong, targeted, and risk-based compliance framework.

Overall, as with any regulatory framework, it may take a number of years before the outcomes of the VTA approach are fully realised, but it should be possible to identify trends through time. In particular, in the initial years, the Commission will gain a greater understanding of the extent to which current licensees are achieving sustainable operations, continuing to meet their obligations, and behaving appropriately towards their customers. An example of how this may work in practice is set out in Appendix 3.

## 4 The role of EWOSA

### Summary

Under industry regulation Acts and industry licence conditions, all licensees are currently required to have effective customer dispute resolution processes in place. This includes escalation to an independent dispute resolution body, where a customer's complaint is not able to be resolved by the licensee.

For all national electricity market and natural gas providers, as well as for SA Water and some (but not all) small-scale water and sewerage service providers, the Commission has specified the Energy and Water Ombudsman (SA) Limited (EWOSA) as the independent dispute resolution body. Where that is not the case, the Commission has permitted some licensees to use other entities, with the understanding that it would monitor customer outcomes over time. The Commission has since observed that licensees have adopted various approaches to dispute resolution and independent dispute resolution, with differing capacities to enforce remedies and differing outcomes for customers.

The Commission has decided that, for the purposes of the industry regulation Acts and industry licence conditions, all licensees must become members of EWOSA by 1 July 2021, for the following reasons:

- ▶ EWOSA is a recognised expert in customer complaint and dispute resolution, having provided that service for over 20 years in regulated essential services markets.
- ▶ Customers benefit from EWOSA's consistent, impartial dispute resolution process, with the ability to impose remedies.
- ▶ Licensees benefit from EWOSA's cost-effective achievement of outcomes that reasonably reflect the interests of all parties, given the nature of the dispute, and the behaviour of the participants to the dispute.
- ▶ The Commission benefits through reporting processes. EWOSA provides the Commission with complaint, dispute and systemic issues data that may be used to identify areas of regulatory concern or potential issues, regarding the manner in which a licensee is conducting its operations. This will be critical information for the VTA approach and, in its absence, the ability of the Commission to reduce licensees' regulatory reporting obligations is more limited.

The Commission acknowledges that the EWOSA scheme has a cost for licensees but, having analysed that cost structure, it is of the view that the benefits of mandatory membership outweigh those costs.

### 4.1 Requirement that licensees join the EWOSA scheme

The Commission can require licensees to join EWOSA as a condition of licence, which is the Commission's decision in this case.

While there was broad support for the proposal as put in the Draft Inquiry Report, Origin Energy's<sup>84</sup> and CTTG's<sup>85</sup> submissions did not support EWOSA membership, stating that it duplicates current complaint and dispute resolution processes. CTTG suggested an alternative is to mandate licensees participate in

<sup>84</sup> Origin Energy, submission to *Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.1.

<sup>85</sup> City of Tea Tree Gully, submission to *Draft Inquiry Report – Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, pp.5-6.

an Ombudsman scheme approved by the Commission. Origin Energy also submitted that licensees reporting to their customers may duplicate EWOSA's public reporting.

Having considered those submissions, the Commission's view remains that a consistent and effective customer complaint process across all licensees is more beneficial, as small-scale network customers are not then subject to differing dispute resolution service levels. Also, CTTG's proposal reflects the current statutory regime – the Commission has discretion to mandate participation in a particular scheme – which is the outcome of the Commission's decision.

As noted in section 2.2.1, many licensees currently rely upon Ombudsman SA, and Ombudsman SA will still have authority in a range of areas relating to small-scale networks. Ombudsman SA and EWOSA have arrangements in place through a memorandum of understanding to deal with any potential overlap of responsibilities.<sup>86</sup>

## 4.2 Functions and scope of EWOSA

EWOSA is a dispute resolution service for participating retailers and distributors supplying electricity, gas, water, and sewerage services, and their customers.<sup>87</sup> EWOSA provides its services directly to customers free of charge, but member licensees are required to pay a joining fee, an annual fee and specific charges for each complaint handled by EWOSA.

EWOSA has a charter setting out its functions, jurisdiction and powers.<sup>88</sup> In general, its functions are to receive, investigate and facilitate the resolution of complaints by customers regarding:<sup>89</sup>

- ▶ billing concerns
- ▶ payment arrangements and difficulty in paying
- ▶ debt collection and credit default listings
- ▶ disconnection or restriction of supply
- ▶ transferring from one energy supplier to another
- ▶ connection and supply of energy or water services
- ▶ the behaviour of licensee staff, including the marketing and customer service departments
- ▶ meters, poles, wires and pipes
- ▶ energy and water supplier actions that may affect land or other property, and
- ▶ privacy related matters.

Excluded functions include complaints relating to the setting of prices, complaints previously considered by a Court, tribunal or arbitrator, and customer contributions to the cost of capital works.<sup>90</sup>

<sup>86</sup> For more information see [https://ewosa.com.au/assets/volumes/general-downloads/EWOSA\\_CorporateDocument\\_MOU\\_South\\_Australian\\_State\\_Ombudsman\\_2015.pdf](https://ewosa.com.au/assets/volumes/general-downloads/EWOSA_CorporateDocument_MOU_South_Australian_State_Ombudsman_2015.pdf)

<sup>87</sup> For more information, see EWOSA's website at <https://ewosa.com.au/>

<sup>88</sup> EWOSA, *Charter of the Energy and Water Ombudsman (SA) Limited*, October 2018, available at [https://ewosa.com.au/assets/volumes/general-downloads/EWOSA\\_CorporateDocument\\_Charter-2018.pdf](https://ewosa.com.au/assets/volumes/general-downloads/EWOSA_CorporateDocument_Charter-2018.pdf)

<sup>89</sup> EWOSA dispute handling process, available at <https://ewosa.com.au/resolving-complaints/our-process>. Also see EWOSA charter, clause 4.

<sup>90</sup> See EWOSA charter, clause 5.

Although the City of Salisbury supported EWOSA membership, it requested all efforts are made to ensure customers cannot perceive EWOSA as a means to bypass a licensee's own procedures.<sup>91</sup> The Commission emphasises that, prior to contacting EWOSA with a dispute, customers should first contact their licensee directly and attempt to resolve the dispute (and indeed EWOSA's practice is to ensure that the licensee has had the opportunity to respond first). Where matters are referred to EWOSA, potential assessment stages for complaints and action to address complaints are (noting that the majority of matters are dealt with in the early stages):<sup>92</sup>

- ▶ Enquiry
- ▶ Refer to Customer Service
- ▶ Consultation
- ▶ Refer to Higher Level
- ▶ Conciliation
- ▶ Investigation
- ▶ Review
- ▶ Determination, and
- ▶ Explanation of Resolution.

Where EWOSA makes a determination, the licensee is bound to comply with the terms or requirements of the determination. However, if a customer is unhappy with the terms of the determination, they may withdraw from the process and will not be bound by the determination.<sup>93</sup>

### 4.3 EWOSA fees

There are three EWOSA member fees:

- ▶ joining fees
- ▶ fixed annual fees, and
- ▶ case handling fees.

The joining fee is charged when a member joins EWOSA. It covers the first financial year of membership and involves a level of induction and support. This means a new member is charged only the joining fee in the first year of membership. In subsequent years an annual fee is charged. Both the joining fee and the fixed annual fee are based on the member's customer numbers. Case handling fees are charged per case, and are dependent on the level of escalation. EWOSA fees for 2020-21 are provided in Appendix 2.

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<sup>91</sup> City of Salisbury, *City of Salisbury Formal Response to the Draft Enquiry Report – Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, p.1, available at <https://bit.ly/2JpPaU1>.

<sup>92</sup> See EWOSA *Our process*, available at <https://ewosa.com.au/resolving-complaints/our-process>. (website viewed 16 April 2020).

<sup>93</sup> However, if the customer does not accept the determination, the licensee is released from the terms of the determination, and the customer is free to pursue remedies in another forum, including legal proceedings. EWOSA can play no further role in the case once a Determination is made. See EWOSA, *Determination*, available at <https://ewosa.com.au/resolving-complaints/our-process> (website viewed 21 April 2020).

#### 4.3.1 The impact of EWOSA membership fees on customer bills

The EWOSA Board has recently revised the joining and fixed annual fee schedule to accommodate licensees with small customer numbers (see Table 5, Appendix 2). The potential customer bill impact of the fee depends on the EWOSA customer fee band, and the degree to which a licensee passes through the fees to customers. Table 5, in Appendix 2, includes the impact of pass throughs for all customer fee bands. It notes:

- ▶ Licensees in the 'up to ten customers' band face the largest potential impact, that is EWOSA annual membership fee might lead to a bill increase of between \$8.33 and \$50.00 (an average of \$13.16) per customer,<sup>94</sup> and
- ▶ Licensees in the '5,001 to 20,000 customers' band<sup>95</sup> face the least potential impact, that is the EWOSA annual membership fee might lead to a bill increase of between \$0.08 and \$0.15 (an average of \$0.11) per customer.

#### 4.3.2 The impact of EWOSA case handling fees on customer bills

Case handling fees are directly dependent upon whether a dispute is referred to EWOSA, and on the extent to which any dispute escalates through EWOSA's complaint handling process. As Table 6, in Appendix 2, shows, case handling fees can escalate from a 'Refer to Customer Service' (\$40 per case) through to a 'Determination' (\$5,000 plus \$3 per minute). EWOSA charges the case handling fees to the licensee.

The Commission notes that the Clean Energy Council raised a concern that fixed joining and annual fees would not provide a financial incentive for licensees to resolve disputes.<sup>96</sup> Having considered that submission, the Commission is of the view that the incentive properties associated with the EWOSA dispute resolution case handling fee structure should encourage licensees to resolve disputes prior to requiring EWOSA's services, unless the potential benefits to the licensee of EWOSA's services outweigh those costs.

Monarto Water Network did not support EWOSA membership, and submitted that the risk of a complaint reaching EWOSA's Determination stage (at a cost of \$5,000) would be financially detrimental for its operations (and potentially other small licensees), inflicting long-term financial harm, and risking the viability of its network.<sup>97</sup> It submitted that smaller licensees (that is, with less than 100 customers) be exempted from the EWOSA scheme. The Commission notes this risk, but, as stated above, it is of the view that the incentive properties associated with the case handling fees should encourage licensees to resolve disputes, prior to requiring EWOSA's services. Also, as an experienced dispute resolution services provider, EWOSA has to maintain a reputation for resolving disputes in an impartial, objective and cost-effective way. Further, a small retailer could seek exemption from the requirement of EWOSA membership, if it considered it appropriate to do so.<sup>98</sup>

<sup>94</sup> This comprises water customers only, with only 19 customers in this band. If one network with a single customer is excluded, the range would be \$8.33 to \$16.67.

<sup>95</sup> The current largest licensee (District Council of Mount Barker) reported customer numbers of 12,377 for 2018-19.

<sup>96</sup> Clean Energy Council, *submission to the Essential Services Commission of South Australia Small-Scale Networks Inquiry*, September 2020, p.1, available at <https://bit.ly/2JpPaU1>.

<sup>97</sup> Monarto Water Network, *Response to Draft Inquiry Report – ESCOSA's Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, October 2020, p.1, available at <https://bit.ly/2JpPaU1>.

<sup>98</sup> For example, section 108(1) of the *Water Industry Act 2012* provides that "The Commission may, with the approval of the Minister, grant an exemption from Part 4, or specified provisions of that Part, on terms and conditions the Commission considers appropriate". In this case, the relevant provision would be section 25(1)(h) which is a licence condition requiring the licensee to participate in an ombudsman scheme determined or approved by the Commission.

The Commission will monitor and liaise with EWOSA and a licensee regarding that licensee's particular usage of EWOSA's services, and any associated accumulation of case handling fees. If, through this process, there is evidence to suggest that a licensee may be unnecessarily accumulating case handling fees and passing these onto its customers, the Commission would, in the absence of an appropriate response from the licensee, consider what remedial action to take from a regulatory perspective.<sup>99</sup>

#### 4.4 Mandatory EWOSA membership delivers net benefit

The Inquiry's Terms of Reference state that the Commission will analyse consumer protections associated with the delivery of services, with the objective of ensuring that any regulatory arrangements it administers are targeted, efficient and appropriate. Access to dispute resolution processes is a critical aspect of this, as it provides an avenue for consumers to practically exercise their rights if needed.

It is the Commission's view that there is overall benefit in mandating EWOSA membership which outweighs the costs, as summarised in Table 3. On that basis, compulsory EWOSA membership will apply from 1 July 2021.

Table 3: Costs and benefits of EWOSA membership

Party	Costs and benefits
Customers	<p><b>Costs</b></p> <ul style="list-style-type: none"> <li>▶ EWOSA-related costs, if passed through to customers.</li> </ul> <p><b>Benefits</b></p> <ul style="list-style-type: none"> <li>▶ Provides consistency in complaint and dispute resolution across all customers.</li> <li>▶ Can enforce a resolution.</li> <li>▶ Customers may gain greater assurance of procedural fairness because of the above points.</li> <li>▶ Licensees have an incentive to deal effectively with any issues prior to getting to the point of an investigation or audit, given the possibility for regulatory action if they behave contrary to this expectation.</li> </ul>
Licensees	<p><b>Costs</b></p> <ul style="list-style-type: none"> <li>▶ EWOSA-related fees.</li> </ul> <p><b>Benefits</b></p> <ul style="list-style-type: none"> <li>▶ Provides opportunities and incentives to resolve complaints prior to getting to the point of an investigation or audit.</li> <li>▶ Dealing with an independent, experienced and expert body in the industry sectors relevant to small scale networks, which has an understanding of what licensees should be able to provide.</li> <li>▶ Provides a support function for licensees on how they best meet customer expectations, given this expertise, experience and specialisation.</li> </ul>
The Commission	<p><b>Costs</b></p> <ul style="list-style-type: none"> <li>▶ No change in cost.</li> </ul> <p><b>Benefits</b></p> <ul style="list-style-type: none"> <li>▶ The Commission will receive consistent and reliable customer complaint information for monitoring and analysis.</li> </ul>

<sup>99</sup> Such options could include a price determination to prevent costs being passed through to customers, or reassessment to Category B to address any underlying problem causing the complaints.

**EWOSA membership – Decision 7**

- ▶ The Commission has decided that, for the purposes of the industry regulation Acts and industry licence conditions, all licensees must become members of EWOSA by 1 July 2021.

## 5 Proposed approach to harmonisation

### Summary

The Commission considered the harmonisation/standardisation of current code and licence obligations across the small-scale industries – the harmonisation project.

Despite submissions supporting the underlying principle of harmonisation, the Commission is concerned that there is potentially limited appetite to undertake a full harmonisation project at this time. As a result, the Commission will not pursue harmonisation as a single, separate project. Rather, harmonisation efforts will occur as part of the Commission's regular reviews of codes and guidelines, and as material evidence-based issues are identified (for example, during the implementation process to the VTA approach).

This Chapter discusses why the Commission is not proceeding with a specific harmonisation project. However, the Commission remains open to pursuing harmonisation in response to evidenced-based examples that show a potential material net benefit

### 5.1 Harmonisation in the context of the Inquiry

For reasons of history and underpinning legislative frameworks, there are various differences between the regulatory arrangements for water, gas and electricity. Harmonisation relates to assessing the merits of changing existing regulatory arrangements, with the objective of ensuring that their contents remain appropriate and relevant, to clarify points where necessary, and to reduce duplication. It also includes adding consistency, as follows:

- ▶ between industries – such as consistency in the consumer protections provided in each industry (for example, adopting the same approach to customer enquiries, complaints, and the resolution of disputes across all small-scale networks), and
- ▶ within industries – such as consistency across licences within an industry (for example, ensuring off-grid electricity licences contain the same core customer obligations, in both form and wording, where practicable).

Changes would occur only after consultation with stakeholders, and would be based on assessing available evidence.

While there are potential benefits of harmonisation, the extent to which it would result in a net benefit for the community needs to be clearly identified prior to implementation. In particular, harmonisation should only materially change the substance of the customer protections that already exist, if there is a demonstrable clear net benefit in doing so.

### 5.2 Why the Commission will not undertake a separate harmonisation project

Based on the submissions received and the meetings undertaken with stakeholders, the Commission considers that, while the principle of harmonisation appears to have general support, stakeholder commitment to undertaking a fully encompassing harmonisation project is unclear. While stakeholders who commented on harmonisation supported a general effort to reduce reporting overlap between regulators, only two submissions provided examples of potential changes in support of undertaking the harmonisation project.



SACOSS submitted that:<sup>100</sup>

- ▶ there should be increased consumer protections and additional reporting requirements introduced for off-grid energy networks supplying customers in remote communities, including hardship provisions, obligations to offer Centrepay, protection from disconnection if receiving concessions or grants, and protection from disconnection if on a hardship program, and
- ▶ additional performance indicators should cover the number of customers in debt, the number of customers on payment plans, and the number of customers receiving concessions and using Centrepay.

The only other issue identified was from Origin Energy. It submitted that a number of licence conditions requiring sharing of information and communication protocols between the distributor and retailer are redundant since, in practice, Origin Energy is both the distributor and retailer.<sup>101</sup>

The Commission understands the SACOSS submission to be focused on achieving a greater level of customer protections for remote electricity users, rather than the concept of harmonisation. To the extent that the SACOSS proposals are applicable within the legislative framework that the Commission has to operate, those concerns could be addressed through the Commission closely monitoring policy changes (section 3.5), and publishing reports on trends and issues (section 3.5.5), as well as by the Commission's forthcoming review of the Pre-payment Meter System Code. This is because the impact of pre-payment metering and its implications for remote community usage, where there are affordability issues, appears to be of particular concern for SACOSS.

With respect to Origin Energy's comments, the Commission notes that, although Origin Energy operates at both the distribution and retail level, this may not be the case for all licensees, now or in the future. While the Commission acknowledges this may be a frustration to multiple licensees such as Origin Energy, this need not suggest the overarching licensing framework should be amended.

Noting those matters, the Commission will not pursue harmonisation as a single, separate project. Rather, harmonisation efforts will occur as part of the Commission's regular review cycle for codes and guidelines, and as material evidence-based issues are identified in practice (as currently occurs).

#### Harmonisation – Decision 8

- ▶ The Commission has decided that it will not pursue harmonisation as a single, separate project. Rather, harmonisation efforts will occur as part of the Commission's regular reviews of codes and guidelines, and as material evidence-based issues are identified.

<sup>100</sup> SACOSS, *Submission to ESCOSA's Draft Inquiry Report into the Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020.

<sup>101</sup> Origin Energy, *submission to Inquiry into Regulatory Arrangements for Small-Scale Water, Sewerage and Energy Services*, September 2020, p.3.

## 6 How the revised framework meets the outcome sought from the Inquiry

The outcome sought from this Inquiry was to identify a regulatory framework covering the relevant services, which meets the terms of reference by:

- ▶ providing for a price-service-quality offering that meets the specific needs of customers of small-scale networks, subject to legislative requirements
- ▶ ensuring incentives and accountability are with the right people
- ▶ minimising the regulatory cost by ensuring regulation is effective, targeted, fit-for-purpose and capable of responding to external influences, and
- ▶ creating consistency across regulatory instruments, where applicable.

The Commission is of the view that implementing the VTA approach, coupled with an enhanced role for EWOSA, meets that outcome, while maintaining consumer protections, as summarised in Table 4.

Table 4: How the proposed framework meets the outcome sought from the Inquiry

Outcome component	Reason
Providing for a price-service-quality offering that meets the specific needs of customers of small-scale networks, subject to legislative requirements.	This requires effective and ongoing communication between licensees and customers, which is a core aspect of competent operation, and an integral aspect of implementing the VTA approach.
Ensuring incentives and accountability are with the right people.	The VTA approach aligns both compliance and performance risks more directly with a licensee's behaviour. The licensee is accountable for its actions and bears the risks associated with its behaviour, through the Commission assigning licensees to Category A or B when applying the VTA approach.
Minimising the regulatory cost by ensuring regulation is effective, targeted, fit-for-purpose and capable of responding to external influences.	<p>The VTA approach provides for a reduction in annual reporting requirements for Category A licensees, and seeks to reduce regulatory oversight, and any associated costs.</p> <p>The VTA approach is also flexible, fit-for-purpose and targeted, because it allows the Commission to increase or decrease certain aspects of regulation as needed, based upon the behaviour and actions of the specific licensee.</p> <p>As external influences change, the Commission can assess any licensee's response to this, and the extent to which this meets the requirements for Category A classification. This applies equally to changing technological, operational, environmental, or other factors, which have an impact on the delivery of water and sewerage retail services, and the sale and/or supply of electricity and LPG services to South Australians via small-scale networks.</p> <p>While mandating EWOSA membership results in additional membership fees, the Commission considers this is outweighed by the benefits of this proposal.</p>
Creating consistency across regulatory instruments where applicable.	<p>Membership of EWOSA for all licensees will provide a consistent complaint and dispute resolution process for all customers.</p> <p>Any material evidence-based harmonisation issue identified will provide an opportunity to harmonise regulatory instruments.</p>

## 7 Next steps

Implementation of the VTA approach will occur in a staged manner, with multiple opportunities for stakeholder engagement and collaboration, so as to facilitate a common understanding of the approach between stakeholders and the Commission.

From the release of this Report until 30 June 2022, the Commission will work with service providers to:

- ▶ develop a data baseline, drawn from market intelligence and existing performance data for each service provider
- ▶ develop an understanding of what is likely to be material in the context of performance outcomes over time, given the operational context of each service provider
- ▶ make changes to reporting guidelines and vary licence conditions where necessary
- ▶ make an assessment of which service providers will be 'trusted' (that is, that the Commission considers are likely running a competent operation) from the operational commencement of the approach on 1 July 2022, and
- ▶ identify what performance information should be published by service providers, and by the Commission, and how that is best done.

From 1 July 2022, the approach will be applied in practice to licensees, with those identified as running competent operations (or otherwise) identified. The new reporting arrangements will apply for data for the 2021-22 reporting period.

Energy and Water Ombudsman SA scheme membership will be required for all service providers from 1 July 2021.

## Appendix 1 – Terms of Reference

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

Pursuant to Part 7 of the *Essential Services Commission Act 2002*

#### 1. BACKGROUND

- 1.1. Pursuant to section 34 of the Essential Services Commission Act 2002 (**Act**), the Essential Services Commission (**Commission**) may, following consultation with the Treasurer, conduct an Inquiry if it considers an Inquiry is necessary or desirable for the purpose of carrying out its functions.
- 1.2. The Commission has statutory licensing and related regulatory powers and functions in relation to the water, sewerage, electricity and gas industries in South Australia.
- 1.3. The Commission is aware of recent and emerging technological, operational, environmental and other, similar, developments which will have impacts on each of the water, sewerage, electricity and gas industries and, as a result, for South Australians and the State economy generally.
- 1.4. Further, in relation to the water and sewerage industries, the current regulatory determination which applies to small-scale water and sewerage retailers serving 50,000 connections or less is due to expire on 30 June 2017.
- 1.5. In order to meet its primary statutory objective of protecting South Australian consumers' long-term interests with respect to the price, quality and reliability of essential services, it is appropriate for the Commission to consider the above matters in the context of its regulatory powers and functions.
- 1.6. Having regard to these matters, the Commission has formed the view that an Inquiry into the way in which it regulates small-scale utility operations is necessary and desirable at this time to ensure that the regulatory frameworks it applies under industry regulation Acts is consistent with its primary statutory objective, and is proportionate and responsive to recent and emerging issues.

#### 2. TERMS OF REFERENCE

- 2.1. Following consultation with the Treasurer, the following are the Terms of Reference for the Inquiry:
  - 2.1.1. The Commission will inquire into appropriate regulatory arrangements administered by the Commission under the Act (including subsidiary regulatory instruments made by the Commission such as industry codes) and price regulation arrangements for small-scale operations for the purposes of carrying out its functions in the following markets:
    - 2.1.1.1. water retail services
    - 2.1.1.2. sewerage retail services
    - 2.1.1.3. the sale and/or supply of electricity outside of the national electricity market, and
    - 2.1.1.4. the sale and/or supply of reticulated liquid petroleum gas.
  - 2.1.2. In undertaking the Inquiry, the Commission will:
    - 2.1.2.1. Analyse consumer protection issues associated with the delivery of small-scale water, sewerage and energy services, with a view to ensuring that any regulatory arrangements it administers are targeted, efficient and appropriate.
    - 2.1.2.2. Identify an appropriate regulatory framework that:

- 2.1.2.2.1. has relevance for customers and for licensees and exempted entities currently providing small-scale water, sewerage and energy services, and
- 2.1.2.2.2. will be relevant in the context of new participants, business models and/or technologies which could deliver more effective and innovative outcomes for customers in the future.

2.1.2.3. Have regard to other relevant contextual matters.

- 2.1.3. The Commission may address such other matters as it thinks fit, consistent with the powers provided to the Commission by the relevant industry regulation Acts, for the licensing, pricing, quality and reliability of services associated with the delivery of small-scale water, sewerage and energy services.

### 3. REQUIREMENTS FOR THE INQUIRY

- 3.1. Consultation with stakeholders will be undertaken in accordance with the Commission's Charter of Consultation and Regulatory Practice. This will include a:
  - 3.1.1. call for submissions to an Issues Paper in August 2016, and
  - 3.1.2. call for further submissions to a Draft Report in January 2017.
- 3.2. The Commission will complete this Inquiry by publishing a Final Report by the end of June 2017.
- 3.3. In accordance with section 38 of the Act, the Final Report will also be:
  - 3.3.1. provided to the Treasurer, and
  - 3.3.2. laid before both Houses of Parliament, within 12 sitting days of receipt by the Treasurer.

Brett Rowse

Chairperson

## Appendix 2 – 2020-21 EWOSA fees

Table 5: EWOSA joining and annual fees based on customer numbers 2020-21<sup>102 103</sup>

Number of customers	Joining fee (ex GST)	Fixed annual fee (ex GST)	Number of licensees <sup>104</sup>	\$ increase per customer (average) Annual fee only <sup>105</sup>
Up to 10	\$50	\$50	10	\$8.33 to \$50 (\$13.16) <sup>106</sup>
11 to 20	\$100	\$100	2	\$5.56 to \$5.88 (\$5.71)
21 to 500	\$200	\$200	27	\$0.41 to \$9.52 (\$0.94)
501 to 5,000	\$500	\$500	40	\$0.11 to \$0.80 (\$0.25)
5,001 to 20,000 <sup>107</sup>	\$4,000	\$1,000	4	\$0.08 to \$0.15 (\$0.11)

Table 6: EWOSA case handling fees 2020-21

Case level	Fee (ex GST) <sup>108</sup>
Enquiries	\$40 per case
Refer to Customer Service (RCS)	\$40 per case
Refer to Higher Level (RHL)	\$125 per case
Explanation of Resolution	\$120 per case
Consultation	\$140 per case
Conciliation	\$250 plus \$1.00 per minute
Level 1 Investigation	\$950 plus \$1.30 per minute
Level 2 Investigation	\$1,050 plus \$1.90 per minute
Level 3 Investigation	\$1,150 plus \$2.20 per minute
Determination	\$5,000 plus \$3.00 per minute
No Contact Charge	\$100 per instance

<sup>102</sup> Where the member has no recorded complaints during the 12 months prior to setting the budget no 'fixed fee based on time on system' is charged.

<sup>103</sup> Ranges are calculated by dividing the annual fee by the number of customers in the licensee with the most customers for that category (column 1), and the licensee with the least customers. The average is the total of annual fees for that category divided by the total number of customers in the category.

<sup>104</sup> Number of licensees based on 2018-19 annual reports.

<sup>105</sup> Using 2018-19 licensee numbers.

<sup>106</sup> The low number of customers in this category results in bill impacts which are relatively high compared to licensees with more customers.

<sup>107</sup> There are no licensees with more than this number of customers.

<sup>108</sup> Minutes are as recorded in the complaint management system. Cases involving multiple addresses/meters relating to a single core issue will be charged as a single case plus the minutes spent on the case.

## Appendix 3 – Application of the VTA approach

This appendix outlines an example of how the VTA approach is to be applied. It is a hypothetical case study, and should not be taken as a blueprint for applying the VTA approach, given that each licensee is different, and Commission responses may therefore be tailored. It should also be noted that all data is hypothetical.

The example starts from the initial assessment of whether a licensee will be defined as a Category A or B licensee. The main objectives of this appendix are to explain in a practical context:

- ▶ How the system functions with lower annual reporting requirements.
- ▶ That the system is a dynamic interactive process between the licensee and the Commission.
- ▶ That the outcome for an individual licensee depends on maintaining competent operation.
- ▶ Competent operation accounts for issues that arise and focuses on the licensee's response.

It is split into the following steps:

- ▶ **Step 1:** Initial implementation: Setting the initial baseline and licensee categorisation.
- ▶ **Steps 2 to 4:** Subsequent application: Applying the VTA approach for three years thereafter.

### Step 1: Initial implementation

#### Setting the initial baseline

Licensee X owns and operates a CWMS that is licensed by the Commission, and subject to the Price Determination applying to Minor and Intermediate Water Retailers, consumer protections under the code, and compliance/monitoring requirements under each. Over a number of years, the Commission has obtained the following information from Licensee X (Table 7).

Table 7: Information provided to the Commission by Licensee X<sup>109</sup>

Category <sup>110</sup>	Description
<b>Financial data (FR1.1):</b> <ul style="list-style-type: none"> <li>• All services</li> <li>• Regulated services</li> </ul>	<p>This provides aggregate financial data of all services offered by the licensee, and those just for regulated services, by the following categories:</p> <p><i>Income</i></p> <ul style="list-style-type: none"> <li>• Rates</li> <li>• Statutory charges</li> <li>• User charges</li> <li>• Grants, subsidies, contributions</li> <li>• Investment income</li> <li>• Reimbursements</li> <li>• Other income</li> </ul>

<sup>109</sup> Note that, in addition to the reporting requirements presented in this table, OP2.1 requires the licensee to report the number of Legal Actions Undertaken for Non-Payment of CWMS services.

<sup>110</sup> Includes reference (e.g., FR1.1) to corresponding section of the annual return proforma - Commission, *Water Regulatory Information Requirements for Minor and Intermediate Retailers*, Water Industry No.3 (WG3/04), July 2015, available at <https://www.escosa.sa.gov.au/ArticleDocuments/398/20150727-Water-InformationRequirementsGuidelineNo3-MinorInte.pdf.aspx?Embed=Y>.

Category <sup>110</sup>	Description
	<ul style="list-style-type: none"> <li>Net gain: joint ventures and associates</li> </ul> <p><i>Expenses</i></p> <ul style="list-style-type: none"> <li>Employee costs</li> <li>Materials, contracts and other services</li> <li>Depreciation</li> <li>Finance costs</li> <li>Net loss: joint ventures and associates</li> </ul> <p>Asset contributions and disposal</p> <ul style="list-style-type: none"> <li>Asset disposal and fair value adjustments</li> <li>Amounts received for new/upgraded assets</li> <li>Physical resources received free of charge</li> <li>Operating results from discontinued operations</li> </ul> <p>In the case of Licensee X, the only regulated service is the CWMS service.</p>
<p><b>Financial data (FR 1.2):</b></p> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides a breakdown of the CWMS financial data, by the following categories:</p> <p><i>Operating income</i></p> <ul style="list-style-type: none"> <li>Residential from usage charges</li> <li>Residential from other charges</li> <li>Non-residential from usage charges</li> <li>Non-residential from other charges</li> <li>Other operating income</li> </ul> <p><i>Capital income</i></p> <ul style="list-style-type: none"> <li>Government contributions (for new/upgraded assets)</li> <li>Customer contributions (for new/upgraded assets)</li> <li>Government contributions (physical resources received at no charge)</li> <li>Customer contributions (physical resources received no charge)</li> </ul> <p><i>Operating costs</i></p> <ul style="list-style-type: none"> <li>Operations and maintenance</li> <li>Bulk charges</li> <li>Treatment</li> <li>Customer service and billing</li> <li>Licence fees</li> <li>Corporate overheads</li> <li>Depreciation</li> <li>Other operating expenditure</li> </ul>
<p><b>Pricing data (PM1.1)</b></p> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on the CWMS pricing structure. This is the type of charges, such as fixed and variable charges, and the pricing levels associated with each charge.</p>



Category <sup>110</sup>	Description
<b>Asset value data (FR2.1 and FR2.2)</b> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on the evolution of the asset values of the CWMS infrastructure, by the following categories:</p> <ul style="list-style-type: none"> <li>Assets – at fair value</li> <li>Capital expenditure – at cost: storage</li> <li>Capital expenditure – at cost: pipes/network</li> <li>Capital expenditure – at cost: treatment</li> <li>Capital expenditure – at cost: corporate</li> <li>Capital expenditure – at cost: other</li> <li>Accumulated depreciation</li> <li>Yearly depreciation charge</li> <li>Disposals</li> <li>Transfers</li> <li>Net revaluations</li> </ul>
<b>Asset structure (OP4.1c)</b> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on the length of mains of the CWMS.</p>
<b>Asset reliability (OP3.2)</b> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on asset reliability for the following categories:</p> <ul style="list-style-type: none"> <li>Total number of planned interruptions</li> <li>Total number of unplanned interruptions</li> <li>Number of customers with 3 or more unplanned full loss events per year</li> <li>Total duration of unplanned sewerage interruptions (minutes)</li> <li>Total number of sewerage mains breaks and chokes</li> <li>Total number of sewerage service outage events</li> <li>Total number of inside building overflow events</li> <li>Total number of outside building (on customer's property) overflow events</li> <li>Total number of external overflow events</li> </ul>
<b>Connections (OP4.1d)</b> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on the total number of CWMS connections.</p>
<b>Customers (OP4.1a)</b> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on CWMS customer numbers for the following categories:</p> <ul style="list-style-type: none"> <li>Residential customers</li> <li>Non-residential customers</li> </ul>
<b>Customer complaints (OP1.1)</b> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on the total number of CWMS complaints.</p>
<b>Financial support (OP2.2)</b> <ul style="list-style-type: none"> <li>CWMS</li> </ul>	<p>This provides data on CWMS customers for the following categories:</p> <p><i>Financial hardship program</i></p> <ul style="list-style-type: none"> <li>Residential customers in a hardship program at 30 June</li> <li>Residential customers who entered the program in the financial year</li> </ul>

Category <sup>110</sup>	Description
	<ul style="list-style-type: none"> <li>Residential customers who exited the program in the financial year</li> </ul> <p><i>Flexible payment arrangements</i></p> <ul style="list-style-type: none"> <li>Residential customers on flexible payment arrangements at 30 June</li> <li>Non-residential customers on flexible payments arrangements at 30 June</li> </ul> <p><i>Concessions</i></p> <ul style="list-style-type: none"> <li>Residential customer receiving a sewerage concession at 30 June</li> </ul>

Based on the information provided, and the Commission undertaking a process of clarifying any omissions or anomalies with Licensee X, the following table summarises the baseline position of Licensee X for its CWMS operation, prior to the implementation of the VTA approach (Table 8).

Table 8: Baseline position for Licensee X

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
CWMS: Income statement (\$m)						
Revenue	1.00	1.00	1.00			
Operating costs (excluding financing costs)	0.25	0.30	0.36			
PBITDA	0.75	0.70	0.64			
Depreciation	0.70	0.72	0.73			
PBIT	0.05	-0.02	-0.09			
Financing costs	0.44	0.46	0.48			
PBT	-0.39	-0.48	-0.57			
Tax	0.00	0.00	0.00			
Retained earnings	-0.39	-0.48	-0.57			
CWMS: asset value (\$m)						
Starting asset value	35.00	34.30	34.58			
Capital expenditure	0.00	1.00	0.50			
Depreciation	0.70	0.72	0.73			
Closing asset value	34.30	34.58	34.35			

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
CWMS: asset structure and performance						
Length of mains (km)	50.00	50.00	50.00			
Number of planned interruptions	5	5	5			
Number of unplanned interruptions	2	4	8			
Number of sewage mains breaks and chokes	10	15	20			
Number of inside building overflow events	0	0	0			
Number of external overflow events	1	2	2			
CWMS: connections and customers						
Number of connections <sup>111</sup>	2,005	2,005	2,005			
Number of residential customers	1,995	1,995	1,995			
Number of non-residential customers	5	5	5			
CWMS: pricing (\$)						
Charge per residential customer per year	500	500	500			
Charge per non-residential customer per year	1,000	1,000	1,000			
CWMS: customer complaints						
Number of customer complaints - ESCOSA	20	22	10			
Number of customer complaints - EWOSA						
CWMS: residential customers on a financial hardship program						
At financial year start (1 July)	0	0	1			
Entering program in the year	0	1	0			
Exiting program in the year	0	0	1			
At financial year end (30 June)	0	1	0			
CWMS: customers on flexible payments arrangements						

<sup>111</sup> Note that the number of connections (physical – parcel of land) need not equal the number of customers (billing).

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
Residential customers at 30 June	0	0	0			
Non-residential customers at 30 June	0	0	0			
<i>CWMS: residential customers receiving a concession</i>						
Residential customers at 30 June	0	0	0			

### Setting licensee categorisation

From this baseline, the following is apparent regarding Licensee X's CWMS:

- ▶ It is not generating sufficient revenue to cover its costs and this is worsening.<sup>112</sup>
- ▶ Asset reliability appears to be declining. The number of unplanned interruptions has quadrupled in the space of three years, with the number of mains breaks and chokes doubling.
- ▶ Operating costs have risen by 20 percent per year over the same period. Licensee X has indicated this is driven by increasing maintenance costs associated with asset reliability issues.
- ▶ Cumulative depreciation over the last three years is greater than cumulative capital expenditure, placing the asset stock at risk of accelerated deterioration.

Despite Licensee X's overall compliance record regarding other aspects of its CWMS service being strong, the above suggests that it is placing the long term sustainability of the CWMS service to its customers at risk. This does not accord with the Commission's primary statutory objective, nor the underlying principles of competent operation. A preliminary view was formed that Licensee X should be considered a Category B Licensee, and subject to the existing full suite of reporting and compliance requirements, unless it could provide reasons as to why it should be classified as Category A.

Licensee X was provided with the opportunity to respond prior to the practical implementation of the VTA approach (on 1 July 2022). In its response, Licensee X agreed that the existing CWMS required investment. It also noted there was a need to expand the CWMS in the near future. Licensee X stated that investment focused on system sustainability would take place alongside that required to expand the system. This was because the alignment of the two projects reduced the overall cost. The business plan underpinning this approach was provided to the Commission. This outlined Licensee X's CWMS network plans and stakeholder engagement strategy, given the acknowledged need to significantly increase pricing.

On the basis of this business plan, Licensee X was classified as a Category A Licensee, and subject to the reduced reporting associated with that classification. However, the Commission noted that there was a need to monitor developments, and the potential need to undertake an audit, depending on how Licensee X's first year under the VTA approach developed.

<sup>112</sup> This assumes Licensee X's cost base is efficient.

## Step 2 to 4: Applying the VTA approach for three years

### First year of implementing the VTA approach

At the end of the first year of the VTA approach, Licensee X provided its annual return to the Commission. The annual return indicated that there had been no material changes relative to the previous year, and that the figures for the previous year provided a fair reflection of the business. However, this did not accord with the market intelligence that the Commission had built up throughout the year, nor the underlying trends within Licensee X's baseline data for the three years prior to implementing the VTA approach, as discussed in the following two sections.

#### Market intelligence

Throughout the year, as per the requirements of a Category A licensee, Licensee X had kept the Commission informed of service outages. There had been a significant number of these. The information provided suggested that both the number of unplanned outages, as well as the number of mains breaks and chokes, was materially higher than the previous year.

The Commission was also aware that Licensee X had implemented price increases of 40 percent and 15 percent, for residential and non-residential customers respectively. This information was gained via customer complaints received directly by the Commission, local news articles, as well as Licensee X's own website. EWOSA also informed the Commission it had received 50 customer complaints regarding Licensee X over the year. These primarily related to pricing, and interruptions to service. A further characteristic of the market intelligence obtained by the Commission was that Licensee X appeared to implement the pricing changes without undertaking any substantive customer engagement, despite previously acknowledging the need to do so.

#### Baseline data (see Table 8 above)

The Commission also noted that, based on Licensee X's baseline data for the three years prior to the VTA approach, the implemented price increases would result in an approximate 40 percent rise in revenue relative to the previous year, if customer numbers were unchanged. Further, such a price increase might potentially impact some customer's ability to pay.

The Commission also noted that, over the three previous years, CWMS operating cost growth was 20 percent per year, with Licensee X attributing this to increasing maintenance costs associated with asset reliability issues. However, it was not clear how such cost growth would cease without capital investment within the network. Licensee X had not reported any material uplift in capital investment, despite previously informing the Commission of its intent to invest in the network.

The Commission communicated all the above concerns to Licensee X, requesting it explain why its annual return indicated there had been no material changes to its operations, when the evidence available to the Commission and Licensee X suggested that this was not the case. The Commission also informed Licensee X that it was considering the need to audit Licensee X's CWMS operations, to ensure that Category A status remained warranted.

In response, Licensee X reviewed and subsequently revised its annual return submission to include the following:

In terms of costs and revenues:

- ▶ CWMS revenue increased in line with the price rises noted.
- ▶ CWMS operating costs grew by approximately 20 percent in the year.

In terms of asset infrastructure:

- Unplanned interruptions were 150 percent higher than the previous year.
- Sewerage mains breaks and chokes were also 150 percent higher than the previous year.
- External overflow events were 400 percent higher than the previous year.

Licensee X stated that over the coming two years its intention was to invest \$15 million to rectify known reliability issues with respect to the CWMS, and to expand the network by 10 kilometres. As a result, asset reliability should improve. The price increase was part of a process to align pricing with costs, to ensure service sustainability across the expanded system over the longer term. Licensee X also noted that, as more customers were connected to the CWMS via the expansion, costs would be spread over a larger customer base.

In terms of affordability, as a result of the pricing increase:

- Customers on a financial hardship program had risen to three from zero.
- Customers on flexible payment arrangements had risen to 10 from zero.

Licensee X noted that, over the coming two years, it anticipated the need for further price increases, and there was a risk that more customers would face affordability problems. As such, it was actively considering its policy options to manage this. Licensee X also suggested it meet with the Commission to outline its subsequent customer engagement plan, noting that its approach to the initial price rise put through needed refining.

Overall, the Commission was concerned with the level of discrepancy in the subsequent reporting, relative to Licensee X's original annual return. Licensee X was requested to explain why this had occurred, given the possibility that the original information provided was wilfully and intentionally misleading. If so, this would likely result in enforcement measures, as well as reclassification to Category B. In this instance, the Commission was satisfied that the discrepancies were not wilful or intentional.<sup>113</sup>

Based on the above information and subsequent discussions with Licensee X, its baseline information was updated as per the table below (Table 9). Licensee X remained a Category A licensee, but the Commission conveyed the need for it to support its plans with substantive action if it were to remain so, and to improve its quality of reporting and engagement with its customers and the Commission.

Table 9: Roll-over of Licensee X's baseline for the first year of implementing the VTA approach

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
<i>CWMS: Income statement (\$m)</i>						
Revenue	1.00	1.00	1.00	1.40		
Operating costs (excluding financing costs)	0.25	0.30	0.36	0.43		
PBITDA	0.75	0.70	0.64	0.97		

<sup>113</sup> If the discrepancies had been found to be wilful and intentional then the Commission would have applied its enforcement policy – see Commission, *Enforcement Policy*, version 2.5, September 2013, available at [https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy\\_V2-5.pdf.aspx?Embed=Y](https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy_V2-5.pdf.aspx?Embed=Y). The enforcement policy sets out the enforcement criteria the Commission uses to determine whether or not to impose any enforcement measure and the nature of that measure. This enforcement criteria is replicated as Appendix 4.

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
Depreciation	0.70	0.72	0.73	0.74		
PBIT	0.05	-0.02	-0.09	0.23		
Financing costs	0.44	0.46	0.48	0.50		
PBT	-0.39	-0.48	-0.57	-0.27		
Tax	0.00	0.00	0.00	0.00		
Retained earnings	-0.39	-0.48	-0.57	-0.27		
CWMS: asset value (\$m)						
Starting asset value	35.00	34.30	34.58	34.35		
Capital expenditure	0.00	1.00	0.50	0.50		
Depreciation	0.70	0.72	0.73	0.74		
Closing asset value	34.30	34.58	34.35	34.11		
CWMS: asset structure and performance						
Length of mains (km)	50.00	50.00	50.00	50.00		
Number of planned interruptions	5	5	5	5		
Number of unplanned interruptions	2	4	8	20		
Number of sewage mains breaks and chokes	10	15	20	50		
Number of inside building overflow events	0	0	0	0		
Number of external overflow events	1	2	2	10		
CWMS: connections and customers						
Number of connections	2,005	2,005	2,005	2,005		
Number of residential customers	1,995	1,995	1,995	1,995		
Number of non-residential customers	5	5	5	5		
CWMS: pricing (\$)						
Charge per residential customer per year	500	500	500	700		
Charge per non-residential customer per year	1,000	1,000	1,000	1,150		
CWMS: customer complaints						
Number of customer complaints - ESCOSA	20	22	10	10		
Number of customer complaints - EWOSA				50		

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
CWMS: residential customers on a financial hardship program						
At financial year start (1 July)	0	0	1	0		
Entering program in the year	0	1	0	3		
Exiting program in the year	0	0	1	0		
At financial year end (30 June)	0	1	0	3		
CWMS: customers on flexible payments arrangements						
Residential customers at 30 June	0	0	0	10		
Non-residential customers at 30 June	0	0	0	0		
CWMS: residential customers receiving a concession						
Residential customers at 30 June	0	0	0	0		

## Second and third year of implementing the VTA approach

Throughout the second and third year, Licensee X remains a Category A licensee, and there are no further issues. It undertakes the \$15 million capital expenditure, continues to increase prices in order to achieve longer term service sustainability, and adopts a more comprehensive transparent program of customer engagement. Gradually, infrastructure reliability starts to improve, and complaints decline. The Commission is aware of this via regular dialogue with Licensee X, its annual return, information from EWOSA, and other market intelligence, such as the media.

However, Licensee X reports that there continues to be a material rise in the number of customers experiencing affordability problems because of the successive price increases – while also noting that, relative to the overall size of the customer base, affordability problems remain low. In order to manage this, Licensee X proposes to develop a subsidy mechanism targeted at providing identified customers with lower, more affordable, bills. Licensee X notes that this approach aligns with the NWI Pricing Principles, and the Minor and Intermediate Retailers price control.<sup>114</sup>

By the end of the first three years of implementing the VTA approach, Licensee X's baseline has evolved as follows (Table 10). Positive outcomes include a small profit being achieved by year 6, along with a downward trend in unplanned interruptions, breaks and chokes and customer complaints.

<sup>114</sup> As noted in section 2.2.2.1 of this Report, small-scale water and sewerage licensees are subject to a Commission determination made pursuant to the price determination powers under Part 3 of the ESC Act, as authorised by Part 4, Division 3 of the *Water Industry Act 2012*. Licensees are responsible to set prices consistent with the NWI Pricing Principles. Clause 66(v)(c) of the Intergovernmental Agreement on a National Water Initiative states that: *where full cost recovery is unlikely to be achieved in the long term and a Community Service Obligation (CSO) is deemed necessary, the size of the subsidy is to be reported publicly and, where practicable, jurisdictions to consider alternative management arrangements aimed at removing the need for an ongoing CSO*. A copy of this IGA is available at: <https://www.agriculture.gov.au/sites/default/files/sitecollectiondocuments/water/Intergovernmental-Agreement-on-a-national-water-initiative.pdf>.



Table 10: Roll-over of Licensee X's baseline after VTA implementation for three years

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
<i>CWMS: Income statement (\$m)</i>						
Revenue	1.00	1.00	1.00	1.40	1.82	2.13
Operating costs (excluding financing costs)	0.25	0.30	0.36	0.43	0.41	0.35
<i>PBITDA</i>	<i>0.75</i>	<i>0.70</i>	<i>0.64</i>	<i>0.97</i>	<i>1.40</i>	<i>1.78</i>
Depreciation	0.70	0.72	0.73	0.74	0.94	1.04
<i>PBIT</i>	<i>0.05</i>	<i>-0.02</i>	<i>-0.09</i>	<i>0.23</i>	<i>0.46</i>	<i>0.74</i>
Financing costs	0.44	0.46	0.48	0.50	0.65	0.74
<i>PBT</i>	<i>-0.39</i>	<i>-0.48</i>	<i>-0.57</i>	<i>-0.27</i>	<i>-0.18</i>	<i>0.01</i>
Tax	0.00	0.00	0.00	0.00	0.00	0.00
<b>Retained earnings</b>	<b>-0.39</b>	<b>-0.48</b>	<b>-0.57</b>	<b>-0.27</b>	<b>-0.18</b>	<b>0.01</b>
<i>CWMS: asset value (\$m)</i>						
Starting asset value	35.00	34.30	34.58	34.35	34.11	43.17
Capital expenditure	0.00	1.00	0.50	0.50	10.00	5.00
Depreciation	0.70	0.72	0.73	0.74	0.94	1.04
Closing asset value	34.30	34.58	34.35	34.11	43.17	47.13
<i>CWMS: asset structure and performance</i>						
Length of mains (km)	50.00	50.00	50.00	50.00	60.00	60.00
Number of planned interruptions	5	5	5	5	5	5
Number of unplanned interruptions	2	4	8	20	4	2
Number of sewage mains breaks and chokes	10	15	20	50	10	5
Number of inside building overflow events	0	0	0	0	0	0
Number of external overflow events	1	2	2	10	1	0
<i>CWMS: connections and customers</i>						
Number of connections	2,005	2,005	2,005	2,005	2,045	2,045
Number of residential customers	1,995	1,995	1,995	1,995	2,010	2,025
Number of non-residential customers	5	5	5	5	5	5
<i>CWMS: pricing (\$)</i>						

	Yr1	Yr2	Yr3	Yr4	Yr5	Yr6
	Pre VTA	Pre VTA	Pre VTA	Post VTA	Post VTA	Post VTA
Charge per residential customer per year	500	500	500	700	900	1,050
Charge per non-residential customer per year	1,000	1,000	1,000	1,150	1,250	1,300
<i>CWMS: customer complaints</i>						
Number of customer complaints - ESCOSA	20	22	10	10	10	0
Number of customer complaints - EWOSA				50	30	10
<i>CWMS: residential customers on a financial hardship program</i>						
At financial year start (1 July)	0	0	1	0	3	6
Entering program in the year	0	1	0	3	3	6
Exiting program in the year	0	0	1	0	0	2
At financial year end (30 June)	0	1	0	3	6	10
<i>CWMS: customers on flexible payments arrangements</i>						
Residential customers at 30 June	0	0	0	10	20	30
Non-residential customers at 30 June	0	0	0	0	0	0
<i>CWMS: residential customers receiving a concession</i>						
Residential customers at 30 June	0	0	0	0	0	0

Going forward, the Commission will continue to monitor Licensee X in accordance with the ongoing verification processes outlined in section 3.4.3, and as employed in this example. These processes will confirm (or otherwise) that Licensee X can maintain its trusted status.

## Appendix 4 – Commission’s enforcement criteria

The Commission’s enforcement policy sets out the enforcement criteria the Commission uses to determine whether or not to impose any enforcement measure and the nature of that measure.<sup>115</sup> This enforcement criteria is replicated below.

### 5. ENFORCEMENT CRITERIA

#### 5.1 *Matters for Consideration*

Enforcement decisions must be made fairly, consistently and properly. The following factors will be considered by the **Commission** in determining whether or not to impose any enforcement measure and the nature of that measure. (The relevance of and weight to be accorded to each matter (or any other factors) will depend upon the particular circumstances of each case). The order of the following matters does not indicate a priority of one over another:

- ▲ whether the offence is a trivial infringement;
- ▲ whether there was a deliberate decision to infringe an obligation;
- ▲ whether there is a history of non-compliance (or compliance) with the South Australian regulatory regime;
- ▲ whether the public could realistically expect some punitive action to be imposed as a result of the breach;
- ▲ whether the offence is remedied quickly or there is a demonstrated willingness to remedy the non-compliance;
- ▲ whether there was a failure to put reasonable measures in place to avoid a contravention;
- ▲ whether there is an appropriate compliance program in place;
- ▲ whether the offence was inadvertent or accidental;
- ▲ whether a prosecution would be likely to create an incentive for compliance and deter future breaches;
- ▲ whether the offence was beyond the person’s control, i.e. as a consequence of a force majeure event or incident;
- ▲ any gain (financial or otherwise) made as a result of the contravention;
- ▲ the degree of harm (actual or potential) in the event of continuing non-compliance (including financial loss to consumers);
- ▲ whether the person promptly and voluntarily disclosed the offence and co-operated with the investigation of the offence by the Commission;
- ▲ the estimated length, complexity and expense involved in an investigation and prosecution; and
- ▲ the factors set out in section 6 of the **ESC Act**.

<sup>115</sup> Commission, *Enforcement Policy*, version 2.5, September 2013, available at [https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy\\_V2-5.pdf.aspx?Embed=Y](https://www.escosa.sa.gov.au/ArticleDocuments/580/130905-EnforcementPolicy_V2-5.pdf.aspx?Embed=Y)



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