

# SA WATER SERVICE STANDARDS

*Draft Framework and Approach*

November 2013



## REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (**the Commission**) invites written submissions from all members of the community in relation to this Draft Report. Written comments should be provided by **Friday, 14 February 2014**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

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

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

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The Essential Services Commission of South Australia is the independent economic regulator of the electricity, gas, ports, rail and water industries in South Australia. The Commission's primary objective is the *protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services*. For more information, please visit [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

# TABLE OF CONTENTS

- Glossary of Terms \_\_\_\_\_ ii
- Executive Summary \_\_\_\_\_ 1
- 1. Introduction \_\_\_\_\_ 5
  - 1.1 Legislative framework and Commission’s role \_\_\_\_\_ 5
  - 1.2 Established service standards \_\_\_\_\_ 7
  - 1.3 Purpose of this report \_\_\_\_\_ 8
- 2. Framework \_\_\_\_\_ 9
  - 2.1 Service standards framework \_\_\_\_\_ 10
  - 2.2 Incentives framework \_\_\_\_\_ 13
- 3. Approach \_\_\_\_\_ 19
  - 3.1 Customer engagement \_\_\_\_\_ 19
  - 3.2 Service standards \_\_\_\_\_ 22
  - 3.3 Targets \_\_\_\_\_ 28
  - 3.4 Financial incentives \_\_\_\_\_ 32
- 4. Next Steps \_\_\_\_\_ 34

## GLOSSARY OF TERMS

<b>AEMC</b>	Australian Energy Market Commission
<b>AER</b>	Australian Energy Regulator
<b>Commission</b>	Essential Services Commission of South Australia
<b>ESC Act</b>	<i>Essential Services Commission Act 2002 (SA)</i>
<b>ESCOSA</b>	Essential Services Commission of South Australia
<b>ESCV</b>	Essential Services Commission of Victoria
<b>EWOSA</b>	Energy And Water Ombudsman SA
<b>First Price Determination</b>	SA Water's Water and Sewerage Revenues 2013/14 - 2015/16 Final Determination
<b>First Regulatory Period</b>	1 July 2013 to 30 June 2016
<b>GSL</b>	Guaranteed Service Level
<b>IPART</b>	Independent Pricing & Regulatory Tribunal, NSW
<b>Ofwat</b>	The Water Services Regulation Authority, the economic regulator of the water & sewerage sectors in England & Wales
<b>OMS</b>	Outage Management System
<b>NPR</b>	National Performance Report
<b>RBP</b>	SA Water's Regulatory Business Proposal
<b>SA Power Networks</b>	South Australia's electricity distribution network operator (formerly ETSA Utilities)
<b>SA Water</b>	South Australian Water Corporation
<b>Second Price Determination</b>	The Commission's price determination to apply to SA Water's retail services for the Second Regulatory Period
<b>Second Regulatory Period</b>	The regulatory period commencing 1 July 2016
<b>SIM</b>	Service Incentive Mechanism (Ofwat)
<b>STPIS</b>	Service Target Performance Incentive Scheme (AER)
<b>Water Industry Act</b>	<i>Water Industry Act 2012 (SA)</i>

## EXECUTIVE SUMMARY

The Essential Services Commission of South Australia (**Commission**), established under the *Essential Services Commission Act 2002*<sup>1</sup> (**ESC Act**), is the independent economic regulator of essential services in South Australia. In undertaking its regulatory functions, the Commission's primary objective is the ***protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.***<sup>2</sup>

### *Purpose*

This paper outlines the proposed service standards and incentives framework for the second price determination (**Second Price Determination**) in respect of the water and sewerage retail services provided by the South Australian Water Corporation (**SA Water**) for the period commencing 1 July 2016 (**Second Regulatory Period**). Service standards are a key element in determining prudent and efficient SA Water capital and operating expenditures.

This framework seeks to mimic the workings of competitive markets, requiring monopoly service providers (in this case SA Water) to engage with customers to determine the best price-service delivery outcomes. Such outcomes achieve the best trade-off between the value to customers of service levels versus the costs of providing them.

Detailed aspects of the framework (e.g., the targets set for service standards) will be set as part of the price determination process. This paper also outlines the proposed approach or process for achieving this.

### *Customer engagement*

In the absence of a competitive market for the services provided by SA Water, effective customer engagement is crucial to the development of service standard targets set for the Second Regulatory Period.

The Commission will therefore require SA Water to engage meaningfully with its customers on matters relating to the level of service.

SA Water will need to demonstrate that expenditure proposals in its Regulatory Business Proposal (**RBP**) and other aspects of the framework as discussed in this paper (e.g., RBP service standard target proposal) have been informed by robust customer consultation. To be able to demonstrate that expenditures are prudent and efficient requires evidence that the corresponding service levels reflect customer preferences. To properly achieve this, customers need to be informed on service level-cost trade-offs, e.g., be in a position to assess whether their preference would be for a lower level of service in return for a stated reduction in bills.

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<sup>1</sup> Refer <http://www.legislation.sa.gov.au/LZ/C/A/Essential%20Services%20Commission%20Act%202002.aspx>.

<sup>2</sup> ESC Act 2002, section 6(a).

The Commission expects to be closely involved in SA Water’s development of its consultation process.

The Commission is releasing this paper to provide all members of the community with the opportunity to provide input into the service standards and incentives framework, as it will do at other stages during the process of making its price determination for the Second Regulatory Period.

*Service standards*

For the purposes of the Second Price Determination, the term *service standard* when used in its specific sense will refer to the element of service quality that customers value.

*Timeliness of water service restoration* is an example of a service standard, which as currently applied to SA Water reads in part:

<i>Adelaide Metropolitan</i>	<i>Target</i>
<i>Percentage of Category 1 events restored within 5 hours</i>	<i>90%</i>
<i>Percentage of Category 1 events restored within 12 hours</i>	<i>99%</i>

Category 1 events apply where the interruption could be life threatening or otherwise have serious consequences.

The timeliness of restoration is influenced by factors such as the availability of crews, the sophistication of the available restoration equipment and how ‘meshed’ the water network is (the latter factor influencing the ability to restore supply to some individuals quickly by re-routing supply from other segments of the network), which in turn impacts on the level of operating and/or capital expenditure. The expectation is that a lower target will require fewer resources and hence lower cost.

In the above example, used in its specific sense the service standard is water service restoration responsiveness. The term *target* will apply to associated numeric values, which in terms of the *timeliness of water service restoration* example would cover the time period (e.g., within 5 hours) and performance level (90%).

However, the broad use of the term *service standard* will be taken to include the associated target(s).

Under the proposed framework, the Commission will determine the service standards and targets (and any supplementary performance indicators). SA Water will be required to propose a target for each service standard, evidence-based through its customer engagement, for the Commission to consider.

That is, the Commission will set service standards and approve targets consistent with the long term interests of customers. However, there will be an onus on SA Water to consult with its customers in its development of proposed targets, so that they reflect the best understanding of customer trade-off between levels of service and associated cost. In the water restoration example, would customers prefer 80% restoration within 5 hours (rather

than 90% within 5 hours) in turn for a reduced bill? Would the reduced bill more than offset the slower on average response time (in terms of value to the customer)?

The Commission will have regard to a number of factors in determining the final targets, such as the evidence-based targets proposed by SA Water, levels of historical performance, customer satisfaction with existing performance levels and interstate comparisons.

The Commission will require SA Water to undertake a level of scenario-testing of any service standard targets proposed, to ensure that customers are given the opportunity to at least consider whether they would prefer to accept higher/lower levels of service in exchange for higher/lower bills.

The Commission will be closely involved with SA Water in its development of its proposed approach to meeting its obligations under the service standard framework, to ensure that the Commission has reasonable confidence in that approach.

During the Second Regulatory Period the Commission will monitor and report on SA Water's performance against the service standard targets to check that the standards set are delivered by SA Water to its customers, on a *best endeavours* basis.

### *Incentive scheme for service standards*

Regulatory regimes in the energy sector often include service incentive schemes that financially encourage service providers to meet service targets (i.e. a level of revenue is put at risk should targets not be met).

Based on the Commission's experience in the energy industry, the financial incentive elements of an efficient service standards framework would comprise:

- ▲ service incentive scheme – if adopted for SA Water, would provide a financial incentive to achieve the service standards; and
- ▲ Guaranteed Service Level (**GSL**) scheme – if adopted for SA Water, would result in customers receiving payment where separately defined levels of service are not met.

For example, in the energy sector service reliability is a key element of service incentive schemes. However, if customer engagement showed reliability not to be such an issue for water (e.g., if supply to customers can generally be maintained even in the case of burst water mains) then the Commission's monitoring and reporting regime which seeks to ensure SA Water's compliance in using its best endeavours to meet service standards may be sufficient. Alternatively, there may be other service standards warranting performance efforts to be reinforced through a financial incentive scheme.

Ultimately it may be simply uneconomic to seek to ensure that all customers receive the average service level targets set, with the approach adopted by some other schemes being the inclusion of GSL payments, with customers receiving a payment where separately defined levels of service are not met. However, GSL schemes involve an expense to establish and maintain.

As indicated above, the Commission has not determined at this time whether either financial incentive component should apply to SA Water for the Second Regulatory Period and will consider whether to apply either component to SA Water as part of its price determination deliberations. A key factor will be the extent to which customer consultation provides justification for their adoption.

### *Next steps*

The Commission is seeking submissions from all members of the community on this Draft Framework and Approach paper, with submissions due on or before **14 February 2014**. All submissions will be placed on the Commission's website, subject to any confidential material being excluded.

It is intended that the Service Standard and Incentives Framework be finalised in July 2014, following consideration of submissions received on this paper. Key elements of this framework (e.g., service standard targets) will be determined as part of the price determination process. An indicative timetable for finalising service standards (including targets) is outlined in Chapter 4 of this paper.

# 1. INTRODUCTION

The establishment of service standards occurs within a statutory framework. This chapter provides an overview of the legislative regime within which the Commission works and the specific provisions which relate to service standard setting, as well as outlining the structure of the rest of this report.

## 1.1 *Legislative framework and Commission's role*

The Essential Services Commission of South Australia (**Commission**) is a statutory authority, established under the *Essential Services Commission Act 2002 (ESC Act)* as a general regulator of essential services in South Australia, including the essential service of water supply.

Section 5 of the ESC Act provides the Commission with a set of regulatory functions:

### **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;*
- (d) to provide and require consumer consultation processes in regulated industries and to assist consumers and others with information and other services;*
- (e) to advise the Minister on matters relating to the economic regulation of regulated industries, including reliability issues and service standards;*
- (f) to advise the Minister on any matter referred by the Minister;*
- (g) to administer this Act;*
- (h) to perform functions assigned to the Commission under this or any other Act;*
- (i) in appropriate cases, to prosecute offences against this Act or a relevant industry regulation Act.*

In the performance of those functions, the Commission is required to meet the statutory objectives set out at section 6 of the ESC Act, which includes a paramount statutory objective:

### **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.*

Together, these sections set out the broad scope of the Commission's role and a framework for its performance of that role. As can be seen from the provisions of section 5(a), the ESC Act expressly contemplates that other Acts, such as the Water Industry Act in the case of setting service standards for SA Water, will at times call up the Commission's powers and functions.

From 1 July 2012 the South Australian water industry has been a regulated industry under the *Water Industry Act 2012* (**Water Industry Act**). Therefore, the Commission has the ability to use its broad regulatory powers and functions under the ESC Act within the South Australian water industry.

Section 25 of the Water Industry Act requires the Commission to make a water retail licence subject to conditions determined by the Commission, including requiring the licensee to comply with minimum standards of service and requiring the licensee to monitor and report as required on service performance indicators.

These standards are set in the context of the Commission's economic regulatory role in the water and sewerage industries and are distinct from health, environmental and technical standards set by other regulatory bodies (such as the Environmental Protection Authority or the Technical Regulator).

The Commission therefore has the power to set service standards for licensed water entities, such as SA Water. SA Water is legally bound to deliver on independently established customer service standards, which are enforceable by the Commission.

Finally, section 25(5) of the ESC Act is relevant to the exercise of setting service standards:

*(5) In making a price determination under this section, the Commission must ensure that—*

*(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.*

## 1.2 Established service standards

In May 2013, the Commission made its First Price Determination in respect of the water and sewerage retail services provided by the South Australian Water Corporation (**SA Water**). The Commission's *SA Water's Water and Sewerage Revenues 2013/14 - 2015/16 Final Determination (First Price Determination)* sets the maximum average revenues that SA Water can earn during the period 1 July 2013 to 30 June 2016 (**First Regulatory Period**).<sup>3</sup>

The Commission took the approach of setting service standards which reflected SA Water's underlying historical service performance outcomes. As noted in the First Price Determination Statement of Reasons:

*"That position was developed through the public process of providing regulatory advice to the Treasurer during 2011 and 2012, was agreed by stakeholders generally and, in particular, was endorsed by SA Water as an appropriate regulatory approach".<sup>4</sup>*

The SA Water service standards for the period from 1 January 2013 through to 30 June 2016<sup>5</sup> are available on the Commission's website.<sup>6</sup>

As also noted in the First Price Determination Statement of Reasons, the final set of targets for the First Regulatory Period were to be set having regard to identified issues with the metropolitan historical performance data able to be supplied by SA Water, with the targets ultimately set in early 2013/14 to reflect the Commission's best understanding of SA Water's underlying historical performance.<sup>7,8</sup>

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<sup>3</sup> Essential Services Commission of South Australia, *SA Water's Water and Sewerage Revenues 2013/14 – 2015/16, Final Determination – Statement of Reasons*, May 2013; available at [http://www.escosa.sa.gov.au/library/130527-SAWater\\_Water\\_SewerageRevenues\\_2013-16-FinalDetermination-StatementOfReasons\\_0.pdf](http://www.escosa.sa.gov.au/library/130527-SAWater_Water_SewerageRevenues_2013-16-FinalDetermination-StatementOfReasons_0.pdf).

<sup>4</sup> *Op. cit.*, page 22.

<sup>5</sup> This period covers the initial six month period (January to June 2013 - reflecting that SA Water was first licensed on 1 January 2013) and the current regulatory period (July 2013 to June 2016).

<sup>6</sup> Refer <http://www.escosa.sa.gov.au/water-overview/codes-guidelines/service-standards.aspx>.

<sup>7</sup> *Op. cit.*, page 25.

<sup>8</sup> Essential Services Commission of South Australia, *SA Water Service Standards 2013/14 – 2015/16, Final Decision*, October 2013; available at [http://www.escosa.sa.gov.au/library/130926-SAWaterServiceStandards\\_2013-2016-FinalDecision.pdf](http://www.escosa.sa.gov.au/library/130926-SAWaterServiceStandards_2013-2016-FinalDecision.pdf).

### 1.3 Purpose of this report

This paper outlines the proposed service standard and incentives framework for the second price determination (**Second Price Determination**) to apply to SA Water in respect of the water and sewerage retail services, for the period commencing 1 July 2016 (**Second Regulatory Period**). This paper provides more detail on the service standard requirements outlined in the Second SA Water Price Determination-Draft Framework and Approach paper.<sup>9</sup>

Determining appropriate service standards is an integral component of the Commission's framework for the second price determination (**Second Price Determination**), for the second regulatory period commencing 1 July 2016 (**Second Regulatory Period**). The objective is for an outcome that achieves the best trade-off between the value to customers of service levels versus the costs of providing them. The Commission must ensure that efficient service standards are set in order to set cost-reflective prices.

Chapter 2 develops the basis for setting efficient service standards and discusses the merits of establishing formal financial incentives for SA Water to achieve those standards.

Chapter 3 outlines the proposed approach for the Commission to be able to set the final targets for the approved service standards.

Chapter 4 presents the next steps in finalising elements of the framework outlined in this paper and achieving a final set of service standards (and targets) to apply to SA Water from 1 July 2016.

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<sup>9</sup> Essential Services Commission of South Australia, *Second SA Water Price Determination-Draft Framework and Approach*, November 2013; available at [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

## 2. FRAMEWORK

The proposed service standards framework covers establishing efficient service standards and then assessing the merits of establishing formal financial incentives for SA Water to achieve those standards, both elements of which are discussed in this chapter.

This framework seeks to mimic the workings of competitive markets, requiring monopoly service providers (in this case SA Water) to engage with customers to determine the best price-service delivery outcomes. Such outcomes achieve the best trade-off between the value to customers of service levels versus the costs of providing them.

Based on the Commission's experience in the energy industry, the components that make up an efficient service standards framework comprise:

- ▲ service standards – the efficient level of service which SA Water will be required to use best endeavours to achieve;
- ▲ service incentive scheme – if adopted for SA Water, would provide a financial incentive to achieve the service standards; and
- ▲ Guaranteed Service Level (**GSL**) scheme – if adopted for SA Water, would result in customers receiving payment where separately defined levels of service are not met.

The service incentive and GSL schemes together comprise the financial incentive element of the framework. Whilst GSLs are directed at customers, by their nature they should also provide a financial incentive for the operator to assess the merits of directly dealing with the causes of poor performance to avoid the need to make the GSL payments, which will have a direct impact on profits.

As indicated above, the Commission has not determined at this time whether either financial incentive component should apply to SA Water for the Second Regulatory Period.

The components can also be considered to represent a progression in costs:

- ▲ establishing average service standards providing the base cost;
- ▲ the service incentive scheme usually set to achieve service levels slightly above efficient levels to allow for a margin of error in setting the service standards (with some service incentive schemes including a factor to encourage service levels exceeding set standards); and
- ▲ GSLs designed to make payments to customers where it is too costly to provide the defined service standards for the individual customers affected.

Detailed aspects of the framework (e.g., the targets set for service standards) will be set as part of the price determination process. This paper also outlines the proposed approach or process for achieving this in Chapter 3.

## 2.1 Service standards framework

### 2.1.1 Background

There is an inherent trade-off between prices and service levels; higher service levels may provide extra benefits to customers, but also raise costs and prices.

The Productivity Commission notes that ensuring that the cost of supplying water, wastewater and stormwater services is not higher than necessary is an important objective for the urban water sector. Achieving this requires that the “... *level of service provided is not higher than can be justified by the value consumers place on the service*”.<sup>10</sup> That is, improvements should only be undertaken where benefits to customers exceed the cost.

In the context of the Commission’s economic regulatory role in the water and sewerage industries, the purpose of setting service standards and associated targets is:

1. To ensure that customers receive the quality of service that they value.
2. To inform the prudent and efficient level of expenditure (capex and opex) for price determination purposes.
3. Then to perform a consumer protection role through enforcement of standards, noting that the Commission’s standards are distinct from health, environmental and technical standards set by other regulatory bodies (such as the Environment Protection Authority or the Technical Regulator).

The Water Industry Act provides the Commission with the power to set service standards as part of a cohesive and legally binding framework for licensees that provide retail services in South Australia.

For the purposes of the Second Price Determination, the term *service standard* when used in its specific sense will refer to the element of service quality that customers value.

*Timeliness of water service restoration* is an example of a service standard, which as currently applied to SA Water reads in part:

<i>Adelaide Metropolitan</i>	<i>Target</i>
<i>Percentage of Category 1 events restored within 5 hours</i>	<i>90%</i>
<i>Percentage of Category 1 events restored within 12 hours</i>	<i>99%</i>

Category 1 events apply where the interruption could be life threatening or otherwise have serious consequences.

The timeliness of restoration is influenced by factors such as the availability of crews, the sophistication of the available restoration equipment and how ‘meshed’ the water network is (the latter factor influencing the ability to restore supply to some individuals quickly by re-routing supply from other segments of the network), which in turn impacts on the level of

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<sup>10</sup> Productivity Commission, *Australia’s Urban Water Sector*, No.55, August 2011, page 57; available at <http://www.pc.gov.au/projects/inquiry/urban-water/report>.

operating and/or capital expenditure. The expectation is that a lower target will require fewer resources and hence lower cost.

In the above example, used in its specific sense the service standard is water service restoration responsiveness. The term *target* will apply to associated numeric values, which in terms of the *timeliness of water service restoration* example would cover the time period (e.g., within 5 hours) and performance level (90%).

However, the broad use of the term *service standard* will be taken to include the associated target(s).

### 2.1.2 Framework

This section provides an overview of what the Commission considers is the key elements of a robust service standards framework.

Key elements of a service standards framework include:

- ▲ Selecting standards that concentrate on service aspects of most importance to customers
  - to focus attention on meeting the highest priority needs of customers and given the expectation that pursuit of standards will drive licensee behavior and hence organisational costs.
- ▲ Standards and accompanying targets will be efficient if set to meet customer requirements in terms of service-cost trade-off
  - customer engagement will be important to inform the efficient service-cost tradeoff, with poor target setting risking poor outcomes – noting higher levels of performance usually entail customers facing higher bills.
- ▲ Standards should only be set for those operational aspects under the control of the licensee
  - to reflect those aspects of performance that can be influenced by the licensee<sup>11</sup>
- ▲ Selecting a limited number of service standards
  - to enable focus to be maintained and to reduce the risk of establishing conflicting objectives for the licensee.
- ▲ Standard needs to be stated as simply and unambiguously as possible
  - to reduce the risk of the licensee not fully delivering the required level of service and/or poor classification reducing confidence in the level of reported performance.
- ▲ Selecting indicators that can accurately and cost effectively reflect performance for the area covered by the chosen standard

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<sup>11</sup> Which would include any outsourced operations, noting that contractual arrangements with third party operators should be established to enable achievement of set service standards.

- service standards based on indicators which in turn allow performance to be measured (e.g., in the case of water service restoration standard, the indicator is the percentage of specified events restored), with such indicators not excessively costly to obtain.
- ▲ Once an indicator is chosen, there needs to be confidence in the data underlying the indicator so that performance can be measured robustly
  - it becomes difficult to hold a licensee to account for performance unless there is confidence that the data reported is an accurate reflection of actual performance.

The Commission proposes to continue to set a number of service standards (and accompanying targets) for the Second Regulatory Period, together with supplementary performance indicators.

Monitoring supplementary indicators rather than setting performance outcomes through service standards can address the risk of setting targets where the required performance and/or the importance to the customer is not clear (refer section 3.2 for more discussion on supplementary indicators).

SA Water would still be required to inform the Commission of the reasons for any potential poor performance identified in supplementary indicator outcomes.

If required, supplementary performance indicators can be converted to service standards with accompanying targets able to be set on a more informed basis.

### 2.1.3 Best endeavours

The Commission proposes to continue to adopt a *best endeavours* approach to determining if a specific service standard target has been met. The Commission's definition of best endeavours in the regulatory context is *"to act in good faith and use all reasonable efforts, skill and resources to achieve an outcome in the circumstances"*.<sup>12</sup>

As explained in the Draft Advice to the Treasurer:

*Although a "best endeavours" obligation is not as onerous as an absolute obligation (like "must" or "shall"), the test to be applied in determining whether a party has satisfied its obligation is that of what is prudent and reasonable in the circumstances. Best endeavours are something less than the efforts which go beyond the bounds of reason, but are considerably more than casual and intermittent activities .... They must at least be doing all that a reasonable person could reasonably do in the*

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<sup>12</sup> Essential Services Commission of South Australia, *Water Regulatory Information Requirements Water Industry Guideline No2 (WG2/01), Explanatory Memorandum*, page 17; available at [http://www.escosa.sa.gov.au/library/121220-WaterIndustryGuidelineNo2\\_WG2\\_01-ExplanatoryMemorandum.pdf](http://www.escosa.sa.gov.au/library/121220-WaterIndustryGuidelineNo2_WG2_01-ExplanatoryMemorandum.pdf).

*circumstances. An obligation to use best endeavours means a party is required to act honestly, reasonably and make a positive effort to perform the relevant obligation.*<sup>13</sup>

The Commission adopts a two-fold test in assessing performance against the best endeavours standards:

1. first, has the target been met?;
2. if not, did the relevant licensee nevertheless use its best endeavours in its attempts to meet the target?

Where targets are not met, SA Water is required to advise the Commission why the target was not met, what action it took at the relevant time in an attempt to ensure the target was met, the nature of any preparations undertaken prior to the event(s) (e.g. internal procedures and protocols set for handling such instances, the level of planning and the ability to call on additional resources when required) and any subsequent improvements implemented. In short, SA Water must provide the Commission with sufficient information to enable the Commission to form a view as to whether or not best endeavours were employed in those circumstances.

It is only in cases where both elements of this test are not satisfied that SA Water will be found to have failed to meet the standard. That is, SA Water may fail to meet a target but, provided it used its best endeavours in attempting to meet that target, it would still satisfy the standard. A test of this sort allows for a more discretionary assessment of performance, focussing on customer service delivery in a wide range of circumstances. Such a test can also better protect consumer interests, on the basis that it permits the Commission to undertake a detailed assessment of particular circumstances or events on their merits and to report those events publicly. It can also drive process improvements for regulated businesses.

The Commission sets high targets for best endeavours service standards where the level of service performance is critical to the customer and the resulting level of reporting by the licensed entity is not unduly onerous.

## 2.2 Incentives framework

Once the service standards and associated targets are set, the Commission's focus becomes one of seeking to ensure that the licensee achieves the standards.

An incentive structure for licensees, such as SA Water, to meet service standards and underlying quality and reliability can be developed from one or more of the following factors:

1. Licence condition, with failure to meet licence conditions risking fine.
2. Public monitoring and reporting by Commission, which has implications for SA Water's corporate standing with its customers.

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<sup>13</sup> Essential Services Commission of South Australia, *Economic Regulation of the South Australian Water Industry-Draft Advice-Public Version*, August 2011, page 51; available at <http://www.escosa.sa.gov.au/library/111110-EconomicRegulationWaterIndustry-DraftAdvice.pdf>.

3. Service incentive schemes developed as an integral part of the price determination.
4. GSL scheme.

Noting that points 3 and 4 comprise the financial incentive elements of the framework discussed at the beginning of this Chapter.

### 2.2.1 Licence condition

As noted above, in the case of SA Water, the statutory obligation to meet service standards already exists noting that the objects of the Water Industry Act 2012 include:

*“...to provide for and enforce proper standards of reliability and quality in connection with the water industry...”<sup>14</sup>*

The Water Industry Act requires the Commission to make a water retail licence subject to conditions determined by the Commission, including requiring the licensee to comply with minimum standards of service and requiring the licensee to monitor and report as required on service performance indicators.<sup>15</sup> The maximum penalty for a contravention of a licence condition is \$1 million.<sup>16</sup>

Generally, enforcement action in relation to a licence condition would be pursued in the case of persistent non-delivery of performance that could not be rectified through other means.<sup>17</sup>

### 2.2.2 Monitoring and reporting

A key benefit of the regulatory framework established by the Commission for the water industry is to make transparent the levels of service being provided to customers and to monitor, and routinely report to customers and other members of the community on the performance of water retailers in meeting those standards.

The Commission has implemented a public monitoring and reporting regime for water licensees, with the first water Annual Performance Report due to be released in March 2014. This includes the release of reporting guidelines and associated explanatory memorandum.<sup>18</sup>

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<sup>14</sup> Section 3(d) of the Water Industry Act.

<sup>15</sup> Section 25 of the Water Industry Act.

<sup>16</sup> Section 27(1) of the Water Industry Act.

<sup>17</sup> Ofgem, *RIO: A New Way to Regulate Energy Networks-Final Decision*, October 2010, Page 30; available at <https://www.ofgem.gov.uk/ofgem-publications/51870/decision-doc.pdf>.

<sup>18</sup> The current relevant documents for SA Water are:

Essential Services Commission of South Australia, *Water Regulatory Information Requirements for Major Retailers, Water Industry Guideline No.2 (WG2/02)*, October 2013; available at

<http://www.escosa.sa.gov.au/library/130926-WaterRegulatoryRequirements-MajorRetailers-GuidelineNo2-WG2-2.pdf>.

Essential Services Commission of South Australia, *Water Regulatory Information Requirements for Major Retailers, Water Industry Guideline No.2 (WG2/02), Explanatory Memorandum*, October 2013; available at <http://www.escosa.sa.gov.au/library/130926-WaterRegulatoryRequirements-MajorRetailers-G2-ExplanatoryMemorandum.pdf>.

During the Second Regulatory Period the Commission will monitor and report on SA Water's performance against the service standards established by the Second Price Determination to check that the standards set are delivered by SA Water to its customers, on a *best endeavours* basis.

In addition to assessing performance in meeting service standards and monitoring supplementary performance indicators, monitoring the level of customer complaints and the extent to which complaints are resolved prior to being handled by the Energy & Water Ombudsman SA (**EWOSA**) will be a key aspect of the Commission's performance monitoring role.

### 2.2.3 Service incentive scheme

In the energy sector, the regulatory revenue determination for electricity distributors incorporates a Service Target Performance Incentive Scheme (**STPIS**), where standards are set for key criteria such as reliability and customer service, where up to 5% of the regulated revenue is at risk should such service standards not be met.

While the STPIS incorporates up to  $\pm 5\%$  of revenue at risk, with +5% to provide an incentive to achieve performance in excess of the standards, it is not considered appropriate to incentivise performance above standards set on an efficient basis, other than to allow for a small buffer to acknowledge the difficulty in setting precise targets.

The Essential Services Commission of Victoria (**ESCV**) is introducing a new incentive scheme involving "...adjusting each businesses revenue requirement to reflect their relative performance on a range of risk and service performance measures. The adjustment would be made through a Risk and Performance (RP) factor".<sup>19</sup>

The ESCV approach relies on being able to set benchmarks and monitor performance for a group of similar water entities. An RP factor would be more likely to operate successfully in the Victorian water industry situation where the ESCV has regulatory control over a number of similar type of water organisations, than would be the case in South Australia where SA Water is the only major water retailer.

The UK water regulator (**Ofwat**) has a Service Incentive Mechanism (**SIM**), which requires quarterly surveys of customers:

- a) The surveys are undertaken by Ofwat, but only cover customers who have had a problem resolved by the company or who have been in contact with the company
  - SIM has an incentive/penalty payment associated with it, although not operational until next price review determination (to occur from 2014).<sup>20</sup>

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<sup>19</sup> Essential Services Commission of Victoria, *2013 Water Price Review - Guidance on Water Plans*; October 2011, page 75; available at <http://www.esc.vic.gov.au/getattachment/3306f0d8-9c21-4574-ac3b-25002c88d9b8/Guidance-Paper-Water-Plan-guidance-for-water-price.pdf>.

<sup>20</sup> Cambridge Economic Policy Associates (CEPA), *Regulated Monopoly Service Providers and Customer Views, Preferences and Willingness to Pay, A Report for IPART* [the Independent Pricing & Regulatory Tribunal, NSW], June 2011, page 66; available at

b) SIM is based on two consumer experience measures:

- a quantitative measure based on number of complaints and unwanted contacts a company receives
  - five individual measures of performance: all lines busy and calls abandoned; unwanted telephone contacts; written complaints; written complaints not dealt with at the first stage of a company's complaint procedure; and complaints not resolved by a company and accepted for investigation by CCWater<sup>21</sup>
- a qualitative measure derived from consumer experience survey.

Whilst STPIS and similar incentive schemes seek to reinforcement reliability standards, other elements such as customer service standards are also incorporated, meaning that conceptually it should be possible to focus such schemes to provide incentives to achieve whatever key standards are identified for water that warrant particular attention being paid.

#### 2.2.4 *GSL scheme*

Ultimately it may be simply uneconomic to seek to ensure that all customers receive the average service level targets set, with the approach adopted by some other regimes being the inclusion of GSL payments, with customers receiving a payment where separately defined levels of service are not met.

A GSL scheme has been an integral component of South Australia's electricity distribution network operator SA Power Networks' Service Standard Framework since 2005/06, with the scheme contained in the Electricity Distribution Code. The GSL scheme requires SA Power Networks to make payments to customers who have received service that is worse than a pre-determined guaranteed level.<sup>22</sup>

GSLs, whilst intended to be payment for poor performance and not compensation, by their nature also provide a financial incentive for the operator, given the impact on profits. That is, there is a trade-off between making the payments or undertaking capital and/or operational expenditure to address any underlying issue.

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[http://www.ipart.nsw.gov.au/Home/Industries/Research/Reviews/Customer\\_Engagement/Customer\\_Engagement\\_on\\_Prices\\_for\\_Monopoly\\_Services\\_2011/01\\_Jul\\_2011\\_-\\_CEPA\\_Discussion\\_Paper/Consultant\\_Report\\_-\\_CEPA\\_-\\_Regulated\\_Monopoly\\_Service\\_Providers\\_and\\_Customer\\_Views\\_Preferences\\_and\\_willingness\\_to\\_Pay\\_-\\_A\\_report\\_for\\_IPART\\_-\\_June\\_2011](http://www.ipart.nsw.gov.au/Home/Industries/Research/Reviews/Customer_Engagement/Customer_Engagement_on_Prices_for_Monopoly_Services_2011/01_Jul_2011_-_CEPA_Discussion_Paper/Consultant_Report_-_CEPA_-_Regulated_Monopoly_Service_Providers_and_Customer_Views_Preferences_and_willingness_to_Pay_-_A_report_for_IPART_-_June_2011).

<sup>21</sup> Walker, A., *The Independent Review of Charging for Household Water and Sewerage Services – Final Report*, December 2009, page 227; available at <http://archive.defra.gov.uk/environment/quality/water/industry/walkerreview/documents/final-report.pdf>.

<sup>22</sup> Essential Services Commission of South Australia, *Electricity Distribution Code (EDC/10)*, February 2013, clause 1.1.4; available at <http://www.escosa.sa.gov.au/library/130131-ElectricityDistributionCode-EDC10.pdf>.

The principles underlying the SA Power Networks GSL scheme, which would be considered applicable to any GSL scheme developed for SA Water, are:

- ▲ customers value each aspect of service that is incorporated into the GSL scheme;
- ▲ the GSL target is a reasonable measure of the customer's expectation;
- ▲ the GSL payment is made to customers receiving a level of service below a predetermined level; and
- ▲ the reason for failure to meet the GSL is within the control of the licensee.<sup>23</sup>

In the Victorian water sector GSLs are more clearly considered a part of the financial incentives framework. According to the ESCV:

*"The GSL scheme was established as an incentive framework for water businesses to address areas of poor performance"*<sup>24</sup>

As a means of increasing customer protection, the ESCV required all Victorian water businesses to propose a GSL scheme for its third regulatory period (covering 1 July 2013 to 30 June 2018, or when the ESCV makes a new determination). As noted by the ESCV:

*"Under the scheme, businesses provide an automatic payment to customers who receive a level of service that is significantly worse than the average level of performance expected by most customers. The scheme helps businesses to identify the worst served customers and specific service areas that require improvement. In addition, the scheme provides financial incentives for businesses to focus on providing good quality, reliable services to all customers"*<sup>25</sup>

The ESCV considers that:

*"GSLs should reflect the most important aspects of service delivery identified by customers. GSLs should be based on customer consultation and be objectively definable, easily understandable and able to be reported. Payment amounts must give businesses incentives to deliver appropriate service levels, not compensate the customer"*<sup>26</sup>

The Commission has not determined at this time the need for SA Water to be subject to a GSL regime, noting that such a regime was only introduced into the Victorian water sector for the third regulatory period (and this current process is the early stages of the Second

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<sup>23</sup> Essential Services Commission of South Australia, *Electricity Distribution Price Review: Service Standard Framework, Initial Thoughts*, April 2003, page 35; available at [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

<sup>24</sup> Essential Services Commission of Victoria, *Review of Water Performance Report Indicators - Final Report*, August 2012, page 7; available at <http://www.esc.vic.gov.au/getattachment/01856383-c3f9-45d1-9dfe-15c25b26bf50/Performance-Indicators-Review-Final-Recommendation.pdf>.

<sup>25</sup> Essential Services Commission of Victoria, *Price Review 2013: Greater Metropolitan Water Businesses, Final Decision*, June 2013, page 5; available at <http://www.esc.vic.gov.au/getattachment/653684bc-1058-4cc9-a62b-c31053e7762a/Metropolitan-water-price-review-2013-18-final-deci.pdf>.

<sup>26</sup> Essential Services Commission of Victoria, *Price Review 2013: Greater Metropolitan Water Businesses, Final Decision*, June 2013, page 51.

Price Determination process for SA Water, with the water regulatory framework only recently established in South Australia).

Such schemes involve an expense to establish and maintain and so it is important that any adoption of a GSL scheme is on the basis of net benefits being identified.

## 3. APPROACH

Chapter 2 outlined the proposed service standards framework, with this chapter concentrating on the approach or process for implementing the framework for the Second Regulatory Period.

### 3.1 Customer engagement

Most South Australian water customers do not currently have a choice of who provides their water and sewerage services. With such monopoly provision comes the risk that consumer needs will not be properly identified, particularly in determining whether there are price-service scenarios more preferred than the one currently on offer from SA Water. A key element of the service standards and incentives framework is to put in place processes that best mimic the outcome of a competitive market, within the constraints of the current industry structure.

Customer consultation will be a key element in determining the final service standards and associated targets for the Second Regulatory Period. The Commission's service standard framework places a clear onus on SA Water to strongly engage with customers in developing its 2016 Regulatory Business Proposal.

Such customer input is important to provide confidence that the quality and reliability levels underpinning the Second Price Determination are consistent with the long term interests of consumers.

As noted by the Productivity Commission:

*“Regulators and policy makers require input from consumers because some policy decisions in the urban water sector require tradeoffs and value judgements”.*<sup>27</sup>

And further:

*“There is no competitive market to reveal the preferences of consumers across a wide range of product characteristics of urban water services. This is particularly the case regarding service quality and reliability matters. For example, there is no obvious mechanism to inform decision makers about how much consumers are prepared to pay for increases in service quality.*

*a) Open and transparent consultation therefore has an important role to play in informing utilities and regulators about the preferences, and preparedness to pay, of water consumers. Consultation can take a number of forms, including submissions, hearings, market research and the use of consumer representative groups”.*<sup>28</sup>

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<sup>27</sup> Productivity Commission, *Australia's Urban Water Sector*, No.55, August 2011, page 234; available at <http://www.pc.gov.au/projects/inquiry/urban-water/report>.

<sup>28</sup> *Op. cit.*, page 256.

From the viewpoint of the development of final service standards for the Second Regulatory Period, the Commission considers that it is important for SA Water to engage with its customers on service-cost trade-offs, in an attempt to mimic the competitive market where the service supplier needs to gain a good understanding of such a trade-off in order to be successful.

Initial review by the Commission shows a variety of approaches across jurisdictions and industries concerning the approach to customer engagement, although there is a current trend towards placing greater responsibility on the regulated business to engage with its customers. For example, in Victoria, the ESCV required water retailers to conduct broad consultation with its customers during the preparation of its regulatory proposals, particularly in the areas of service priorities and pricing, and to discuss with customers any areas of discretionary spending and the implications of that spending on prices and bills.<sup>29</sup>

In the UK water industry, Ofwat will be requiring water businesses to engage directly with their customers in developing pricing proposals and to establish “customer challenge groups”, which will review the business’ customer engagement strategy and provide advice to Ofwat on the effectiveness of that strategy and how the business has taken customers views into account.<sup>30</sup>

In terms of the price review process, Ofwat initiates customer involvement:

- a) Ofwat provides direction to companies to engage with consumers but also allows a high degree of individual discretion over the approaches.
- b) Willingness to pay survey undertaken in 2009, and next to occur in 2014.
- c) Customer involvement strategy, which involves customer surveys (explore customer views on value for money etc..).
  - stated preference surveys and use of benefit valuation techniques
  - as part of the 2009 review (PR09) companies “...were obliged by Ofwat to assess customer priorities and service preferences and base benefit valuations upon these priorities”.<sup>31</sup>

The AER has released a draft consumer engagement guideline for network service providers, which proposes that energy network businesses develop consumer engagement strategies to be adopted in the development of its pricing proposals to the AER.<sup>32</sup> The aim of the guideline is to develop a principles-based framework to assist electricity and gas network service providers in developing consumer engagement strategies and approaches to apply across their business and assist in preparing regulatory proposals that reflect the long term interests of their customers.

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<sup>29</sup> Essential Services Commission of Victoria, *Guidance Paper 2013 Water Price Review*, page 109; available at <http://www.esc.vic.gov.au/getattachment/3306f0d8-9c21-4574-ac3b-25002c88d9b8/Guidance-Paper-Water-Plan-guidance-for-water-price.pdf>.

<sup>30</sup> Ofwat, *Involving Customers In Price Setting – Ofwat’s Customer Engagement Policy Statement*, August 2011; available at [http://www.ofwat.gov.uk/future/monopolies/fpl/customer/pap\\_pos20110811custengage.pdf](http://www.ofwat.gov.uk/future/monopolies/fpl/customer/pap_pos20110811custengage.pdf).

<sup>31</sup> *Op. cit.*, Page 66.

<sup>32</sup> Australian Energy Regulator, *Better Regulation, Draft Consumer Engagement Guideline for Network Service Providers*, July 2013; available at <http://www.aer.gov.au/node/18894>.

The AER guideline is structured around:

- ▲ Best practice principles for consumer engagement in undertaking each component of the guideline
  - accessible
  - transparent
  - communication
  - inclusive
  - measurable
- ▲ Four components that sit under the principles
  - Priorities: the need to identify issues and set priorities for engagement with consumers
  - Delivery: the activities that service providers would be expected to undertake to engage with consumers
  - Results: an articulation of the outputs and measures of success, focusing on explaining how consumer input affected the service providers' decision making
  - Evaluation and review: a robust process to identify, and make renewed commitment to addressing, area of improvement.

SA Water will need to demonstrate that expenditure proposals in its Regulatory Business Proposal (**RBP**) and other aspects of the framework as discussed in this paper will be informed by a robust customer consultation. To be able to demonstrate that expenditures are prudent and efficient requires evidence that the corresponding service levels reflect customer preferences. To properly achieve this customers need to be informed on service level-cost trade-offs, e.g., be in a position to assess whether their preference would be for a lower level of service in return for a stated reduction in bills (refer further discussion on this point in section 3.3.1).

The Commission expects to be closely involved in SA Water's development of its consultation process.

Whilst the Commission does not propose to dictate the approach to customer engagement to be employed by SA Water, the expectation is that it would be consistent with best practice, and that the AER guideline represents a reasonable model for what constitutes as best practice noting that SA Water's operation shares many of the characteristics of an energy service provider for the purposes of the Second Price Determination.

The Commission will also be engaging with customers as part of its price determination process:

- ▲ consulting on this draft framework;
- ▲ release of SA Water's RBP and accompanying Commission Issues Paper, allowing further consultation on service standards; and

- ▲ release of the Commission’s draft Second Price Determination for public consultation, allowing consultation on the Commission’s proposed service standards (and final targets).

An indicative timetable for this Commission process is provided in Chapter 4 of this paper.

Given the importance of standard setting informing efficient costs the timetable for consultation on service standards (incorporating targets) is intimately linked to the consultation process for the Second Price Determination development.

## 3.2 Service standards

The Commission proposes to implement a robust service standard framework for SA Water’s Second Regulatory Period (refer section 2.1.2) by:<sup>33</sup>

- ▲ continuing to adopt a framework that comprises a combination of service standards and key supplementary indicators to be monitored
  - the Commission will monitor supplementary indicators to make an assessment as to whether the demonstrated performance is adequate without setting specific targets, as will be required for service standards;
- ▲ confirming a set of service standards that reflect areas of key interest to customers, identified through consultations undertaken by the Commission in developing the current standards set for the First Regulatory Period
  - with the proposed set further tested through SA Water’s customer consultation confirming the aspects of service quality and reliability of most relevance to customers;
- ▲ making it a requirement that SA Water undertakes a thorough customer consultation exercise to inform its 2016 RBP
  - SA Water will be required to propose service standards targets for Commission consideration in its 2016 RBP informed by its customer consultation exercise;
- ▲ having regard to a number of factors in setting the final targets for the Second Regulatory Period, including the evidence-based targets proposed by SA Water, levels of historical performance, customer satisfaction with existing performance levels and interstate comparisons
  - with further opportunity for customer input prior to the Commission’s determination of final targets to apply for the Second Regulatory Period;
- ▲ continuing to assess the veracity of the performance data supplied by SA Water, instigating audits and other measures as appropriate.

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<sup>33</sup> The Commission’s proposed approach is informed by the Victorian water sector approach to determining service standards, e.g., refer to Essential Services Commission of Victoria, *Guidance Paper 2013 Water Price Review*; available at <http://www.esc.vic.gov.au/getattachment/3306f0d8-9c21-4574-ac3b-25002c88d9b8/Guidance-Paper-Water-Plan-guidance-for-water-price.pdf>.

The Commission has previously consulted widely on the service standards it has set (to cover the period until 30 June 2016), but will have regard to any other key areas of interest to customers demonstrated through the SA Water customer consultation process and Commission consultation during the price determination process to identify any gaps in the current set of standards.

The proposed set of service standards to apply to SA Water is set out in Table 3-1, and represents the current set applied to SA Water.<sup>34</sup> At this time no new or additional service standards have been identified by the Commission.

**Table 3-1: Proposed Service Standards – SA Water (2016-2020)**

<b>Retail water</b>	<b>Status</b>
Timeliness of attendance at water breaks, bursts & leaks (OP3.2:WG2-02)	Existing
Timeliness of water service restoration (OP3.3:WG2-02)	Existing
<b>Retail sewerage</b>	
Timeliness of sewerage service restoration (OP3.5:WG2-02)	Existing
Timeliness of sewerage overflow attendance (OP3.6:WG2-02)	Existing
Timeliness of sewerage overflow clean up (OP3.7:WG2-02)	Existing
<b>Retail customer service</b>	
Timeliness of response to telephone calls (OP1.1:WG2-02)	Existing
Timeliness of response to complaints (OP1.3:WG2-02)	Existing
Timeliness of response to water quality complaints (OP1.4:WG2-02)	Existing
Timeliness of connection (OP1.5:WG2-02)	Existing
Timeliness of processing trade waste applications (OP1.6:WG2-02)	Existing

The current set of service standards cover a range of water and sewerage services provided by SA Water.

The England & Wales independent Walker Report on water reforms argues that *“future incentive mechanisms need to be ambitious and must penalise companies who are not performing well in resolving and reducing complaints, in order to mimic the effect of poor performance in a competitive market”*.<sup>35</sup>

### 3.2.1 Water Quality

The Commission currently monitors a number of complaint categories as part of its range of supplementary performance indicators.

<sup>34</sup> For SA Water service standards refer to the Commission’s website at <http://www.escosa.sa.gov.au/water-overview/codes-guidelines/service-standards.aspx>.

<sup>35</sup> Walker, A., *The Independent Review of Charging for Household Water and Sewerage Services – Final Report*, December 2009, page 148; available at <http://archive.defra.gov.uk/environment/quality/water/industry/walkerreview/documents/final-report.pdf>.

Customers are understood to rate water quality highly. The current SA Water water quality service standard is *'timeliness of response to water quality complaints'*.

The Department of Health has responsibility for ensuring compliance with quality of water guidelines which it has established; the Commission has no regulatory remit in that area.<sup>36</sup> Rather, the Commission's role is in ensuring compliance with service standards it has established for economic regulation purposes, with the water quality standard set by the Commission requiring differing response times to customer complaints concerning water quality depending on the potential severity or priority of the issue.

As noted in the Water Industry Guideline No.2 Explanatory Memorandum,<sup>37</sup> the Commission has accepted advice from SA Water that having the complaint responded to is most important for the customer, with the customer asked a series of questions by the SA Water operator at the time of raising the complaint to ascertain the seriousness of the issue. In addition, any attendance may not be at the customer's house but at the source of any issue (e.g. the affected water source may be a considerable distance away from the customer).

Some studies have considered the issue of trade-offs to improvements in water quality.<sup>38</sup> Were there to be a call for a more specific water quality service standard (set for economic regulatory purposes) care would need to be taken in establishing a customer position on water quality. For example, there are likely to be different groups of customers each having a different view on what the standard should be and the cost they would be prepared to pay to achieve it:

- ▲ those customers who have installed filters for drinking and cooking may consider they have addressed the issue and may not be willing to pay any more for improve quality;
- ▲ those customers who purchase filtered water in bulk and know the cost (technique sometimes employed for such studies – 'revealed preference in surrogate market', i.e. effectively a substitute for better service)<sup>39</sup>, might be able to clearly articulate the level of service they require and the amount they would be prepared to pay for it; and
- ▲ those that have taken no action to date may be happy with current levels of service, given they have not sought to achieve improved quality through other means available to them.

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<sup>36</sup> That is, the Commission has no role in setting microbiological, chemical parameters and other health related parameters. The Commission's role is in setting and enforcing customer service standards, such as requiring a timely response to customer complaints associated with water quality.

<sup>37</sup> Essential Services Commission of South Australia, *Water Regulatory Information Requirements for Major Retailers, Water Industry Guideline No.2 (WG2/02), Explanatory Memorandum*, October 2013, page 28; available at <http://www.escosa.sa.gov.au/library/130926-WaterRegulatoryRequirements-MajorRetailers-G2-ExplanatoryMemorandum.pdf>.

<sup>38</sup> For example, Walker, A., *The Independent Review of Charging for Household Water and Sewerage Services – Final Report*, December 2009, page 18; available at <http://archive.defra.gov.uk/environment/quality/water/industry/walkerreview/documents/final-report.pdf>.

<sup>39</sup> Devicienti, F. et al, *Willingness to pay for water and energy*, Energy Working Notes, Energy and Mining Sector Board, No.3, December 2004.

### 3.2.2 Reliability

In its Draft Revenue Determination for SA Water, the Commission noted that:

*“ Cardno recommended that the Commission consider setting targets for the frequency with which service incidents occur, in addition to the timeliness of response to those incidents. The Commission will consider that recommendation in developing the service standards and targets to apply from 1 July 2016”.<sup>40</sup>*

As stated by Cardno:

*“We observe that these service standards are mostly focused on the timeliness of response of SA Water to a service incident. It is our experience that service standards will also include targets relating to the frequency with which service events occur. This creates a focus for the utility to avoid the incident in the first place. We recommend that the Commission consider introducing service standards of this nature in future”.<sup>41</sup>*

At this time, service events are considered captured in the supplementary performance indicators that SA Water is currently required to report on under Water Industry Guideline No.2.<sup>42</sup> Drawing from Guideline No.2, the proposed set of supplementary performance indicators to apply to SA Water is set out in Table 3-2. At this time no new or additional supplementary performance indicators have been identified. Nevertheless, the Commission remains open to revising the list of supplementary indicators, or converting some of the supplementary indicators to standards, based on the results of customer engagement. In relation to the latter point, conversion to standards would require an evidence based identification of the importance of the relevant indicator to customers and that it is possible to set robust targets.<sup>43</sup>

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<sup>40</sup> Essential Services Commission of South Australia, *SA Water's Water and Sewerage Revenues 2013/14-2015/16, Draft Determination: Statement of Reasons*, February 2013, Page 20; available at [http://www.escosa.sa.gov.au/library/130206-SAWatersWaterSewerageRevenues\\_2013-16-DraftDetermination-StatementOfReasons.pdf](http://www.escosa.sa.gov.au/library/130206-SAWatersWaterSewerageRevenues_2013-16-DraftDetermination-StatementOfReasons.pdf).

<sup>41</sup> Cardno, *Review of Capital and Operating Expenditure Plans for SA Water – 2013/14 to 2015/16 Price Determination - Final Report*, page 30; available at <http://www.escosa.sa.gov.au/library/130207-ReviewofCapexOpexPlansofSAWater-Cardno-FinalReport.pdf>.

<sup>42</sup> Essential Services Commission of South Australia, *Water Regulatory Information Requirements for Major Retailers, Water Industry Guideline No.2 (WG2/02)*, October 2013; available at <http://www.escosa.sa.gov.au/library/130926-WaterRegulatoryRequirements-MajorRetailers-GuidelineNo2-WG2-2.pdf>.

<sup>43</sup> In limited instances it may be possible to set robust targets in the absence of reliable historical data where customers have been able to clearly identify the level of service required.

**Table 3-2: Proposed Supplementary Performance Indicators – SA Water (2016-2020)**

<b>Retail water</b>	<b>Status</b>
Unplanned water supply interruptions (OP3.1:WG2-02)	Existing
Number of customers experiencing ≥ 3 unplanned water supply interruptions p.a. (OP3.1:WG2-02)	Existing
Average duration of unplanned water supply interruptions (OP3.1:WG2-02)	Existing
Average frequency of unplanned water supply interruptions (OP3.1:WG2-02)	Existing
Infrastructure leakage index (OP3.1:WG2-02)	Existing
Real losses (OP3.1:WG2-02)	Existing
<b>Retail sewerage</b>	
Unplanned sewerage service interruptions (OP3.4:WG2-02)	Existing
Sewerage mains breaks & chokes (OP3.4:WG2-02)	Existing
Number of customers experiencing ≥ 3 sewer blockages p.a. (OP3.4:WG2-02)	Existing
Average sewerage interruption minutes (OP3.4:WG2-02)	Existing
<b>Retail customer service</b>	
Complaints received by SA Water (OP1.1:WG2-02)	Existing
Complaints to EWOSA (by request to EWOSA)	Existing

In considering the continued relevance of the above standards and supplementary performance indicators, the Commission has reviewed the service standards currently set for SA Water against the Victorian service standards for the water industry.<sup>44</sup>

The Victorian water service standards include a number of reliability standards for *planned* water outages. The approach the Commission has adopted in the energy sector is to concentrate on monitoring compliance in notifying customers of planned outages, on the basis that customers are generally able to deal with an outage providing sufficient advanced notice is provided.<sup>45</sup> Accordingly, it is treated as a compliance matter rather than setting a specific service standard.

In relation to retail sewerage services, SA Water’s current reporting framework<sup>46</sup> monitors a number of sewerage infrastructure reliability indicators (e.g., number of unplanned interruptions, number of customers with 3 or more unplanned full loss events per year and average annual sewerage interruption), with a number of these set as standards under the

<sup>44</sup> Essential Services Commission of Victoria, *Customer Service Code, Urban Water Businesses*, July 2013; available at <http://www.esc.vic.gov.au/getattachment/ae2ad9a6-5392-47a9-80d1-c6552be35798/Code-Customer-Service-Code-for-Victorian-metropoli.pdf>.

<sup>45</sup> The notice requirements for planned interruptions are provided by clause 16.7 of the Commission’s *Water Retail Code-Major Retailers WRC-MR/01*, January 2013; available at <http://www.escosa.sa.gov.au/library/121116-WaterRetailCode-MajorRetailers.pdf>.

<sup>46</sup> Refer Essential Services Commission of South Australia, *Water Regulatory Information Requirements for Major Retailers – Water Industry Guideline No.2 (WG2/02)*, October 2013; available at <http://www.escosa.sa.gov.au/library/130926-WaterRegulatoryRequirements-MajorRetailers-GuidelineNo2-WG2-2.pdf>.

Victorian approach. SA Water's current sewerage services standards focus on restoration and attendance (as listed in Table 3-1).

A similar situation occurs in relation to retail water services. At this time the Commission has chosen to deal with any minimum flow rate concerns through adopting a separate customer complaint category of *Number of drinking water flow rate or pressure complaints*, rather than establish a service standard.

Even if the view was taken that similar reliability standards (if not targets) to that adopted for Victorian water licensees should be applied to SA Water, as noted in the framework section (section 2.1.2), such service standards would need to be able to be set based on reliable data (indicators). The National Performance Report (**NPR**) data compiled by the National Water Commission provides a potential source for benchmarking performance. In relation to average duration of unplanned water supply interruptions, the only NPR data for SA Water relates to 2011/12 showing 200.6 minutes, which is high when compared against other similar sized water entities for that year. Yet the 2012/13 Water Guideline No.2 data for SA Water shows a figure of around 130 minutes.<sup>47</sup> Regardless as to how SA Water performs over time, it appears that it may not be possible to determine a reliable historical average on the data available at this point in time, were it deemed appropriate to do so.

A longer time series of SA Water data is available in relation to water loss indicators. Based on a review of the NPR data for the infrastructure leakage index,<sup>48</sup> SA Water appears to be within the lower and higher bounds set by similar sized water entities for this indicator. A more thorough examination to consider a range of factors (e.g., soil types) would need to be undertaken in order to make a proper assessment. The value of the infrastructure leakage index for SA Water appears to be fluctuating, having increased to 1.2 in 2012/13 (based on Water Guideline No.2 data) a value last achieved in 2009/10 (based on NPR data), having dropped to just under 1.1 for 2010/11 and 2011/12. The extent to which water loss is an issue, and the rectification cost if it is, would need to be determined before setting a standard.

The Commission is less inclined to adopt additional service standards for areas already subject to monitoring through relevant supplementary performance indicators. Where monitoring of indicators over time identifies areas of persistent poor performance, then conversion to a service standard could be contemplated. However, the Commission has not been monitoring SA Water's performance long enough to make such a call at this time. It is also not clear that this position would change with two more years' data, which would be available before the Commission needs to make its Second Price Determination.

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<sup>47</sup> Water Guideline No.2 data definition is set to be the same as the NPR definition for this indicator. Water Guideline No.2 reported data has 2012/13 average duration of 126 minutes for Adelaide Metropolitan and 130 minutes for regional.

<sup>48</sup> National Water Commission, *2012-13 National Performance Framework: Urban Performance Reporting Indicators and Definitions handbook*, 2013, page 32 states that "*The infrastructure leakage index (ILI) is an indicator of how effectively real losses in the distribution system are being managed at current operating pressures. It is the preferred indicator for state and national comparisons (metric benchmarking), and has been adopted by the International Water Association as the preferred indicator for international comparisons*".

Other performance indicators (e.g., average sewerage interruption) are also difficult to assess because of the limited time series data available.

The Victorian water service standards include a customer service standard for complaints to the Ombudsman. At this stage the Commission proposes to monitor the ratio of EWOSA complaints to total complaints received by SA Water, consistent with the approach adopted by the Commission for the energy sector. Whilst it is important that SA Water seeks to provide service at levels that minimises the level of complaints, the Commission is particularly interested to see a high proportion of complaints being resolved directly by SA Water, to demonstrate that proper engagement with customers is occurring. As indicated in Table 3-1 and Table 3-2, no change is proposed at this time to the service standards<sup>49</sup> and supplementary performance indicators currently set for SA Water. However, the Commission is open to receiving submissions, and will factor in the results of customer consultation engagement undertaken during the course of preparing for the Second Price Determination.

### 3.3 Targets

#### 3.3.1 Identifying value to the customer

The energy sector provides some useful models to consider in the task of developing service standards and targets. The Australian Energy Market Commission (**AEMC**) has proposed an economic assessment process to inform the setting of reliability targets. Under this process a number of cost-value scenarios would be developed, with the expectation that the most economic scenario was selected. This process involves explicitly assessing the cost of providing specific types of service against the value customers place on the service.<sup>50</sup>

While the AEMC has specifically developed this framework for setting and regulating energy distribution reliability,<sup>51</sup> the framework itself is considered applicable more broadly. In practical terms, the operator (e.g., SA Water) would determine the cost of a number of different levels of service (the scenarios) for service levels above and below a base level, and test these through some form of 'willingness to pay' measure designed to identify the value to customers.

'Choice Modelling' was the 'willingness to pay' framework used for 2009 Yarra Valley Water Water Plan.<sup>52</sup> The approach adopted was that at least two-thirds of participants should agree with a service proposition and demonstrate a very clear willingness to pay. Results reflected that customers were prepared to pay more for reduced CO<sub>2</sub> emissions and water

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<sup>49</sup> That is, an important task for the Second Price Determination is the setting of targets for service standards for the Second Regulatory Period, even if the current set of service standards remains unchanged.

<sup>50</sup> Australian Energy Market Commission, *Review of the National Framework for Distribution Reliability, Final Report*, September 2013; available at: <http://www.aemc.gov.au/market-reviews/completed/review-of-the-national-framework-for-distribution-reliability.html>.

<sup>51</sup> As indicated above, the Commission proposes to monitor SA Water water and sewerage services reliability via supplementary indicators, rather than service standards.

<sup>52</sup> Yarra Valley Water is the largest of Melbourne's three retail water businesses and part of the greater metropolitan water businesses.

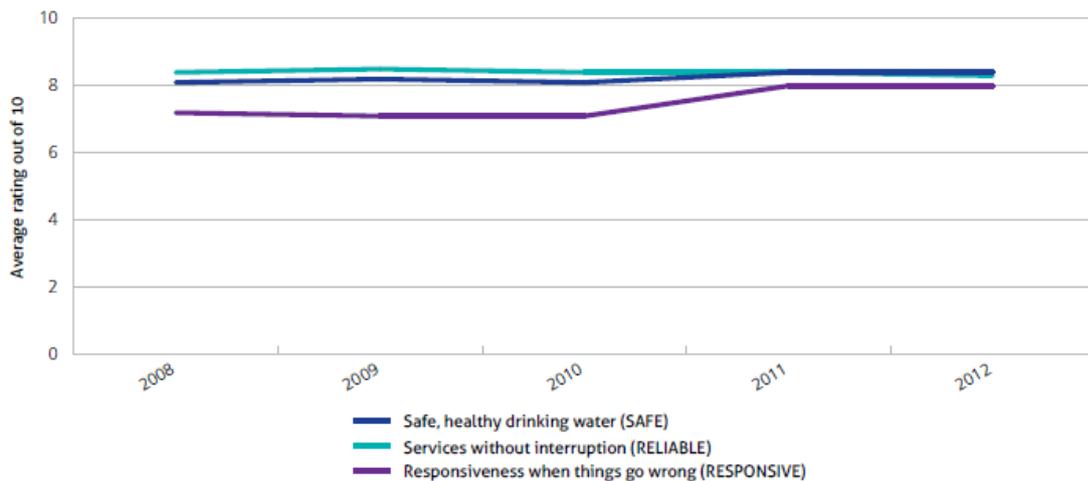
mains flushing. In the end, the initiative was deferred in light of proposed supply augmentations leading to large price increases, to ensure bills no more than doubled by 2012/13.<sup>53</sup>

Based on SA Water’s 2013 RBP (First Price Determination) there appears to be a high level of customer satisfaction with current service levels provided by SA Water. Figure 3.1 shows satisfaction levels around 80% for the measured factors, with relatively high levels of overall satisfaction, with SA Water advising it received an average rating of 7.3 out of 10 in the April 2012 customer satisfaction survey:

*“In the past five years, respondents have consistently indicated high levels of satisfaction in the service quality and reliability attributes they have identified as most important, namely: providing safe and healthy drinking water; maintaining water and sewer infrastructure and responding quickly if something goes wrong...”<sup>54</sup>*

SA Water in its 2013 RBP proposed a major consumer issues/perception survey every 3 years to allow SAW to track key consumer issues and propose measures to address these in its plans.<sup>55</sup>

**Figure 3.1: Satisfaction with key service attributes - residential customers<sup>56</sup>**



Noting the consistent results over a five year period (refer Figure 3.1), historical performance would appear to be a relevant factor to consider in determining targets and forming a useful base for assessing alternative service-price trade-offs.

<sup>53</sup> Cambridge Economic Policy Associates (CEPA), *Regulated Monopoly Service Providers and Customer Views, Preferences and Willingness to Pay, A Report for IPART*, June 2011, page 139.

<sup>54</sup> SA Water, *Regulatory Business Proposal 2013*, page 40; available at [http://www.escosa.sa.gov.au/library/121012-SAWaterRegulatoryBusinessProposal\\_2013.pdf](http://www.escosa.sa.gov.au/library/121012-SAWaterRegulatoryBusinessProposal_2013.pdf).

<sup>55</sup> SA Water, *Regulatory Business Proposal 2013*, page 41.

<sup>56</sup> SA Water, *Regulatory Business Proposal 2013*, Figure 3-7.

### 3.3.2 Requirements on SA Water when proposing targets

SA Water would need to involve the Commission when developing its customer consultative framework for the 2016 RBP, to enable the Commission to comment and gain confidence that the outcomes can be relied upon for the purposes of the service standard framework for the Second Price Determination.

Under the Victorian Water Industry approach administered by the ESCV, all businesses are required to propose annual targets in their Water Plans for each of the standards.<sup>57</sup> Procedural requirements include the need for businesses to consult with customers and relevant regulatory agencies and before submitting their Water Plan to the ESCV.<sup>58</sup> This includes a requirement to consult with the ESCV on standards and conditions of service and supply.

The Commission proposes to adopt the broad model employed in the Victorian water industry, with SA Water required to undertake the level of consultation required of Victorian water entities.

As noted by Cardno, the Commission has previously indicated that it anticipated that by the time of the Second Regulatory Period “...willingness to pay and other investigations should have taken place that may allow performance to be lessened in trade-off for reduced costs”.<sup>59</sup>

As noted by the Commission in the Statement of Reasons for the SA Water Draft Revenue Determination, the Commission would monitor SA Water’s performance against the service standard targets set for the First Regulatory Period:

*“... and may have regard to other factors, such as willingness to pay survey of SA Water’s customers, in determining the service standards to apply from 1 July 2016 (i.e. during the second regulatory period).”<sup>60</sup>*

It was noted in the Commission’s Final Advice to the Treasurer:

*“The Commission will be able to consider appropriate service standards for this regulatory period with the benefit of some experience with monitoring the performance of SA Water (i.e. over the first two periods).”*

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<sup>57</sup> Essential Services Commission of Victoria, *Price Review 2013: Greater Metropolitan Water Businesses-Final Decision*, June 2013; available at <http://www.esc.vic.gov.au/getattachment/653684bc-1058-4cc9-a62b-c31053e7762a/Metropolitan-water-price-review-2013-18-final-deci.pdf>.

<sup>58</sup> *Op. cit.*, page 2.

<sup>59</sup> Cardno, *Review of Capital and Operating Expenditure Plans for SA Water – 2013/14 to 2015/16 Price Determination - Final Report*, page 28; available at <http://www.escosa.sa.gov.au/library/130207-ReviewofCapexOpexPlansofSAWater-Cardno-FinalReport.pdf>.

<sup>60</sup> Essential Services Commission of South Australia, *SA Water’s Water and Sewerage Revenues 2013/14-2015/16, Draft Determination: Statement of Reasons*, February 2013, page 19; available at [http://www.escosa.sa.gov.au/library/130206-SAWatersWaterSewerageRevenues\\_2013-16-DraftDetermination-StatementOfReasons.pdf](http://www.escosa.sa.gov.au/library/130206-SAWatersWaterSewerageRevenues_2013-16-DraftDetermination-StatementOfReasons.pdf).

*In setting the revised service standards for this regulatory period, in addition to reviewing the above, the Commission would have regard to:*

- *detailed benchmarking review; and*
- *the results of a “willingness to pay” survey.”<sup>61</sup>*

Whilst it would be open for SA Water to propose targets that reflect historical average performance, the Commission would require SA Water to undertake a level of scenario testing.

In this regard, SA Water would have the responsibility to determine and develop methods of engaging customers’ priorities and assessing willingness to pay, to demonstrate that the proposed targets are consistent with the best customer service level-value trade-off.

The ESCV approach is to be:

*“...open to proposals for reduced targets for core service standards ....., if businesses can demonstrate a corresponding cost and price trade-off and if customers support the changes”.<sup>62</sup>*

The Commission agrees with that approach.

SA Water would need to ensure this work was undertaken in order that its RBP fully reflected the outcomes, with the RBP due by August 2015, but having discussed the approach and outcomes with the Commission before submitting its RBP. A separate discussion on timelines is provided below.

However, as noted by ESCV:

*“Proposals for service standards targets should also reflect recent and proposed expenditure. Businesses recently incurring or proposing significant expenditure should include performance targets that exceed the five-year average.”<sup>63</sup>*

The Commission recognises that developing and assessing a full range of scenarios for each service standard (refer Table 3.1) would be both time consuming and expensive, noting that even in relation to energy distributors reliability is usually the factor singled out for detailed attention. This suggests that SA Water, having canvassed the full range of preferences with consumers, might then select one or two service standards for detailed review based on identification through customer engagement as to the priority services from the customers’ perspective. In addition, expenditure on meeting service standards for such services should

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<sup>61</sup> Essential Services Commission of South Australia, *Economic Regulation of the South Australian Water Industry, Final Advice*, June 2012, page 61; available at: <http://www.escosa.sa.gov.au/library/120607-EconomicRegulationWaterIndustry-FinalAdvice.pdf>

<sup>62</sup> Essential Services Commission of Victoria, *2013 Water Price Review - Guidance on Water Plans*; October 2011, page 26; available at <http://www.esc.vic.gov.au/getattachment/3306f0d8-9c21-4574-ac3b-25002c88d9b8/Guidance-Paper-Water-Plan-guidance-for-water-price.pdf>.

<sup>63</sup> Essential Services Commission of Victoria, *2013 Water Price Review - Guidance on Water Plans*; October 2011, page 26.

have a material impact on the cost of SA Water operations, to warrant the resources involved in undertaking the assessment.

Such criteria would suggest water service restoration and/or sewerage service restoration may be appropriate candidates. However, even here based on Water Guideline No.2 data, there are very few category 1 (life threatening or otherwise serious consequences) or category 2 events (interruption causing a disruption to a customer's business activities) for either of these candidates.

Even selecting one or two standards to assess would involve a material cost to undertake a full economic evaluation (e.g., willingness to pay study). Such studies should perhaps be undertaken every second review to be cost-effective. The Commission would welcome views from members of the community as to whether a full economic assessment should be undertaken for selected services for the Second Price Determination. Noting the historically high and steady levels of customer satisfaction reported by SA Water (refer Figure 1) it might be possible to concentrate on one or two scenarios in which customer preference is tested as to whether a lower level of service would be acceptable for a reduced bill, relative to current service levels.

The Commission would see any historical performance based targets being set using averages based on the most recent five years of data, where available. But given previously identified data issues with SA Water, the data set will be limited to the period 2012/13 (subject to favourable audit results) to 2015/16.<sup>64</sup> The expectation is that SA Water would develop its 2016 RPB based on actual data for 2012/13 to 2014/15, for any targets based on historical performance, noting that final targets should be based on historical performance including the results of 2015/16.

The Commission would have regard to a number of factors in approving the final targets, including the evidence based targets proposed by SA Water, levels of historical performance, customer satisfaction with existing performance levels and interstate comparisons.

### *3.4 Financial incentives*

As noted in section 2.2.3, service standards regulatory regimes in the energy and water sectors often include financial incentive schemes to encourage service providers to meet and/or exceed service targets.

The merits of adopting a formal service incentive scheme for SA Water, and what form such a scheme should take, will be assessed as part of considerations required for the Commission's Second Price Determination. The views of members of the community as to the merits and form of any such scheme will form important inputs into such an assessment. To assist the Commission any member of the community proposing adoption of such schemes should identify which specific services standards they believe should be reinforced by such a scheme.

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<sup>64</sup> The maximum possible period given that the First Regulatory Period covers from 1 July 2013 to 30 June 2016.

Ultimately it may be simply uneconomic to seek to ensure that all customers receive the service level targets set, with the approach adopted by some other regimes being the inclusion of GSL payments, with affected customers receiving a payment where separately defined levels of service are not met.

Both schemes (service incentive scheme and GSL scheme) would involve a cost to establish and operate. At issue is whether this additional cost would be more than offset by improved SA Water performance, over and above what is achieved through the reporting and monitoring process already implemented for SA Water.

The Commission would however be willing to consider an evidenced-based proposal from SA Water (e.g., clear evidence in support determined from customer consultation) for the adoption of a GSL regime for the Second Regulatory Period. SA Water would be expected to work closely with the Commission in the development of any such scheme. The Commission would have regard to criteria adopted by the ESCV for the Victorian water industry scheme, such as:

- ▲ *“...the proposed GSL events reflect areas of service of most concern to customers (demonstrated by evidence of customer support)*
- ▲ *each GSL is objectively definable, easily understandable, and able to be reported*
- ▲ *payment amounts provide sufficient incentive for businesses to provide appropriate service levels to all customers.*<sup>65</sup>

A key requirement for a functioning GSL scheme is the ability for the licensee to be able to identify when individual customers receive service of a level that would trigger the GSL payment, which needs to be able to be made automatically (i.e., not require the customer to claim the payment). SA Power Networks (South Australia’s electricity distribution network operator) required an allowance to install an Outage Management Scheme (**OMS**) to be able to identify individual customers impacted by supply outages. It is not known to what extent SA Water would require infrastructure to support a GSL scheme, which would be dependent on the nature of any GSL scheme proposal made by SA Water.

This approach does not mean that if SA Water does not propose a GSL scheme then there would be no further consideration: the Commission will be interested to receive the views of members of the community as to whether it should be reviewing the merits of a GSL scheme independently of any proposal from SA Water, or consistent with the approach adopted by the ESCV require SA Water to propose a GSL scheme for the Second Regulatory Period.

To assist the Commission any submissions proposing adoption should identify which specific services standards are required to be reinforced by a GSL scheme.

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<sup>65</sup> Essential Services Commission of Victoria, *2013 Water Price Review - Guidance on Water Plans*; October 2011, page 28; available at <http://www.esc.vic.gov.au/getattachment/3306f0d8-9c21-4574-ac3b-25002c88d9b8/Guidance-Paper-Water-Plan-guidance-for-water-price.pdf>.

## 4. NEXT STEPS

Submissions and comments are sought on the issues raised in this Paper and any other matter members of the community may wish to raise that is pertinent to the matters addressed in this Paper.

Written comments should be provided by **14 February 2014**. It is highly desirable for an electronic copy of the submission to accompany any written submission. Please refer to submission instructions on the inside cover of this paper.

The final service standards and incentives framework for the SA Water's Second Price Determination will be published once the Commission has had time to evaluate submissions received to this Paper.

An indicative timetable for finalising service standards and associated targets is set out below

### *Indicative timetable for establishing SA Water Service Standards and Targets to apply from July 2016*

STAGE	TIMING
Release SA Water Service Standards: Draft framework and approach (this paper)	November 2013
Submissions to this paper due	14 February 2014
Release SA Water Service Standards: Final framework and approach <sup>66</sup>	July 2014
Receive SA Water's RBP, containing proposed service standards targets	August 2015
Release RBP and an Issues Paper for public consultation, allowing further consultation on service standards	Sep/Oct 2015
Release Draft Second Price Determination for public consultation, allowing consultation on Commission proposed service standards (and final targets)	Jan/Feb 2016
Publish Final Second Price Determination, incorporating final service standards (and targets)	May 2016

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<sup>66</sup> This refers to the framework only. As indicated in the following steps in the timetable, the service standards targets will be finalised as a part of the Commission's price determination.



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