



# SA Water Regulatory Determination 2020

## Framework and Approach

July 2018

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## Glossary of terms

Business plan	SA Water's regulatory business plan to apply from 1 July 2020 to 30 June 2024
CEP	Consumer Experts Panel
Commission	Essential Services Commission, established under the Essential Services Commission Act 2002
CWG	Customer Working Group
EPA	Environment Protection Authority
ESC Act	Essential Services Commission Act 2002
Minister	Minister for the Environment and Water
SACOSS	South Australian Council of Social Service
SA Water	SA Water Corporation
SAW RD16	SA Water Regulatory Determination 2016
SAW RD20	SA Water Regulatory Determination 2020
Treasurer	Treasurer of the South Australian Government

# 1 Executive Summary

The Essential Services Commission (**Commission**) has developed, through a public consultation process, the framework and approach for the next economic regulatory determination to apply to SA Water from 1 July 2020 to 30 June 2024 (**SAW RD20**).

Since 2013, the Commission's economic regulation regime has been effective in supporting SA Water's delivery of lower-priced and more customer-focused service provision. Under that regime, SA Water has delivered real revenue and price reductions to customers, maintained service levels and improved its asset management capability. SA Water's drinking water and sewerage revenues are now approximately \$110 million per annum lower than the annual revenue outcomes in 2012, in real terms.

The next stage in the ongoing economic regulatory process will be the making of a new regulatory determination to take effect in 2020 (SAW RD20).

This next determination will challenge SA Water to:

- ▶ provide water and sewerage services at the lowest sustainable price for the quality and reliability levels valued by customers, and
- ▶ have in place sound long-term asset management, operating and financing strategies, which support the provision of those services for customers of today and tomorrow.

Those intended outcomes are consistent with the Commission's primary objective of protecting the long-term interests of consumers with respect to the price, quality and reliability of essential services.

## 1.1 Framework and Approach for SAW RD20

Submissions to the Commission's draft SAW RD20 Framework and Approach paper focused on the role of customers in the determination process and the need for information to be made transparent to stakeholders, to better inform the input that stakeholders provide to the determination. The Commission has addressed those submissions by designing a framework for SAW RD20 that will:

- ▶ Put customers' interests and the consumer voice at the centre of the regulatory process.
- ▶ Provide opportunities for the early identification and resolution of issues and provide up-front clarity on regulatory issues.
- ▶ Obtain an earlier and wider range of evidence on matters relevant to the determination – particularly customer views – and to maximise the potential of existing bodies and knowledge bases (including other regulators and the Commission's and SA Water's consumer advisory committees).
- ▶ Embed SA Water's focus on ownership of its performance, the customer relationship and engagement and obtain a wider range of views to deliver a regulatory business plan to apply from 1 July 2020 (**business plan**) that meets customers' expectations.
- ▶ Introduce direct customer challenge and negotiation into the preparation of SA Water's draft business plan, in a constructive and non-adversarial approach, including through the use of a negotiation forum.

The roles and responsibilities of each of the bodies involved in the process are:

**The Commission:**

- ▶ will establish the framework and approach for the determination and provide guidance to inform the process of negotiation between SA Water and the customer representatives (the Customer Negotiation Committee).
- ▶ will remain responsible for making the final regulatory determination to ensure that SA Water provides the water and sewerage retail services valued by customers for the lowest sustainable cost. It will draw on the full range of evidence provided by all stakeholders before making the determination.

**SA Water:**

- ▶ will continue to be accountable for delivering water and sewerage services that meet its customers' needs, while meeting all relevant regulatory obligations.
- ▶ will facilitate a direct negotiation process with the Customer Negotiation Committee during the development of SA Water's business plan and will nominate three senior staff to undertake those negotiations on behalf of SA Water.
- ▶ will be responsible for delivering the final plan and transparently reporting progress and outcomes to customers on an ongoing basis.

**Customer Negotiation Committee:**

- ▶ will represent all customers of SA Water in challenging and negotiating SA Water's proposed business plan before it is submitted by SA Water to the Commission for review.
- ▶ will be led by an Independent Chairperson, appointed by the Commission but not subject to the Commission's control. The Independent Chairperson will prepare a public report following completion of the negotiation process, summarising the views of the Customer Negotiating Committee and any areas where further analysis is required by the Commission in making its regulatory determination.
- ▶ will consist of two other members: one appointed from the Consumer Experts Panel and another from SA Water's Customer Working Group.
- ▶ will be supported by the Commission.

**Independent Probity Advisor:**

- ▶ will provide oversight of the integrity of the process and information exchange in the Negotiation Forum.
- ▶ will liaise with the Independent Chairperson of the Customer Negotiation Committee and SA Water to draw issues forward and advise the Commission of those areas of process where more information is required.
- ▶ will liaise with the Commission on any probity concerns that arise during the negotiation process and prepare a public report to the Commission summarising the probity of the process.

### Consumer Experts Panel:

- ▶ will consist of all members of the Commission's existing Consumer Advisory Committee and SA Water's Consumer Advisory Groups.
- ▶ panel members will continue to work directly with their constituencies to gather evidence on any particular issues for those groups of customers and provide research and evidence to inform SA Water's business plan and the Negotiation Forum.

### Regulators' Working Group:

- ▶ will promote coordination between regulators of SA Water during SAW RD20, to minimise regulatory duplication and to identify joint solutions or efficiencies (where possible).
- ▶ will consist of representatives from the Commission, the Environment Protection Authority, SA Health, the Office of the Technical Regulator and the Department of Environment and Water.
- ▶ will continue to work together throughout the 2020-2024 regulatory period to jointly monitor, evaluate and report (as appropriate), developing a more holistic understanding of SA Water's operations and service delivery outcomes.

The governance structure for SAW RD20 is summarised in Figure 3.1 of Chapter 3 of this report.

## 1.2 The negotiation process is non-binding and will inform the Commission's determination

A successful negotiation process does not require the Customer Negotiation Committee and SA Water to reach agreement on all aspects of the draft business plan. The negotiation process is non-binding and the Commission will remain responsible for making a regulatory determination that best serves consumers' long-term interests. However, where issues are successfully negotiated between the parties and are consistent with the guidance provided by the Commission up front, the Commission is likely to accept or give significant weight to those outcomes when making its determination. Where there are areas of disagreement, the Commission expects those areas to be made clear in SA Water's submitted business plan and in the report from the Chairperson of the Customer Negotiation Committee. The Commission will exercise its judgement on those issues in making its regulatory determination.

This negotiation process, together with more structured input from consumer representatives, will allow a customer perspective to better inform the Commission's determination. The Commission is mindful that an absence of customer input to regulatory processes may not deliver the lowest sustainable prices or best service levels to customers. This can arise from a lack of evidence on customer views in relation to those matters.

## 1.3 Process for SAW RD20

To provide SA Water, the Customer Negotiation Committee and all other stakeholders with the necessary guidance prior to the development of SA Water's business plan, the Commission will, by the end of October 2018, issue Guidance Papers on various technical matters. It may issue further guidance during the negotiation process as required. Those papers will set out background information relevant to the negotiation and determination process and, where appropriate, the Commission's expectation of the reasonable range of outcomes that should form the boundaries of the negotiation process.

The Commission is currently finalising the governance arrangements for SAW RD20 and, over the coming months, will provide support during a period of introduction and information provision to the new bodies that are being established.

SA Water has commenced its planning process for the next regulatory determination and, by February 2019, will be prepared to discuss and negotiate draft business plan proposals with the Customer Negotiation Committee over a four-month period from February 2019 to May 2019.

Following those negotiations, the Commission expects SA Water to submit its business plan by October 2019. The Commission will assess that business plan in the context of:

1. statutory objectives and factors under the Commission's legislative framework
2. reports from the Chairperson of the Customer Negotiation Committee, the Independent Probity Advisor, the Consumer Experts Panel and regulators of SA Water, and
3. stakeholder submissions.

The Commission will release a Draft Regulatory Determination by February 2020 for further public consultation. It will consider submissions received during that consultation period and will issue a Final Regulatory Determination by May 2020. The key output of the determination is an approved SA Water business plan. SA Water will be accountable for delivering the outcomes of that plan.

## 2 Introduction

Since 2012, the Essential Services Commission (**Commission**) has been responsible for the independent economic regulation of the water industry including SA Water and all other South Australian licensed water and sewerage retailers, in accordance with the Water Industry Act 2012.

A principal element of the Commission's regulatory function for SA Water is the making of regulatory determinations which set the maximum revenues that SA Water may earn and the service standards that SA Water must provide to its drinking water and sewerage customers. The current regulatory determination applied from 1 July 2016 and will expire on 30 June 2020. The Commission will make a new regulatory determination to apply from 1 July 2020 to 30 June 2024 – SA Water Regulatory Determination 2020 (**SAW RD20**).

### 2.1 Legal requirements for a determination

The Commission's primary objective is to protect the long-term interests of consumers with respect to the price, quality and reliability of essential services (which include water and sewerage services).<sup>1</sup>

In pursuit of this objective, the Commission may make determinations regulating prices, conditions relating to prices and price-fixing factors for goods and services in a regulated industry (such as the water and sewerage services industry).<sup>2</sup> The Commission's previous determinations of SA Water's maximum drinking water and sewerage revenues is a form of price determination.

In making a price determination, the Commission must ensure that:

- ▶ wherever possible the costs of regulation do not exceed the benefits, and
- ▶ its decision takes into account and clearly articulates any trade-off between costs and service standards.<sup>3</sup>

There are other legislative requirements and objectives that guide the Commission's determinations. Those objectives generally focus on the principles of economic efficiency which, when applied to SA Water, means that the Commission encourages it to maximise the potential of its resources and seek continuous improvement in areas of service that its customers value.

A summary of the legal framework that applies to the Commission's regulatory determinations is contained in Appendix 1.

The Commission's economic regulatory function exists within a broader policy and regulatory system that applies to the water industry. There are other regulators and agencies that are responsible for the environmental, health, social and technical regulation of SA Water. Appendix 2 describes those organisations and their roles.

### 2.2 Making a regulatory determination that will promote consumers' interests

SA Water provides monopoly drinking water and sewerage retail services. Economic regulation can help SA Water to deliver those services at efficient prices and at service levels that are valued by customers, through the obligations and incentives imposed under licence conditions and related regulatory requirements. Since 2013, the Commission has exercised its discretionary powers to make a price determination and issue Codes in order to protect the long-term interests of SA Water's customers and it will continue do so from 1 July 2020, on the basis that SA Water will continue to be the monopoly water and sewerage retailer for most South Australians.

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<sup>1</sup> Essential Services Commission Act 2002, section 6(a).

<sup>2</sup> Essential Services Commission Act 2002, section 25.

<sup>3</sup> Essential Services Commission Act 2002, section 25(5).

## 2.3 The 2016 SA Water Regulatory Determination

In June 2016, the Commission released its SA Water Regulatory Determination for the 2016-2020 regulatory period (**SAW RD16**), which included:

- ▶ a price determination that set four year revenue caps for drinking water retail services and sewerage retail services and specified pricing principles for other retail services (including recycled water and connections services), and
- ▶ service standards and customer service obligations that SA Water must meet during the four year regulatory period.

The process for making SAW RD16 involved the Commission:

- ▶ monitoring the process used by SA Water to gather evidence of customers' service preferences
- ▶ developing a set of minimum customer services and reliability service standards informed by the high-level insights SA Water gained from its customer engagement program and its historical performance in these areas
- ▶ testing whether SA Water's proposed expenditure was prudent and efficient
- ▶ setting a cap on the maximum amount of revenue SA Water could recover from customers for its drinking water and sewerage services
- ▶ establishing pricing principles that SA Water must follow when setting prices for retail services other than drinking water and sewerage services
- ▶ seeking the views of customer representative bodies, including through the Commission's Consumer Advisory Committee, and
- ▶ inviting public feedback on SA Water's Regulatory Business Proposal 2016 and the Commission's draft SAW RD16.

## 2.4 The Commission's approach has facilitated SA Water's delivery of customer benefits

Since the Commission's first SA Water Regulatory Determination in 2013, SA Water has delivered real price reductions to customers, maintained service levels and improved its asset management capability.

SA Water's drinking water and sewerage revenues are now approximately \$110 million per annum lower than the annual revenue outcomes in 2012, in real terms (that is, by removing the effects of inflation).

The annual drinking water bill for a typical residential customer has decreased, in real terms (using 2013-14 prices), from \$884 in 2013-14 to \$779 in 2016-17 (a seven per cent reduction), with the corresponding annual residential sewerage bill reducing from \$510 in 2013-14 to \$415 in 2016-17 (a 19 per cent reduction).<sup>4</sup>

SA Water has achieved significant cost savings since 2012-13, which has facilitated those price reductions. Figures 2.1 and 2.2 below show the trends in SA Water's capital and operating expenditure since 2012-13 in real terms.<sup>5</sup>

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<sup>4</sup> Bureau of Meteorology, *National Performance Report 2016-17: Urban Water Utilities*, Part B (available at <http://www.bom.gov.au/water/npr/>).

<sup>5</sup> SA Water's drinking water and sewerage operating expenditure for 2012-13 is not available.

Figure 2.1: Trends in SA Water's capital expenditure (\$m, in Dec14 prices)

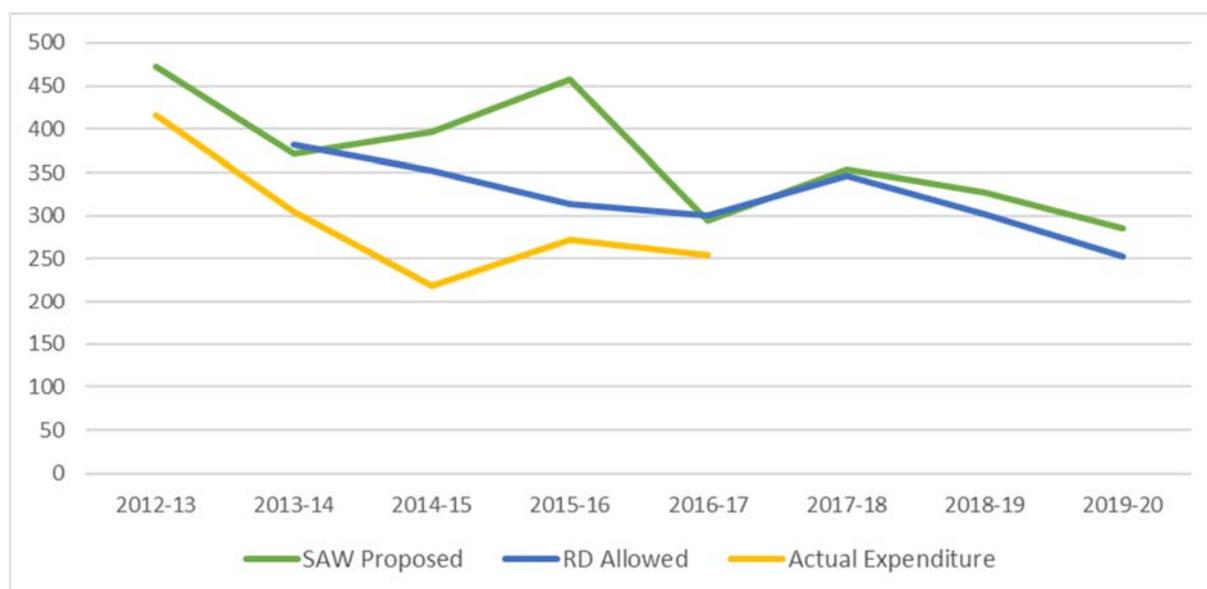
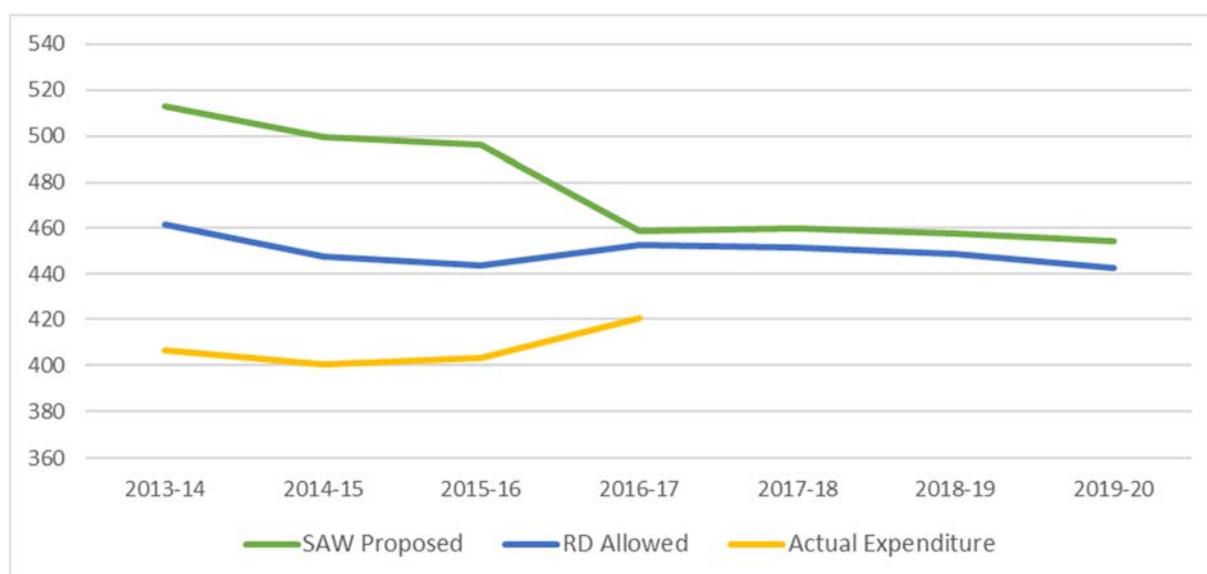


Figure 2.2: Trends in SA Water's operating expenditure (\$m, in Dec14 prices)



Customers benefit from SA Water's cost savings as actual expenditure in a regulatory period is used as the basis for establishing revenues and prices for the subsequent regulatory period.

To ensure that cost reductions are not achieved at the expense of service levels, the Commission's regulatory framework requires SA Water to maintain service levels over time. Since 2013, SA Water has maintained its service levels to customers while also delivering consistently on the broader consumer protections provided in the *Water Retail Code – Major Retailers*.

SA Water has also demonstrated improvements in its asset management capability and is now compliant with the international standard for asset management, ISO 55000.

Those achievements suggest that SA Water has responded well to the Commission's regulatory approach. Notwithstanding, the Commission's approach under SAW RD20 challenges SA Water to find ways to put further downward pressure on prices while continuing to maintain service levels and improving asset management practices.

## 2.5 Stakeholder input has shaped the Framework and Approach

The Commission's framework and approach for SAW RD20 has been informed by stakeholder feedback to a draft Framework and Approach paper released for consultation in November 2017.<sup>6</sup> The Commission received five submissions to that paper, from:<sup>7</sup>

- ▶ Business SA
- ▶ Environment Protection Authority
- ▶ SA Council of Social Services
- ▶ SA Water
- ▶ Uniting Communities

In addition to receiving those submissions, the Commission engaged directly with key stakeholders in preparing this final Framework and Approach paper. It thanks all stakeholders that assisted the Commission during this process.

The matters raised in submissions have been carefully considered and, where relevant, certain arguments and submissions have been mentioned in this report, either by direct quotation or by reference to themes or arguments, to assist stakeholders to understand the positions that have been reached. A failure to reference an argument or submission does not mean that it has not been considered by the Commission in arriving at its conclusions. Submissions that have commented on various technical matters will be addressed by the Commission in its Guidance Papers, to be released by end-October 2018.

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<sup>6</sup> The SAW RD20 draft Framework and Approach paper is available on the Commission's website at <http://www.escosa.sa.gov.au/ArticleDocuments/1170/20171123-Water-SAWaterRegulatoryDetermination2020-FrameworkApproach-Draft.pdf.aspx?Embed=Y>.

<sup>7</sup> Submissions to the SAW RD20 draft Framework and Approach paper are available on the Commission's website at <https://www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2020-framework-and-approach>.

## 3 The Framework and Approach for SAW RD20

The SAW RD20 process is the next step in the evolution of the Commission's approach to regulating SA Water. It builds on the successful customer outcomes delivered under previous SA Water regulatory determinations, as discussed in the previous chapter.

The framework and approach for SAW RD20 will continue to challenge SA Water to:

- ▶ provide water and sewerage services at the lowest sustainable price for the quality and reliability levels valued by customers, and
- ▶ have in place sound long-term asset management and financing strategies and delivery, which support the provision of those services for customers of today and tomorrow.

Those intended outcomes are consistent with the Commission's primary objective of protecting the long-term interests of consumers with respect to the price, quality and reliability of essential services.

It will promote that objective by:

- ▶ ensuring that SA Water understands what customers value and develops proposals for services and prices that respond to those needs
- ▶ challenging SA Water to continually improve and become more efficient over time, taking a long-term approach to its decision-making, asset management and financing strategies, to ensure that the essential services it provides are sustainable, and
- ▶ ensuring that customers pay the lowest sustainable price for SA Water's water and sewerage services, for the quality and reliability levels valued by customers.

These intended outcomes are consistent with the Commission's statutory objective to protect South Australian consumers' long-term interests with respect to the price, quality and reliability of essential services and with those that applied for SAW RD16. In particular, they are aimed at promoting a high performing water utility that understands and responds to the requirements of its customers while becoming more efficient over time.

### 3.1 Clarifying roles within the decision-making process

The Commission has established a clear governance framework for SAW RD20, clarifying the roles and opportunities for various stakeholders to be involved in the Commission's decision-making process. It provides greater certainty about the level of influence various stakeholders can have on the final decision the Commission needs to make.

Responses to the draft Framework and Approach paper suggested that the Commission needed to challenge itself to reconsider whether its approach was going to be open and inclusive enough to provide it with the evidence it needs to make decisions in the long-term interests of SA Water's customers. Reflecting on these comments, the Commission has designed a stakeholder engagement approach that will draw on the feedback and expertise from a wide range of parties. Many of these parties were involved in the last review (**SAW RD16**), but the new approach clarifies their roles and relationships.

The process will involve stakeholders in the review process much earlier than in SAW RD16. Stakeholders will be provided with more opportunities to provide feedback to SA Water as it develops its regulatory business plan to apply from 1 July 2020 (**business plan**), rather than waiting to comment on a fully developed draft plan as was the case in previous determinations. This will ensure that the business plan submitted to the Commission has been thoroughly tested and challenged by a wide range of stakeholders.

A key element of this strategy will be the preparation and publication, by the Commission, of a series of Guidance Papers. Those papers will set out background information, principles and preliminary positions in relation to matters of methodology, parameters and expectations for the SAW RD20 process.

This is a change from the Commission’s past practice, where such detailed guidance would often be provided only after SA Water submitted its draft business plan. The change is consistent with the view expressed in the South Australian Council of Social Service (**SACOSS**) submission that the Commission should be clear from the outset about the principles adopted and the expectations of SA Water before it prepares its business plan.<sup>8</sup>

The initial Guidance Papers will address the following matters, as summarised in Table 3.1:

Table 3.1: Proposed content of Guidance Papers for SAW RD20

Guidance Paper	Purpose
Overview of economic regulation of SA Water	Provide background information on: <ul style="list-style-type: none"> <li>▶ the Commission’s role as economic regulator of SA Water,</li> <li>▶ its relationship with other regulators and</li> <li>▶ the objectives and desired outcomes of SAW RD20, including the appropriate allocation of risk between SA Water and customers.</li> </ul>
SA Water performance, past and present	Discuss SA Water’s current and historical performance (operational and financial).
Determining revenues/prices of drinking water and sewerage	Explain how revenues/prices will be determined for SA Water’s drinking water and sewerage services using the cost-based (building blocks) approach.
Regulation of recycled water, connections and miscellaneous services	Discuss evidence of SA Water’s performance/prices for recycled water, connections and miscellaneous services and explain the Commission’s proposed approach to regulation of those services.
Existing SA Water Initiatives	Explain SA Water’s initiatives from its 2016 Regulatory Business Proposal, their current status and discuss the new initiatives that SA Water is undertaking, subsequent to preparing that proposal. Those initiatives will have an impact on future costs and services.
Future cost drivers	Outline the major external factors that are likely to influence SA Water’s business plan, including regulatory requirements, external cost drivers and any changes to customer preferences.
The cost of new and existing assets	Explain the methodology and reasonable range of outcomes when calculating the costs of new and existing assets, in particular the return on, and of, regulated assets.

<sup>8</sup> SACOSS submission to SAW RD20 draft Framework and Approach paper, available on the Commission’s website at <https://www.escosa.sa.gov.au/ArticleDocuments/1171/20180216-Water-SAWRD2020-FA-Draft-Submission-SACOSS.pdf.aspx?Embed=Y>.

Guidance Paper	Purpose
Prudent and efficient service delivery	Outline the Commission's expectations and to provide guidance for SA Water's expenditure proposals required to deliver drinking water and sewerage services, including reasonable ranges of efficient expenditure.

The Commission may release further Guidance Papers to inform and to assist the negotiation process as required.

The Guidance Papers will comprise a critical part of the Commission's assessment of the business plan. Through the formal determination process, it will look to ascertain the extent to which that plan falls within the framework established by these papers. Where it does not, the Commission will seek to understand whether the reasons for departure are reasonable and have been supported, or even proposed, by customers through SA Water's consultation and engagement process.

The Commission has also considered the positive improvements that it has seen in SA Water. The Commission will provide SA Water with the opportunity to play a leading role in working with its customers to develop a business plan that reflects the widest range of views while making sure it develops a plan that can deliver services that are sustainable in the long term.

The Commission will set clear expectations for SA Water to develop its business plan for 2020 to 2024 with more direct input from customers. This will include requiring SA Water to convene a Negotiation Forum to assist it with developing and testing its business plan, within the guidance parameters as set out by the Commission. Such a process of negotiation and challenge between SA Water and consumer representatives was advocated by Uniting Communities in its submission to the draft Framework and Approach paper.<sup>9</sup> This approach is consistent with leading regulatory practice both in Australia and internationally - including water regulatory practice in the United Kingdom as well as energy regulation in Australia - where customer challenge is a central feature of the regulatory process.

The enhanced process will capture additional value from the input of the Commission's existing stakeholders through a structured, supportive and coordinated process. The Commission will provide and support additional forums for customers, and customer representatives, to debate, discuss and understand the needs, preferences and priorities of SA Water's diverse customer base. This will include establishing and supporting a Consumer Experts Panel, drawn from existing Commission and SA Water consumer advisory groups, that will conduct a series of workshops with the intention of developing a public Priorities Report for consideration and debate by the Negotiation Forum.

Finally, the Commission will facilitate greater coordination between the technical, safety, environmental and public health regulators through a Regulators' Working Group. This will allow for greater coordination of the obligations and expectations that each regulator places on SA Water through a joint planning approach, to the extent possible.

### 3.2 Overview of the roles of key parties

Figure 3.1 illustrates the governance structure for SAW RD20. Importantly, the Commission remains responsible for making the final regulatory determination in accordance with the statutory framework to ensure that SA Water provides the water and sewerage retail services valued by customers for the lowest sustainable cost. It will draw on the full range of evidence provided by all stakeholders in making that determination.

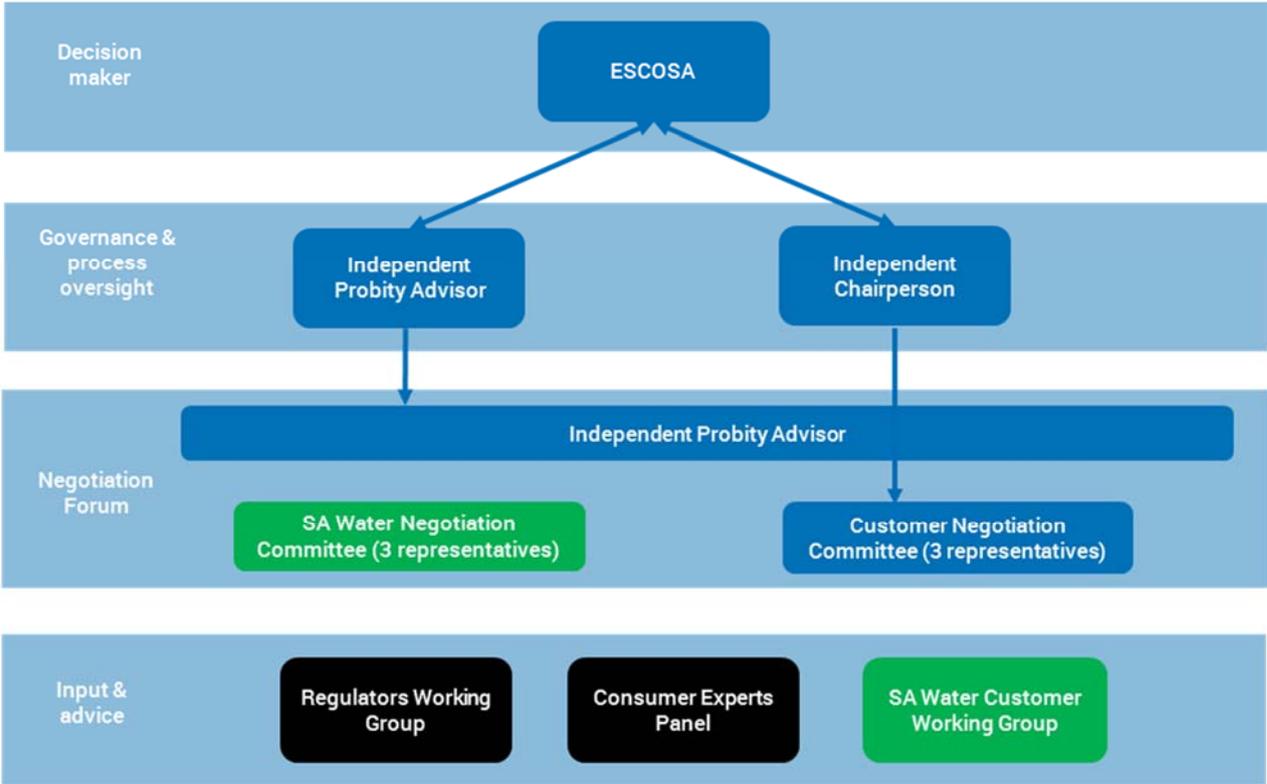
<sup>9</sup> Uniting Communities' submission to SAW RD20 draft Framework and Approach paper, available on the Commission's website at <https://www.escosa.sa.gov.au/ArticleDocuments/1171/20180216-Water-SAWRD2020-FA-Draft-Submission-UnitingCommunities.pdf.aspx?Embed=Y>.

The governance structure provides separation between the Commission’s decision-making role and the process of negotiation between SA Water and customer representatives along with independent oversight.

The governance structure also does not change the role of SA Water; it will continue to be accountable for delivering services that meet its customers’ needs, while meeting all relevant regulatory obligations. The approach only enhances that accountability by facilitating a direct negotiation process between SA Water and customer representatives, during the development of SA Water’s business plan. That plan will ultimately represent SA Water’s commitment to its customers. It will also be expected to report its progress against its plan to all stakeholders regularly in a transparent and meaningful manner.

A summary of the new roles to be established under the SAW RD20 process is provided in the following sections.

Figure 3.1: SAW RD20 governance structure



**3.2.1 The Negotiation Forum**

The Commission will require SA Water to establish and support a Negotiation Forum to allow a group of customer representatives to challenge SA Water as it develops its business plan.

The Negotiation Forum will comprise:

- ▶ a three-member Customer Negotiation Committee, led by an Independent Customer Chair (appointed by the Commission), along with a customer representative from SA Water’s Customer Working Group and a customer representative from the Consumer Experts Panel
- ▶ a three-member SA Water Negotiation Committee, sourced and supported by the highest levels of SA Water’s management, and

An Independent Probity Advisor, appointed by the Commission, will provide oversight of the Negotiation Forum.

SA Water will chair the meetings and provide the secretariat support, to ensure that SA Water maintains ownership of the development and delivery of its business plan.

To assist it in its role, the Customer Negotiation Committee will be provided with the Commission's Guidance Papers, the report from the Consumer Experts Panel, additional background information from other regulators, the ability to seek further guidance from the Commission at any time, and the opportunity to seek access to independent expert advice, if needed.

A successful negotiation process does not require the Customer Negotiation Committee and SA Water to reach agreement on all aspects of the draft business plan. The negotiation process is non-binding and the Commission will remain responsible for making a regulatory determination that best serves consumers' long-term interests. However, where issues are successfully negotiated between the parties and are consistent with the guidance provided by the Commission up front, the Commission is likely to accept or give significant weight to those outcomes when making its determination. Where there are areas of disagreement, the Commission expects those areas to be made clear in SA Water's submitted business plan and in the report from the Chairperson of the Customer Negotiation Committee. The Commission will exercise its judgement on those issues in making its regulatory determination.

### 3.2.2 Independent Chair

The Independent Customer Negotiation Committee Chair will be appointed by the Commission and will have the responsibility of representing SA Water's customers during the negotiation process. Key functions include:

- ▶ leading, managing and coordinating the Customer Negotiation Committee's input to the Negotiation Forum
- ▶ liaising with the Commission to identify areas of process particularly where more information is required
- ▶ preparing a public report to the Commission following the negotiation process which summarises the views of the Customer Negotiating Committee and those areas where further analysis and judgement is required by the Commission in making its regulatory determination. That report will follow and respond to SA Water's business proposal. SA Water will not provide input into the Independent Chair's public report.

### 3.2.3 Independent Probity Advisor

The Independent Probity Advisor will be appointed by the Commission and will be responsible for monitoring and reporting any probity issues that may arise during the negotiation process between SA Water and the Customer Negotiation Committee. Key functions include:

- ▶ Observing the Negotiating Forum and providing oversight of the integrity of the negotiation process and information exchange between SA Water and the Customer Negotiation Committee.
- ▶ Liaison with the Independent Customer Negotiation Committee Chair and SA Water to draw issues forward.
- ▶ Liaison with the Commission to raise any probity concerns and identify areas of process where more information is required or where other actions to address any deficiencies in the process may be necessary.
- ▶ Preparing a public report to the Commission on any probity issues arising under the negotiation process and comment on the overall integrity of the process.

### 3.2.4 The Consumer Experts Panel

Members of the Commission's Consumer Advisory Committee and SA Water's Customer Advisory Groups will be invited to join the Consumer Experts Panel. The Consumer Experts Panel will provide a more structured manner for consumer representatives and advocates to provide input to the process, to challenge SA Water and to reflect consumer views more broadly. Its membership will cover a diverse group of consumers who all have an interest in helping shape the services SA Water provides.

The individual Consumer Experts Panel members already provide insights into the needs and preferences of particular customer segments. They work directly with their constituencies to gather evidence on any particular issues for those groups of customers.

Those groups, however, have advised that they have limited resources available to engage in regulatory consultation processes and there are many competing interests they need to manage. The SAW RD20 framework and approach seeks to provide members with the opportunity to have their views heard through an efficient, effective and inclusive process.

The Commission will invite the Consumer Experts Panel to prioritise the key issues that need to be considered as SA Water develops its business plan through a Priorities Report. The Consumer Experts Panel will be invited to share the findings from that report and its other research, with the aim of consolidating the group's collective knowledge about the needs of SA Water's customers. Where this process identifies some gaps, and where further research will be required, the Commission will provide resources to assist with the organisation and conduct of the consolidated priority research program.

The evidence, and other outputs, from these joint issue identification and prioritisation exercises will be provided to SA Water and to the Negotiation Forum and will be a critical input to the determination process. The Commission will invite the Consumer Experts Panel members to provide further information to the Negotiation Forum as it conducts its detailed discussions.

### 3.2.5 Regulators' Working Group

The Commission will facilitate greater coordination between the technical, safety, environmental and public health regulators through a Regulators' Working Group to clarify each regulator's respective role in the regulatory system, to minimise duplication of effort, and to identify joint solutions or efficiencies (where possible). Those regulators are the Environment Protection Authority, SA Health, the Office of the Technical Regulator and the Department of Environment and Water. The Commission has held preliminary discussions with those regulators and they have expressed support for this approach.

It is important to recognise that each regulator has an important role to play in the overall regulatory system and that individual members have an obligation to perform their duties. The Commission took steps to better coordinate its approach with other regulators during SAW RD16. This included working with them to better understand their roles, functions and priorities. The Commission also worked to introduce greater transparency around the obligations SA Water was required to meet, by requesting public submissions from these other regulators on the extent to which SA Water's 2016 Regulatory Business Proposal reflected their requirements. The Commission continues to meet quarterly with regulators to discuss emerging issues.

Stakeholders have expressed support for even greater coordination between regulators to ensure that SA Water can efficiently meet a range of regulatory requirements imposed at least cost to consumers. They also commented on the need to ensure that regulatory costs are transparent.

SA Water will be asked to provide briefings to the group on various aspects of its strategy, performance and future plans. Starting with a shared understanding of the issues will allow for greater coordination of the obligations and expectations we each place on SA Water through a joint planning approach. The Regulators' Working Group, to be chaired by the Commission, will ensure that any minimum service standards or requirements are clearly communicated to SA Water, and the other members of the

Negotiation Forum, prior to its discussion. This approach should reduce the overall cost of regulating SA Water, which will ultimately flow through to savings for customers.

The Regulators' Working Group will continue to work together throughout the 2020-2024 regulatory period to jointly monitor, evaluate and report (as appropriate) developing a more holistic understanding of SA Water's operations and service delivery outcomes.

### 3.3 Why has the Commission enhanced its review process?

The Commission is aiming to overcome the challenges inherent in the current approach, including:

- ▶ the large information asymmetries between SA Water, the Commission and other stakeholders
- ▶ the lack of involvement of customers in the decision-making process, and
- ▶ the limited time to resolve issues identified in SA Water's regulatory business proposal once developed.

The framework and approach for SAW RD20 addresses those issues by facilitating earlier engagement on regulatory issues, increased opportunities for stakeholder feedback and giving customers greater input into the process through the Consumer Expert Panel and Customer Negotiation Committee.

The negotiation process, together with more structured input from consumer representatives, will allow a customer perspective to better inform the Commission's determination. The Commission is mindful that an absence of customer input to regulatory processes may not deliver the lowest sustainable prices or best service levels to customers. This can arise from a lack of evidence on those matters which properly reflect customer views.

The Commission is responding to the challenge raised by stakeholders to enhance its engagement process. The submissions from SACOSS, Business SA and Uniting Communities all called for greater transparency and for greater involvement of consumers and their representatives in the regulatory process.<sup>10</sup> The Commission's approach seeks to deliver that improvement.

The approach also recognises the improvements SA Water has made since SAW RD16 in becoming a more customer-focused business, and by delivering significant cost reductions, which have flowed through to lower prices for customers.

The Commission has also taken into account that regulatory processes within Australia and overseas are also using stronger consumer involvement processes that aim to deliver better customer outcomes. The enhancements to its regulatory determination process will ensure that South Australia remains at the forefront of good regulatory process and practice.

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<sup>10</sup> Those submissions are available on the Commission's website at <https://www.escosa.sa.gov.au/projects-and-publications/projects/water/sa-water-regulatory-determination-2020-framework-and-approach>.

## 4 The proposed review process

The proposed process for SAW RD20 is set out in Table 4.1. The process includes multiple stages where stakeholder input will be sought.

Table 4.1: Proposed SAW RD20 process

Date	SAW RD20 Milestone
July 2018	Release of final Framework and Approach
July 2018	Commission appoints Customer Negotiation Committee, Independent Probity Advisor and establishes Consumer Experts Panel
End-Oct 2018	Release of Guidance Papers
End-Oct 2018	Consumer Experts Panel produces Priorities Report
Feb-Jun 2019	Negotiation Forum
Oct 2019	SA Water submits proposed business plan for 2020-2024
Oct 2019	Independent Chair of the Customer Negotiation Committee submits report on negotiation process and outcomes
Oct 2019	Independent Probity Advisor submits report on integrity of negotiation process
Oct – Dec 2019	Consultation on SA Water's proposed business plan and reports of the Independent Chair and Independent Probity Advisor
Feb 2020	Commission issues draft regulatory determination
Feb – Mar 2020	Consultation on draft regulatory determination
May 2020	Commission issues final regulatory determination
July 2020	Approved SA Water business plan takes effect

The Commission will consult with a wide range of stakeholders and work with the State Government and other regulators to ensure that the regulatory frameworks under which SA Water must operate are clear, well in advance of SA Water submitting its business plan. The State Government has an important role in setting certain requirements for SA Water, including the community service obligations that SA Water must provide. It will also be conducting an inquiry into SA Water's prices, including the value of SA Water's regulated asset base, prior to SAW RD20 taking effect. The Commission will work with the State Government to make sure that the proposed approach is consistent with those policy requirements.

## Appendix 1: Legal framework for the economic regulation of SA Water

The regulatory functions of Commission are set out in Section 5 of the ESC Act. Functions relevant to the economic regulation of SA Water include:

### *5 – Functions*

*The Commission has the following functions:*

- (a) to regulate prices and perform licensing and other functions under relevant industry regulation Acts;*
- (b) to monitor and enforce compliance with and promote improvement in standards and conditions of service and supply under relevant industry regulation Acts;*
- (c) to make, monitor the operation of, and review from time to time, codes and rules relating to the conduct or operations of a regulated industry or regulated entities.*

In performing these functions, the following objectives (including the Commission's primary objective when undertaking any function) inform and guide the Commission. They are set out in Section 6 of the ESC Act.

### *6 – Objectives*

*In performing the Commission's functions, the Commission must –*

- (a) have as its primary objective protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services; and*
- (b) at the same time, have regard to the need to –*
  - (i) promote competitive and fair market conduct; and*
  - (ii) prevent misuse of monopoly or market power; and*
  - (iii) facilitate entry into relevant markets; and*
  - (iv) promote economic efficiency; and*
  - (v) ensure consumers benefit from competition and efficiency; and*
  - (vi) facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and*
  - (vii) promote consistency in regulation with other jurisdictions.*

With regard to the Commission's principal statutory objective, three elements of service delivery are captured – price, quality and reliability – and these are to be interpreted in a context of economic efficiency. That is particularly so in light of the fact that Sections 6(b)(iv) and (v) of the ESC Act expressly refer to efficiency considerations.

## Price determination powers

### Under the ESC Act

Part 3 of the ESC Act sets out a legislative scheme governing the exercise of the Commission's price determination powers and functions.

Sections 25(1) and 25(2) have the combined effect of empowering the Commission to make price determinations where authorised to do so by a relevant industry regulation Act, which, in this case, is the Water Industry Act.

Section 25(3) provides that a price determination may regulate prices, conditions relating to prices, or price fixing factors in any manner the Commission considers appropriate. Examples include:

- (a) fixing a price or the rate of increase, or decrease, in a price
- (b) fixing a maximum price, or maximum rate of increase, or minimum rate of decrease, in a maximum price
- (c) fixing an average price for specified goods or services, or an average rate of increase or decrease in an average price
- (d) specifying pricing policies or principles
- (e) specifying an amount determined by reference to a general price index, the cost of production, a rate of return on assets employed, or any other specified factor
- (f) specifying an amount determined by reference to quantity, location, period or other specified factor relevant to the supply of goods or services
- (g) fixing a maximum average revenue, or maximum rate of increase, or minimum rate of decrease in maximum average revenue, in relation to specified goods or services, or
- (h) monitoring the price levels of specified goods and services.

These examples are not exhaustive and the Commission may make a price determination to operate in a manner it considers appropriate, subject to any specific requirements of an industry regulation Act. In the case of the Water Industry Act, certain requirements do exist, as discussed below.

As well as the general factors set out in Section 6 of the ESC Act, Section 25(4) specifies additional factors to which the Commission must have regard when exercising its price determination function. They include:

- (a) the particular circumstances of the regulated industry and the goods and services for which the determination is being made
- (b) the costs of making, producing or supplying the goods or services
- (c) the costs of complying with the laws or regulatory requirements
- (d) the return on assets in the regulated industry
- (e) any relevant interstate and international benchmarks for prices, costs and return on assets on comparable industries
- (f) the financial implications of the determination
- (g) any factors specified by a relevant industry regulation Act, or by regulation under the Act, and
- (h) any other factors that the Commission considers relevant.

Two further statutory imperatives arise under section 25(5) of the ESC Act in relation to price determinations. They are:

- (a) wherever possible, the costs of regulation do not exceed the benefits, and
- (b) the decision takes into account and clearly articulates any trade off between costs and service standards.

Finally, section 25(6) provides that subsections 25(3), 25(4) and 25(5) have effect in relation to a regulated industry, subject to the provisions of the relevant industry regulation Act for that industry (in this case, the Water Industry Act).

### **Under the Water Industry Act**

Section 17 of the Water Industry Act declares that the water industry is a regulated industry for the purposes of the ESC Act. Accordingly, the Commission has a general power to regulate prices in the water and sewerage industries.

Specifically, in terms of the price regulation function, the Water Industry Act provides that:

#### *7 – Functions and powers of Commission*

(1) *The Commission has (in addition to the Commission's functions and powers under the Essential Services Commission Act 2002) –*

- (a) *the licensing, price regulation and other functions and powers conferred by this Act...*

The provisions of the Water Industry Act that confer pricing powers on the Commission are set out in section 35. Consistent with the general discretionary powers under Part 3 of the ESC Act, the price determination power set out in section 35 of the Water Industry Act is discretionary:

#### *35 – Price regulation*

(1) *Subject to this section, the Commission may make a determination under the Essential Services Commission Act 2002 regulating prices, conditions relating to prices, and price fixing factors for retail services.*

A 'retail service' is defined in section 4 of the Water Industry Act to include a service constituted by:

- (a) *the sale and supply of water to a person for use (and not for resale other than in prescribed circumstances (if any)) where the water is to be conveyed by a reticulated system; or*
- (b) *the sale and supply of sewerage services for the removal of sewage,*  
*(even if the service is not actually used) but does not include any service, or any service of a class, excluded from the ambit of this definition by the regulations.*

Accordingly, any operations or services falling outside the scope of the above definition are not subject to price regulation by the Commission – for example, the provision of network services on a stand alone basis. In addition, section 5(2) of the Water Industry Act states that services provided, or infrastructure held, by irrigation trusts (as defined in the Irrigation Act 2009), the Renmark Irrigation Trust or persons providing irrigation services designated by the Minister, are not subject to the provisions of the Water Industry Act.

## Pricing Orders

The price regulation provisions of the Water Industry Act also include a framework for the Treasurer to issue pricing orders. Section 35(4) provides that the Treasurer may issue a pricing order that:

- (a) sets out any policies or other matters that the Commission must have regard to when making a determination
- (b) specifies various parameters, principles or factors that the Commission must adopt or apply in making a determination, and
- (c) relates to any other matter that the Treasurer considers to be appropriate in the circumstances.

Pursuant to section 35(3) of the Water Industry Act, the Commission must comply with the requirements of a pricing order when making a determination.

## Industry licences, codes and rules

The Commission has additional powers to issue licences to entities providing water and sewerage retail services and make industry codes or rules that apply to the conduct or operations of such entities, once licensed.

### Under the ESC Act

Part 4 of the ESC Act provides the Commission with broad powers to make, vary and amend industry codes or rules. Industry codes prescribe the rules of conduct and procedures that must be followed by regulated entities providing essential services. The use of industry codes allows for a high degree of regulatory flexibility while maintaining appropriate scrutiny, accountability and transparency in the process of their development. Industry codes can cover any number of areas within a regulated industry, from consumer protection to technical matters.

Section 28(3) requires the Commission to consult with the relevant industry Minister, representative bodies and participants in the regulated industry prior to making, varying or revoking a code or rule. Further, section 28(8) requires that any codes or rules be periodically reviewed by the Commission to ensure they continue to be relevant and effective.

### Under the Water Industry Act

The Water Industry Act requires the Commission to issue SA Water with a non-transferable perpetual licence, which it did on 1 January 2013. Section 25(1) requires it to make a licence subject to various conditions. While some conditions must be imposed as stand alone licence conditions, others must be prescribed in industry codes and rules made by the Commission under the ESC Act.<sup>11</sup>

In issuing licences under section 25(1) of the Water Industry Act, Section 25(2) requires the Commission to have regard to the scale and nature of the operations of the water industry entity – with the scale and nature being determined by it after consultation with the entity or a person or body nominated by the entity.

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<sup>11</sup> The Code has been made by the Commission pursuant to the requirements of Section 25(1).

In addition, section 25(5) requires the Commission, in making an industry code under section 25(1), to include provisions to assist customers who may be suffering specified types of hardship relevant to the supply of any services (such provisions to comply with any direction of the Minister). This provision operates in conjunction with section 37(1) of the Water Industry Act which requires the Minister to develop and publish a customer hardship policy in respect of residential customers of water industry entities. In summary, the Minister's hardship policy must set out:

- ▶ the processes water industry entities must have in place to identify residential customers experiencing payment difficulties due to hardship, and
- ▶ the range of processes or programs that a water industry entity should use to assist hardship customers.

The Minister published the applicable hardship policy in February 2013. Section 37(3) requires a water industry entity to adopt the Minister's hardship policy and section 37(4) makes compliance with the policy a condition of a licence issued to a water industry entity by the Commission.

## Appendix 2: Roles and responsibilities of participants in water regulation

The Commission undertakes its role as the economic regulator within a broader legislative and policy framework. A summary of the key entities involved in the regulation of SA Water is provided in the table below.

Entities involved in the regulation of the water industry

Entity	Overview of role within the water industry	Relevant legislation
Consumer and Business Services	Responsible for administration of the Australian Consumer Law, covering consumer protection and fair trading, in South Australia  Regulates the relationship between landlords and tenants for the payment of rates and charges for water and sewerage services  Regulates the professional conduct of plumbers	Competition and Consumer Act 2012  Residential Tenancies Act 1995  Plumbers, Gasfitters and Electricians Act 1995
Department of Human Services	Develops customer hardship and concession policies  Administers the Consumer Advocacy and Research Fund	Water Industry Act 2012
Department of 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 water 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	Regulates behavioural standards for the sale and supply of water and sewerage retail services  Establishes average customer service and reliability service standards for water and sewerage retail services and assesses the prudent and efficient costs for delivery of water and sewerage retail services  Regulator for the third party access regime	Essential Services Commission Act 2002  Water Industry Act 2012
Minister for Environment and Water	Administers the Water Industry Act  Directs SA Water's Board in performing its functions	Water Industry Act 2012  South Australian Water Corporation Act 1994  Public Corporations Act 1993
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	Water Industry Act 2012
Treasurer of South Australia	Sets licence fees for water industry entities  Issues pricing orders	Water Industry Act 2012



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