



Small-scale Networks Inquiry

Framework and Approach

June 2019

Request for submissions

The Essential Services Commission (**Commission**) invites written submissions on this paper. Written comments should be provided by **Friday, 9 August 2019**.

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

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

Responses to this paper should be directed to: **Small-scale networks inquiry**

It is preferred that submissions are sent electronically to: escosa@escosa.sa.gov.au

Alternatively, submissions can be sent to:

Essential Services Commission
GPO Box 2605
Adelaide SA 5001

Telephone: (08) 8463 4444
Freecall: 1800 633 592 (SA and mobiles only)
E-mail: escosa@escosa.sa.gov.au
Web: www.escosa.sa.gov.au

Contact officer: Sean McComish, Director Advisory and Research

Table of contents

Glossary of terms	ii
1 Overview	3
1.1 The functions and powers of the Commission	3
1.2 Small-scale networks.....	4
1.3 The Small-Scale Networks Inquiry	5
1.4 Purpose and structure of this report	6
1.5 Consultation	7
1.6 Next steps	7
2 Current Regime	9
2.1 Statutory framework.....	9
2.2 Application and outcomes.....	10
2.2.1 How regulation is currently applied.....	11
2.3 Is the Commission's regulatory regime effective?.....	14
2.3.1 Pricing issues.....	14
2.3.2 Service levels	15
2.3.3 Current understanding.....	17
3 Potential changes to regulation.....	19
3.1 Harmonisation	19
3.2 Prescriptiveness of approach	19
3.3 Potential options.....	20
4 Explaining the options	21
4.1 EWOSA and external dispute resolution	21
4.2 Option 1: other than EWOSA membership, do not change the current regulatory regime	22
4.3 Option 2: as per Option 1 but harmonise between and within industries	23
4.4 Option 3: trust-verify without modifying regulatory instruments.....	23
4.4.1 The trust-verify approach.....	23
4.5 Option 4: trust-verify and harmonisation between and within industries	26
5 Next steps	27
5.1 Timetable for this Inquiry	27
Appendix 1 – Terms of Reference.....	28
Appendix 2 – Regulation of small-scale networks.....	30
Appendix 3 – Dispute resolution framework.....	31

Glossary of terms

Commission	Essential Services Commission, established under the Essential Services Commission Act 2002
Competent operator	A service provider that provides essential services that customers value, that are sustainable, and provided at a price that accounts for customer's willingness to pay, legislative requirements and affordability (see Box 1)
CWMS	Community wastewater management system
DSD	Department of State Development, Energy Markets and Programs
ESC Act	Essential Services Commission Act 2002
EWOSA	Energy and Water Ombudsman (SA)
LGA	Local Government Association
LPG	Liquid petroleum gas
Minister	Minister responsible for relevant Act
NWI	National Water Initiative
SACOSS	South Australian Council of Social Service
SAFCA	South Australian Financial Counsellors Association
Small-scale networks	Comprising, South Australian: <ul style="list-style-type: none"> ▶ water and sewerage networks with 50,000 connections or less ▶ off-grid electricity, and ▶ reticulated LPG networks
This Inquiry	This small-scale networks inquiry
Treasurer	Treasurer of the South Australian Government
Trust-verify	Trust and verify approach to regulation (see Box 1)
WI Act	Water Industry Act 2012

1 Overview

The Small-Scale Networks Inquiry (**this Inquiry**) has been established to determine the most appropriate future regulatory framework, to be administered by the Commission, to cover the services South Australian customers receive from service providers of:

- ▶ water and/or sewerage networks with 50,000 connections or less
- ▶ off-grid electricity, and
- ▶ reticulated liquid petroleum gas (LPG) networks.

These activities are collectively referred to as **small-scale networks**.

The primary purpose of the Commission's small-scale network regulatory framework is to protect consumers' long-term interests with respect to the price, quality and reliability of essential services.

This Inquiry is important in the wider context of the changing ways in which essential services are delivered, community expectations about essential services and their interactions with network service providers, and the need to ensure that regulatory regimes (such as this framework) support business and economic development in South Australia.

This Inquiry is also important because the application of regulation to small-scale networks should fit the requirements of those networks; 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 with respect to their small-scale counterparts.

Given that context, the purpose of this Framework and Approach paper is to outline, for stakeholder consideration and comment, the approaches the Commission could adopt in determining the future framework for small-scale water and sewerage, off-grid electricity and reticulated LPG. Of note, this paper has been informed by submissions received in response to an earlier Issues Paper, released in 2016.¹

1.1 The functions and powers of the Commission

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. The corresponding industry regulation Acts² set out the underpinning statutory requirements for regulation of those industries. They provide a mix of mandatory matters (for example, service providers must be either licensed or exempted), discretionary matters (for example, the Commission may establish pricing regimes) and hybrid matters (for example, the Commission must make a binding consumer protection code but the content of that code is left to the Commission's discretion).

The Commission also develops compliance and reporting guidelines, which set out the frameworks it uses to monitor the performance of regulated entities against the obligations set out in the Acts, licences, price determinations and codes.

¹ See the Commission's Inquiry into regulatory arrangements for small-scale and off-grid water, gas and electricity services, available at <https://bit.ly/2JpPaU1>.

² Water Industry Act 2012, Electricity Act 1996, and Gas Act 1997.

While those powers and functions relate to all relevant activities across the State, the focus of this Inquiry is on their application to small-scale networks within those industries. The Commission currently regulates small-scale networks by requiring persons operating in those industries to:

- ▶ hold a licence and continue to satisfy the conditions of that licence related to governance, consumer protection, safety and technical matters
- ▶ provide their customers with various protections in their day-to-day operations, with service provider obligations set out in licence conditions and/or industry codes, and
- ▶ set their prices using a transparent process that allows them to recover the long-term efficient costs of providing those services (currently only exercised in the water and sewerage industry).

The outcomes arising from the application of the regulatory framework must be consistent with the industry Acts and meet the primary statutory objective set out in the ESC Act: the protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.³

In developing and administering the 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.

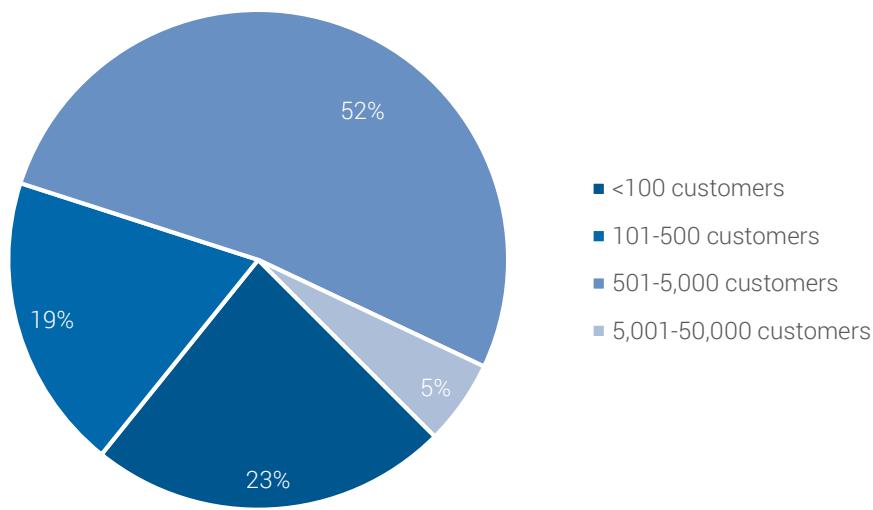
Small-scale network service providers are also covered by a number of regulatory schemes administered by other agencies, such as the Department of Health for water quality and the Environment Protection Authority for the environment (see Appendix 2 for more details). A detailed description of the current regulatory regime is provided in Chapter 2.

1.2 Small-scale networks

The Commission licenses 79 small-scale network service providers. The network service providers include councils, private service providers and community associations. 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 107,000 customers. Figure 1 illustrates the percentage of networks by customer size.

³ Section 6(a) of the ESC Act.

Figure 1 Small-scale networks by customer numbers⁴



Small-scale network service providers:

- ▶ operate one or more geographically isolated networks
- ▶ adopt differing business models, with maximising returns a lesser priority for local government network service providers, and
- ▶ generally have a low number of customers from which they can recover their costs.⁵

From the customers' perspective, choice is generally limited to being part of that network or being self-sufficient. Some customers purchase each service (for example, electricity and water) from different service providers.

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

1.3 The Small-Scale Networks Inquiry

This Inquiry's terms of reference (Appendix 1) require the Commission to:

- ▶ analyse consumer protection associated with the delivery of services in the small-scale networks, with the objective of ensuring that any regulatory arrangements it administers are targeted, efficient and appropriate, and
- ▶ identify an appropriate regulatory framework that:
 - has relevance for customers and licensees, and

⁴ Calculated from performance reports – *Off-grid (energy) regulatory performance report 2017-18*, available at <https://www.escosa.sa.gov.au/industry/electricity/regulatory-reporting/regulatory-performance-reports>, and *Minor and Intermediate (water) retailers regulatory performance report 2017-18*, available at <https://www.escosa.sa.gov.au/industry/water/regulatory-reporting/regulatory-performance-reports>

⁵ The size of the communities served by these networks varies from fewer than 100 customers up to 10,000 customers. The majority of networks serve fewer than 1,500 customers.

- promotes effective and innovative outcomes.

Given this, the outcome sought from this Inquiry is to identify a regulatory framework covering the defined services, that:

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

The key elements of the existing framework are outlined in section 2.1. This represents a ‘baseline’ from which this Framework and Approach paper identifies alternative regulatory frameworks to be examined. Others can be proposed, including variations to those outlined, in submissions to this paper.

As the evidence the Commission has already assessed indicates small-scale network customers generally appear satisfied with their network service providers, the focus of this paper is on regulatory alternatives that are less prescriptive, but maintain or increase benefits to customers. Examples include service providers having closer, regular engagement with customers (leading to a potentially better price/service mix for the customer) and better targeting the cost of regulation without compromising the regulatory benefits (see Chapter 4).

This Inquiry focuses on identifying a suitable and flexible regulatory framework. The development of supporting regulatory instruments (codes and guidelines), if required, will be a subsequent exercise, subject to a separate consultative process. The reason for this approach is there is little value in developing supporting regulatory instruments until it is apparent stakeholders consider it beneficial.

1.4 Purpose and structure of this report

This paper has been informed by submissions received in response to an Issues Paper the Commission released in 2016.⁶ While that Issues Paper sought information regarding the regulation of small-scale networks, it did not provide alternative options to the Commission’s existing approach. This paper provides alternative approaches the Commission is actively considering and seeks stakeholder views on those.

- ▶ Chapter 2 details the current regulatory regime and how the Commission applies it. It also assesses if that regime and its application is effective.
- ▶ Chapter 3 details the potential changes to the regulatory regime.
- ▶ Chapter 4 explains the combination of options arising from the decision of which changes (if any) to adopt.
- ▶ Chapter 5 lists the next steps for this Inquiry.

⁶ See the Commission’s Inquiry into regulatory arrangements for small-scale and off-grid water, gas and electricity services, available at <https://bit.ly/2JpPaU1>

1.5 Consultation

The Commission requested submissions to an Issues Paper in August 2016, and received submissions from:⁷

- ▶ City of Onkaparinga
- ▶ Department of State Development, Energy Markets and Programs (**DSD**)
- ▶ District Council of Lower Eyre Peninsula
- ▶ District Council of Mount Barker
- ▶ Energy and Water Ombudsman SA (**EWOSA**)
- ▶ Environmental Land Services
- ▶ Local Government Association of South Australia (**LGA**)
- ▶ Mid Murray Council
- ▶ Origin Energy
- ▶ SA Water
- ▶ Mr C Shipard
- ▶ South Australian Council of Social Service (**SACOSS**)
- ▶ South Australian Financial Counsellors Association (**SAFCA**), and
- ▶ Urban Development Institute of Australia, SA Division.

In addition, the Commission received two confidential submissions.⁸

Issues raised in those submissions, and the Commission's responses to them, can be found in the Inquiry's 'Response to Issues Paper Submissions'.⁹

The Commission is keen to receive and understand views on the approaches outlined in this paper, as it will form the basis for the rest of the work for this Inquiry. Accordingly, an important aspect of this Framework and Approach paper is to test the evidence and receive feedback on the findings made in this paper. It also represents an opportunity for stakeholders to provide more evidence to the Commission.¹⁰

1.6 Next steps

The Commission seeks comments on this Framework and Approach paper by Friday, 9 August 2019. For details on how to make submissions, please see the inside cover of this paper.

The Commission would be pleased to meet with stakeholders, either individually or with representative organisations, to discuss the proposals outlined in this Framework and Approach paper, as well as any

⁷ Public (non-confidential) submissions to the Inquiry Terms of Reference are available at <https://bit.ly/2JpPaU1>.

⁸ In the interests of transparent decision-making, it is the Commission's policy to make all submissions publicly available on its website, except where a submission contains confidential or commercially sensitive information. However, points contained in confidential submissions cannot be publicly tested and therefore may not be given the same weighting as published submissions.

⁹ Essential Services Commission, *Response to Issues Paper Submissions*, May 2019, available at <https://bit.ly/2JpPaU1>

¹⁰ Essential Services Commission, *Charter of Consultation and Regulatory Practice*, September 2014, available at <https://www.escosa.sa.gov.au/ArticleDocuments/567/20140910-Corp-CharterConsultationRegulato.pdf.aspx?Embed=Y>.

alternative options. Such meetings could be held as public forums in Adelaide and/or regional centres if there is sufficient interest. If you or your organisation wishes to meet with Commission staff, please use the contact details on the inside cover of this paper.

The Commission will also seek to establish a reference group – comprising of representatives from the small-scale networks industry – to provide expert advisory assistance and to assist in filling information gaps following the release of this paper.

The Draft Decision paper is due to be released in October 2019, followed by the Final Decision paper in February 2020.

2 Current Regime

This chapter discusses the statutory framework regarding the regulation of small-scale networks, how the Commission applies that framework, and assesses whether the current approach is effective.

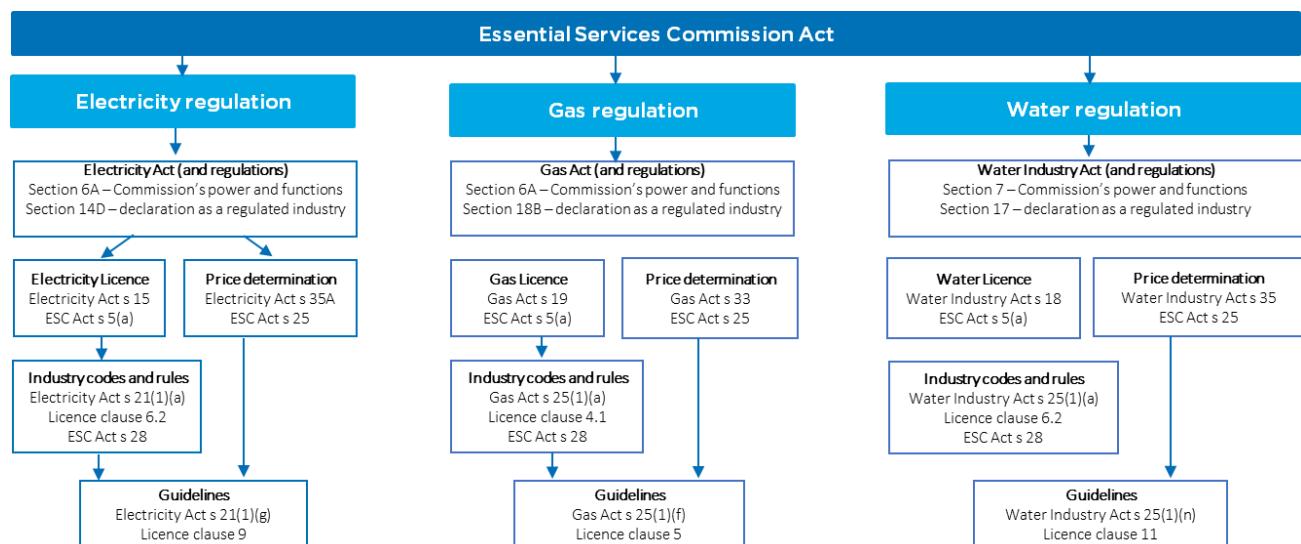
2.1 Statutory framework

The Commission's functions in industries declared to be regulated under the industry regulation Acts¹¹ are set out in section 5 of the ESC Act. The water and sewerage, electricity and gas industries are declared to be regulated industries for the purposes of the ESC Act. Together, the ESC Act and industry regulation Acts 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:

- ▶ performing licensing¹² and other functions under the relevant industry regulation Acts
- ▶ 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 entities¹³
- ▶ monitoring and enforcing compliance with, and promoting improvement in standards and conditions of service and supply under relevant industry regulation Acts, and
- ▶ regulating prices.¹⁴

The relationship between the ESC Act and the industry regulation Acts is illustrated in Figure 2.

Figure 2 The Commission's powers and functions in small-scale networks



The industry regulation Acts require:

- ▶ That a person providing small-scale network service(s) for payment must hold a licence as follows:

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

¹² Water Industry Act 2012, section 19, Electricity Act 1996, section 16 and Gas Act 1997, section 20.

¹³ Essential Services Commission Act 2002, Part 4, Water Industry Act 2012, section 25, Electricity Act 1996, section 21 and Gas Act 1997, section 25.

¹⁴ Essential Services Commission Act 2002, Part 3, Water Industry Act 2012, section 35, Electricity Act 1996, section 35A and Gas Act 1997, section 33.

- water and sewerage: licence retail
 - off-grid electricity: separately licence generation, distribution and retail,¹⁵ and
 - reticulated LPG: separately licence distribution and retail.
- 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 determined by the Commission, such as requiring:
- compliance with applicable codes or rules¹⁶ made under the ESC Act
 - the licensee to maintain specified accounting records and to prepare accounts according to specified principles¹⁷
 - a specified process to be followed to resolve disputes between the licensee and its customers¹⁸
 - the licensee to monitor and report as required by the Commission on indicators of service performance determined by the Commission,¹⁹ and
 - the water industry entity to provide, in the manner and form determined by the Commission, such other information as the Commission may from time to time require.²⁰

The industry 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).²¹ However, once the Commission adopts the form of regulation, then the service provider (licensee) is obliged to comply, as a result of the conditions placed in its licence. This flexibility in part explains the differences in approach in the application of regulation across water and sewerage, off-grid electricity and reticulated LPG services, and will be important in considering whether the Commission can better tailor its regulatory response.

An industry regulation Act may also contain its own specific requirements, such as section 25(2) of the Water Industry Act 2012 (**WI Act**) requiring the Commission to have regard to the scale and nature of the operations of the licensee.

2.2 Application and outcomes

As stated in section 2.1, the Commission has broad discretion in the form and manner in which regulation is applied.

¹⁵ Where off-grid electricity service providers provide multiple services under the Electricity Act, 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).

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

¹⁷ For example, s25(1)(f), Water Industry Act 2012.

¹⁸ For example, s25(1)(g), Water Industry Act 2012.

¹⁹ For example, s25(1)(i), Water Industry Act 2012.

²⁰ For example, s25(1)(n), Water Industry Act 2012.

²¹ 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.

2.2.1 How regulation is currently applied

The differences in the Commission's regulatory approach between small-scale network services can be summarised as follows:

- ▶ water and sewerage services:²²
 - Commission has published a retail code²³
 - Commission has published a reporting/information requirements guideline,²⁴ with an accompanying explanatory memorandum²⁵
 - Commission has published a compliance system and reporting guideline²⁶ and enforcement policy,²⁷ and
 - Commission has made a price determination, which is currently in operation.²⁸
- ▶ off-grid electricity services:²⁹
 - there are no retail codes or guidelines, with all requirements (including customer protection and reporting/information requirements³⁰) set as licence conditions
 - Commission has published an energy compliance guideline³¹ and enforcement policy,³² and
 - Commission has not made a price determination.

²² 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>.

²³ 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>.

²⁴ 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>.

²⁵ 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>.

²⁶ 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>.

²⁷ 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.

²⁸ 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 WI Act also include a framework for the Treasurer to issue Pricing Orders. Such a pricing order in force. This requires the Commission to adopt or apply the National Water Initiative (NWI) Pricing Principles when making a price determination. The NWI Pricing Principles relate to cost recovery, pricing and transparency of drinking water, recycled water and stormwater services. The Pricing Order excluded the principles for recovering the costs of water planning and management activities. While not required to do so, the Commission has determined to adapt and apply the NWI Pricing Principles to the pricing of CWMS services.

²⁹ 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>.

³⁰ For reporting/information requirements, refer to annual return obligation.

³¹ 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.

³² 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.

- ▶ reticulated LPG services:³³
 - Commission has published an industry code³⁴
 - Licensee reporting/information requirements are provided as general obligations contained in the industry code³⁵
 - Commission has published an enforcement policy,³⁶ and
 - Commission has not made a price determination.

2.2.1.1 Consumer protections

The consumer protections in each industry are broadly similar. Whether defined in industry codes (water, sewerage and reticulated LPG) or solely in licence conditions (off-grid electricity), customer protections cover:

- ▶ standard form customer contracts that service providers can use to ensure that there are clear and legally enforceable rights in the sale and supply of services
- ▶ minimum requirements around billing, billing disputes, payment terms and methods to ensure that customers receive accurate billing information in a timely manner
- ▶ limitations on the grounds on which service providers can disconnect or restrict customers' supply and requirements to ensure that customers can have their supply reconnected or reinstated quickly
- ▶ minimum requirements for assistance that must be offered to help customers experiencing financial hardship,³⁷ and
- ▶ procedures for dealing with customer enquiries, complaints and the resolution of disputes between the customer and the service provider.

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.³⁸ Further, the regulatory instruments requiring service providers to provide protections for customers are different, with requirements split between licences and industry codes.

All service providers must have an independent dispute resolution body. The majority of councils have nominated Ombudsman SA as their external dispute resolution body. Nine water and one electricity small-scale network service providers have joined the EWOSA scheme.³⁹ At least three network service providers have chosen to rely upon independent bodies.

³³ 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>.

³⁴ 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.

³⁵ Refer clause 2.1 of the Reticulated LPG Industry Code.

³⁶ 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.

³⁷ In the case of water and sewerage services, this provision operates in conjunction with section 37(1) of the WI Act which requires the Minister to develop and publish a customer hardship policy in respect of residential customers.

³⁸ 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.

³⁹ EWOSA website viewed 23 April 2019, available at <https://ewosa.com.au/members/our-scheme-members>

2.2.1.2 Price determinations

The Commission has made a price determination under section 35 of the WI Act. This determination, which only applies to small-scale water and sewerage service providers, is a combination of a price monitoring framework and pricing principles, which are consistent with the National Water Initiative (NWI) Pricing Principles. Under this form of regulation, small-scale network water service providers retain the responsibility for determining their own prices. This approach provides a level of transparency into the price setting process by:

- ▶ requiring these service providers to take certain principles into account in determining their costs and developing their prices, and
- ▶ demonstrating to the Commission that they have done so.

The Commission does not currently regulate the way that small-scale electricity and reticulated LPG network service providers set their prices. Section 35A of the Electricity Act provides the Commission with a price setting authority for the sale and supply of electricity to small-scale customers, but to date the Commission has not used that power. Instead, the Commission requires small-scale network service providers of electricity networks to publish prices on their website. Further, around 60 percent of small-scale electricity customers are supplied electricity through the Remote Area Energy Supply (RAES) and Aboriginal Communities scheme.⁴⁰ The cost of electricity through those schemes is subsidised by the South Australian Government, and tariffs in the scheme are set based on prices in the on-grid market.

Section 33 of the Gas Act provides the Commission with a price setting authority for reticulated LPG, but to date the Commission has not used that power. Instead, it requires transparent information about prices be provided directly to customers on entering a market contract. On a regular basis thereafter, prices should be available from the service provider's website. This is based on the assessment that reticulated LPG faces competition from substitutes such as bottled gas and electricity.⁴¹

2.2.1.3 Service standards

Unlike larger service providers, such as SA Water, which is 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), the Commission does not generally set any customer service and reliability service standards or targets for small-scale network service providers. An exception to this are the licences of small-scale electricity network service providers which contain quality and interruption of supply obligations.

Overall, the Office of the Technical Regulator monitors compliance with Safety, Reliability, Maintenance and Technical Management Plans of small-scale network service providers, and ensures the safe and reliable operation of infrastructure.

⁴⁰ Based on small-scale customer numbers and RAES/Aboriginal Communities customer numbers provided by the Department of Energy and Mining, available at:
http://www.energymining.sa.gov.au/energy_and_technical_regulation/energy_resources_and_supply/south_australias_energy_supply_and_market/remote_area_energy_supply

⁴¹ Essential Services Commission, *Regulatory arrangements for reticulated LPG Networks Final Decision*, April 2013, p.37, available at: <https://www.escosa.sa.gov.au/ArticleDocuments/653/130404-RegulatoryArrangementsForReticulat.pdf.aspx?Embed=Y>

2.2.1.4 Monitoring and reporting

The Commission publicly reports each year on small-scale service providers' regulatory performance, based on the annual reports service providers are required to submit.⁴² To produce those reports, the Commission collects information including (dependent on industry):

- ▶ financial data such as income, expenses, operating surplus
- ▶ operational performance 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 Is the Commission's regulatory regime effective?

The Commission seeks to identify if its regulation of small-scale networks can be considered effective. To do this, the Commission has considered whether there is evidence that service providers are behaving in a manner that has a material detrimental effect on customer outcomes; that is, to the detriment of price, quality or reliability of services. If this is consistently and persistently the case, it indicates the Commission's regulatory regime may not be effective.

2.3.1 Pricing issues

Regulating prices is about protecting customers with respect to the level of price charged for services, and promoting the ongoing provision of services. In the absence of regulatory intervention, small-scale network service providers' pricing strategies may under or over-recover the cost of service.

Ideally, small-scale network service providers should make every effort to recover from their customers the full, efficient costs of providing the service at a sustainable level.

2.3.1.1 Pricing of water and sewerage

Small-scale water and sewerage network service providers must take the NWI pricing principles into account when setting prices for their water and sewerage service (see section 2.2.1.2).⁴³ In 2017-18, 72 percent of those network service providers reported full compliance with all of the relevant pricing principles.⁴⁴ The remaining 28 percent reported meeting some but not all of the relevant pricing principles.

Of those which had reported that they were not yet fully compliant with the pricing principles, the key reasons were:

- ▶ difficulty in achieving full cost recovery due to a small customer base and/or customers' capacity to pay, and
- ▶ asset management plans that were yet to be finalised.

For the same year, a similar number of water and sewerage network service providers reported operating income which covered operating costs and depreciation (71 percent). Of the remaining

⁴² 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).

⁴³ The NWI pricing principles includes fully recovering costs of new capital assets using return on capital and return of capital (depreciation).

⁴⁴ Essential Services Commission, *Water: Minor and Intermediate Retailers Regulatory Performance Report 2017-18*, 2019 available at <https://www.escosa.sa.gov.au/industry/water/regulatory-reporting/regulatory-performance-reports>

29 percent, many are still transitioning to full cost recovery and are gradually adjusting prices in order to limit the price shock to customers. Some of those 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 or strategic reasons such as attempting to increase the customer base. Overall, this suggests customers of those networks are not being charged excessive prices, unless there is evidence indicating the cost base of any specific small-scale network is demonstrably inefficient. To date, the Commission is not aware of any such evidence.

2.3.1.2 Pricing of electricity

Regarding small-scale electricity, the RAES and Aboriginal Communities scheme set prices based on competitive market rates. In addition, as discussed in section 2.2.1.2, small-scale network service providers of electricity must publish prices on their website. While this provides a level of transparency for customers and assures that 58 percent of small-scale network customers face pricing consistent with on-grid competitive rate, it does not necessarily mean that pricing reflects the efficient costs of each off-grid network. To date, however, the Commission is not aware of any evidence suggesting this is a concern.

2.3.1.3 Pricing of LPG

As discussed in section 2.2.1.2, small-scale network service providers of reticulated LPG must publish prices on their website. In addition to this form of price monitoring, stakeholder submissions from network service providers suggest that reticulated LPG faces competition from substitutes and that customers may have the ability to signal their dissatisfaction by selecting alternative sources of gas (see item 7, Response to Issues Paper Submissions). 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, or that viable substitutes do not exist.

2.3.2 Service levels

In the context of small-scale network service providers, poor service levels (including a failure to deal with complaints) could be perpetuated where customers lack alternatives. However, based on the trend in the number of complaints received from small-scale customers, the available evidence suggests that customers of small-scale network service providers generally do not appear to be expressing dissatisfaction with the service received via persistently high levels of complaints (see Table 1). However, there are some localised concerns.

2.3.2.1 Customer complaints

All small-scale network service providers 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.

Table 1 collates the total number of complaints from small-scale network service providers since 2014-15.⁴⁵

Since 2014-15, there have been no complaints reported to the Commission relating to quality of supply with the reticulated LPG network service providers, although EWOSA has recorded infrequent complaints. While not all small-scale network service providers of electricity services have to report complaint data, of those that do, complaints have remained consistently low. The exception being 2017-18, where one service provider accounted for 11 of the 13 complaints.

⁴⁵ Note LPG service providers only have to report complaints relating to quality of supply.

Regarding water and sewerage, there are a small number of network service providers responsible for the majority of complaints. For example, in 2017-18, three network service providers accounted for 86 percent of water-related complaints. For the same year, six network service providers accounted for 81 percent of sewerage-related complaints.

Additional analysis of complaint data from 2014-15 shows that of the 50 sewerage/CWMS retailers, 24 have never reported a complaint. The breakdown for the remaining 26 retailers from 2014-15 (four years of operation) shows:

- ▶ 14 retailers reporting 20 or less complaints
- ▶ seven retailers reporting between 21 to 40 complaints
- ▶ three retailers reporting between 41 to 60 complaints, and
- ▶ two retailers reporting more than 80 complaints.

The two retailers reporting in excess of 80 complaints have customer bases of 2,300 and 6,500 respectively.

Table 1 Number of customer complaints per year⁴⁶

	2014-15	2015-16	2016-17	2017-18
Water	63	86	168 ⁴⁷	99
Number of service providers reporting a complaint	13	12	9	9
Number of service providers reporting complaints in consecutive years	NA	7	8	5
Sewerage	205	162	183	214 ⁴⁸
Number of service providers reporting a complaint	16	14	15	21
Number of service providers reporting complaints in consecutive years	NA	10	9	12
Electricity	1	6	3	13
Number of service providers reporting a complaint	1	1	1	3
Number of service providers reporting complaints in consecutive years	0	1	0	1
LPG	0	0	0	0
Number of service providers reporting a complaint	0	0	0	0
Number of service providers reporting complaints in consecutive years	0	0	0	0

2.3.3 Current understanding

While acknowledging that the evidence available is limited, the Commission considers the assessment suggests that, in general, small-scale network service providers do not appear to be behaving to the detriment of their customers. In part, this may indicate that the Commission's regulatory regime is assisting in achieving desired outcomes. However, that does not mean changes are not possible.

In particular, a move toward a less prescriptive, targeted approach may be possible and desirable. This should result in tangible benefits for consumers and service providers alike, through reducing reporting

⁴⁶ From Essential Services Commission, *Water: Minor and Intermediate Retailers Regulatory Performance Report 2014-15 to 2017-18*, and Essential Services Commission, *Energy: Off-Grid Regulatory Performance Report 2014-15 to 2017-18*.

⁴⁷ The spike in water-related complaints in 2016-17 can be attributed to customers of one network service provider being transitioned from groundwater to a managed aquifer.

⁴⁸ The 214 sewerage/CWMS complaints represents 0.23 percent of the customer base of 94,000. 32 of the 214 complaints (2017-18) were associated with a metropolitan council that reported no complaints in 2016-17. The majority of these complaints were in respect to the council's septic tank desludge contractor, for example, missing appointment dates and times. This council has approximately 1,900 CWMS customers as at 30 June 2017. A further 19 of the 214 complaints (2017-18) were associated with a regional council that only reported six complaints in 2016-17. This council has approximately 8,100 CWMS customers as at 30 June 2017.

obligations and emphasising customer engagement. Removing regulation altogether is not an option, however, as the legal context requires small-scale service providers to be subject to regulation, the form to be set broadly at the discretion of the Commission.

Given that the option of removing regulation is not possible, the Commission considers that two potential changes for the regulation of small-scale networks, relative to the existing arrangements, might include:

- ▶ harmonisation within and between regulation of the industries, and
- ▶ reducing the prescriptiveness of the approach, where it is possible to do so.

These are explored in the following chapters.

3 Potential changes to regulation

Section 28 of the ESC Act, as well as best practice regulation, requires a regulator to constantly review and determine if regulatory action is still effective or required, and make periodic adjustments to meet new conditions. What was previously necessary may not be right for today. Having regard to this, the Commission has identified two potential overarching changes to its approach to small-scale networks regulation:

- ▶ harmonisation within and between regulation of the industries, and
- ▶ reducing the prescriptiveness of the approach, where it is possible to do so.

This chapter examines those points.

3.1 Harmonisation

The regulatory instruments could remain unchanged. Alternatively, there is the option of harmonising the regulation of small-scale networks, to the extent practicable.

Harmonisation would include assessing the merits of changing regulatory instruments through consultation with stakeholders (in a subsequent process to this Inquiry). The objective would be to ensure that the content of the instruments remain appropriate (for example, removing redundant or obsolete clauses from metering obligations), to clarify points where necessary and to reduce duplication where present.

Harmonisation would also include adding consistency:

- ▶ 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).

While there are potential benefits of harmonisation, the extent to which it would result in a material net benefit for the community needs to be clear. In particular, harmonisation should not materially change the substance of the regulatory approach with respect to the customer protections that already exist.

3.2 Prescriptiveness of approach

Regulatory alternatives can be considered as sitting on a spectrum, from highly prescriptive ‘heavy-handed’ regimes to much less prescriptive ‘light-handed’ regimes. A highly prescriptive approach could include price determinations, and detailed service standards and customer protections. This might be accompanied by comprehensive reporting requirements and rigorous monitoring.

By contrast, a less prescriptive approach could place greater emphasis on trusting the small-scale network service providers to operate effectively without recourse to highly prescriptive obligations and reporting requirements. In the first instance, such an approach places greater emphasis on compliance auditing. Highly prescriptive obligations and reporting requirements would only be triggered for service providers that were not complying with obligations.

The Commission’s existing regulatory approach displays the characteristics of a more prescriptive regime (termed ‘reporting-compliance’ in Chapter 4), given it involves service standards and detailed customer protections (although the level of prescription differs across industries). While this approach remains applicable it is open for assessment. It is possible that transitioning towards a less prescriptive

approach might provide better outcomes from both a customer and service providers' perspective – for example, enhanced price-service mix outcomes at lower cost.

3.3 Potential options

Combining these provides four possible alternatives, illustrated in Figure 3.

Figure 3 Potential alternatives

	Do not harmonise	Harmonise
Reporting-compliance (includes existing approach)	Option 1: do not change the regulatory regime (reporting-compliance approach) and retain existing regulatory instruments	Option 2: retain the reporting-compliance approach but harmonise between and within industries
Trust-Verify (reflecting a less prescriptive approach)	Option 3: adopt a lighter-handed approach and retain existing regulatory instruments, with the Commission able to exempt individual entities from reporting requirements	Option 4: adopt a lighter-handed approach, and harmonise between and within industries

As a working hypothesis, the Commission considers that Option 4 – harmonise the current regulation while transitioning toward a lighter-handed approach – represents a potential transition path. This is because, on face value, it provides potential improvements for customers and service providers of small-scale networks that merit further investigation. The Commission is keen to understand stakeholder views with respect to all four options outlined, as well as any additional options stakeholders might consider relevant.

4 Explaining the options

Chapter 3 provided an overview of some overarching possible options for the regulation of small-scale networks. This chapter provides details of the potential outcomes of each option as well as outlining the Commission's view on their advantages and disadvantages (see Table 2). Common across all options is the proposal to require all small-scale service providers to be members of EWOSA. This is discussed in section 4.1.

Table 2 Advantages and disadvantages of each option

Option	Advantages/Disadvantages
Option 1	Advantages <ul style="list-style-type: none">• Current reporting-compliance approach known and understood• Avoid transaction costs associated with change Disadvantages <ul style="list-style-type: none">• Inconsistencies across and within industries• Potential for duplication• Reporting obligations
Option 2	Advantages <ul style="list-style-type: none">• Consistent approach to regulation• Potential to reduce duplication• Current reporting-compliance approach known and understood Disadvantages <ul style="list-style-type: none">• Transaction costs associated with change• Reporting obligations
Option 3	Advantages <ul style="list-style-type: none">• Approach is flexible and targeted• Less prescriptive approach for trusted small-scale service providers, particularly with respect to reporting obligations• Requires a 'cultural change' from service providers and the Commission (see Box 2) Disadvantages <ul style="list-style-type: none">• Inconsistencies across and within industries• Potential for duplication• Requires a 'cultural change' from service providers and the Commission (see Box 2)• Transaction costs associated with change
Option 4	Advantages <ul style="list-style-type: none">• Consistent approach to regulation• Potential to reduced duplication• Approach is flexible and targeted• Less prescriptive approach for trusted small-scale service providers, particularly with respect to reporting obligations• Requires a 'cultural change' from service providers and the Commission Disadvantages <ul style="list-style-type: none">• Requires a 'cultural change' from service providers and the Commission (see Box 2)• Transaction costs associated with change

4.1 EWOSA and external dispute resolution

This Inquiry's Terms of Reference include the requirement for the Commission to 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. Given the essential nature of the services, the Commission considers it important for customers to have access to an external complaint handling mechanism in a consistent manner.

The availability of an independent dispute resolution body is important as it ensures fair practice and effective dispute resolution between service providers and their customers. By being independent of the service provider, the dispute resolution body can enable a just resolution while maintaining good working relationships with both parties.

Accordingly, regardless of whether further changes are made to the small-scale regulatory regime, the Commission proposes for consultation that all small-scale network service providers become a member of the EWOSA scheme. This would provide customers with a single transparent avenue through which to channel complaints that cannot be resolved directly with the service provider.

Many local government small-scale network service providers have nominated Ombudsman SA as their dispute resolution body. Ombudsman SA may investigate any administrative act undertaken by an agency to which the Ombudsman Act 1972 applies.⁴⁹ Ombudsman SA can make recommendations for remedial action, but is not able to enforce such recommendations - where not complied with Ombudsman SA can report this to the Premier and Parliament.⁵⁰ Whereas EWOSA can resolve disputes between a service provider and a customer.⁵¹ Ombudsman SA and EWOSA have signed a memorandum of understanding to enable a specific customer complaint to be handled by the best placed ombudsman.⁵² Requiring local government network service providers to join the EWOSA scheme will enable their customers to have access to the best ombudsman services to resolve disputes in relation to the essential services being provided.⁵³

Requiring all small-scale network service providers to have EWOSA membership will also provide a consistent and reliable source of complaint information for the Commission.

Regarding service providers, EWOSA membership would deliver benefits by dealing with an experienced and expert body with an understanding of what service providers should be able to provide. EWOSA should enable the efficient management of complaints, while offering a support function to advise service providers on how they best meet customer expectations. In the case of a competent operator (refer Box 1), the cost implications of this scheme are expected to be small compared with the benefits.⁵⁴ In the case where a specific small-scale service provider is not appropriately addressing customer complaints and EWOSA has to investigate, the small-scale service provider bears EWOSA's costs. This should provide some incentive for any small-scale service provider to avoid the need for EWOSA to investigate complaints against it, thereby placing emphasis on complaint resolution with the small-scale service provider.

A schematic for how the small-scale network dispute resolution framework is envisaged to work is provided as Appendix 3.

4.2 Option 1: other than EWOSA membership, do not change the current regulatory regime

Option 1 is broadly the status quo: retaining the way small-scale networks are currently regulated (with the addition of requiring all small-scale network service providers to join the EWOSA scheme). It is, in effect, the framework outlined in section 2.2.1. This means the essence and content of existing codes,

⁴⁹ Sections 3 and 13 of the Ombudsman Act 1972. Local government councils are agencies to which the Ombudsman Act 1972 applies.

⁵⁰ Ombudsman SA powers, available at <https://www.ombudsman.sa.gov.au/complaints/what-powers-does-the-ombudsman-have/>.

⁵¹ EWOSA conciliation, available at <https://ewosa.com.au/resolving-complaints/our-process>.

⁵² EWOSA and Ombudsman SA, *Memorandum of Understanding*, January 2013, available at https://www.ombudsman.sa.gov.au/wp-content/uploads/policy_appendix_2013.pdf.

⁵³ Pricing and tariff complaints, which EWOSA does not deal with, would be passed to the Commission for resolution.

⁵⁴ EWOSA has revised its fee structure, implementing a low joining fee and annual fees (for example, for service providers with up to 20 customers paying a joining fee of \$100, then annual membership of \$100), but additional costs if complaints need to be investigated.

licences (including any embedded customer protection obligations), price determinations and guidance notes will remain unchanged. Further, there will be no change to the existing reporting-compliance approach, or the approach to implementing remedial measures.

The two main advantages of retaining the status quo are that the current system is known, and that there is no incremental cost associated with keeping it unchanged. The disadvantages include the inconsistent application of the framework (including regulatory instruments) and any reporting duplication across regulatory authorities. Further, while its continuation might not result in an increase in cost, it may be that ongoing costs are higher compared to other options. Finally, the current approach may be considered burdensome by some service providers (see items 29 and 33, Response to Issues Paper Submissions).

4.3 Option 2: as per Option 1 but harmonise between and within industries

Option 2 retains the current approach to regulation (that is, a reporting-compliance approach) but harmonises the framework (see section 3.1). This includes the process of changing regulatory instruments to ensure they remain appropriate, to clarify points where necessary, to add consistency between and within industries, and to reduce duplication where present. This process involves consultation with stakeholders.

The advantages of this option largely relate to having a consistent approach to the way the Commission regulates licensees.

The main disadvantage of this option is that it retains the 'reporting-compliance' focus and the associated reporting obligations. This may be considered burdensome relative to the lighter-handed approaches. It would also require investment to revise existing regulatory instruments.

4.4 Option 3: trust-verify without modifying regulatory instruments

For Option 3, the current regulatory instruments remain as they are, but the Commission could adopt a lighter-handed approach to regulation – a 'trust and verify' approach (**trust-verify**). To enable the Commission to adopt a light-handed approach, it is proposed that the Commission have the ability to switch-off (exempt) individual entities from reporting requirements.

4.4.1 The trust-verify approach

The trust-verify approach seeks to incorporate the competent operator and trust-verify concepts outlined in Box 1. Under this approach, once initial trust is gained, service providers are presumed to be acting competently and performing appropriately unless evidence is presented to the contrary.

Box 1: The Competent Operator and Trust-Verify concepts

Competent Operation

A competent small-scale network operator (**competent operator**) is a service provider that provides essential services that customers want, that are sustainable, and provided at a price that accounts for customer's willingness to pay, legislative requirements and affordability – noting the need to effectively manage any conflicting tensions between these factors.

In order for a small-scale network service provider to demonstrate competent operation, it should be able to provide evidence to the Commission's satisfaction, upon request, that demonstrates business practices that:

- ▶ are customer-focussed, appropriately account for legislative requirements and involve consistent and genuine engagement and consultation with customers
- ▶ result in services that meet customer requirements and are priced in a manner that takes account of efficient costs, willingness to pay, minimum legislative standards and affordability, noting that these may conflict
- ▶ provide a clear understanding of the relevant assets, asset maintenance and replacement needs, including analysis of alternative approaches to service delivery with its customer base, and
- ▶ indicate there is, or will be, sufficient financial strength to ensure the long-term viability of the service.

The ability to demonstrate such business practices is the responsibility of the small-scale network service provider, noting such practices align with the primary objective of Section 6 of the ESC Act: the protection of the long-term interests of South Australian consumers with respect to price, quality and reliability of essential services. They also resemble those practices of any business seeking to remain viable over the long term.

Trust and Verify

The desired outcome is that each network service provider is acting as a competent operator and can demonstrate this to the Commission's satisfaction. A competent operator can be trusted to operate the small-scale network without the need for prescriptive reporting and compliance frameworks. It is expected that in the first instance the majority of existing small-scale service providers could demonstrate the characteristics of competent operation.

By contrast, the Commission would closely monitor newly licensed service providers, as well as those existing small-scale service providers previously not complying with their regulatory obligations. The specific approach adopted would account for newly licensed service providers having worked closely with the Commission to become licensed and understand the concept of acting competently). This would be undertaken for a period of time which would vary on a case-by-case basis until the Commission is confident the service provider has taken the necessary remedial steps and is acting competently. That is, it is acting in a way which serves its customers without needing prescriptive regulatory oversight.

Once trust is gained, service providers are presumed to be acting competently and performing appropriately unless evidence is presented to the contrary. Such evidence would be identified through liaising with EWOSA and monitoring complaint data, as well as through other market intelligence, including audits undertaken by the Commission. Those audits will not take place based on a defined timetable. This is because within a trust-verify framework, the small-scale network service provider should be able to demonstrate competent operation to the Commission's satisfaction with minimal preparation at any time.

Importantly, monitoring in this manner means a small-scale service provider can gain and lose trust based on its own actions. The loss of trust would signal to the service provider's stakeholders that it is not operating competently. Further, the Commission's regulatory approach in this framework would be directly related to the outcome of the small-scale service provider's actions.

The trust-verify approach would be implemented in tranches as the amount of evidence that small-scale providers are acting competently is gathered. Initially, the approach will reduce annual reporting, given the Commission's ability to rely on market intelligence (noting that operators would need to make available information if required as a result of an audit). Then, based on evidence over time that operators were engaging with customers and demonstrating that customers had appetite for further changes, the Commission might be in position to 'switch off' further obligations. As stated above, the Commission would have the capacity to turn obligations back on at any time, to ensure appropriate customer protections.

The trust-verify approach is based on recognition that compliant behaviour need not be guaranteed by written regulation alone, and that regulation will be most effective where it is based on the collaborative involvement of all parties.⁵⁵ To this end, it is envisaged that a prerequisite for this option would be gaining an undertaking from service providers that they would uphold the values of the trust-verify model. This is because customers have to be confident that they need not have to rely on prescriptive regulatory requirements in the first instance.

In return for upholding those values, service providers would enjoy lower reporting requirements and potentially greater operational flexibility. For example, the Commission may only request annual reports containing data on office holders, basic metrics (for example, customer numbers), and significant changes to operations along with a statement of assurance that the service provider has the appropriate systems and controls in place to ensure compliance with obligations. The approach also means the Commission would not publish annual reports on all service providers. Instead, what will be published are the findings of audits, as well as complaint data published by EWOSA.

Service providers would still be expected and trusted to comply with the regulatory requirements set by the Commission – for example, industry relevant service standards, customer protections and price determinations (details of which will be determined in a subsequent inquiry if Option 2 or 4 are progressed). Service providers will also need to possess the necessary information to demonstrate competent operation. It is expected that if asked to provide evidence of competent operation a small-scale network service providers could provide such information either on request or through a formal audit process.

Customers would also need to be confident they were protected from those service providers not able to gain the Commission's trust or those evidenced to be failing to meet their commitments. In either case, under a trust-verify approach the Commission would adopt more prescriptive and intrusive regulatory measures targeted at such service providers. Those remedial actions would trend toward and potentially extend beyond the current reporting-compliance approach, depending on need. The imposition of remedial measures arguably represents a reputational risk to the small-scale service provider because it implies they are not delivering an essential service to their customers in a competent manner.

The main advantage of the trust-verify approach is that it is proportionate and efficient. Competent operators can run their operations with as much flexibility that is practicably possible in the context of essential service delivery, with the Commission targeting its efforts to those service providers that present the greatest risk to achieving good customer outcomes. This would cover both existing and new operations. In this manner, the cost of regulation is targeted and dependent on the problem. Further, although service providers would need to retain relevant information to inform audits and any follow-up the Commission might undertake in response to customer complaints, this should not be onerous for a competent operator, given it should be consistent with good business practice.

⁵⁵ Christopher Hodges, *Ethical Business Regulation: Understanding the Evidence*, Department for Business Innovation and Skills, Better Regulation Delivery Office, February 2016, p. 3, available at <https://www.gov.uk/government/publications/ethical-business-regulation>.

As explained in Box 2, the trust-verify approach would require cultural changes, as well as a change in the relationship between the Commission and network service providers, to one more based on reciprocal trust, notwithstanding a regulatory response where necessary. This would require commitment and effort on the behalf of all parties, particularly with respect to the transition to an auditing basis for monitoring.

Box 2: Cultural change

Any transition towards a trust-verify approach will require cultural change on behalf of the Commission and the small-scale network service providers. Specifically, the Commission has to focus less on the current 'reporting and compliance' approach and more on a critical assessment of Commission risk-based compliance measures and market intelligence.⁵⁶ In particular, the extent to which the practices of small-scale network service providers represent 'competent operation' (see Box 1).

Meanwhile, small-scale service providers will not be able to rely on a 'reporting and compliance' approach and the Commission identifying issues requiring attention. In the first instance, the small-scale service provider will have this responsibility and bear the risks associated with not meeting customer expectations or not being considered to be operating competently. This likely requires the small-scale service provider to ensure it has an active relationship and collaborative relationship with both its customers and the Commission. Overall, this creates the need for reciprocal trust between the small-scale network service provider and the Commission.

Finally, a disadvantage of Option 3 is that inconsistent application of the regulatory instruments remains. The investment in cultural change might also be considered a disadvantage as it imposes up-front investment needs.

4.5 Option 4: trust-verify and harmonisation between and within industries

Option 4 is a combination of harmonisation between and within industries (Option 2) as well as adopting a trust-verify approach to regulation (Option 3). As with Option 3, it will be dependent on small-scale service providers supporting the move and their willingness to commit to a trust-verify approach.

Advantages of this option include those from Options 2 and 3 (see sections 4.3 and 4.4.1). The main disadvantages of this may be the up-front investment associated with changing the relationship required between the Commission and small-scale network service providers (though as mentioned, this may also be considered an advantage), and the investment associated with revising existing regulatory instruments.

⁵⁶ Such as the outcomes of targeted and risk-based Commission assessment measures (for example, periodic and ad-hoc audits) and regular information gathered from other regulators, EWOSA, the media, and similar sources.

5 Next steps

In addition to meeting with stakeholders, the Commission invites written submissions from stakeholders and members of the public on this Framework and Approach paper. Written comments should be provided by Friday, 9 August 2019.

The Commission is particularly interested to understand which overarching options stakeholders prefer and why, as well as any alternatives considered relevant and their advantages and disadvantages.

5.1 Timetable for this Inquiry

Key dates for this consultation are shown in Table 3 below.

Table 3 Key dates for consultation

Key date	Process
June – August 2019	Initial consultation with all stakeholders
October	Release of the Draft Decision paper
October – November 2019	Consultation on the Draft Decision Paper
February 2020	Release of the Final Decision paper

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

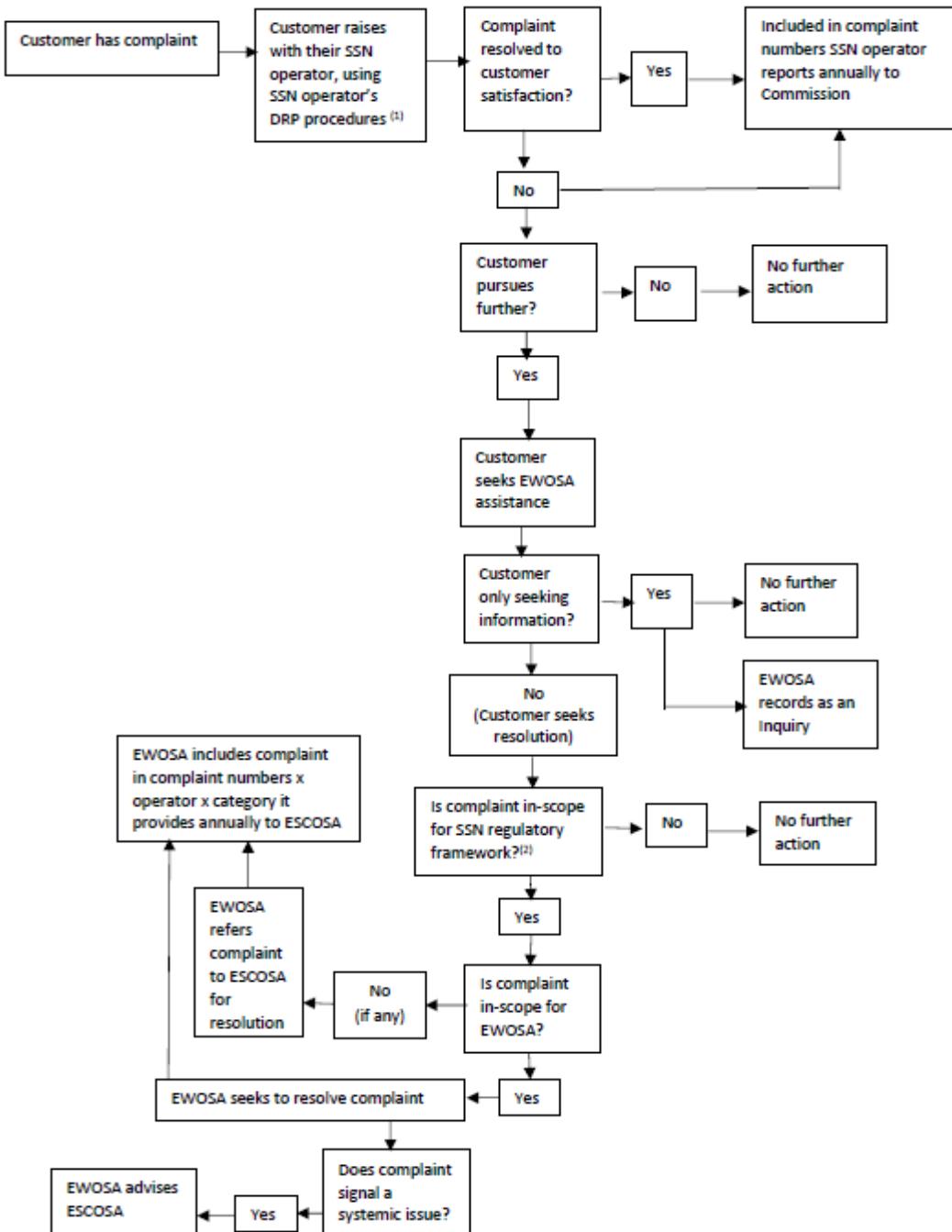
Chairperson

Appendix 2 – Regulation of small-scale networks

Entity	Overview of role within the water industry	Relevant legislation
Consumer and Business Services	<p>Responsible for administration of the Australian Consumer Law, covering consumer protection and fair trading, in South Australia</p> <p>Regulates the relationship between landlords and tenants for the payment of rates and charges for water and sewerage services</p> <p>Regulates the professional conduct of plumbers, gasfitters and electricians</p>	Competition and Consumer Act 2012 Residential Tenancies Act 1995 Plumbers, Gasfitters and Electricians Act 1995
Department of Human Services	<p>Develops customer hardship (water industry) and concession policies (electricity and water industries)</p> <p>Administers the Consumer Advocacy and Research Fund (water industry)</p>	Electricity Act 1996 Water Industry Act 2012
Department for Environment and Water	Regulates state water resources and other natural resource management matters	Natural Resources Management Act 2003
Energy and Water Ombudsman SA	Handles complaints from customers of retailers that have joined the scheme	Water Industry Act 2012
Environment Protection Authority	Regulates the environmental impact of water businesses	Environment Protection Act 1993
Essential Services Commission	<p>Economic regulator for suppliers of water, sewerage, electricity and LPG services to ensure they are efficiently delivered in the long-term interests of consumers</p> <p>Licenses the entry of suppliers of water, sewerage, electricity and LPG services in South Australia</p>	Electricity Act 1996 Essential Services Commission Act 2002 Gas Act 1997 Water Industry Act 2012
Minister for Transport, Infrastructure and Local Government	Administers the Local Government Act	Local Government Act 1999
Minister for Energy and Mining	Administers the Electricity Act and Gas Act	Electricity Act 1996 Gas Act 1997
Minister for Environment and Water	Administers the Water Industry Act	Water Industry Act 2012
Ombudsman South Australia	Investigates complaints about South Australian Government and local Government agencies	Ombudsman Act 1972
SA Health	Regulates public health requirements for providing drinking water supplies	Safe Drinking Water Act 2011
Technical Regulator	Regulates safety and technical matters	Electricity Act 1996 Gas Act 1997 Water Industry Act 2012
Treasurer of South Australia	Sets licence fees for industry entities Issues Pricing Orders (for the water industry)	Electricity Act 1996 Gas Act 1997 Water Industry Act 2012

Appendix 3 – Dispute resolution framework

All small-scale network (SSN) operators to join EWOSA scheme



Notes:

- (1) DRP = Dispute Resolution Procedures. The DRP involves a two-step procedure where the complaint is not resolved in the first instance. Where the customer's initial attempt fails, then the customer is required to use the operator's escalation process prior to seeking external dispute resolution (i.e., prior to seeking EWOSA's assistance).
- (2) Not all potential complaints will be captured by the SSN customer protection framework. For example, complaints concerning behind the meter equipment failures (such as warranty issues with solar panels and batteries) would not be covered. Such issues would fall under the Australian Consumer Law, with assistance provided by [Consumer and Business Services](#).



The Essential Services Commission
Level 1, 151 Pirie Street Adelaide SA 5000
GPO Box 2605 Adelaide SA 5001
T 08 8463 4444
E escosa@escosa.sa.gov.au | W www.escosa.sa.gov.au