# ECONOMIC REGULATION OF THE SOUTH AUSTRALIAN WATER INDUSTRY

## FINAL ADVICE

**June 2012**

The Essential Services Commission of South Australia
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# PURPOSE AND PROCESS

On 27 September 2010, the Treasurer wrote to the Essential Services Commission seeking its advice on what it would consider to be an appropriate form of price and non-price regulatory regime to apply to the South Australian water industry were the proposed Water Industry Bill 2010 to be enacted.

The Treasurer sought that advice under section 5(f) of the Essential Services Commission Act and required the Commission to consult publicly on the matter in accordance with its Charter of Consultation and Regulatory Practice.

On 3 December 2010, the Commission submitted to the Treasurer an initial Statement of Issues, which was subsequently publicly released on 14 December 2010 for stakeholder consultation. On 14 August 2011, following the introduction into Parliament of the revised Water Bill 2011, the Commission provided the Treasurer with its Draft Advice, which was subsequently published on 11 November 2012.

The Draft Advice contained the Commission's preliminary views on the regulation of SA Water's prices, other providers' prices and non-price matters. The Commission had intended to provide its final views on all of those matters in its Final Advice, to be published once the Water Industry Act 2012 was enacted.

The Water Industry Act 2012 received Royal Assent on 17 April 2012. On 23 May 2012, the Treasurer wrote to the Commission confirming that he would be issuing to the Commission one or more Pricing Orders under that Act. Such orders permit the Treasurer to direct the Commission on various matters in the making of a price determination. That letter is included in Appendix 1.

The Commission must take account of the Pricing Order in its first price determination for SA Water and the Commission will need time to consider how the Pricing Order will affect the approach it will adopt in making that Price Determination. Therefore, the Commission has decided to exclude consideration of its approach to price regulation of SA Water's drinking water and sewerage from this Final Advice. The Commission intends to publicly release a Statement of Approach on the price regulation of SA Water in early July 2012.

This Final Advice takes into account the issues raised (other than those regarding regulation of SA Water prices) in submissions made during the Commission's public consultation process on its Draft Advice.

The purpose of this Final Advice and the Statement of Approach to be released in July is to set out the Commission's positions on the matters of principle as sought by the Treasurer. The Commission will also shortly release draft regulatory instruments and further detailed Discussion Papers, including a draft Water Retail Code, which will provide more details on the Commission's price and non-price regulatory frameworks, to facilitate stakeholder consultation, in line with the consultation requirements set out in the Essential Services Commission Act.

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# GLOSSARY OF TERMS

| | |
|---|---|
| **ADP** | Adelaide Desalination Plant |
| **AI GROUP** | Australian Industry Group |
| **AWQC** | Australian Water Quality Centre |
| **BILL** | *Water Industry Bill 2011*, as introduced into Parliament on 27 July 2011 |
| **CCSA** | Conservation Council of South Australia |
| **COAG** | Council of Australian Governments |
| **COMMISSION** | Essential Services Commission of South Australia |
| **CORPORATIONS ACT** | *Corporations Act 2001* |
| **CSO** | Community Service Obligation |
| **COTA** | Council Of The Aging (COTA Seniors' Voice) |
| **CWMS** | Community Wastewater Management System |
| **ELECTRICITY ACT** | *Electricity Act 1996 (SA)* |
| **EPA** | Environment Protection Agency |
| **ERA** | Economic Regulation Authority |
| **ESC ACT** | *Essential Services Commission Act 2002 (SA)* |
| **EXPLANATORY MEMORANDUM** | Published by the Commission in August 2011 outlining the key principles guiding the inclusion of the provisions in a water industry code made under Part 4 of the ESC Act |
| **GAS ACT** | *Gas Act 1997 (SA)* |
| **GOVERNMENT** | Government of South Australia |
| **GSLS** | Guaranteed Service Levels |
| **GUIDELINE 4** | Energy Industry Guideline No. 4 - Compliance Systems and Reporting |
| **HANDBOOK** | National Performance Framework: Urban Performance Reporting Indicators & Definitions Handbook |
| **IPE** | Independent Procurement Entity |
| **KPIS** | Key Performance Indicators |
| **LG ACT** | *Local Government Act 1999* |
| **LRMC** | Long run marginal cost |
| **MOU** | Memorandum of Understanding |
| **NATIONAL ELECTRICITY MARKET** | Arrangements for which are set out in the National Electricity Law, which is a Schedule to the *National Electricity (South Australia) Act 1996* |
| **NPR** | National Performance Reporting |
| **NWC** | National Water Commission |

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| **NWI** | National Water Initiative |
| **NWI PRICING PRINCIPLES** | The NWI pricing principles were developed jointly by the Australian Government and state and territory governments to provide a set of guidelines or road map for rural and urban pricing practices and to assist jurisdictions to implement the NWI water pricing commitments in a consistent way |
| **PRICING ORDER** | To be made by the Treasurer setting the terms under which the Commission can make a price determination |
| **RAB** | Regulatory Asset Base |
| **REPORTING GUIDELINE** | Water Industry Reporting Guideline, to be developed once of the scope and coverage of the water regulatory instruments is defined |
| **SACOSS** | South Australian Council of Social Service |
| **SEWERAGE ACT** | *Sewerage Act 1929* |
| **SRMC** | Short-run marginal cost |
| **STATEMENT OF ISSUES** | Statement of Issues on the Economic Regulation of the South Australian Water Industry, released by the Commission in December 2010. |
| **TERMS OF REFERENCE** | The Treasurer sought advice from the Commission pursuant to section 5(f) of the ESC Act. The Terms of Reference seek advice on the appropriate form of regulatory regime to deal with the matters relating to licensing, consumer protection, service standards, compliance and pricing for the water industry |
| **URTG** | Urban Round Table Group |
| **WATER CONSERVATION ACT** | *Water Conservation Act 1936* |
| **WATER RETAIL CODE** | Industry Code to be developed by the Commission |
| **WATERWORKS ACT** | *Waterworks Act 1932* |
| **WATER FOR GOOD** | A comprehensive framework of reforms and commitments to address water security issues in South Australia is contained in "Water for Good: a plan to ensure our water future to 2050". This plan designates the Commission as the independent economic regulator for monopoly supplies of urban water and sewerage services in South Australia published by the Government in June 2009 |
| **WSA** | Water Services Association |

# TERMS OF REFERENCE

Government of South Australia

**Hon Kevin Foley** MP
Deputy Premier
Treasurer
Minister for Federal/State Relations
Minister for Defence Industries

TF10D04273
T&F09/1724

Date : 27 SEP 2010

Dr Patrick Walsh
Chair
Essential Services Commission of South Australia
GPO Box 2605
ADELAIDE SA 5001

Patrick,

Dear Dr Walsh

The Government has recently approved the drafting of the Water Industry Bill, which would include the appointment of the Essential Services Commission of South Australia (ESCOSA) as independent economic regulator of the South Australian water industry.

Pursuant to section 5(f) of the *Essential Services Commission Act 2002*, I am writing to seek ESCOSA's advice on the following matters:

- An effective licensing framework for retailing of water and sewerage services in the South Australian water industry where the services are provided to the customer by network infrastructure.
- Codes relating to consumer protection.
- Any guidelines required for the performance monitoring and compliance frameworks and regulatory accounts.
- The development of information requirements for ESCOSA's first pricing determination on SA Water's drinking water and sewerage services.
- The most appropriate form of economic regulation for:
    - SA Water's trade waste and miscellaneous services;
    - drinking water and sewerage retail services provided by suppliers other than SA Water, where the services are provided to the customer by network infrastructure; and
    - non drinking water, including recycled water, retail services provided to the customer by network infrastructure.

ESCOSA's advice on these matters should be based on the NWI Pricing Principles and developed in a manner that is consistent with ESCOSA's Charter of Consultation and Regulatory Practice.

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A statement of issues about these matters should be provided to me by 30 November 2010, interim advice by 1 March 2011, and final advice would be provided by 1 June 2011. If you have any queries about these matters, please do not hesitate to contact Penny Black-Tiong on (08) 8204 1727.

Yours sincerely

Kevin Foley MP
**DEPUTY PREMIER**
**TREASURER**

The Commission received a further letter from the Treasurer noting that the timetable for introduction of the *Water Industry Bill 2011* to Parliament had been delayed and that the Commission's Draft Advice was not required until August 2011. On 10 November 2011, the Commission advised that it would submit its Final Advice to the Treasurer as soon as possible after the Water Industry Act 2012 had received Royal Assent.

# 1 INTRODUCTION

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

In 2009, the Government of South Australia (**the Government**) announced a framework of reforms and commitments to address water security issues. That framework was embodied in the Government's plan entitled "*Water for Good: a plan to ensure our water future to 2050*" (**Water for Good**).[1]

Action 70 of *Water for Good* provides that the Government will:

> *Appoint ESCOSA as the independent economic regulator for monopoly supplies of urban and regional water and wastewater services in South Australia. This will apply to SA Water's potable water and wastewater services in the first instance.*[2]

To give effect to action 70 (and other related actions set out in *Water for Good*) the Government prepared the *Water Industry Bill 2011*.[3] The Bill was introduced into Parliament on 27 July 2011 and was enacted by Parliament in April 2012.[4] The resulting *Water Industry Act 2012* (**Act**) received Royal Assent on 19 April 2012.[5]

Under the Act the water industry is declared to constitute a regulated industry for the purposes of the ESC Act.[6] That declaration, which is expected to have effect from 1 July 2012, will enliven the Commission's broad regulatory powers and functions under the ESC Act. However, the specific powers and functions relating to consumer protection,

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1 *Water for Good* sets out 94 key actions, in the areas of planning, desalination, stormwater and wastewater recycling, water use and savings, rain, rivers, reservoirs and aquifers, fostering innovation and efficiency, pricing and market instruments and associated legislative and regulatory changes, which are to be implemented in the short to medium term. Refer the *Water for Good* website at http://www.waterforgood.sa.gov.au.

2 Refer *Water for Good*, Part 7, Table 12 Summary of Actions, available http://www.waterforgood.sa.gov.au/wp-content/uploads/2009/06/complete-water-for-good-plan.pdf, p. 170.

3 On 23 November 2010, the Government tabled a draft version of that Bill in Parliament, signalling the commencement of a public consultation period. As a part of that consultation program, the Government released an Explanatory Paper, which provided an overview of the key areas of the draft Bill. A copy of the Explanatory Paper is available on the *Water for Good* website at http://www.waterforgood.sa.gov.au/wp-content/uploads/2010/11/dfw_explanatorypaper_wib.pdf. At the time of writing, the *Water Industry Bill 2011* was available from the South Australian Legislation website of the Attorney-General's Department at http://www.legislation.sa.gov.au/browseBills.aspx.

4 Refer http://www.legislation.sa.gov.au/LZ/B/CURRENT/WATER%20INDUSTRY%20BILL%202011/B_AS%20INTRODUCED%20IN%20HA/WATER%20INDUSTRY%20BILL%202011.UN.PDF.

5 Refer The South Australian Government Gazette, 19 April 2012, page1406; available at http://www.governmentgazette.sa.gov.au/2012/april/2012_028.pdf

6 Refer Water Industry Act 2012, section 17.

licensing and pricing which are to be conferred on the Commission under the Act will not commence until 1 January 2013.

The Act represents a significant legislative reform and deals with an array of issues, including economic regulation, technical regulation and water planning and management. From the perspective of economic regulation, the key aspects of the Act are as follows:

- ***Licensing***: Any person or entity wishing to provide retail services to South Australian consumers will be required to obtain a licence from the Commission authorising those operations. The licence issued will require the licensee to comply with a number of regulatory obligations relating to supplying customers, achieving minimum standards of service, maintaining dispute resolution processes, notifying the Commission of changes to corporate structures and complying with industry codes made by the Commission.
- ***Consumer protection***: Licensees will be required to comply with industry codes made by the Commission under the ESC Act. The Commission will create a consumer protection regime to deal with matters such as binding service standards, billing, payment, disconnection/flow restriction and contractual matters. The protection of consumers' interests is of paramount importance in the provision of any essential service, particularly where those services are not provided in a competitive market. The Commission will establish a regime which serves to protect the long-term interests of consumers.
- ***Pricing***: The Commission will undertake independent price regulation. Independent price regulation is often established in industries in which certain activities have natural monopoly characteristics. For example, in the electricity, gas, telecommunications and water industries, it may be uneconomic to duplicate some network infrastructure. If so, the absence of competition may lead to market failure, with prices exceeding the efficient cost of service delivery or where services valued by customers are under-provided.

  Independent price regulation of the water sector can facilitate greater economic efficiency by:

  - providing independent scrutiny over the costs of service delivery, to help minimise inefficient expenditure;
  - providing greater confidence and certainty to consumers and investors in the industry (including potential new entrants), that pricing decisions will be made subject to clear economic objectives and by providing greater transparency in the decision-making process;
  - addressing, in a transparent manner, any situations where revenues are insufficient to meet efficient costs, which may result in inefficient consumption decisions or threaten the ongoing viability of operations; and
  - ensuring that prices and price structure reflect efficient costs and provide appropriate price signals to both consumers and investors.

## *1.1 Background to this Advice*

To provide greater certainty as to the proposed scope and operation of the economic regulation regime envisaged under the Act, the Government sought the advice of the Commission as to the nature and form of the regulatory regime that the Commission would implement if the Bill were enacted.

On 27 September 2010, the Treasurer sought such advice pursuant to section 5(f) of the ESC Act, which permits the Treasurer to seek the advice of the Commission on any matter. The terms of the Treasurer's request are set out at the front of this advice; in summary, however, the scope of the request was to obtain the Commission's advice on the nature of:

- a licensing regime under the Act;
- any consumer protection industry codes to be developed and implemented under the Act;
- any guidelines required for the performance monitoring and compliance frameworks and regulatory accounts;
- information requirements for the Commission's first pricing determination on SA Water's drinking water and sewerage services.
- the most appropriate form of economic regulation for:
  - SA Water's trade waste and miscellaneous services;
  - drinking water and sewerage retail services provided by suppliers other than SA Water, where the services are provided to the customer by network infrastructure; and
  - non-drinking water, including recycled water, retail services provided to customers by network infrastructure.

The Treasurer's request noted that the Commission's advice on those matters was to be based on the NWI Pricing Principles (so far as they are relevant to the issue put to the Commission) and developed in a manner consistent with the Commission's Charter of Consultation and Regulatory Practice.

Ultimately, the purpose of the Treasurer's request was to enable the Commission to undertake preliminary work on the broad nature of a regulatory regime for water and wastewater retail services in this State. In the absence of that request, the Commission would not have had any legal powers to undertake such work. As the Act has now passed Parliament, that legal constraint no longer applies and the Commission has the legal ability to issue materials necessary to prepare for its forthcoming regulatory roles under the Act. That said, the Commission regards it as important to conclude the advice process and therefore has prepared this Final Advice.

## *1.2 Timing*

In this first instance, as noted in the text of the Treasurer's letter, the Government envisaged that the advice provision process would have been concluded by June 2011.

This did not come to pass.

Delays in the preparation and provision of both Draft and Final Advice to the Treasurer were driven by changes to the timetable for introduction and, subsequently, passage of the (then) Bill, as compared with the assumptions made about those matters at the time the request for advice was issued to the Commission. Those delays were driven by the necessity for the Commission's advice to reflect the most up-to-date policy positions of the Government (as expressed in the final form of the Bill initially introduced into Parliament in July 2011 and restored to Parliament in February 2012) and ultimately the Parliament (as expressed in the final form of the Act passed in April 2012).

The Commission was, and remains, aware that its advice is a matter of public record and that stakeholders will have regard to the advice in transitioning to the new legislative regime for the water and wastewater industry. To promulgate advice that did not reflect (or potentially worse, anticipated) the final policy positions of Government and the Parliament would not, in the Commission's view, be consistent with the purpose for which its advice was sought nor would it be in consumers' and other stakeholders' interests.

Therefore, while there has been a delay in the timetable for the provision of advice, those delays have allowed for the formulation of advice that properly takes into account all relevant considerations.

Of note, while the Commission had intended to deal with all relevant matters in its Final Advice, it has subsequently been advised that the Treasurer intends to issue a Pricing Order under the Act. Such orders may be issued by the Treasurer and may have the effect of directing the Commission to have regard to, take into account or comply with various matters contained within the order, when making a price determination.

At the time of the Statement of Issues and the Draft Advice, the Commission was aware of those provisions but not of the nature of any proposals of the Treasurer in respect of such a Pricing Order. Subsequently, the Treasurer has advised the Commission that, notwithstanding its earlier advice as to how an economically efficient price regulation regime ought to operate, he intends to issue a Pricing Order which the Commission must comply with in making a price determination for SA Water. In a letter to the Commission dated 23 May 2012, the Treasurer advised the Commission as follows:

> *I intend to issue pricing orders that, for the first price determination, require ESCOSA to:*
>
> - *adopt a regulatory period of 1 July, 2013, to 30 June, 2016;*
> - *comply with the National Water Initiative pricing principles;*

- *adopt a revenue cap or average revenue cap as the form of price regulation for SA water's drinking water and sewerage services;*
- *adopt a specified initial regulated asset base;*
- *treat identified non-commercial activities, externalities and water and planning management charges in a specified manner.*

The letter also noted the Treasurer's intention to request that the Commission undertake a broad ranging Inquiry into a number of matters. A copy of that letter, setting out the Pricing Order terms shown above and detailing the likely scope of the Inquiry to be referred is contained in Appendix 1 to this Final Advice.

However, in the absence of firm detail on the nature and scope of the five elements of the Pricing Order, it is difficult for the Commission to provide any advice to the Treasurer as to its regulatory approach to the setting of prices for SA Water at this point.

In those circumstances, and with a view to not delaying the publication of its advice on all other areas of the new water and wastewater regulatory frameworks under the Act, the Commission has decided to not deal with pricing for SA Water in this Final Advice. Instead, it will release a Statement of Approach on that issue in early July, detailing its principles and proposed processes for pricing for SA Water.

At the same time, to provide stakeholders with a chance to comment on the specific terms of regulatory instruments to apply from 1 July 2012 (such as industry codes), the Commission will release a suite of draft instruments for stakeholder comment.

## *1.3 Consultation process*

As outlined above, the Commission received the initial request for advice from the Treasurer on 27 September 2010. As a first stage in responding to that request, the Commission released a Statement of Issues on 14 December 2010. Thirteen submissions were received in response to that Statement, from the following stakeholders:

- Australian Civic Trust;
- Australian Industry Group;
- Conservation Council of SA;
- COTA Seniors' Voice;
- The District Council of Mt. Barker;
- Local Government Association;
- Port Augusta City Council;
- Public and Environmental Health Council;
- SA Water Corporation;
- SA Water Customer Council;
- South Australian Council of Social Service;

- The City of Tea Tree Gully, The City of Salisbury, The City of Charles Sturt, The City of Onkaparinga and The City of Playford; and
- Water Action Coalition.[7]

Having reviewed the matters raised in submissions, and taking into account further developments proposed for the Bill, the Commission prepared Draft Advice, which it provided to the Treasurer on 15 August 2011. Following his consideration of that Draft Advice, the Treasurer sought additional advice on certain matters, which was subsequently provided by the Commission and incorporated into the Draft Advice. The revised Draft Advice was then publicly released on 11 November 2011. Ten submissions were received from the following stakeholders:

- Australian Industry Group;
- Conservation Council of SA;
- Council of the Aging South Australia;
- Energy Industry Ombudsman SA;
- Knoxstead Pty Ltd;
- Local Government Association;
- SA Water Corporation;
- South Australian Council of Social Service;
- The City of Tea Tree Gully, The City of Salisbury, The City of Charles Sturt, The City of Playford and The City of Onkaparinga; and
- The District Council of Mount Barker.[8]

The Commission acknowledges the importance of the matters raised in submissions by stakeholders and appreciates the time, effort and enthusiasm put into the preparation of the materials provided to it. The Commission has carefully considered the matters raised and, where relevant to the Commission's regulatory task, has taken them into account in preparing its Final Advice to the Treasurer.

While the Commission has quoted from submissions in this Final Advice, it has not necessarily duplicated comments where more than one stakeholder has raised the same issue. Further, the Commission has not necessarily quoted from each submission received; this is not because it has not valued or had regard to or given weight to a particular point raised (as noted above, it has carefully considered all materials in all submissions) but simply reflects the broad scope of submissions received.

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[7] Copies of the submissions are available from the Commission's website at http://www.escosa.sa.gov.au/projects/162/economic-regulation-of-the-south-australian-water-industry.aspx#stage-list=1.

[8] Copies of the submissions are available from the Commission's website at http://www.escosa.sa.gov.au/projects/162/economic-regulation-of-the-south-australian-water-industry.aspx#stage-list=5

Where matters raised are outside the scope of the Commission's remit but are nevertheless important matters from a broader perspective, the Commission has noted those matters in this advice (refer below, section 1.7).

## *1.4 Nature and scope of this Advice*

This Final Advice is based on the Commission's understanding of the regulatory context that will apply from the time the Commission takes over the independent regulation of the water industry. A high level overview of the Commission's advice is set out below, with the details of each area being explored in more detail in subsequent chapters.

Of note, this advice sets out the general policies and principles which the Commission intends to adopt in its new regulatory role; it does not specify the detail of each regulatory instrument or potential price determination it might make. As the Commission now has statutory powers to deal with such matters, and given that the ESC Act contemplates that the Commission is to conduct its own consultation processes on those matters, it will deal with those issues through a further public consultation process to commence from 1 July this year to prepare for the formal commencement of its licensing and pricing roles from 1 January 2013. [9]

That further consultation process will also deal with pricing for the retail services provided by SA Water as, for the reasons which are set out in section 1.4.3 below, that matter is not dealt with in this Final Advice.

### 1.4.1 Licensing arrangements

A key aspect of the Commission's proposed regulatory framework is licensing arrangements. The Commission will license those who provide retail services—that is, supply water and/or sewerage services to consumers. Licences will contain conditions, dealing with matters that are central to the provision of retail services, such as: an obligation to supply services to a consumer on request; obligations to comply with consumer protection codes established by the Commission; a requirement to belong to and participate in an industry ombudsman scheme; and obligations to comply with and report on mandatory service standards.

### 1.4.2 Consumer protection industry codes

Under that licensing regime, the Commission will establish industry codes. Those industry codes will establish the details of the binding standards of service for water businesses, relating to matters such as the way in which businesses respond to queries and complaints or how quickly businesses will be required to restore service following a disruption.

[9] Refer generally Acts Interpretation Act 1915, section 14C.

The Commission will also regulate standard contractual terms and conditions under which all water businesses will provide their services to consumers. The Commission will ensure that contractual terms are fair and reasonable, particularly in relation to rights of connection, billing and the provision of information, and that any disputes arising under those contracts are dealt with by the businesses appropriately.

### 1.4.3 Pricing for retailers other than SA Water

The Commission intends to implement a set of pricing principles, to guide the prices set by retailers other than SA Water. The Commission will issue separate pricing principles covering the provision of drinking water, sewerage services, recycled water, other non-potable water and miscellaneous services. The pricing principles will be implemented through price determinations and retailers will be required to comply with those principles, subject to any transitional provisions that the Commission may introduce.

To complement that approach, the Commission will introduce a regime for monitoring the prices and costs of certain services, to promote increased transparency and to enable the Commission to determine the extent to which regulatory intervention is required in the longer-term.

Details of the pricing principles and price monitoring regimes will be developed by the Commission through a subsequent consultation process.

## *1.5 The Commission's overall approach*

As noted above, the ESC Act provides that, in performing its statutory functions, the Commission is required to have as its primary objective, the:

> *…protection of the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services.*[10]

The ESC Act also sets out seven other factors to which the Commission must have regard in performing its functions, such as promotion of economic efficiency and the viability of regulated entities.

The Commission interprets its primary objective by considering the welfare of consumers both today and in the future. The Commission recognises that current and future consumer welfare must be carefully traded off. While the Commission's focus is on consumer welfare, it recognises that the interests of regulated entities and other stakeholders are relevant to the extent that they affect the current and/or future welfare of consumers. For example, the Commission must ensure that appropriate investment incentives exist today to ensure that the future needs of consumers are met.

[10] Essential Services Commission Act 2002, section 6.

As the Act will formally bring water and wastewater services within the Commission's regulatory scope, it is important for the Commission to confirm that it will continue to apply its primary objective to those industries in the manner outlined above.

That said, as is the case for each industry it regulates, it is important for the Commission to understand the particular circumstances of that industry and the services provided within it.

While difficulties in accessing the services provided by other industries regulated by the Commission, most notably electricity, can have significant impacts on consumers' ability to engage in our society and, in some cases, on their health and wellbeing, an inability to access water and sewerage services can, in a very short time, lead to serious health concerns, even death. As noted by COTA Seniors' Voice, in its submission to the Statement of Issues:

> *There is no doubt that water is essential to life and must therefore be treated as an entitlement rather than a commodity… While the best way to guarantee this entitlement is through the [Act], the role of ESCOSA will be vital in either complementing the [Act] or in providing the "rules of the game" to sit beneath the [Act].*[11]

Similarly, in its submission to the South Australian Government on the then draft Water Industry Bill, the Australian Industry Group noted that:

> *For us, it follows that the provision of a staple necessity such as potable (and other higher quality) water supplies, should be transparently and independently regulated and that the Essential Services Commission of South Australia (ESCOSA) is the appropriate body to assume that role, and provide the price-setting, regulatory and licensing capabilities for the water sector into the future*.[12]

It is in this context, therefore, that the Commission must develop and implement its economic regulatory role.

## *1.6 The regulatory context*

Under the Act, the Commission will regulate retail services: water and sewerage services provided to end-users. The most appropriate retail economic regulation framework for an industry depends on the context in which that framework will be implemented. For example, highly competitive or contestable markets generally require less regulation of market outcomes. Therefore, it is important to state the Commission's understanding of key elements of the regulatory context that will apply at the time of commencement of the Act (relevantly, from 1 January 2013 for practical purposes).

In particular, the Commission understands that at that time:

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[11] COTA Seniors' Voice, submission to Statement of Issues, February 2011, page 7.

[12] Australian Industry Group, submission to SA government on draft Water Industry Bill, January 2011, page 3.

- SA Water will remain a large vertically-integrated government-owned business enterprise;
- an effective state-based third-party access regime will not be in place; and
- the Treasurer is likely to have issued a Pricing Order containing requirements which the Commission must comply with in making any price determination.

The Commission notes that one of the objects of the Act is to promote competition. While the Act puts the foundations in place for the achievement of that object, the Commission does not expect that significant competition will eventuate during the early period of the new regulatory arrangements. This is consistent with the lessons learned from the early years of reform in other network industries (such as telecommunications), when vertically integrated (and sometimes government owned) incumbents were retained and access regimes were weak.

However, the Commission also understands that aspects of the regulatory context may change over time and that it may need to adapt its proposed regulatory approach as a result.

The Commission notes that key objects of the Act include the promotion of efficiency, competition and innovation in the water industry.[13]

The Commission believes that further reforms to promote competition (and therefore innovation and the entry of alternative service providers) merit strong and early consideration. While transportation pipelines may be natural monopolies, other parts of the supply chain (including bulk water supply and retailing) are not. Competition in those parts of the supply chain may result in greater efficiencies and/or innovations that reduce costs, promote efficient investment and/or provide greater value to customers.

The Commission believes that the introduction of a strong, comprehensive and effective access regime is imperative for the achievement of the Act's objectives. The Commission also believes that the access regime will need to cover infrastructure services that are subject to the potential misuse of market power, including natural monopolies (such as transportation pipelines and distribution infrastructure) and other infrastructure services largely controlled by SA Water (such as bulk water supply sources).

The Commission notes that section 26 of the Act, which it understands will commence on 1 January 2013, specifies requirements with which the Minister for Water must comply in relation to the development of an access regime:

***26—Third party access regime***

*(1) The Minister must publish a report about third party access to water infrastructure and sewerage infrastructure services.*

*(2) The report must address—*

[13] Refer clause 3(b) of the Bill.

*(a) various options for third party access; and*

*(b) the extent of coverage of a third party access regime; and*

*(c) the procedures that should be established for seeking access and the resolution of disputes; and*

*(d) access pricing principles; and*

*(e) compliance with relevant national competition principles; and*

*(f) the maintenance of public health, environmental and safety standards,*

*and may address such other matters as the Minister thinks fit.*

*(3) The Minister must publish the report within 1 month after the commencement of this section and cause copies of the report to be laid before both Houses of Parliament within 12 sitting days after the report is published.*

*(4) The Minister must use his or her best endeavours to introduce into Parliament within 9 months after the commencement of this section a Bill for an Act to provide for a third party access regime to water infrastructure and sewerage infrastructure services operated by entities licensed under this Part (after taking into account the contents of the report prepared under subsection (1) and any other relevant factor).*

While the Commission notes the timetable established under section 26, and also notes its willingness to assist the Treasurer in the development and implementation of the access regime, for the purposes of providing this Final Advice the Commission has made the conservative assumption that an effective access regime will not be in place at least until the latter part of the period of its first price determination for SA Water.

*Water for Good* flagged a transition to a single potable water use price for SA Water's non-residential customers between 2011 and 2016 (action 71). The Commission notes that the Government has achieved this outcome in its recent 2012/13 pricing decision for SA Water. The Commission also notes that *Water for Good* flagged that the Commission would "*examine price structures that may benefit economic efficiency and water security*" between 2015 and 2020 (action 73). The Commission observes in that regard that the Treasurer intends to refer this matter to the Commission as part of the proposed Inquiry (refer Appendix 1) and agrees that there is merit in conducting such a review earlier than the *Water for Good* timeline. In other jurisdictions, for example New South Wales, inclining block tariffs have already been eliminated and replaced by a single use charge based on long-run marginal cost (**LRMC**).[14]

The Commission also notes that *Water for Good* flagged that the Government will "*continue to support regional communities through the application of statewide pricing*"

[14] Refer National Water Commission, *Urban water in Australia: future directions*, April 2011, available http://www.nwc.gov.au/resources/documents/Future_directions.pdf.

on an ongoing basis (action 82) and that the Commission will "*monitor and report on the effect of statewide pricing*" (action 76).

Finally, as the Commission noted in its Draft Advice, little competition is likely to exist during the early years of independent economic regulation. The Commission's proposed regulatory framework recognises that, at least initially, competitive forces cannot be relied on to ensure that the long-term interests of consumers are protected. However, the Commission advises that its regulatory framework may need to change as the extent of competition, the coverage and effectiveness of a potential third-party access regime and other key elements of the regulatory context change over time.

The Commission notes that future changes that the Government may make could significantly change the regulatory context. For example, the coverage of the regulatory regime could be broadened to encompass not only retail service providers but also operators of networks and possibly other upstream participants. The Government has publicly stated its desire to achieve goals such as efficiency and innovation through means such as promoting competition and further private sector participation. The Commission supports those sentiments and advises that, in the interests of South Australian consumers of water services, such further reforms merit early consideration.

## *1.7 General comments*

While respondents have provided the Commission with many substantive submissions which go to the nature and scope of the regulatory regime which it is to administer under the Act, some of the comments received by the Commission were of a more general nature.

To the extent that those comments raised themes which need to be addressed at the outset, or which the Commission wishes to publicly note but which are at the same time outside of its statutory remit or which depend on further legislative or Government decisions before they fall within its statutory remit, those matters are dealt with below.

### 1.7.1 The "level playing field" argument

Through its submissions on the Statement of Issues and the Draft Advice, SA Water raised the issue of the need for what it considers to be a "level playing field" to be uppermost in the Commission's mind. SA Water put the view that having water entities providing substantially the same service regulated in the same or a similar manner is a fundamental underpinning of a competitive market.

In its submission to the Draft Advice, SA Water argued (in the context of potential exemptions from the application of the Act or specified elements of the Act) that:

> *…all customers should be entitled to the same level of service irrespective of provider…*[15]

[15] SA Water, submission to Draft Advice, January 2012, page 3.

However, the Commission must consider the relative benefits and costs of regulating different service providers and services. The Commission remains mindful of the differences in scale and scope of service providers. The benefits of regulation are most likely to be high when the regulated entity is large and has high market power. Therefore, a stronger regulatory approach is appropriate in that situation.

There is, in the Commission's view, a distinction to be drawn in the "level playing field" debate between those services which are provided to a broad customer base by multiple and competing service providers and those which are provided to a relatively small number of customers in the non-metropolitan areas of this State.

In the former case, the Commission would agree that the regulatory regime should treat all retail service providers equally such that, assuming that any necessary regulatory obligations imposed on those providers are targeted and deliver optimal levels of consumer protection, competitive forces will drive efficiencies which benefit consumers in the long-run.

This requires the existence of a competitive or, at the very least, a contestable market. For the vast majority of retail water and wastewater operations in South Australia, this is not currently the case; there is only very limited competition for water and wastewater services in most instances and, in any event, there are no market structures or systems to permit mass-market retail transactions.

At the same time, the Commission is firmly of the view that the overall regulatory framework, including the Act and any statutory instruments made by the Government under the Act, should adopt these same principles so as to provide the underpinnings for the development and emergence of truly competitive markets over time.

In the case of services provided to a relatively small number of customers, particularly in stand-alone operations and non-metropolitan areas, there is a further distinction to be drawn between the services provided by SA Water, as a large State-owned corporation able to draw on significant financial, technical and human resources as a result of its scale and scope, and those which are provided by local government entities and small private providers. It is in respect of those cases that the Commission would adopt an approach different to that proposed by SA Water in its submission to the Draft Decision.

In part, this is driven by the provisions of the Act, particularly section 25(2), which provides that in establishing and administering the licensing regime for retail service providers:

> *The Commission must… have regard to the scale and nature of the operations of the water industry entity (with the scale and nature being*

*determined by the Commission after consultation with the entity or a person or body nominated by the entity).*[16]

However, it is also driven by the realities of water and wastewater supply services as they currently exist in this State. As noted by SA Water itself in its submission to the Issues Paper:

> *The structure of the water industry in South Australia is very diverse with one large public provider and many small providers, primarily based in regional or remote areas. The provision of these services reflects the population density, supply sources and geography. To maintain viability of the various service providers, different approaches to, for example, the quality and reliability of service may need to apply*.[17]

These are important matters; in submissions to the Commission, local government representatives have noted that the provision of retail services by bodies such as local councils has often been a matter of necessity rather than a true commercial undertaking and that any regulatory regime should account for this. For example, as noted by the Local Government Association in its submission to the Statement of Issues:

> *Most townships in regional South Australia are provided with wastewater services by Local Government through various forms of Community Waste Management Systems. It is submitted that Councils did not "choose" to become involved in the provision of wastewater services as historically this was the role of the South Australian Engineering and Water Supply Department (E&WS) and subsequently SA Water under the Sewerage Act 1929. In particular, section 18 of that Act provided for any area of the State to be proclaimed as a "drainage area" which empowered E&WS/SA Water to construct, manage and rate traditional deep drainage sewerage systems. In practice however, the proclamation of "drainage areas" was historically limited to the Adelaide metropolitan area and major provincial cities.*[18]

The Commission is aware of these circumstances and, as it has publicly stated in both the Statement of Issues and in its Draft Advice, it intends to adopt an approach to the implementation of the regulatory regime which gives the necessary recognition to the particular scale and scope of retail operations. To do so not only observes the requirements of the Act but is also consistent with the Commission's general regulatory approach.

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16 Water Industry Act, section 25(2)

17 SA Water submission to Statement of Issues, January 2011, page 2.

18 Local Government Association, submission to the South Australian Government on the Water Industry Bill, January 2011, page 1.

That said, in the development of the regulatory regime, the Commission will adopt a different approach, insofar as it will look to develop a set of consumer protections and standards which best meet consumers' needs at the broadest level. In doing so the Commission will have regard to the specific mischief which needs to be addressed by a regulatory response (for example, consumer information requirements), the need to ensure that the costs of regulation do not outweigh the benefits and the need to ensure that the mode of regulation used is the most efficient and effective one available.

To make sure that the development and implementation phases of the Commission's regulatory regime are harmonious, it will be necessary for the Commission, having developed the base set of regulatory arrangements, to modify or tailor their application to suit specific water and wastewater undertakings. This is consistent with the approach which has been adopted by the Commission in respect of off-grid electricity undertakings in this State.

### 1.7.2 Environmental concerns

In response to both the Statement of Issues and the Draft Advice, some respondents put the view that either the Commission or, more commonly, the Act was deficient insofar as environmental concerns were not explicitly addressed.

The Australian Civic Trust, the Conservation Council SA and the Water Action Coalition all made submissions to the Commission emphasising that it should, through its regulatory regime, recognise environmental concerns.

The Commission appreciates the concerns raised by those stakeholders but would confirm its general position that, as a statutory authority created by an Act of Parliament, its legal remit only extends to those matters conferred on it under that Act or related Acts. At this point in time, the Commission has no express remit to take into account environmental concerns in a general sense.

That said, the Commission notes a specific submission put by the Conservation Council SA in response to the Draft Advice:

> *… the Conservation Council does not support economic regulation that would reduce water industry investment in environmental protection and sustainability. Standards and investment in environmental performance should certainly not be less than in previous years and should in fact be improved given South Australia's pressing need to attain sustainability, adapt to climate change and prepare for a larger population.*[19]

The Conservation Council SA notes that SA Water undertakes a number of environmental investments at present, some of which are performed as a legislative or statutory requirement, such as those established by the

[19] Conservation Council SA, submission on Draft Advice, January 2012, page 5.

Environmental Protection Authority, while others are performed outside of such obligations.

The essential thrust of that submission, as the Commission understand it, is a concern that the Commission will not take environmental investments into account in setting prices – particularly for SA Water.

In responding to that submission, the Commission would note two broad matters of principle.

First, where SA Water is subject to a legal requirement to deliver an environmental outcome, the Commission will take into account the prudent and efficient costs of meeting that obligation in setting prices. It will not look behind the obligation to form a view as to whether the Commission supports it (or otherwise).

Under this approach, South Australian consumers will continue to receive the benefit of the designated environmental outcome but will pay no more than the prudent and efficient costs of that outcome.

Second, where SA Water delivers an environmental program but has no legal requirement to do so, it will be a matter for SA Water, or another respondent to the Commission's price determination process, to make a case as to why:

- the costs of that program are in the long-term interests of South Australian consumers; and
- ought to be recovered from water customers; and
- in the event that this case can be made out, why the costs associated with it are prudent and efficient.

In the absence of such evidence, the Commission will not take such costs into account.

The Commission will meet its responsibility to have regard to the prudent and efficient costs of service delivery while acknowledging the limits of its statutory powers and functions. To the extent that there are environmental policy aims which need to be pursued, it is appropriate that the proper entities, such as the Government, pursue them. It is not appropriate for an economic regulator to make policy decisions on matters falling outside its role and expertise.

# 2 NON-PRICE REGULATION

This Chapters sets out the Commission's advice on the nature of the non-price regulatory regime to apply to persons providing water and wastewater retail services in this State in accordance with the provisions of the Act. While it is operationally difficult to separate the price and non-price elements of an economic regulatory regime, at the developmental level, it is helpful to consider them separately.

This Chapter therefore considers the:

- legislative framework;
- licensing and exemption framework;
- consumer protection framework;
- service standards and reporting framework; and
- compliance framework,

for non-price economic regulation of the South Australian water and wastewater industries under the Act.

## *2.1 Legislative framework for non-price regulation*

Section 17 of the Act provides that the water industry is declared to constitute a regulated industry for the purposes of the ESC Act. This declaration serves to enliven the Commission's general regulatory powers under the ESC Act.

Questions arise, however, as to the particular nature and scope of the relevant "industry" which is to be declared: what are the specific activities and undertakings which the Commission is to regulate?; and as to the nature of persons to be afforded the consumer protections of the Act and the Commission's regulatory regime: who will be a "customer" and does that include tenants?

### 2.1.1 The Commission's powers and functions

Section 7 provides the Commission with a broad range of powers and functions in respect of the water industry as established under the Act. In particular, the Act provides that the Commission has, in addition to its general powers and functions under the ESC Act:

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

*(b) any other functions and powers conferred by regulations under this Act.*[20]

These broad powers which are to be granted to the Commission are not unfettered. In performing its functions, the Commission is required to have regard to its statutory objectives, as set out in section 6 of the ESC Act. This means that, in regulating the water and sewerage industries, the Commission must protect the long-term interests of the consumers of water and sewerage services with respect to the price, quality and reliability of those services. To the extent that additional factors are expressly established under the Act (for example, by way of Regulation) as being matters to which the Commission must have regard in performing its functions, then the Commission will need to consider how those factors are best weighed and addressed in meeting its primary objective.

The Act establishes three distinct areas of power for the Commission: the licensing of certain water entities; the establishment of binding service standards (embodying a consumer protection regime as well as performance standards); and, the setting of prices (or pricing methodologies) for certain water services, having regard to the binding service standards set. Later sections of this Chapter set out a range of specific matters which arise in respect of these three areas – at this stage it is sufficient to note the high-level characteristics of each.

### 2.1.2 The water industry

Section 4 of the Act sets out definitions of the various terms used within it. In that section, the term "water industry" is defined as follows:

***water industry*** *means any operations associated with the provision of water services or sewerage services.*

This is a broad definition. It includes not only the direct provision of water services and sewerage services (as discrete activities) but also those operations which are associated with that direct provision.

The terms "water service" and "sewerage service" are further defined in section 4:

***water service*** *means -*

*(a) a service constituted by the collection, storage, production, treatment, conveyance, reticulation or supply of water; or*

*(b) any other service, or any service of a class, brought within the ambit of this definition by regulations.*

***sewerage service*** *means -*

[20] Refer Act, clause 7(1). These provisions replicate section 5(a) of the ESC Act.

*(a) a service constituted by the collection, storage, treatment or conveyance of sewage through the use of a reticulated system; or*

*(b) any other service, or any service of a class, brought within the ambit of this definition by regulations.*

These definitions, too, are broad. In relation to the term water service, the Commission notes that the relevant service need not be performed in respect of a reticulation system. In both cases, the Commission notes that there is the potential for other services to be brought within the definition by later regulation.

Perhaps most importantly, however, and as noted above, the effect of the definitions as established under section 4 is that any operations associated with the provision of either a water or a sewerage service are considered to be a part of the water industry. This has significant implications for the scope of regulation under the Act and ensures that there is the potential for all relevant activity to be controlled under the Act should the protection of the public interest warrant that outcome.

### 2.1.3 Water industry entities

While the Act defines a broad scope for water services, it also sets out a narrower class of activities undertaken by those who meet the definition of a "water industry entity". Under section 4, a "water industry entity" is a person who holds a licence issued by the Commission or who has been "recognised" by the Minister for Water as such an entity.

Whether licensed by the Commission or "recognised" by the Minister for Water, becoming a "water industry entity" vests a set of statutory rights and places a set of statutory obligations on a person. Those rights, in particular, are in many cases fundamental to the proper operations of the water industry, such as the powers and duties in relation to land and infrastructure (established under Part 5 of the Act) and technical and safety issues (established under Part 7 of the Act).

For example, pursuant to section 49 of the Act, a person is prohibited from creating any form of encroachment over an easement that exists for the purpose of providing a water service without the permission of the relevant water industry entity. Furthermore, if such an encroachment is created, then the relevant water industry entity is granted powers to enter onto the land to carry out inspections and may require the person to take remedial action.

Similarly, under section 68 of the Act, water industry entities are required to take reasonable steps to ensure that the infrastructure and related equipment they operate complies with technical and safety requirements and standards specified

by the Technical Regulator.[21] This is an important consumer protection mechanism and is common (usually as a condition of licence) in other sectors regulated by the Commission. However, where the entity providing the service is neither licensed by the Commission nor "recognised" by the Minister for Water, then those obligations in relation to technical and safety matters do not attach to that entity.

The two examples described above are simply typical of the types of rights and obligations granted under the Act; the Act provides for a large number of such rights and obligations as a central pillar of the statutory regime.

The Commission's licensing and economic regulatory role is limited to those entities which provide, or seek to provide, "retail services". Those services are defined in section 4 of the Act to be:

- the sale and supply of water to a person for use (and not for resale other than in prescribed circumstances (if any)) where the water is to be conveyed (whether or not by the seller) by a reticulated system; or
- the sale and supply of sewerage services for the removal of sewage,

(even if the service is not actually used) but does not include any service, or any service of a class, excluded from the ambit of the definition by Regulation under the Act. Similarly, services can also be brought within the ambit of the above definition by Regulation.

The Commission may issue a licence to a person who provides a service on those terms and may also make a price determination under the ESC Act in relation to such services. However, where an entity provides a service within the water industry which does not fit within the definition of "retail service", the Commission has no regulatory role to play in respect of that service.

This will be the case, for example, where an entity operates a water network but does not sell water to a customer for consumption. In those cases, notwithstanding that the entity may well be a monopoly service provider, there is no role for the Commission in reviewing or setting prices. While the Commission might review the prices charged by the retailing entity, that price control is at best one step removed from the source of the costs. While the Act currently provides for the licensing of retail service providers, given the intention to introduce an access regime[22] (as indicated by section 26 of the Act), the Commission would

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[21] Part 3, Division 2 of the Act provides details of the proposed functions of the Technical Regulator in the water industry which are similar to those of the Technical Regulator established under section 7 of the Electricity Act and section 7 of the Gas Act. The Technical Regulator is responsible for monitoring and regulation of safety and technical standards and for the provision of advice to the Commission in respect of those standards. Refer http://technicalregulator.sa.gov.au/ for more information.

[22] Under Action 77 in *Water for Good*, the Government has committed to the development of a state-based access regime by 2015, in order to further develop the framework for regulated negotiations between the owner of monopoly water or sewerage infrastructure and the business seeking access to that infrastructure.

expect the licensing regime to expand to capture network service providers in the future.

### 2.1.4 Entities to be regulated

As the regulator of the water industry, the Commission will assess licence applications and issue licences authorising the provision of a retail service to successful applicants. The Commission expects that the type of entities it will licence will range from Government-owned corporations to local councils to private companies. Each type of entity has different roles, functions and powers. While the Commission's regulatory approach will not differentiate between entities based on their legal status, it is important to understand that each type of entity may have different commercial and/or social drivers in undertaking their regulated activities.

***South Australian Water Corporation Act***

The South Australian Water Corporation Act 1994 establishes the South Australian Water Corporation as a statutory corporation and makes it subject to the Public Corporations Act 1993. SA Water is a State-owned corporation with the principal responsibility of providing water and sewerage services for the benefit of the people and economy of South Australia.

As an established corporation, SA Water has perpetual succession and a common seal and is capable of suing and being sued in its corporate name. SA Water has all the powers of a natural person together with the powers specifically conferred by the SA Water Corporation Act or any other Act.

SA Water's primary functions are to provide services for the supply of water by means of reticulated systems; for the storage, treatment and supply of bulk water; and for the removal and treatment of sewage by means of sewerage systems.

It also has other functions including carrying out research and works to improve water quality and sewage disposal and treatment methods; develop commercially and market its products, processes and intellectual property produced or created in the course of the SA Water's operations; and encourage and facilitate private or public sector investment and participation, whether from within or outside the State, in the provision of water and sewerage services and facilities.

In addition, SA Water delivers various Community Service Obligations (**CSO**) on behalf of the South Australian Government.

***Local Government***

The Constitution Act 1934, the Local Government Act 1999 (**LG Act**), and the Local Government (Elections) Act 1999, create the legal framework within which Local Government operates.

Councils largely operate autonomously within the framework of the legislation and are primarily accountable to their local communities. They are generally not subject to Ministerial direction by either State or Federal Governments. Sometimes Councils work jointly with the State Government, and their decisions may be subject to advice and direction from State Government.

The principal role of Councils include providing and co-ordinating various public services and facilities and to develop their communities and resources in a socially just and ecologically sustainable manner; encouraging and developing initiatives within their communities for improving the quality of life within them; and representing the interests of their communities to the wider community.

***Corporations Act***

A company's main purpose is to generate profits for its shareholders. Shareholders carry all the risks of ownership, and their return depends on a company's underlying business performance.

A company is an entity in its own right and is incorporated under the Corporations Act 2001 (**Corporations Act**). It has a separate legal identity from the people who own and manage the business. The liability of shareholders is limited because the company is seen as separate from the people involved. The personal assets of shareholders are not threatened by company losses or debts except where shareholders are guarantors for the performance of the company.

The Corporations Act sets out the boundaries for operating a company including, but not limited to, duties of company officers, how a company can be formed, how it must be dissolved, and how it keeps records.

A company is managed by appointed directors, secretaries and managers, all of whom have set responsibilities. It is also able to have employees, who may include shareholders and directors. Transfer of company ownership may be a simple process and the company does not have to be wound up upon the disability, death or retirement of any one of the persons involved.

### 2.1.5 Designations, customers and consumers

Under section 25 of the Act, each licence issued by the Commission is required to contain conditions obliging the licensee to comply with industry codes made by the Commission prescribing various consumer protection and service standards matters. Those matters range from the provision of timely and accurate bills to consumers through to the levels of technical service performance required from the network. Price controls imposed by the Commission (including circumstances where the Commission uses more light-handed price regulation methods, such as price monitoring) are established having regard to the level of service standards set.

In addition, section 25 sets out a number of other mandatory conditions (for example, relating to standard contractual terms and conditions, regulatory accounting, dispute resolution and performance monitoring)[23] which would also be appropriate to be dealt with through the use of an industry code.

The shape of this consumer protection regime will necessarily be determined by the characteristics of the persons and services to whom it will apply. While the Act defines both matters in general terms, the mandatory licence conditions in section 25 introduce a degree of specificity such that there will be a tailoring of which customers and retail services will receive the benefit of the consumer protection regime.

This specificity is gained through the use of a Ministerial designation power, which will allow the Minister for Water to designate particular customers, services or classes of customers, as falling within the scope of individual consumer protection elements.[24]

For example, section 25(1)(b), dealing with the code provisions described above, provides as follows:

> ***25—Licence conditions***
>
> *(1) The Commission must make a licence subject to conditions determined by the Commission—*
>
> *****
>
> *(b) requiring the water industry entity to comply with code provisions as in force from time to time (which the Commission must make under the Essential Services Commission Act 2002) relating to the following matters with respect to designated customers, or designated classes of customers:*
>
> *(i) standard contractual terms and conditions to apply to the sale or supply (or the sale and supply) of designated services;*
>
> *(ii) minimum standards of service that take into account relevant national benchmarks developed from time to time;*
>
> *(iii) limitations on the grounds on which the supply of designated services may be discontinued or disconnected;*
>
> *(iv) the processes to be followed before designated services are discontinued or disconnected.*

[23] Refer, sections 25(1)(c), (e), (g) and (k) of the Act, respectively.

[24] Refer clauses 4(1), (2) and (3) of the Act, respectively.

Having regard to the scope of matters within this section alone, it is clear that the designations which are ultimately made by the Minister for Water will have a fundamental bearing on the particulars of the Commission's consumer protection regime. In the absence of formal designation at this stage, for the purposes of preparing this Final Advice, the Commission has made assumptions as to which customers and which services are to be designated.[25] The Commission would also note that, in the absence of any designation under the Act, it would still create a targeted consumer protection framework using those same assumptions, under its generic code making powers proposed in section 25(1)(a) of the Act.

***Table 2.1: Commission's assumptions about Ministerial designations of retail services, customers and classes of customers***

| Retail Service | | | | | | |
|---|---|---|---|---|---|---|
| Water | | | | Sewerage | | |
| Drinking Water | | Non-drinking Water | | Trade Waste | Other | |
| Residential | Non-residential | Residential | Non-residential | Non-residential | Residential | Non-residential |

In deriving its assumptions, the Commission has balanced the need for specificity with the need for flexibility, so as to ensure that the regime applies no more and no less than is necessary. Therefore, the Commission has assumed that the designations made by the Minister will create broad classes, with the Commission itself retaining its code making and associated powers to tailor the application of regulatory obligations within those classes.

***Designation of services***

The Act provides for two broad categories of retail service: water retail services and sewerage retail services. Having reviewed the nature of the water industry supply chain, the Commission understands that those services may be disaggregated into:

- Water: "drinking water retail services" and "non-drinking water retail services"; and
- Sewerage: "trade waste retail services" and "other retail services".

***Designation of customers or classes of customers***

While the Act only provides for customers as a generic class, it is the Commission's view that there are two natural categories of customers which should be

[25] Those assumptions are based on the Commission's own views as well as on discussions with stakeholders. The Commission understands, however, that the designations ultimately made may differ from its assumptions.

established for regulatory purposes: residential (or domestic) customers and non-residential customers.

It is important to note that, unlike other essential service utilities regulated by the Commission, customers will be, unless otherwise determined by the Minister for Water, land owners. Uncertainty arises where users of retail services do not have a direct contractual relationship with a water industry entity (e.g. residential and commercial tenants).

***Customers other than landowners***

In its Statement of Issues and its Draft Advice, the Commission noted a tension in the (then) Bill in respect of the definition of a "customer" of water and wastewater services. That tension remains in the Act as passed.

The particular problem posed by the definition of "customer" is that retail services are defined to be services provided to that class of person. Central to the definition of "customer" under the Act is the concept of a land owner. As the Act currently stands, only such persons can be customers of a retail service provider. It therefore follows that only such persons are given the benefit of consumer protections under the Act, such as the protection afforded by any consumer protection codes mandated by the Commission as a condition of licence for retail service providers: all other classes of person who might receive retail services and who are not land owners, notably tenants, will not receive those protections.

This outcome is currently embedded structurally and textually within the Act. The Commission cannot, through a subordinate instrument under the Act, change that position.

However, while the Act defines a customer as a person who owns land in relation to which a retail service is provided, this definition allows for some expansion to include non-land-owners (tenants) where:

- a person is supplied, in prescribed circumstances with retail services as a consumer or user of those services, without limiting the definition of customers to owners of land; or
- the Regulations declare a class of persons to be customers.

While there are presently no circumstances which have been prescribed, nor are any Regulations available for consideration, it is noted that, if invoked, this mechanism will allow tenants to be afforded some of the consumer protections available under an industry code made by the Commission under Part 4 of the ESC Act.

Respondents to the Draft Advice, particularly those from welfare and sectoral advocacy groups, noted dissatisfaction with this state of affairs.

COTA SA submitted that:

> *COTA remains concerned that water customers are still defined in the Bill as property owners first and foremost, although the Minister for Water has the power to further define other classes of consumer as customers. COTA believes that ESCOSA is obligated to advise the government through the Treasurer that this anomaly must be addressed to allow for a useful and manageable consumer protection framework*.[26]

Similarly, the South Australian Council of Social Service submitted that:

> *In its previous submission SACOSS highlighted a number of issues of concern with the draft legislation and the implications of these issues for the regulatory framework that would apply to the water industry. Of particular relevance to the Commission's Draft Advice is the lack of certainty around the treatments of customers vs consumers to the point where it is not certain that tenants – who are not customers as they do not own the property to which water is connected – may still not be afforded the consumer protections afforded in the Draft Advice.*[27]

In a considered submission, dealing with the practical realities of the tension between the concepts of "customer" and "consumer", the Energy Industry Ombudsman submitted:

> *We note that, unlike other essential services utilities, customers of the water industry entities will be land owners, unless otherwise determined by the Minister for Water. The Water Industry Bill does potentially provide that tenants may be prescribed as customers.*
>
> *We understand that up to 30% of water industry customers are tenants, and submit that tenants should also be afforded some, if not all, the consumer protections available under industry codes and the licensing framework.*
>
> *We anticipate that enquiries will be received and complaints lodged not only by owners, but also by tenants. In these cases we can refer the tenants to their landlords, or to the Consumer and Business Services, should there be a dispute between the tenant and the landlord. Nevertheless, there may be cases where it would be appropriate and prudent for us or for the water industry entities to be able to deal with the tenant directly, such as in the case of potential restriction of supply for debt, or for faults and emergencies.*[28]

The Commission acknowledges that these are valid concerns; however, it remains the case that, in the absence of action by the Government to prescribe a class of

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[26] COTA SA, submission on Draft Advice, January 2012, page 3.

[27] South Australian Council for Social Services, submission on Draft Advice, January 2012, page 6.

[28] Energy Industry Ombudsman SA Pty Ltd, submission on Draft Advice, December 2011, page 2.

customer so as to include tenants or to make a Regulation under the Act otherwise dealing with the matter, the Commission is constrained from making assumptions as to the extent to which tenants will be brought within its regime. In any event, even if it were to prefer that tenants are within that regime (which, as a matter of principle, it considers should be the case) the legal reality is that the Commission's codes cannot extend the reach of the regulatory regime to tenants.

The Commission notes that there is some protection for tenants currently incorporated within the Act. Section 114 of the Act provides that:

***114—Protection of tenants and lessees of residential premises***

*(1) This section applies in relation to a tenant or lessee occupying residential premises.*

*(2) A water industry entity must not, in relation to a tenant or lessee who is a consumer—*

*(a) take action to recover from the tenant or lessee any amount for which the landlord or lessor is legally liable; or*

*(b) take action to recover from a tenant or lessee any amount on account of any default on the part of the landlord or the lessor; or*

*(c) take other action against the tenant or lessee on account of any default on the part of the landlord or lessor unless such action is reasonably justified in the circumstances and is in accordance with any relevant provision prescribed by the regulations or contained in a code or set of rules published by the Commission for the purposes of this section.*

While these are important provisions which will provide financial protections to tenants, they do not extend the scope of the Commission's regime to tenants. As noted above, this can only happen through prescription or the making of a Regulation under the Act

The Commission therefore advises that the Government needs to address this matter as a priority and would emphasise its willingness to work with the Government to best give consumer protections to tenants.

## *2.2 Licensing and exemption framework*

The Act establishes, at Division 2 of Part 4 (sections 18 to 34) a licensing regime which applies to persons who provide retail services to South Australian consumers.[29] Pursuant

[29] As described in the introductory section of this advice, a retail service is a service constituted by the sale and supply of water to a person for use (and not for resale other than in prescribed circumstances (if any)) where the water is to be conveyed by a reticulated system and the sale or the sale and supply of sewerage services for the removal of sewage, even if the services is not actually used (but does not include any service or any service of a class, excluded by regulation).

to section 18, those who engage in the activity of providing retail services (or any other activity for which a licence is required by regulation) are required to hold a licence issued by the Commission.

The range of activities captured by the definition of "retail service" is broad and will cover not only the activities of SA Water but also those undertaken by local councils and private enterprises, such as:

- the operation of Community Wastewater Management Systems (**CWMS**);
- the sale and supply of drinking water to persons in remote areas;
- the sale and supply of re-use or recycled water for use; and
- the sale and supply of harvested storm water.

The "retail only" licensing approach means that water network services fall outside the scope of the regulatory framework. Entities that provide these services alone will therefore not be licensed by the Commission. This position may change, however, when an access regime is introduced in accordance with section 26 of the Act.

The licence issued, in the event that applicants (other than SA Water) satisfy the Commission that the statutory assessment criteria are met, will require the licensee to comply with various regulatory obligations. Those obligations will include the requirement to comply with the terms of industry codes established by the Commission (under Part 4 of the ESC Act) dealing with consumer protection matters, such as billing, payment, disconnection/flow restriction and contractual matters.

While the default position under the Act is that water entities providing retail services are licensed, pursuant to section 108 of the Act, the Commission may, with the approval of the Minister for Water, grant an exemption from Part 4, or specified provisions of Part 4, on terms and conditions it considers appropriate.

### 2.2.1 Draft Advice

In its Draft Advice, the Commission determined that:

- entities wishing to provide retail services (other than SA Water) would need to apply to the Commission for a licence; and
- taking into account matters put forward by a water industry entity and the objectives of the ESC Act, the Commission would consider exempting individual entities from the requirement to obtain a licence (or from specific licence requirements) on a case-by-case basis.

### 2.2.2 Summary of submissions

From the submissions received in response to the Draft Advice in respect of the licensing regime, two opposing views were apparent. The view was put by the LGA

that certain retail services, particularly small scale CWMS, should be given the benefit of a general exemption from the requirement to be licensed and that the larger schemes should only be subject to light handed regulation.

In contrast, submissions from SA Water and the Energy Industry Ombudsman supported the licensing of all entities providing retail services to ensure a "level playing field" for all industry participants. In their view, by exempting certain water entities entirely, the Commission runs the risk of establishing different service standards for consumers of water services and undermining the fairness and competitiveness of the South Australian water industry. SACOSS was also supportive of the implementation of a licensing regime and noted that while its supports the granting of exemptions on a case by case basis, exemption decisions made by the Commission should be transparent and affected stakeholders should be given the opportunity to make submissions prior to any exemption being granted.

### 2.2.3 Commission's consideration

In its Draft Decision, the Commission set out its preferred position to impose a licensing regime whereby exemptions would be used as an instrument to recognise exceptional circumstances where licensing (or the imposition of certain licence conditions) was not appropriate.

In summary, those reasons included the following:

- a licence gives a licence holder value and certainty, the right to enter and remain on land to contract or repair water or sewerage infrastructure or restrict water supply when necessary;
- the regime allows the Commission to set minimum service standards and require an appropriate level of consumer protection for South Australian consumers of water and sewerage services;
- the regime allows the Commission to impose a licence fee, set at a level determined by the Treasurer which will, at least in part, reflect the costs of the administration of the Act and is payable by each licensee in order to cover those costs;
- the Commission has a much larger range of enforcement actions in respect of licensees and also more discretion on how compliance matters can be effectively addressed; and
- exempted entities that fail to comply with the conditions of an exemption are then subject to the full licensing regime under the Act. The only enforcement action available to the Commission in these circumstances is to prosecute the exempted entity for a breach of Part 4 of the Act if it does not subsequently apply to the Commission for a licence, an outcome which does not benefit any stakeholder.

The Commission is of the view that the reasons set out in its Draft Advice continue to be persuasive in terms of supporting the implementation of a licensing regime which will require entities wishing to provide retail services to be issued with a licence by the Commission. Notwithstanding this position, the Commission is open to considering the establishment of particular classes of licence to better take into account the size and scope of a water entity's operations.

Considering the approach taken by the Commission in the other utility sectors it regulates, the Commission also believes that it is appropriate for a water entity seeking an exemption to demonstrate why it should not be licensed or why specific parts of the Act should not apply to it. In determining whether to grant an exemption, the Commission would consider the impact of the proposed exemption on the achievement of the various factors specified in section 6 of the ESC Act, in particular, the need to ensure that the long-term interests of consumers with respect to price, reliability and quality of supply are served. The introduction of a class or blanket exemption does not allow the Commission to have proper regard to these important considerations on a case by case basis.

### 2.2.4 Final Advice

***Final Advice 1.***

***The Commission's final advice is that:***

- ***entities wishing to provide retail services (other than SA Water) will need to apply to the Commission for a licence; and***
- ***taking into account matters put forward by a water industry entity and the objectives of the Essential Services Commission Act, the Commission will consider exempting individual entities from the requirement to obtain a licence (or from specific licence requirements) on a case-by-case basis.***

## *2.3 Applying for a licence*

Section 19 of the Act requires a water industry entity to apply to the Commission for the issue of a licence in a form approved by the Commission. Notwithstanding that requirement, by the force of section 18(2) of the Act, SA Water is entitled to be issued with a licence from the commencement of the Water Industry Act without going through an application process.

The Commission is required to consider an application submitted by a water industry entity and may determine to issue or refuse to issue a licence to the applicant. In addition to the factors specified in section 6 of the ESC Act, to which the Commission must have regard when considering an application, section 20(2) of the Act provides that the Commission may only issue a licence if further satisfied that:

- the applicant is a suitable person to hold the licence; and
- the applicant will be able to meet reasonably foreseeable obligations under contracts for the sale or supply of water or the supply of sewerage services for the removal of sewage (or both), as the case may require; and
- the water infrastructure or the sewerage infrastructure (or both), as the case may require, to be used in connection with the relevant service is (or the proposed infrastructure will be) appropriate for the purposes of which it will be used; and
- the applicant has the capacity (including financial, technical, organisational and other necessary capacity) to provide the services safely and to appropriate standards that would be authorised by the licence; and
- the applicant meets any special requirements imposed by the regulations for the holding of the licence; and
- the grant of the licence would be consistent with criteria (if any) prescribed by the regulations for a licence of the relevant category.

In deciding whether an applicant is a suitable person to hold a licence, the Commission may consider:

- the applicant's previous commercial and other dealings and the standard of honesty and integrity shown in those dealings; and
- the financial, technical and human resources available to the applicant; and
- the officers and, if applicable, major shareholders of the applicant and their previous commercial and other dealings and the standard of honesty and integrity shown in those dealings (including breaches of statutory and other legal obligations); and
- other matters prescribed by regulation or considered relevant by the Commission.

The Commission has previously acknowledged that the list of matters to be considered prior to it issuing a licence is comprehensive. Further the Commission remains conscious of the fact that the level of information required by new applicants in order to satisfy the Commission of those matters should not be so onerous as to deter them from the application process altogether or cause significant resourcing issues.

### 2.3.1 Draft Advice

In its Draft Advice, the Commission determined that:

- it would develop and consult on a draft set of prudential standards to apply to entities applying for a licence under the Act; and

- pursuant to sections 20(2) and (3) of the Act, in assessing a licence application, it would consider other matters that may be relevant on a case-by case-basis.

### 2.3.2 Summary of submissions

Submissions received on the Draft Advice in respect of the application process from Councils and the LGA primarily raised issues around the types of information applicants would need to give to the Commission as part of the application process.

In particular, the Councils noted that parts of the draft application form released for consultation by the Commission requested information that was more relevant to private enterprise rather than local government. They also noted that it was unclear what level of detail was required in respect of certain aspects of the application form such as the description of services to be carried out. Further, Councils were unsure whether they would need to provide details of officers who were involved in the water or sewerage services carried out by a council or whether the request extended to all officers appointed by a Council. The Councils were also keen to understand how they would apply for an exemption from certain licence conditions as part of the application process and what form the exemption process would take more generally.

The Energy Industry Ombudsman's submission recommended that if exemptions were granted they should, to the greatest extent possible, be standard and consistent rather than varying between entities. The Energy Industry Ombudsman indicated that it would be quite difficult and time consuming dealing with customer complaints if all water industry licensees were required to comply with different obligations. SACOSS reiterated its view that decisions by the Commission regarding the granting of exemptions during the application process should be transparent and interested stakeholders should be given the opportunity to participate in a consultation process.

### 2.3.3 Commission's consideration

In its Draft Advice, the Commission advised that it would undertake further research to identify and analyse the types of risks faced by the different water entities operating in South Australia. The Commission acknowledged that this was required so that it could develop a set of appropriate prudential standards that applicants would be required to satisfy as part of the application process.

To this end, the Commission sought advice on the types and levels of assessment that were appropriate to allow the Commission to properly form a view on an applicant's suitability to meet, in particular, the requirements of sub-sections 20(2)(a), (b), (c) and (d) and 20(3) (a), (b) and (c) of the Act.

As a first step, the risks inherent in the water industry in South Australia had to be identified. Once the key risks, which are identified below, were assessed, additional advice was given to the Commission in respect of the appropriate prudential standards to apply to licence applicants to mitigate the occurrence of such risks.

It is relevant to note at this point that the risks identified and prudential standards recommended apply to entities undertaking both the sale and supply of retail services. The application of the framework will undoubtedly become more complex under a third party access regime where the activities of sale and supply become separated. In these circumstances, the requirement for a retail service to relate to the "sale and supply of water to a person" under a linear contractual arrangement will necessitate the final supplier to the end user evidencing issues regarding the quality and security of supply that may best reside with the operator of the water infrastructure. This is likely to be a matter that will require further consideration when the parameters of the third party access regime are known.

The four core risk areas identified were:

- Delivery risk – the risk that a licensee or a counterparty of the licensee may not be able to fulfil their regulatory or contractual obligations to provide services. Delivery risk focuses on whether the licensee is able to physically provide the relevant service.
- Customer service/consumer protection risk – the risk that a licensee is unable to implement adequate systems and processes to fulfil its regulatory obligations with respect to customer service and consumer protection. Customer service/consumer protection risk focuses on whether a licensee is able to provide the relevant service to the required standard.
- Financial risk – the risk that a licensee does not have adequate cash flows or financial arrangements (such as, but not limited to, parent guarantees) to meet its obligations.
- Organisational risk – a risk arising from execution of a licensee's business functions, specifically, the people, systems and processes through which a licensee operates.

To address each of the risks identified, the Commission also received advice on the appropriate prudential standards that retail licence applicants would need to satisfy as part of the application process.

In summary, the recommended prudential approach involves applicants being requested to demonstrate their satisfaction of the licence requirements through the provision of documentation or descriptions of processes and procedures rather than an approach whereby applicants would provide declarations as to their capacity. For example, applicants may be requested to provide a copy of

their Asset Management Plan or details on the contingency arrangements in place to ensure continuity of service by the applicant in circumstances of the service failure by a third party, rather than providing a declaration that such documents or arrangements exist.[30]

The Commission would emphasise, however, that the issuing of a licence is a point-in-time assessment made on the basis of the best available evidence: it does not (and cannot) guarantee the medium or long-term financial, technical and operational viability of any water business.

Given the range of entities captured by the licensing regime and the differing services that are being provided, it would be very difficult for the Commission to satisfy itself that a licence should be issued in the absence of the detailed information that would be obtained through this approach. That said, the Commission will have regard to the scale and nature of the operations of the water industry entity applying for a licence during this process. Further, the Commission will accept information from applicants which may have already been provided to other regulatory agencies in the form required by those agencies (to ensure applicants aren't required to double handle such information) provided that information is up to date and addresses the application form requirements.

In light of the particular concerns raised by submissions about the application process and the advice received by the Commission on the prudential standards that should apply to retail licence applicants since the Draft Advice was released, the Commission will engage with potential licence applicants in relation to the licence application process. The intention is to provide applicants with application forms and detailed practical information about the licensing process, regime and the manner in which a particular application may be tailored having regard to the scale and scope of operations.

As a final point, pursuant to section 20(3)(d) of the Act, the Commission is able to take into account other matters that it considers relevant in determining whether an applicant is a suitable person to hold a licence.

The Commission received no specific submissions on this aspect of the process and, as envisaged in the Draft Advice, the Commission has determined that it is appropriate for it to consider matters relevant to a licence application that are outside of those set out in the Act on a case by case basis. This is the approach the Commission takes in respect of entities applying for licences in the energy sector and it sees no reason for departing from this approach.

[30] An exception to this approach may be required in respect of an applicant's ability to demonstrate its competency, in particular in relation to the appropriateness of an applicant's water and sewerage infrastructure. In the absence of the appointment of a Technical Regulator to whom the technical information provided by the applicant can be referred, it is likely that the Commission would have to rely on a declaration signed by the applicant to assure itself of such matters.

### 2.3.4 Final Advice

***Final Advice 2.***

***The Commission's final advice is that:***

- ***the Commission will separately consult with potential licence applicants on the licensing process, obligations and mandatory licence conditions; and***
- ***pursuant to section 20(3) of the Act, in assessing a licence application, the Commission will consider other matters that may be relevant on a case-by case-basis.***

## *2.4 Mandatory licence conditions under the Act*

Section 25 of the Act sets out the mandatory licence conditions to be imposed on water industry entities that are issued with a licence. For ease of reference these licence obligations are reproduced below:

- requiring compliance with applicable codes or rules made by the Commission under the ESC Act;
- requiring compliance with code provisions in relation to designated customers (i.e. customers or classes of customers designated by the Minister for Water by notice in the Gazette), relating to:
  - standard contractual terms and conditions to apply to the sale or supply (or the sale and supply) of designated services;
  - minimum standards of service that take into account relevant national benchmarks developed from time to time;
  - limitations on the grounds on which the supply of designated services may be discontinued or disconnected;
  - the processes to be followed before designated services are discontinued or disconnected;
- requiring a water industry entity, at the request of a designated customer, to provide designated services at the entity's standard contract price and subject to the water industry entity's standard contractual terms and conditions;
- requiring a water industry entity to comply with code provisions relating to the provision of pricing information to designated customers or designated classes of customers;

- requiring a water industry entity to include in each account for services provided to designated customers, or customers of a designated class, information prescribed by the regulations;
- requiring the water industry entity to maintain specified accounting records and to prepare accounts according to specified principles;
- requiring a specified process to be followed to resolve disputes between the water industry entity and its customers;
- if the water industry entity provides designated services to designated customers, or designated classes of customers, requiring the water industry entity to participate in an ombudsman scheme determined or approved by the Commission;
- requiring the water industry entity to monitor and report as required by the Commission on indicators of service performance determined by the Commission;
- relating to the water industry entity's financial or other capacity to provide services or to continue operations or activities under the licence;
- requiring the water industry entity to maintain specified kinds and levels of insurance;
- requiring the water industry entity to have all or part of the services, operations or activities authorised by the licence audited and to report the results of the audit to the Commission;
- requiring the water industry entity to notify the Commission about changes to officers and, if applicable, major shareholders of the entity;
- requiring the water industry entity to provide, in the manner and form determined by the Commission, such other information as the Commission may from time to time require;
- requiring the water industry entity to comply with the requirements of any scheme approved and funded by the Minister for Water for the provision by the State of customer concessions or the performance of community service obligations by water industry entities;
- requiring the water industry entity to comply with the requirements of any scheme approved and funded by the Minister for Water for the purposes of providing specified exemptions from the requirement to pay for the provision of specified services;
- any further conditions that the Commission is required by regulation to impose on the issue of such a licence;[31] and

[31] The Commission notes that no Regulations have been prepared at the time of writing.

- any further conditions considered appropriate by the Commission.

As discussed in section 2.1.5 of this Final Advice, the Minister for Water still needs to make a number of designations to determine the extent to which various licence conditions will apply. For the purposes of this advice, however, it is the Commission's expectation that the mandatory licence conditions specified above will apply to the majority of water industry entities from the commencement of the licensing regime.

### 2.4.1 Draft Advice

In its Draft Advice, the Commission determined that it would, on application by a water industry entity, consider exempting that entity from various licence conditions specified in the Act where it is demonstrated by that entity that such conditions are irrelevant or unduly onerous having regard to the scale or scope of the operations undertaken by the entity.

### 2.4.2 Summary of submissions

Submissions received from Councils on the Draft Advice in respect of the licence conditions argued that a number of the mandatory conditions were problematic from a practical perspective. Licence conditions requiring a water industry entity to maintain specified accounting records according to specified principles (which may include ring fencing arrangements) or to maintain specified kinds and levels of insurance were specifically identified as being difficult for councils to comply with.

In contrast, SA Water and the Energy Industry Ombudsman reiterated their views that by imposing consistent licence conditions, all industry participants, including any new participants would be required to operate under the same standards and controls thereby creating a fair, competitive market which affords appropriate protections. SACOSS was also of the view that the starting point for any entity providing a retail service in the water industry should be that it comply with all mandatory conditions. Further, SACOSS encouraged the Commission to be particularly diligent when considering any request for an exemption, particularly if the relevant applicant intended to provide services to residential customers.

### 2.4.3 Commission's consideration

The Commission has noted earlier in this Final Advice (refer section 1.7.1) that there is significant diversity in the types of retail services provided by entities operating within the water industry and that the regulatory arrangements will need to recognise that fact.

It also recognises that the corporate structure, existing regulatory obligations and, most importantly, the size and scale of certain water industry entities will mean that in certain extenuating circumstances, certain licence conditions set out in section 25 of the Act may not be appropriate. The power of the Commission to

exempt water industry entities from the requirement to be licensed or from complying with certain licence conditions is set out in sections 105(1) or (2) of the Act. The Commission reiterates its position with respect to granting exemptions by confirming that entities wishing to seek an exemption from any of the mandatory licence conditions will need to apply to the Commission for that exemption and, in doing so, provide persuasive reasons for why it is appropriate for an exemption to be granted.

It is important to note at this point, however, that many of the mandatory licence conditions reflect existing State Government policy on the proper management of retail services and water and sewerage infrastructure. Accordingly, the Commission will need to carefully consider whether exempting an entity from such conditions is appropriate in light of this clear policy intent.

Of relevance to this issue is the requirement on the Commission contained in section 25(2) of the Act to have regard to the scale and nature of the operations of a water industry entity in determining the scope of the mandatory licence conditions it must impose.

The scale and nature of those operations can only be determined by the Commission after consultation with the entity (or a person or body nominated by the entity). While the Commission already takes a collaborative approach with entities that submit licence applications to it in the energy industry, and has no intention of changing its approach in the context of licensing water industry entities, this requirement of the Act will ensure that all applicants have the opportunity to engage with the Commission during the licence application process.

With the release of the Draft Advice, the Commission also released a draft water retail licence for consultation. Several stakeholders argued that certain licence conditions would pose problems from a compliance perspective. The Commission understands that local government may already have obligations relating to accounting methods or insurance and will work with such entities to ensure licence conditions are appropriate.

The final form of a water retail service licence(s) is an important aspect of the water regulatory regime. As previously mentioned, the Commission is open to considering the merit in establishing different classes of licence as a “one size fits all” approach is unlikely to be appropriate or in the long term interests of consumers, especially if that approach could result in current retail service providers ceasing operations or increasing prices as a result of burdening regulatory compliance costs.

### 2.4.4 Final Advice

***Final Advice 3.***

***The Commission's final advice is that, in considering the application of mandatory licence conditions, the Commission will take into account the corporate structure, existing regulatory obligations and, most importantly, the size and scale of certain water industry entities.***

## *2.5 Contravention of licence conditions*

Pursuant to section 27(1) of the Act, it is an offence for a licensee to contravene a licence condition. The maximum penalty for doing so is $1 million.

### 2.5.1 Summary of submissions

While no submissions were submitted in respect of this issue in response to the Draft Advice, Councils have previously raised concerns about the maximum penalty amount that can be imposed for a breach.

### 2.5.2 Commission's consideration

The Commission has previously advised that it is important to recognise that a breach of a licence condition could have a significant impact on public health and consumer protection. For these reasons, which are still relevant, the penalty for a breach needs to have the requisite level of deterrence. Further, the amount set out under the Act is consistent with the maximum penalty that may be imposed under the Electricity Act and the Gas Act.

Notwithstanding the above, the maximum penalty would not be automatically applied by a Court in every instance that a contravention of licence is prosecuted. The penalty to be applied will always be at the Court's discretion and will be dependent on the circumstances surrounding the contravention. In addition, section 27(2) of the Act provides that a contravention of a licence condition may be prosecuted as a summary offence (as opposed to an indictable offence) at the discretion of the prosecutor. If prosecuted as a summary offence, the penalty that may be imposed for a beach of licence cannot exceed $20,000.

The Commission's approach to compliance and enforcement is further set out in section 2.14, below)

## *2.6 Statutory exemptions*

In the context of granting exemptions, it is relevant to note that, pursuant to section 115 of the Act, the Governor may make such regulations as are contemplated by, or necessary

or expedient for the purpose of, the Act. Specifically, section 115(2)(i) of the Act provides that a regulation made by the Governor may:

> *exempt (conditionally or unconditionally) any persons or operations from the application of this Act or specified provisions of this Act.*

The Governor has made statutory exemption frameworks in the energy sector pursuant to a similar power set out in the Electricity and Gas Acts.[32] Provided that entities wishing to rely on the exemption satisfy, and continue to satisfy, certain conditions, they are not required to be licensed under Part 3 of the Electricity Act or Part 3 of the Gas Act.

Finally, the Technical Regulator may also grant exemptions from Part 7 of the Act, or specified provisions of Part 7, which deal with safety and technical matters. Such exemptions may also be subject to specific conditions as deemed appropriate by the Technical Regulator.

## *2.7 Other powers of the Commission under the Act*

The Commission has other licensing powers granted to it under the Act such as the power to vary, transfer, suspend or cancel a licence (refer sections 28, 29 and 33 respectively). As previously advised by the Commission in its Draft Advice, in considering the exercise of each of these powers should the occasion arise, the Commission will consider the merits of each case and have regard to its statutory objectives under the ESC Act and the scope and purview of the regime under the Act.

## *2.8 Consumer protection framework*

The Act requires the establishment of a consumer protection framework through the use of industry codes. In the Commission's view, the necessary consumer protection framework for the water and wastewater industries is broad, capturing not only the regulation of retailer behaviour when dealing with customers (such as information provision, billing matters and dispute resolution procedures) but also includes the formation of standard form customer contracts and the establishment of the service standards that customers can expect to receive from their water and/or sewerage retailer.

Under Part 4 of the ESC Act, the Commission can make industry codes or rules regulating the conduct or operations of a regulated industry or regulated entities. There is a statutory process established under that Part governing the manner in which the Commission may make an industry code or rule, requiring consultation with stakeholders, including consumers, industry participants and relevant Ministers. Compliance with any applicable industry code or rule is a mandatory condition of licence within the industry, with a breach of an industry code or rule considered to be a breach of licence and punishable as a criminal offence.

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[32] Refer to regulation 6 in the *Electricity (General) Regulations 1997* and regulation 6A in the *Gas Regulations 1997*.

The purpose of industry codes and rules is to prescribe detailed rules of conduct and procedure which must be followed by those to whom the relevant instrument applies. The Commission has no powers to make an industry code or rule binding on any entities except licensees (or, where so determined by the Commission or by regulation, a person exempted in whole or in part from licensing requirements); the Commission therefore cannot directly bind consumers by means of an industry code.[33]

The use of industry codes or rules allows for a higher degree of regulatory flexibility to be utilised by the Commission as the independent economic regulator, while maintaining appropriate scrutiny, accountability and transparency of process in their development. Industry codes or rules may cover any number of discrete regulatory areas within a regulated industry, from consumer protection matters to technical matters, such as metering and network reliability standards.

### 2.8.1 Draft Advice

In respect of water industry codes, the Commission's Draft Advice was that:

- the consumer protection requirements would be incorporated into a single industry code, the Water Retail Code, that would:
  - be broadly consistent with the retail codes that apply to other essential services regulated by the Commission and draw on the provisions of the national consumer protection framework for retail energy markets, where appropriate;
  - specify the minimum requirements for the retailer-customer relationship in relation to customer information, billing, payments and payment difficulties, restrictions, disconnections and reinstatement of services following restriction or disconnection; and
  - specify areas where additional protections would be made available for residential customers;
- if licensed, water industry entities that provide retail services would be required to comply with the Water Retail Code, however exemptions from specific requirements under the Water Retail Code would be considered on a case-by-case basis;
- licensees providing a retail service (water or sewerage) to a residential customer would be required to use standard contractual terms and conditions set by the Commission, as prescribed in an industry code (while not limiting the ability for licensees to apply to the Commission for approval of non-standard terms and conditions); and

[33] The Commission's direct regulatory controls extend only to licensees and, in certain circumstances, those exempt from holding a licence. It is to be noted, however, that by requiring licensees (or exemptees) to comply with regulatory requirements, particularly those relating to contractual terms and conditions, the Commission's framework can have the indirect effect of binding consumers.

- licensees providing a retail service (water or sewerage) to non-residential customers would be required to contract with customers using terms and conditions that were consistent with principles and obligations specified by the Commission in an industry code or licence.

The Commission released an Explanatory Memorandum alongside the Draft Advice setting out the principles on which the various clauses of a consumer protection industry code would be based.[34]

### 2.8.2 Summary of submissions

There was general support for basing the consumer protection framework encapsulated in the water industry codes on the energy consumer protection framework, with suggestions that the energy framework had served South Australian customers well and it was reasonable for South Australian customers to expect similar consumer protections for all essential service utilities.

While supportive of this starting point, SACOSS and COTA advocated for the creation of a residential drinking water retail code to signal to current and potential water industry entities that supplying drinking water to South Australian households is accompanied by significant obligations.

The consumer advocacy sector submitted that a customer-centric approach was required in the following key consumer protection areas:

- payment flexibility, (including the prescription of a requirement to offer Centrepay arrangements);
- in the absence of legislative requirements, the development of robust Hardship provisions; and
- requirements around disconnections and restrictions for non-payment, including the need to publicly consult on the establishment of the minimum amount owing for restriction and the restricted water flow rate.

While highlighting a general need for the consumer protection framework to recognise the particular characteristics of the water industry compared with other essential services regulated by the Commission, (noting the requirements around safeguarding public health and the relationship with the environment in respect of water resource management and wastewater disposal as examples), SA Water did not provide any specific comment on the proposed consumer protection framework.

The Energy Industry Ombudsman called for clarification of the respective jurisdiction of the State Ombudsman and the Energy Industry Ombudsman,

[34] Refer http://www.escosa.sa.gov.au/library/111110-WaterConsumerProtectionFrameworkExplanatoryMemo.pdf

suggesting that it would be appropriate for the scope of the latter's current charter and constitution to be extended to the water industry.

Submissions from the Local Government sector advocated the introduction of a flexible, light-handed approach to regulation of water retail services provided by the Local Government sector, raising concerns about the interplay between the requirements of the Water Industry Act and the existing governance and legislative framework within which Local Government operates.

While supportive of the notion of flexibility in application of non-price regulation to the Local Government sector, the LGA submitted that it would be preferable to establish an agreed set of criteria to assign classes to CWMS where the lowest and smallest class would be exempt from the requirement to hold a licence, through to light-handed regulation for larger CWMS. The submission from the Councils engaged in the sale of reuse/recycled water raised a similar concern about the practical operation of the exemption process. The Energy Industry Ombudsman also highlighted the potential difficulties that would arise in assisting customers with complaints and dispute resolution if the regulatory obligations varied between water industry entities, suggesting that any specific requirements and exemptions should be in a standard, uniform format, rather than varying from entity to entity.

The LGA questioned whether the Commission's regulatory framework would be in addition to, or supersede, existing obligations on Local Government, citing a number of sections of the *Local Government Act 1999* as examples of commonality to elements of the Commission's proposed framework, covering budgeting processes and approvals; external auditing requirements; investigation and review by the State Ombudsman and the Minister for Local Government; and codes of conduct for council employees.

The District Council of Mt Barker submitted that, even with refinement of the regime to better align with the current governance and legislative environment for Local Government, there were likely to be significant additional costs that would need to be passed on to its water retail service customers, including the cost of compliance with the Commission's regulatory regime. The District Council of Mt Barker noted that in some instances, the current prices paid by recipients of services that would be captured under the definition of "water retail services" did not adequately reflect the cost of that service; resulting in cross subsidies between its water retail service customers and other ratepayers.

### 2.8.3 Commission's consideration

The Act provides that the Commission must make a licence to provide a retail service subject to the requirement to comply with applicable codes or rules made under the ESC Act. The Commission must, therefore, develop water industry

code/s outlining the requirements for water industry entities licensed to undertake retail services in South Australia.

Of relevance to the development of the consumer protection framework, section 25(1) of the Act provides that a water industry entity must comply with code provisions relating to the following matters:

- standard contractual terms and conditions to apply to the sale or supply (or the sale and supply) of designated services;
- minimum standards of service that take into account relevant national benchmarks developed from time to time;
- limitations on the grounds on which the supply of designated services may be discontinued or disconnected;
- the processes to be followed before designated services are discontinued or disconnected; and
- provision of pricing information to designated customers or designated classes of customers.

As a minimum, the consumer protection framework must contain provisions dealing with the above issues. However, it is also relevant to consider some of the other licence conditions contained in the Act and whether or not they should be covered in that framework. For example, the Act also makes it a condition of licence that the water industry entity licensed to undertake a retail service must:

- include on each account for services provided to designated customers, or customers of a designated class, information prescribed by the regulations;
- have in place processes to be followed to resolve disputes between the water industry entity and its customers;
- participate in an ombudsman scheme determined or approved by the Commission (if the water industry entity provides designated services to designated customers, or designated classes of customers);
- monitor and report on indicators of service performance, as determined by the Commission;
- comply with the requirements of any scheme approved and funded by the Minister for Water for the provision of customer concessions or the performance of community service obligations by water industry entities; and
- comply with the requirements of any scheme approved and funded by the Minister for Water for the purposes of providing specified exemptions from the requirement to pay for the provision of specified services.

Section 25(5) of the Act also provides that the consumer protection framework must, if the Minister for Water so requires, include provisions to assist customers who may be suffering specified types of hardship relevant to the supply of water retail services. In that context, the Commission also notes that section 37 of the

Act contains a separate provision which requires the Minister, not the Commission, to deal with the development and administration of hardship policies:

***37—Customer hardship policies***

*(1) The Minister must develop and publish a customer hardship policy in respect of the residential customers of water industry entities that sets out—*

*(a) processes to identify residential customers experiencing payment difficulties due to hardship, including identification by a water industry entity and self-identification by a residential customer; and*

*(b) an outline of a range of processes or programs that a water industry entity should use or apply to assist customers identified under paragraph (a).*

*(2) The Minister may vary a policy under subsection (1) from time to time.*

*(3) A water industry entity must—*

*(a) adopt a customer hardship policy published by the Minister under this section; or*

*(b) with the approval of the Commission, adopt such a policy with modifications.*

*(4) It will be a condition of a water industry entity's licence that it complies with the customer hardship policy applying in relation to the entity under subsection (3).*

*(5) In this section—*

*residential customer means a customer or consumer who is supplied with retail services for use at residential premises.*

The Commission is of the view that its experience in the regulation of other essential services suggested that, in dealing with the issues required by the Act, the consumer protection framework should:

- reflect key customer concerns, particularly those related to reliability, billing and payment and complaint handling;
- be consistent across the various water industry entities covered by the Act, while allowing for arrangements to be tailored to reflect differences across the water industry (allow sufficient flexibility to design arrangements to meet localised customer issues); and
- facilitate consistency with consumer protection measures that apply in other essential services regulated by the Commission.

### 2.8.4 Final Advice

***Final Advice 4.***

***The Commission's final advice is that the Water Retail Code/s will include the following consumer protection provisions:***

- ***Customer Charter: this will establish the requirement for licensees to prepare a Customer Charter that sets out, as a minimum:***
  - ***the respective rights and obligations for a retail service under the Code; the standard customer sale contract; the Water Industry Act (and associated Regulations under the Act); and any relevant health or water quality guidelines;***
  - ***the minimum standards of service (as determined by the Commission and set out in the Code) that a licensee must provide to its customers;***
  - ***for a water retail service, details of where the customer can obtain water efficiency advice; and***
  - ***for a non-drinking water retail service, information on the safe and proper use of the non-drinking water.***
- ***Enquiries, Complaints and Dispute Handling Procedures: this will deal with the development of procedures for handling customer enquiries, complaints and disputes. It would also require that such procedures must include the ability for customers to have their complaints addressed by an independent party where the issue cannot be satisfactorily resolved by the licensee.***
- ***Critical Needs Customers: this will contain obligations for customers to register a supply address in which a person reliant on life support equipment resides to ensure their water service is not restricted or disconnected.***
- ***Billing: this will deal with measures designed to ensure that customers receive accurate billing information in a timely manner to allow them to verify that their bills have been correctly calculated and to monitor and manage their consumption. It will also include protections to ensure that customers' needs are addressed when errors are determined.***
- ***Payment and Payment Difficulties: this will contain provisions relating to minimum requirements for payment terms, payment methods and the requirements for managing temporary payment difficulties experienced by customers. The minimum requirements for the following matters will be addressed:***

- ***establishment of mandatory billing frequency (i.e. quarterly billing);***
- ***establishment of a minimum time for payment of a bill/due dates for payment;***
- ***requirement for various payment methods to be provided to customers (e.g. mail, direct debit, in person);***
- ***establishment of rules for entering and terminating direct debit arrangements;***
- ***requirements for referral to Government concessions, rebates or grants;***
- ***requirements for licensees to provide payment flexibility for customers experiencing temporary payment difficulties;***
- ***allowing for customers to make payments in advance or have their bills forwarded to someone else upon request free of charge;***
- ***requirements for referral to a licensee's hardship program for customer's experiencing more permanent financial difficulties; and***
- ***establishment of limitations on debt recovery if a customer is participating in an agreed payment plan or is a hardship program customer.***

- ***Hardship Programs: this will deal with measures designed to assist hardship customers to avoid having their retail services restricted or disconnected due solely to an inability to pay.***
- ***Restrictions and Disconnections: this will contain limitations on the grounds on which water and wastewater services may be restricted or disconnected and the obligations on licensees prior to restricting (or, in limited circumstances, disconnecting) for non-payment. It will include a blanket prohibition on SA Water disconnecting water retail services for non-payment, and will also contain a general (i.e., to apply to all licensees) prohibition from disconnecting or restricting sewerage services for non-payment.***
- ***Reinstatement of Supply After Restriction or Disconnection: this will contain the requirement for licensees to restore a customer's water services. The key elements will be recognition of the ability for licensees to charge a reasonable fee for removal of a flow restriction device (where such devices are permitted) and the inclusion of mandatory timeframes for supply to be restored.***
- ***Illegal Use: this will deal with the rights and obligations of licensees and customers where a customer has used a retail service illegally.***

***The Commission will consult on the final form of any industry codes, with consultation to commence in early July 2012.***

## *2.9 Standard form customer contracts*

Section 36 of the Act provides a mechanism for the formation of deemed statutory contracts between licensees and customers. This model, adopted from the Electricity Act and the Gas Act, allows for binding and valid contractual relationships to be deemed to exist between licensees and customers in respect of the sale and supply of services. Importantly, this model provides both parties with a legal means of enforcing their rights, which is particularly important in the event of default by the other party.

Given the binding statutory nature of the contract arising under this section, and the associated potential for "unfair" terms to be imposed on customers by licensees, section 36(4) of the Act establishes a measure of regulatory oversight and control, by providing that the terms and conditions, including price, must comply with relevant regulatory requirements.

In relation to pricing, the Commission notes that while the clause requires that prices charged under the statutory contract must not exceed any maximum prices fixed under the Act, this does not mean that all prices charged under that contract need to be fixed under the Act. It is the Commission's position that the obligation only has effect where there are prices which have been fixed by the Commission using the pricing powers given to it under the Act. Where the Commission has not exercised those powers, or where those powers do not arise, the prices which may be charged by an entity are those which would otherwise apply.

### 2.9.1 Draft Advice

The Draft Advice outlined various options available to the Commission in exercising its power in this area, namely:

- place no regulatory restrictions on the nature, form and scope of standard contractual terms and conditions;
- establish principles with which such terms and conditions must demonstrably conform (for example, that the terms and conditions must be consistent with regulatory requirements established under an industry code); or
- prescribe the terms and conditions which must be adopted.

The Commission sought comment on whether it should require licensees' customer sale contract terms and conditions to be consistent with specified matters or principles, or whether a set of specified terms and conditions should be contained within a water industry code.

### 2.9.2 Summary of submissions

Submissions contained mixed views on how the Commission should exercise its power to develop standard form customer sale contracts.

CSV strongly favoured forms of customer contract being set by the Commission, suggesting the adoption of the model used in other essential service utilities regulated by the Commission.

An alternative view was put forward by the Councils, suggesting that application of the licence condition requiring all licensees to develop standard contract terms, conditions and prices should be limited. Further, if the proposal to allow for the development of voluntary codes of practice was accepted, it would be more appropriate to allow greater flexibility in developing standard form customer contracts. The Councils indicated preparedness to be involved in the development of any such arrangements. In particular, the District Council of Mt Barker recommended that consideration be given to existing documentation and arrangements in place, noting that it was in the process of finalising a model water supply agreement.

Concern was also raised about the impact of the Water Industry Act on existing long-term individualised contracts negotiated on a case-by-case basis with private entities for the construction and maintenance of infrastructure and the treatment and disposal of stormwater and wastewater/effluent.

### 2.9.3 Commission's consideration

The Commission acknowledges that there are competing views on the appropriateness of it setting standard terms and conditions. On the one hand, there is a level of centralised oversight, certainty and competitive equity provided through the Commission setting terms and conditions; on the other hand, fixed terms and conditions may impede retail activities in certain circumstances, particularly in smaller scale operations.

Some stakeholders have put the view that the Commission should provide customers and licensees alike with a level playing field, in terms of contractual terms and conditions. At the start of a new regime, there is merit in ensuring that customers' rights and obligations are consistent and do not vary by locality or service provider. Furthermore, as the regime is new, making certain that rights and obligations are properly and fairly expressed is an appropriate transitional measure. Finally, while the Commission permits energy retailers to develop their own contractual terms and conditions (based on standards expressed in the Energy Retail Code), that decision was founded on the premise that competitive forces would drive improved contractual arrangements. The same does not hold true, at least in the short to medium term, for the water industry; a retailer will be in a monopoly position and have no incentive to deliver attractive contractual terms and conditions.

The Councils' submissions do, however, raise an important point: the need for flexibility in regulatory arrangements. The risk in fixing one set of standard terms and conditions is that they are unlikely to be appropriate for all circumstances, particularly where the retail operations are small scale and localised. There is some precedent in the Commission's energy regulatory regime for allowing flexibility as sought by Councils; remote and non-grid connected electricity operators are required to develop standard terms and conditions (in accordance with prescribed principles) and to submit those terms and conditions to the Commission for approval prior to implementation. Similarly, under the Electricity Distribution Code, for large customers (those using more than 160 MWh of electricity annually) ETSA Utilities is permitted to depart from the set of terms and conditions fixed by the Commission. Further, with the Commission's express approval, ETSA Utilities may depart from the standard terms and conditions for a small customer (although this has not been done during the twelve years of the Commission's regulatory oversight).

Having regard to those matters and the nature of the new water regulatory regime, the Commission's proposed approach is to balance the need for certainty and consistency with the need for flexibility. The appropriate reference point for that balance is, in the Commission's view, the nature of the customer receiving the retailer service.

For residential customers, the Commission considers that certainty and consistency of treatment is paramount. Therefore, the Commission's general position is that it will require licensees providing retail services (water or sewerage) to use standard contractual terms and conditions set by the Commission . This is consistent with the approach used in the energy market prior to the commencement of full retail competition in the small customer market.

The terms and conditions of a licensee's customer sale contract (under section 36 of the Act) would have no effect to the extent of any inconsistency with the Code and will cover the following matters

- the parties to the contract;
- definitions;
- application of the terms and conditions;
- commencement and termination of the contract;
- scope/coverage of the contract;
- preconditions;
- liability and limitation of liability;
- appointments;
- prices for retail services and how those prices can and will be varied;
- billing issues, including when bills are sent, calculation of bills and estimations;

- payment terms, methods and any applicable late fees;
- payment difficulties;
- undercharging and overcharging;
- restriction and disconnection of supply;
- reinstatement or reconnection of supply;
- illegal use;
- details outing the processes for queries and complaints; and
- privacy and confidentiality.

For all other customers, the Commission is of the view that an appropriate level of certainty and consistency can be delivered by specifying a set of principles in an industry code. Any standard form contract utilised for non-residential customers of retail services would be required to be consistent with those principles. This is consistent with the situation in the energy retail market for all customers (other than those who choose to remain on the regulated standing contract) and has proven to be generally acceptable in practice.

Finally, the Commission acknowledges that there may be cases of necessity, such as the small scale operations undertaken by local councils or private enterprises or other cases, such as pre-existing long-term contracts, where the standard terms and conditions it fixes for residential retail customers simply will not work. In such cases, the Commission will provide flexibility by allowing a licensee to apply to it for the approval of varied terms and conditions. Where the Commission does not accept proposed variations, it may either require the licensee to use the standard terms and conditions or fix an alternative set of terms and conditions which the Commission considers better meet the needs of the circumstances. This process of flexibility should, however, be seen as a last resort option.

### 2.9.4 Final Advice

***Final Advice 5.***

***The Commission's final advice is that:***

- ***licensees providing residential customers with retail services (whether water or sewerage) will be required to contract with customers using standard terms and conditions developed by the Commission;***
- ***licensees providing non-residential customers with retail services (whether water or sewerage) will be required to contract with customers using terms and conditions which are consistent with principles and obligations specified by the Commission in an industry code or licence; and***

- ***to provide appropriate flexibility in contractual arrangements, licensees providing residential customers with retail services (whether water or sewerage) will be permitted to apply to the Commission for approval of non-standard terms and conditions.***

## *2.10 Service standards - general*

As discussed in the Commission's Draft Advice, the need to comply with all consumer protection requirements is fundamental to the operations which are authorised by a water retail licence. However, the nature of service standards is such that they can form a separate set of metrics by which the performance of an individual licensee can be monitored and assessed at either the individual customer or a whole-of-undertaking level. Service standards can also have specific financial penalties and rewards associated with them.

The Commission notes that while some water businesses may have established internal key performance indicators (**KPIs**) to drive particular business behaviours, there is no independent regulation and scrutiny of the levels of service provided in exchange for the prices charged by water businesses.

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

### 2.10.1 Draft Advice

In its Draft Advice, the Commission proposed that service standards would form part of the terms and conditions for the standard contract between a licensee and its customers. It envisaged that these standards would be expressed as "targets" or "minimum-levels" of service that customers can expect to receive for the price they pay, with penalties attached for a failure to meet the service levels agreed.

Recognising the difference in the scale and scope of water retail services undertaken by licensees, the Commission's service standards will take into consideration the scope of operation and where services are materially different, a separate set of service standards should apply.

Furthermore, the Commission proposed to adopt a best endeavours approach for defining the required standard of effort to be expended in meeting a service standard target.

### 2.10.2 Summary of submissions

The Australian Industry Group and the Energy Industry Ombudsman supported the Commission's view that service standards should be set with consideration given to the scale and scope of the licensee's operations rather than one set of

service standards irrespective of the provider. This view was not supported by SA Water; and COTA was of the view that Local Government providers should prove that meeting a particular service standard would be impractical.

A concern was raised by SACOSS regarding the deletion of confidential information; commenting that this lack of transparency made it difficult to assess the merits of the proposed approach. SACOSS encouraged the Commission to undertake a willingness to pay survey as a priority component of the regulatory framework.

A common view put by Councils was that further discussion was required in developing appropriate service standards for the local government sector, given that the scale and scope of operations undertaken by individual licensees is varied and recognising that they are already monitored by a number of agencies.

### 2.10.3 Commission's consideration

It is the Commission's intention to focus the initial set of service standards at a level that is not worse than current performance. The approach towards setting standards for SA Water and other licensees may vary slightly if it is determined that the scope of operations and volume of customers differ greatly.

The Commission is mindful that many councils and other small businesses do not currently report (or report in a very limited form) on water performance indicators, as their customer base is quite small and they provide wider services to those customers. For these reasons, the Commission is of the view that the setting of services standards should take into account the scope of operations, customer-base and current reporting mechanisms.

Since the release its Draft Advice, the Commission has engaged with SA Water to gain further understanding of its current operations and performance measures. That process included a request for information, which has used been as a basis for setting a proposed set of service standard for the initial Regulatory Period (the details of this process are set out below in "*proposed approach to setting SA Water service standards"*).

In relation to other licensees, the Commission will continue to develop appropriate service standards in consultation with stakeholders and a separate process is currently underway, seeking statistical information from potential licensees as a necessary first step.

In terms of the test proposed for best endeavours, the Commission has concluded that it will implement a definition such that the term will mean: *'to act in good faith and use all reasonable efforts, skill and resources to achieve an outcome in the circumstances'*.

As set out in the Draft Advice:

> *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 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.*

In practical terms, the Commission generally adopts a two-fold test in assessing performance against best endeavours standards: first, has the target been met?; if not, did the relevant licensee nevertheless use its best endeavours in its attempts to meet the target? Where targets are not met, then the licensee would be 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 preparatory activity 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, the licensee will need to provide the Commission with sufficient information in such circumstances to enable the Commission to form a view as to whether or not best endeavours were employed by the licensee in those circumstances.

It is only in cases where both elements of this test are not satisfied that the licensee would be found to have failed to meet the standard. That is, the licensee may fail to meet a target but, provided it used its best endeavours in attempting to meet that target, it will 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.

The Commission's preliminary view is that a "willingness to pay" or similar study, may be useful in helping the Commission set service standards that reflect the trade-off between customer benefits and costs of provision.

### 2.10.4 Final Advice

***Final Advice 6.***

***The Commission's final advice is that:***

- ***it will implement a best endeavours service standards regime for all licensees;***
- ***the details of that regime may vary between licensees depending on the scale and scope of their operations.***

## *2.11 Setting SA Water service standards*

The Commission will develop service standards for SA Water in a staged manner: the initial regulatory period 1 January 2013 to 30 June 2013; the first price determination period (1 July 2013 to 30 June 2016); and the second price determination period (1 July 2016 to 30 June 2020).

The Commission intends to adopt SA Water's current operational segmentation between its metropolitan and regional (country) operations for both the Initial Regulatory Period and the First Regulatory Period.

### 2.11.1 Initial regulatory period 1 January 2013 to 30 June 2013

The draft SA Water service standards contained in this Final Advice are intended to cover the period from commencement of operation of the Act to 30 June 2013, i.e. for the duration of the current prices set for SA Water by the Minister for Water.

Service standards for this initial period are to be based on the level of SA Water's current performance. SA Water's future performance under the new regulatory framework should not be less than existing levels of performance, unless as a result of a conscious decision to permit reduced levels of performance in return for lower prices (e.g. such decision informed by a willingness to pay survey).

The approach to developing the draft standards in the attached table has been to:

- review data for the last five years (2006/07 to 2010/11) supplied by SA Water in response to Commission data request;
- verify the simple averages in the SA Water data and having regard to the maximum performance achieved over the historic period;
- have regard to the importance of the metric in terms of the importance to the customer in receiving prompt service;
- adopt a "best endeavours" approach (defined above) rather than a "must achieve" approach;

- set standards at a level that achieves an appropriate balance in the extent of reporting by SA Water on reasons for any failed performance; and
- round targets to nearest 5%, unless in the case of rounding to 100% there are sufficient factors in favour of setting at 99%.

***Table 2.2: Service standards to apply to SA Water 1 January 2013 to 30 June 2013***

| Service Standard | Proposed Target |
|---|---|
| **1. Telephone responsiveness** | |
| Percentage of telephone calls answered within 30 seconds | 85% |
| **2. Complaint responsiveness** | |
| Percentage of written complaints that do not require investigation responded to within 5 business days | 95% |
| Percentage of complaints where an investigation is required responded to within 20 business days<br>*[Note: that in both cases of complaint responsiveness, where the complaint cannot be resolved within these timeframes, "responded to" means the customer has been advised of the licensee's suggested course of action, identified when the action will be taken and the name of the appropriate contact person for further enquiries.]* | 95% |
| **3. Drinking water quality complaint responsiveness** | |
| Percentage of Priority 1 complaints attended:<br>• metropolitan – within 1 hour<br>• regional – within 1 hour | <br>100%<br>100% |
| Percentage of Priority 2 complaints attended:<br>• within 2 hours (metro and regional)<br>• within 12 hours (metro and regional) | <br>Metro-95%<br>Regional-95%<br>Metro-100%<br>Regional-100% |
| Percentage of Priority 3 complaints where further action is required and the customer is contacted within 2 hours to negotiate attendance within 24 hours and the resulting attendance is not more than 15 minutes late [excluding lateness due to circumstances beyond the reasonable control of the licensee] | Metro-99%<br>Regional-99% |
| **4. Timeliness of connection** | |
| Percentage of new standard water connections installed, within 25 business days of application processed and fees received | 95% |
| Percentage of new non-standard water connections installed, within 35 business days of application processed and fees received | 95% |
| Percentage of new standard sewer connections installed, within 30 business days of application processed and fees received | 95% |
| Percentage of new non-standard sewer connections installed, within 50 business days of application processed and fees received | 95% |

| Service Standard | Proposed Target |
|---|---|
| **5. Timeliness of processing trade waste applications** | |
| Percentage of trade waste applications processed within 10 business days | 99% |
| **6. Timeliness of attendance at water breaks, bursts & leaks** | |
| Percentage of Priority 1 complaints attended:<br>• metropolitan – within 1 hour<br>• regional – within 1 hour<br>• regional – within 2 hours<br>*[Note: attendance means the time from when the licensee was first notified of a service fault, or becomes aware of a service fault, to when a representative of the licensee arrives on site.]* | <br>100%<br>95%<br>100% |
| Percentage of Priority 2 complaints attended:<br>• within 5 hours<br>• within 12 hours | Metro-95%<br>Regional-95%<br>Metro-100%<br>Regional-100% |
| **7. Timeliness of water service restoration** | |
| Percentage of Category 1 events restored:<br>• metropolitan – within 5 hours<br>• regional – within 5 hours<br>• regional – within 12 hours<br>*[Note: restoration means the total job duration, including time from receiving first notification or becoming aware, responding to, and rectifying the fault such that a water supply is restored to the original flow rates (i.e. the rate prior to the event). Where the loss of water supply is due to the shutdown of a section of water main, the water supply interruption begins when the water supply is shut off and ends when the main is fully recharged.]* | <br>99%<br>95%<br>99% |
| Percentage of Category 2 events restored:<br>• metropolitan - within 5 hours<br>• metropolitan - within 18 hours<br>• regional - within 5 hours<br>• regional - within 18 hours | <br>99%<br>99%<br>95%<br>99% |
| Percentage of Category 3 events restored:<br>• metropolitan - within 12 hours<br>• metropolitan - within 24 hours<br>• regional - within 12 hours<br>• regional - within 24 hours | <br>99%<br>100%<br>99%<br>100% |

| Service Standard | Proposed Target |
|---|---|
| **8. Timeliness of sewerage service restoration** | |
| Percentage of Category 1 events restored:<br>• metropolitan – within 5 hours | 100% |
| • regional – within 5 hours<br>*[Note: restoration means the total job duration, including time from receiving first* notification *or becoming aware, responding to, and rectifying the fault such that a sewerage (or CWMS) system is discharging effectively – when 'normal' service is restored.]* | 100% |
| Percentage of Category 2 events restored:<br>• metropolitan - within 5 hours | 95% |
| • metropolitan - within 18 hours | 100% |
| • regional - within 5 hours | 95% |
| • regional - within 18 hours | 100% |
| Percentage of Category 3 events restored:<br>• metropolitan - within 12 hours | 95% |
| • metropolitan - within 24 hours | 100% |
| • regional - within 12 hours | 95% |
| • regional - within 24 hours | 100% |
| Percentage of partial loss events restored:<br>• metropolitan – within 18 hours | 95% |
| • metropolitan - within 36 hours | 100% |
| • regional – within 18 hours | 95% |
| • regional – within 36 hours | 100% |
| **9. Timeliness of sewerage overflow attendance** | |
| Percentage of inside building overflows attended:<br>• metropolitan – within 1 hour | 100% |
| • regional – within 1 hour<br>*[Note: attendance means the time from when the licensee was first notified of a service fault, or becomes aware of a service fault, to when a representative of the licensee arrives on site.]* | 100% |
| Percentage of outside building overflows attended:<br>• metropolitan –within 2 hours | 100% |

| Service Standard | Proposed Target |
|---|---|
| • regional – within 2 hours | 100% |
| Percentage of external overflows attended: | |
| • metropolitan – within 4 hours | 100% |
| • regional – within 4 hours | 100% |
| **10. Timeliness of sewerage overflow clean up** | |
| Percentage of inside building clean ups completed: | |
| • metropolitan –within 4 hours of notification | 99% |
| • metropolitan – within 15 hours of notification | 100% |
| • regional – within 4 hours of notification | 99% |
| • regional – within 15 hours of notification | 100% |
| Percentage of outside building (on property) clean ups completed: | |
| • metropolitan –within 6 hours of notification | 95% |
| • metropolitan – within 15 hours of notification | 100% |
| • regional – within 6 hours of notification | 95% |
| • regional – within 15 hours of notification | 100% |
| Percentage of external (e.g. road or footpath) clean ups completed: | |
| • metropolitan –within 8 hours of notification | 95% |
| • metropolitan – within 15 hours of notification | 100% |
| • regional – within 8 hours of notification | 95% |
| • regional – within 15 hours of notification | 100% |

### 2.11.2 First price determination period (1 July 2013 to 30 June 2016)

The first regulatory period will be 1 July 2013 to 30 June 2016. This will be the first period for which service standards can be set within the context of determining prices.

Service standards will have regard for those developed for the Initial Regulatory Period, varied to take account of the following:

- alignment with energy sector standards;
- initial review of benchmarking with other relevant water industry entities;

- capital and operating decisions and expenditures intended to impact on performance of service standards;
- results of a willingness to pay survey (if undertaken and results are available at this time); and
- ability to collapse some categories within a standard, having assessed any distribution data able to be supplied by SA Water.

When finalised, these revised service standards would be included in a revised Water Retail Code to operate from 1 July 2013.

### 2.11.3 Second price determination period (1 July 2016 to 30 June 2020)

The second price determination period will be 1 July 2016 to 30 June 2020.

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).

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.

When finalised, these revised service standards would be included in a revised Water Retail Code.

## *2.12 Setting service standards for other water entities*

The Commission will develop service standards for other licensees having regard to the scale and scope of operation.

From the commencement of the regulatory regime on 1 January 2013, the Commission's objectives for the initial period will be to identify levels of performance, the scope of operations and to understand the current reporting mechanisms for all non-SA Water licensees.

Therefore, rather than setting specific service standards, the Commission will focus on obtaining data that will provide a basis for setting services standards for subsequent Regulatory Periods. The Commission will ensure that this phase of data collection is sufficient to provide relevant and accurate data and yet not too long such that the benefits of setting standards are foregone due to delays.

The approach to developing the standards for the various types of operations will include:

- reviewing relevant data collected, including any available data over the last five years (2007/08 to 2011/12);

- benchmarking with other relevant water industry entities and where applicable, alignment with SA Water standards;
- having regard to the importance of the metric in terms of the importance to the customer in receiving prompt service;
- adopting a 'best endeavours' approach (defined above);
- setting standards at a level that achieves an appropriate balance in the extent of reporting on reasons for any failed performance; and
- having regard to the results of a willingness to pay survey (if undertaken).

Of note, the standards ultimately derived may vary between entities and, for the same entity, over time. This process will be iterative and will need to have regard to the costs and benefits to consumers of regulation in this area.

## *2.13 Performance monitoring and reporting*

The Act requires licensees to monitor and report, as required by the Commission, on indicators of service performance determined by the Commission. Good regulatory practice requires that only information relevant and useful to the regulator and/or other participants is collected.

Performance monitoring and reporting is a useful tool for informing customers about the level of service that they are receiving and identifying reasons for the level of performance. It allows for the comparison of businesses by gauging relative performance within an industry (comparative competition) or with businesses performing comparable operations in other industries; and identifies baseline performance of individual businesses and provides incentives for improvement.

Performance monitoring also provides the information and data required for developing service standards (or targets) and for ongoing assessment of compliance with such standards; and informs the decision making processes of regulatory agencies, water businesses and the Government.

The Commission considers that the performance reporting framework should be developed having regard to the following principles:

- performance indicators need to be relevant to the services provided by each licensee;
- performance indicators need to be meaningful and relate to key issues of importance to both licensees and their customers;
- performance indicators need to be defined and collected on a consistent basis across licensees to provide a valid measure of actual performance and to allow reasonable comparisons;
- the costs of collecting information and data need to be balanced against the benefits of collecting the information. The performance monitoring framework

should focus on a reasonable range of meaningful indicators, so it is not excessively onerous or costly to implement;

- wherever possible, the framework should draw on accepted existing performance indicators to minimise the costs of collecting information and to aid comparison; and
- the accuracy and reliability of information provided by businesses must be verifiable.

### 2.13.1 Draft Advice

In its Draft Advice, the Commission proposed that its performance reporting regime would be targeted at monitoring performance of licensees in meeting the technical and customer service standards contained in a water industry code. As a consequence, the measures to be monitored are dictated by those ultimately adopted in a water retail industry code.

The Commission also noted its intention, subject to stakeholder comment, to adopt the approach that it has used for the energy sector of releasing an Annual Performance Report, supplemented by quarterly reporting on key statistics and ad hoc reports released to respond to any significant events occurring throughout the year. Regulatory audits would be conducted to provide independent assurance on the integrity of the data being reported to the Commission.

The Commission asked stakeholders to consider the above principles in formulating their submissions.

### 2.13.2 Summary of submissions

There was general support for the Commission's approach to performance monitoring. There was recognition that transparency is an extremely important aspect of regulating essential services and comprehensive performance monitoring can promote positive compliance outcomes and identify trends and emerging issues that may warrant regulatory intervention. Measures of particular importance highlighted were: the number of concession recipients and hardship customers, direct debit default numbers, price fluctuations, compliance with hardship provisions, telephone responsiveness and compliance with agreed service standards.

However, there was also support for adopting a light-handed approach, with the costs of collecting information and data being balanced against the benefits gained from its collection. The Commission's intention to draw on accepted existing performance indicators was supported as a means of minimising data collection costs and to aid comparison over time and between licensees.

### 2.13.3 Commission's consideration

There are two elements to the Commission's performance reporting framework. The Commission intends to focus its public reporting on each licensee's performance in key customer interactions on an annual basis, including an assessment of a licensee's achievement (or otherwise) of established service standards. This would be supplemented by reporting under the National Performance Reporting (**NPR**) requirements and ad hoc reports released to respond to any significant events occurring throughout the year.

***Reporting achievement of service standards and targets***

Regular, clear and concise performance monitoring and reporting by the Commission will give consumers information on whether or not licensees are meeting, improving or failing the service standards and how prices are changing over time. Public reporting on performance ensures licensees are accountable to their customers and strengthens the incentives to maintain and improve performance.

Outside of the direct relationship which each consumer will have with their water business, it will also be important for the Commission to be able to provide South Australians with a snapshot of how the water industry is performing overall. Information of this nature will equip consumers to better make decisions (including investment decisions for business consumers) and will hold water businesses publicly accountable for their actions.

The Commission will introduce quarterly reporting for larger licensees, such as SA Water. This is consistent with the approach in other essential services regulated by the Commission and allows monitoring throughout the year to identify any emerging issues, rather than rely on annual reporting. It is likely that smaller entities (e.g. Council CWMS operations) would only be required to report annually, on the basis that ad hoc reporting requests could be made by the Commission should poor performance become apparent during the year.

The Commission will develop a Water Industry Reporting Guideline (Reporting Guideline) containing data reporting templates, definitions and quality assurance requirements, consistent with those developed for other essential service utilities regulated by the Commission. While the Reporting Guideline will be developed alongside the Commission's water industry codes, the Explanatory Memorandum provides an indication of the data SA Water would be required to report to demonstrate its performance against the established service standards.

***National Performance Report under the National Water initiative***

The NPR, produced by the National Water Commission (NWC), delivers on the National Water Initiative (NWI) commitment to publicly and independently report on the performance of Australian water utilities. Underpinned by principles of

comparability, accuracy and consistency, the NPR includes information from around 70 water utilities supplying approximately 18.3 million Australians with urban water services. The data contained in the NPR encompasses five key areas: pricing; financial performance; capital expenditure; operational expenditure and recycling.

The National Performance Framework: Urban Performance Reporting Indicators & Definitions Handbook (the Handbook) is developed by the Urban Round Table Group (URTG) each year and forms the basis of the information required from SA Water for input into the NWC's annual NPR.

To provide a level of independent oversight to this process, the Treasurer requires that the Commission provide advice on the integrity of SA Water's data to ensure that it meets the requirements of the Handbook and is suitable for input into the NPR.

While there are benefits in achieving consistent definitions across essential service utility sectors over time, the Commission's long-term intention needs to be tempered by the decision to employ currently reported statistics, where available. Consequently, the Commission will work with relevant bodies, and, for example, through the URTG, to achieve consistency in definitions across essential service utility sectors for relevant measures, where necessary and desirable to do so (e.g. definitions of complaints and telephone responsiveness), noting that it might take some time for this to be achieved.

Regulatory audits would be conducted from time to time to complement the performance reporting framework and provide independent assurance that key service obligations were being met, and that accurate and reliable information was being reported.

### 2.13.4 Final Advice

***Final Advice 7.***

***The Commission's final advice is that the Performance Monitoring Framework will comprise:***

- ***a Water Industry Reporting Guideline to specify licensees' performance against key requirements of the Commission's Water Retail Code;***
- ***an initial focus on the reporting requirements for SA Water, with reporting requirements for smaller licensees to achieve an appropriate balance between the benefits of the information and the cost to the entity of providing it;***
- ***annual reporting on industry performance by the Commission to give consumers information on whether or not the water businesses are meeting, exceeding or failing the service standards and how prices are changing over time; and***
- ***reporting under the National Water Initiative National Performance Reporting requirements and ad hoc reports to be released to respond to any significant events occurring throughout the year.***

## *2.14 Compliance framework*

The ESC Act specifies that the statutory functions of the Commission include:

- monitoring and enforcement of compliance with, and promotion of improvement in, standards and conditions of service and supply under relevant industry regulation Acts; and
- in appropriate cases, conducting prosecutions for contraventions of the ESC Act or relevant industry regulation Acts.

Pursuant to section 25(1)(a) of the Act, each licence issued will include a condition requiring the water industry entity to comply with applicable industry codes or rules made by the Commission under Part 4 of the ESC Act. In addition, section 25(1)(l) of the Act requires that all, or part of, the services, operations or activities authorised by the licence are audited with the results of the audit to be reported to the Commission.

In terms of enforcement, under Part 8 of the Act, the Commission is given powers to issue warning notices and apply to the District Court for an injunction requiring a person to cease or take specified action. The Commission also has the power to suspend or cancel a

licence,[35] or take over licensed operations on specific grounds, including where a licensee contravenes legislation related to the licensed operations.

The Commission will give effect to its regulatory compliance role through a number of related actions. First, regulated entities will be made aware of the regulatory obligations which bind them and of the consequences of non-compliance. Second, compliance will be closely monitored by the Commission, with a variety of strategies implemented to ensure that the compliance regime is effective (e.g., regular compliance reporting by licensees). Finally, appropriate enforcement action will be taken in cases where non-compliance is detected.

In undertaking its compliance role, the Commission is guided by its legislative objectives and, in particular, the need to protect the long-term interests of South Australian consumers with respect to the price, reliability and quality of essential services. The Commission is of the view that fostering a strong culture of compliance within regulated businesses is consistent with the protection of consumer interests.

Bearing this in mind, in other industries regulated by the Commission, a collaborative compliance regime has been established which:

- encourages regulated entities to actively co-operate in the early reporting and rectification of any identified non-compliance;
- uses a risk-based approach as far as possible in both compliance monitoring and enforcement, based on the likelihood of a breach of a regulatory obligation and the possible consequences (e.g. on SA consumers) of such a breach; and
- reserves stronger enforcement action (e.g. prosecution) for more serious cases involving willful or systemic non-compliance with major consequences, or circumstances in which other processes have not had the desired remedial effect.

The regulatory approach adopted for compliance matters in the energy industry is set out in the Commission's Energy Industry Guideline No. 4 (**Guideline 4**).[36]

In summary, Guideline 4 establishes an exception-based reporting regime, permitting licensees to report non-compliance to the Commission, rather than providing positive assurance of compliance each year. Integral to that approach is the expectation that each licensee has and uses an internal compliance system meeting the specifications of Australian Standard 3806 – Compliance Programs (AS - 3806).

Under Guideline 4, licensed entities are required to provide regular compliance reports that:

[35] It should be noted, however, that these powers do not extend to the licence proposed to be held by SA Water.

[36] Refer *Compliance Systems and Reporting: Guideline 4,* available on the Commission's website at http://www.escosa.sa.gov.au/library/100623-EnergyIndustryGuideline-V3.pdf.

- testify that the licensee has a sound and effective compliance system (based on AS – 3806), which appropriately monitors, reports on and addresses compliance with all applicable regulatory obligations;
- report, on an exception-basis, any non-compliance with applicable regulatory obligations during the relevant reporting period; and
- address the impact of non-compliance on consumers and other entities, the implications for the effectiveness of the licensee's compliance systems and remedial actions taken or anticipated.

The compliance reporting regime is based on a requirement for licensees to provide compliance reports to the Commission as follows:

- an immediate compliance report as soon as a licensee becomes aware of a breach of a specific regulatory obligation which requires urgent reporting and/or is of a material nature; and
- an annual compliance report relating to all applicable regulatory obligations for each year ending on 30 June.[37]

Immediate compliance reports must be signed by the licensee's Chief Executive Officer (or equivalent office holder), while annual compliance reports must be signed by either at least two Directors (one of whom is an external Director) or two members of the Compliance Committee (one of whom is an external member).

Licensees that are unable to meet such sign-off requirements also have the option, or may be required by the Commission, to appoint an external, independent auditor (nominated by the licensee and approved by the Commission) prior to the end of a reporting period. The Commission may approve alternative sign-off arrangements in limited and exceptional circumstances.

Regardless of the sign-off option, annual compliance reports must be approved by the regulated entity's Board of Directors, in recognition of the importance that the Commission attaches to the credibility of the compliance reporting framework and to the assurance provided by the ultimate governing body of each regulated entity.

A further element of Guideline 4 is a detailed compliance auditing framework. The audit framework establishes a means by which the Commission may undertake:

- ad hoc audits – aimed at promptly addressing emerging and particular compliance matters of significance, which may involve one or more licensees; and
- targeted audits – undertaken in specific areas of regulatory concern identified through a risk-based approach.

[37] In addition, electricity and gas distribution businesses and electricity transmission businesses are required to submit quarterly compliance reports related to regulatory obligations identified by the Commission as requiring more regular reporting.

While the Commission can require an independent audit to be undertaken in respect of a licensee in circumstances where questions as to the robustness of that licensee's compliance system are raised, it is considered important that licensees have an internal audit plan which summarises:

- the procedures used to ensure compliance with regulatory obligations, including the use of internal audits as appropriate; and
- the procedures utilised to measure and quantify the levels of non-compliance with any regulatory obligations.

To ensure regulatory compliance, and in keeping with the Commission's risk-based approach to compliance, for at least an initial period following the commencement of the new water regulatory regime, the Commission will require SA Water, and may require some other licensees, to prepare and submit for approval an internal audit plan.

In the event that the Commission undertakes independent audits of licensees, or requires a licensee to prepare and submit an internal audit plan, it will work with those licensees to resolve any compliance matters that are identified through this process.

The reporting and audit regime established by the Commission - a light-handed exception reporting regime supplemented, where necessary, by audit - has proven to be a generally effective scheme in assisting the Commission to monitoring licensees' compliance with regulatory obligations.

In the event that enforcement action is necessary (e.g., for ongoing systemic breaches of important regulatory obligations), the Commission has statutory enforcement actions available to it as follows:

- **Administrative** – through the exercise of roles and functions which are prescribed under legislation or arise in the ordinary course of performance of a legislative function;
- **Disciplinary** – through the exercise of powers granted under legislation to protect South Australian consumers; and
- **Prosecutorial** – through the exercise of powers granted under legislation to bring punitive action against an entity, which does not comply with legislative requirements.

The Commission has published an Enforcement Policy, which provides detailed guidance on the criteria and processes it uses in determining the type of enforcement action required on a case-by-case basis.[38] In general terms, the exercise of the Commission's administrative processes is the primary means of enforcement used by the Commission, with disciplinary and prosecutorial processes reserved for the more serious matters of non-compliance.

[38] Refer *Enforcement Policy*, available on the Commission's website at http://www.escosa.sa.gov.au/library/090402-EnforcementPolicy.pdf.

The Commission considers that the compliance framework it administers operates effectively as a mechanism to ensure that licensees in other industries regulated by the Commission focus on compliance issues in a rigorous manner.

### 2.14.1 Draft Advice

The Draft Advice recognised that there is a diverse range of operations undertaken in South Australia by water entities of varying sizes, resources and capabilities. They do, however, all have to comply with various regulatory obligations relating to environmental and public health matters, and are therefore not unfamiliar with the world of regulatory compliance. In light of this fact, the Commission put the view that water industry entities will be subject to a compliance regime.

The Draft Advice also noted that a "one size fits all" approach to compliance is not likely to deliver consumer protection at an appropriate level of regulatory cost to licensees. The Commission suggested that while its current compliance framework could be applied to large-scale water industry entities with established compliance programs, it may be that a more light-handed approach is required in some circumstances.

It was noted that this is consistent with the light-handed approach the Commission takes with "off grid" licensees in the energy sector, which are primarily entities that provide electricity or gas network and/or retailing services to small regional communities that are not connected to the National Electricity Market.[39]

Stakeholders were asked to provide comment on whether any aspects of the compliance regime administered by the Commission for the energy sector would be problematic if implemented for all water industry entities. In addition, stakeholders were asked for their views on whether it would be appropriate to adopt a different compliance approach for licensees providing limited retail services to a small community or region.

### 2.14.2 Summary of submissions

While some submissions expressed concern at the potential for a compliance regime to be overly burdensome in terms of time and resources, the submissions generally supported the multi-tiered compliance approach proposed by the Commission.

The support for the application of a compliance regime in the water industry was evident from the submissions of SA Water, the Australian Industry Group and the

[39] For example, remote area licensees are only required to comply with key consumer protection obligations set out in the Energy Retail Code which relates to matters such as billing, disconnections and special needs. In addition, where appropriate, the reporting and sign off requirements imposed on these licensees are less stringent to reflect the scope of the operations performed and their corporate structures. Refer, for example, the licence held by the District Council of Coober Pedy, available from the Commission's website at http://www.escosa.sa.gov.au/library/070621-ElectricityGenerationDistributionRetailLicence-CooberPedy.pdf

District Council of Mt Barker. The submission from the District Council of Mt Barker did, however, identify the need for appropriate lead time to allow newly licensed entities to adopt new compliance systems (if necessary) and adequately train staff on those systems. Further, comments were made with respect to the 'sign off' requirements for Councils given their organisational structures.

SACOSS submitted that it would be appropriate for the Commission to emphasise compliance with requirements in relation to residential drinking water and sewerage services in the early years of the regulatory regime in particular; suggesting that a robust reporting and compliance framework can contribute significantly to the confidence held by consumers regarding the new regulatory regime.

### 2.14.3 Commission's consideration

The Commission has considered the submissions made and in recognition of the fact that the implementation of new systems and processes takes time, the Commission will not require licensees to satisfy the full range of compliance reporting requirements from the commencement of the Act and the any industry codes. That said, the Commission will expect licensees to be able to report instances of material non-compliance within mandated timeframes and provide a comprehensive compliance report at the end of the first year of the Act being in force.

The Commission has developed a draft Compliance Systems and Reporting Guideline which sets out the regulatory approach that will be adopted by the Commission for compliance matters in the water industry for stakeholders to review and provide comment on as part of this second phase of consultation.[40]

### 2.14.4 Final Advice

***Final Advice 8.***

***The Commission's final advice is that:***

- ***the Commission's current approach to compliance in other essential services industries will be applied (with appropriate modifications) to entities providing retail services in the water industry; and***
- ***the Commission will liaise with licensees regarding the compliance reporting requirements to apply from the commencement of the Water Industry Act.***

[40] Refer http://www.escosa.sa.gov.au.

# 3 PRICE REGULATION OF DRINKING WATER AND SEWERAGE SERVICES

As noted earlier in this report, the Commission's Final Advice excludes consideration of price regulation of SA Water. The Commission's approach to regulating SA Water's prices will be subject to the terms of one or more Pricing Orders, to be made by the Treasurer. The Commission will publicly release a Statement of Approach to the regulation of SA Water's prices in the second week of July, which will be based on advice from the Government on the contents of the Pricing Order(s).

Many providers other than SA Water supply drinking water and sewerage services (including trade waste) in South Australia. Most of those operations are relatively small in scale and undertaken by Local Government or private enterprises.

These providers deliver 'core' water and sewerage services, as well as a number of other services that are ancillary to water and sewerage supply. This chapter discusses the core services provided by non-SA Water providers, whilst other miscellaneous services are covered in Chapter 5.

The Commission's view is that price regulation should only be imposed where there are clear benefits to be gained, and where those benefits are not outweighed by the costs of regulation. This principle is reflected in the ESC Act.[41]

In considering the form of price regulation (if necessary) that should apply to these services, the Commission is particularly mindful of the cost and complexity of regulatory compliance that would be imposed on small scale providers, which would ultimately flow through to customers.

## *3.1 Draft Advice*

The Commission's Draft Advice discussed the various options for price regulation, including a direct form of price control, a lighter handed approach such as a pricing principles approach, or no price regulation.

The Commission formed the view that the net benefits, if any, that would be derived from imposing a direct form of price control on these providers were not clear. Direct price regulation is information intensive and imposes significant reporting obligations. For non-SA Water providers of drinking water and sewerage services, these costs are likely to outweigh the benefits of such regulation, given the smaller number of customers to which the regulatory regime would apply.

The Commission also considered the option of applying no price regulation to these other suppliers, however it decided this approach was not preferable for the following reasons:

[41] Refer *Essential Services Commission Act 2002*, Sections 25 (4) and (5)

- First, the Commission wanted to establish a clear understanding of the pricing issues that are relevant to each of the operations, by ensuring that prices were made transparent to customers and to the Commission. Although strong price protection may be necessary in certain circumstances, the Commission needed to determine whether or not there was any real evidence to support such an approach. If the Commission chose the option of no price regulation, such transparency would not be achieved; and
- Second, the Commission recognised that many of these smaller operations might not be achieving the full recovery of efficient costs. The Commission noted that this is an important objective under the National Water Initiative (NWI), which is intended to apply to all operations, including smaller regional operations. Without any price regulation, there would be no vehicle for the Commission to pursue this objective.

The Commission's Draft Advice was therefore for these providers to be regulated by a "light-handed" pricing principles/price monitoring approach, on the basis that this balances the need to minimise the regulatory burden on businesses, while ensuring that there is sufficient transparency in the determination of prices.

Under the Commission's price monitoring/pricing principles approach, it will develop a set of pricing principles to which the providers will be required to have regard to when developing their prices. Further, these providers will be required publish their prices, and provide a statement demonstrating how the Commission's pricing principles have been applied in determining those prices.

## *3.2 Summary of submissions*

The Commission received four written submissions in response to its Draft Advice that commented on issues relating to the price regulation of other providers of drinking water and sewerage services.

The COTA and Ai Group submissions both supported the Commission's proposed light-handed approach to the regulation of other providers on the basis that it would minimise the regulatory burden on smaller providers.

Whilst the LGA submission also supported the position that any form of regulation to apply to local council CWMS activities should be commensurate with the scale of the operations within each council, it argued that schemes with less than 1,600 connections should be exempted from any form of regulation. No information was provided in the submission to support why councils with CWMS schemes of 1,600 connections or less should be exempted nor how the proposed threshold was derived.

The SA Water submission argued that all providers of water and/or wastewater services should be treated equally, providing a "level playing field", and ensuring that there is no potential for differing levels of costs and benefits to be imposed upon different providers or customer groups. Should certain providers be exempted from certain regulatory

requirements, SA Water argued that it would entrench different service standards for consumers and thus undermine the fairness and competitiveness of the South Australian water industry.

## *3.3 Commission's consideration*

The LGA submission highlights that the form of regulation should be commensurate with the scale of operations; the Commission notes that this principle is consistent with the intent of the Water Industry Act. Section 25(1) of the Act states that the Commission, in making licence conditions, must have regard to the scale and nature of the operations of the water industry entity (with the scale and nature being determined by the Commission after consultation with the entity or a person or body nominated by the entity).

With respect to the LGA's proposal for councils with collective CWMS schemes of 1,600 connections or less to be exempted from price regulation, the Commission's analysis shows that this would preclude around 10% of South Australia's sewerage service customers from any form of price regulation.[42] In the absence of any detailed information in the LGA submission to explain how the threshold was derived and why it should apply, the Commission is not able to determine the reasonableness of the LGA's proposal on this matter.

The argument made by SA Water that the Commission's approach to price regulation should be consistent with that applied to SA Water is not accepted by the Commission. The reasons why the Commission does not accept SA Water's "level playing field" argument were discussed in section 1.7.1. of this Final Advice.

In light of the above, the Commission notes the support of COTA and Ai Group, and reaffirms its Draft Advice to apply a pricing principles/price monitoring approach to the provision of drinking water and sewerage services by non-SA Water providers for the first regulatory period.

To determine the precise form of the pricing principles/price monitoring framework, the Commission proposes to conduct a separate public consultation process to provide stakeholders with the opportunity for input. This process will be carried out between July and December 2012, culminating with the making of a price determination by the end of 2012, setting out the pricing principles and associated transitional arrangements. The Commission will also consider how it will review the effectiveness of the pricing principles/price monitoring approach, and the length of the regulatory period, as part of the review.

A Discussion Paper will be released for stakeholders' comment shortly after the release of this Final Advice. The Commission will be seeking stakeholders' comment on the following matters through the public consultation process.

[42] Calculated from Local Government Association (LGA) CWMS data (LGA)(2012) http://www.lga.sa.gov.au/site/page.cfm?u=1117, Accessed 2 April 2012.

### 3.3.1 Pricing principles

The Commission will develop a set of pricing principles which providers will be required to have regard to when developing their prices, including:

- Principles relating to the identification and 'ring-fencing' of water and sewerage financial information;
- Principles for the recovery of capital expenditure (for example, the methodology used to value the regulatory asset base and the recovery of efficient capital costs); and
- Principles for water and sewerage tariffs, including matters relating to:
  - Cost reflectivity;
  - Tariff structures; and
  - Willingness to pay.

In developing the pricing principles framework, the Commission will also consider the following:

- Consistency with relevant national pricing principle frameworks, including the NWI Pricing Principles;
- The price regulation practices adopted in other regulated essential services in South Australia; and

Consistency with regulatory practices in other jurisdictions.

### 3.3.2 Price monitoring

The Commission notes that NERA Economic Consulting (NERA)[43] and the Northern Territory Utilities Commission[44] have identified several implementation principles that they believe should underpin the operation of a price monitoring regime. These combined principles are presented in Table 3-1.

[43] NERA Economic Consulting, *Assessment of Price Monitoring in Australia, A Briefing Note to the AEMC*, 14 December 2007, p. 9.

[44] Utilities Commission, *Review of Options for the Development of a Retail Price Monitoring Regime for Contestable Electricity Customers – Issues Paper*, February 2010, p. 23.

***Table 3-1: Implementation Principles of Price Monitoring***

| | |
|---|---|
| **Transparency** | The method for monitoring prices should be known, conclusions (where made) or further action should be based on observations and results of monitoring activities (where not confidential) should be published. |
| **Flexibility** | The regime should be sufficiently flexible to allow the monitoring body to report on areas of concern (e.g. barriers to entry may not be considered to be substantial at the beginning of a monitoring regime and therefore not reported but this may change over time). |
| **Timeframe** | Price monitoring should not be indefinite. NERA refers to the Productivity Commission's (PC) recommendation that price monitoring should, preferably, be for a three year period or less, or five years in exceptional cases. |
| **Non-intrusive** | Price monitoring should not be intended as a form of price control or entail unwarranted intrusion into the operation of businesses. |
| **Not costly to administer or comply with** | Reporting requirements should not be overly onerous on the businesses being monitored. |
| **Consistency** | Information must be disclosed on a consistent basis to allow meaningful comparison over time and against benchmarks. |
| **Relevance** | Published information must be relevant to meet stakeholders' need. |

The Commission concurs with both NERA and the Utilities Commission that the abovementioned principles are critical to the effectiveness of a price monitoring regime, noting that pricing principles accompanied by poorly designed procedures are likely to lead to sub-optimal outcomes. The Commission considers that these principles are relevant in the context of the South Australian water industry.

The Commission will therefore use these principles as the basis to develop the proposed price monitoring framework for water and sewerage services for stakeholder comment.

### 3.3.3 Length of regulatory period

The length of the regulatory period can be defined as the fixed period over which certain parameters of a price determination are fixed. The Commission believes it is prudent to establish a framework for a limited period, to ensure an opportunity exists to review the effectiveness of the regulatory regime and make improvements if necessary.

An important decision that the Commission must reach in this public consultation process is therefore the length of the regulatory period. Whilst the Water Industry

Act does not specify a minimum duration for a price determination in respect to services provided by non-SA Water operators, the Commission's practice across other regulated industries is to make a price determination of at least 3 years duration.

It is important to undertake reviews of the form of price regulation from time to time, to ensure that regulation remains appropriate to the context, and is in line with best regulatory practice. The Commission's proposed initial approach for price regulation of water retailers other than SA Water is focused particularly on promoting increased transparency. Once that transparency is achieved, it may be appropriate to consider alternative forms of regulation, depending on the issues that have been identified during the first period. The Commission wishes to remain open to that possibility.

A shorter initial regulatory period (e.g. 2-3 years) will provide greater flexibility to modify the regulatory approach should circumstances warrant it. However, it imposes greater costs through more frequent reviews and reduces certainty. A longer period (e.g. 5-10 years) promotes longer-term certainty, but is less flexible should there be a need to vary the approach.

Having regard to the advantages and disadvantages of a longer-term price regulation versus a shorter period, the Commission will be seeking stakeholders' comment on the appropriate length of the initial regulatory period.

### 3.3.4 Other matters

The Commission also notes recent and future regulatory and legislative developments that may impact the provision of some of these services when they are provided by Local Government. Possible future changes in the regulatory context were discussed in general terms in Chapter 1. Some specific regulatory changes that will impact on Local Government include the Technical Regulation reforms to be implemented as a part of the Water Industry Act, and the forthcoming Public Health Wastewater Regulations 2012. These may impact the fee setting arrangements (i.e. for administrative, regulatory and enforcement functions) for Local Government water industry entities.

Price regulation for these services will need to take these regulatory and legislative developments into account, and will be considered as a part of the consultation process for the Discussion Paper.

## *3.4 Final Advice*

***Final Advice 9.***

- ***The Commission's Final Advice is that it will apply a pricing principles/price monitoring approach to the provision of drinking water and sewerage services provided by non-SA Water providers for the first regulatory period.***
- ***The Commission will undertake a separate review to determine the precise form of the pricing principles/price monitoring framework, including the duration of the first regulatory period.***

# 4 PRICE REGULATION OF RECYCLED AND OTHER NON-DRINKING WATER SERVICES

This Chapter discusses the recycled water and other non-drinking water services provided by non-SA Water providers.

## *4.1 Recycled water*

*Water for Good* defines recycled water as water derived from sewerage systems or stormwater drainage systems that has been treated to a standard that is appropriate for its intended use.[45]

In recent years in Australia, water recycling has increased in prominence as alternative water supply due to a convergence of inter-related factors such as concerns about climate change and below-average rainfall.

In South Australia, recycled water services are supplied by a number of different providers (e.g. local councils and private operators) for both residential and non-residential uses. These services can be classified as either mandated or voluntary schemes (refer Box 1).

According to data released by the NWC, Metropolitan Adelaide has one of the highest rates of water recycling, when compared with other metropolitan centres.[46]

In 2010/11, approximately 12% of the volume of water supplied by SA Water was recycled water.[47] By far the greatest use of this recycled water (61%) was for agricultural purposes.[48]

While the Commission recognises that the South Australian Government currently has no plans to use recycled water as a source of drinking water, it understands that an increasing number of South Australian Government initiatives are aimed at replacing drinking water supply with recycled water for non-drinking purposes by industrial, agricultural, and to a smaller extent, domestic customers.

It is envisaged that the use of recycled water will continue to grow for the foreseeable future, and that an increasing number of new residential developments will be serviced by mandated water recycling schemes.

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45 Water for Good (2009) p.186.

46 National Water Commission (2012) *National Performance Report 2010-11 urban water utilities*, http://www.nwc.gov.au/publications/topic/urban/npr-2010-11, accessed 4 April 2012.

47 National Water Commission (2012) op. cit.

48 National Water Commission (2012) op. cit.

***Box 1: Mandated and Voluntary Water Recycling Schemes***

***Mandated Schemes***

Mandated schemes predominantly service new residential developments where recycled water is supplied through third-pipe developments. As the connection to these schemes is mandated, providers of these services have considerable market power, with the potential for misuse of that power in the absence of effective economic regulation.

***Voluntary Schemes***

Voluntary schemes service customers who are connected to the recycled water at their discretion. As these customers are able to choose whether or not to connect to the recycled water network, it could be argued that the extent of market power is not as great as that observed for customers connected to mandated recycled water schemes.

The Commission understands that the prices charged for the provision of such services to non-residential customers are sometimes determined through commercial negotiation on an individual basis and, in some cases, are not set at a cost-reflective level.

## *4.2 Draft Advice*

In developing its Draft Advice the Commission considered the following three key issues that it believes are relevant in considering the form of price regulation to apply to recycled water and non-drinking water services:

- ***Market power*** – while the Commission noted that the consequence of market power in the provision of recycled water was that prices may be higher than would otherwise occur, it was also mindful of the fact that the price of recycled water was primarily quality driven. A higher price was therefore not necessarily a sign of market power being exercised. The Commission also noted that prices for recycled water in South Australia were mainly negotiated on an individual basis and, in some cases were not set at a cost-reflective level;
- ***Policy settings and directions*** – the Commission noted that both Water for Good and the NWC's guideline for recycled water pricing had recommended pricing principles as the preferred form of economic regulation for recycled water to ensure prices do not exceed users' willingness to pay and to allow effective price signals to be delivered; and
- ***Experiences in other jurisdictions*** – the Commission noted that economic regulators in other jurisdictions had tended to implement a light-handed form of economic regulation for recycled water through the development of pricing principles. In most instances, those regulators had limited their involvement to the regulation of developer charges and to setting prices for large residential third-pipe schemes.

The Commission recognised that the form of economic regulation for recycled water should allow businesses the flexibility to develop prices in accordance with a number of

different parameters, such as differing competitive environments and cost structures, quality of recycled water, and proximity to point of use (transport distance).

However, it also recognised that consideration needs to be given to the extent to which customers have any choice over the purchase of recycled water, and the role that recycled water plays as a part of the broader water supply industry.

Having regard to these key issues, the Commission's Draft Advice was that a pricing principles/price monitoring framework should be applied to mandated water recycling schemes on the basis that it provides both incentives for economic efficiency and an effective deterrent against the misuse of market power. With respect to voluntary water recycling schemes, the Commission recommended that a pricing principles approach, consistent with the pricing principles developed by the NWC, be applied on the basis it would enhance price transparency and facilitate commercial negotiations between providers and consumers of such services.

## *4.3 Summary of submissions*

The Commission received three submissions in response to its request for comment on the form of economic regulation that should apply to recycled water in South Australia.

The LGA submission cautioned against establishing a regulatory regime which created disincentives for harvesting, recycling and sale of stormwater resources. It stated that the vast majority of council Stormwater Harvesting Schemes were essential "public services" rather than commercial operations and should therefore either be exempted from the provisions of the *Water Industry Act 2012* or be subject to minimal or no regulation by the Commission.

The submission further stated that where councils are involved in the genuine commercial supply of water or wastewater, regulation should be commensurate with the economic scale of the business. It also noted that transitional arrangements should reflect that councils have existing long-term contractual arrangements for the supply of treated wastewater and stormwater.

The Ai Group submission stated that it accorded with the Commission's proposal to apply a lighter approach than SA Water's "heavy handed" approach, for other entities and services.

Similar to the LGA view, the Public and Environmental Health Council (PEHC) submission commented that many local councils operate recycled water schemes to fulfill community service obligations (e.g. watering of open spaces) and are not profit driven. It also noted that those schemes were only made possible with the assistance of grant funding received from the Australian Government, and that as recycled water is often supplied at no cost to the community, it is unlikely that there would be any further growth in the number of water recycling schemes in the absence of any additional grant funding.

## 4.4 Commission's consideration

The Commission notes the issue raised by the LGA and the PEHC, that many council recycling schemes are 'public services' and not commercial/profit orientated.

In response to this matter the Commission makes the following points:

- Under the Water Industry Act, only retail services will require a licence and will be subject to price regulation by the Commission. This would, for instance, not include the scenario where a council-owned and operated recycled water scheme is supplying water only for sole benefit of the council (e.g. watering council-owned public space).
- Appropriate cost recovery and efficient pricing of water retail services, including those operated by local governments, are essential to the long-term interests of the consumers of those services. The importance of these principles has been recognised in both national and state government policies (e.g. the NWI and Water for Good).

The Commission, therefore, does not subscribe to the view that all recycled water services offered by councils should be precluded from price regulation.

Where councils are involved in the genuine commercial supply of water or sewerage services (such as recycling), the form of regulation should reflect the scale of the operation. This is consistent with both the ESC Act and the Water Industry Act, which governs the Commission's approach to price regulation.

With respect to mandated water recycling schemes, the Commission reaffirms its Draft Advice to apply a pricing principles/price monitoring framework to such services. The Commission believes that such an approach strikes an appropriate balance between the need to provide an effective deterrent against the misuse of market power (thereby promoting economic efficiency) and minimising regulatory costs.

With respect to voluntary recycled water schemes, the Commission reaffirms its Draft Advice to apply a pricing principles framework, consistent with the pricing principles developed by the NWC.

The Commission will seek to ensure that the set of pricing principles will be sufficiently flexible to reflect both the scale and nature of such operations.

As noted, the precise form of the pricing principles and the price monitoring framework, including the duration of the first regulatory period, will be dealt with as part of a separate public consultation process, to provide stakeholders with the opportunity for input. This consultation process will consider, and seek stakeholder comment on, matters similar to those raised in section 3.3 of this Final Advice. These are discussed briefly below.

### 4.4.1 Pricing principles for voluntary schemes

The NWI pricing principles are set out in Box 2. The Commission understands from consultation during the Draft Advice period, that these principles are broadly consistent with current water recycling pricing practice in South Australia.

However, not all voluntary scheme service providers include a volumetric charge component to address consumption based pricing (NWI Pricing Principle 3). This practice is usually undertaken for domestic users, due to the costs of installing individual meters.

In its review, the Commission will consider the extent to which it would adopt this principle as part of its recycled water pricing principle framework.

On the principle of allocating costs (NWI Pricing Principle 2), the Commission proposes the following:

- Where the recycled water service is the *lowest cost method of disposal*, costs should be paid by *sewerage customers*;
- Where the users are *industrial, agricultural or municipal customers*, costs should be paid by the *beneficiaries of the service*; and
- Where the recycled water service is *discretionary*, the costs should be paid by the *water utility customer base*, provided they have demonstrated willingness to pay.

It is also the Commission's view that the pricing framework must be sufficiently flexible to allow parties to reach commercial outcomes, where the agreed prices may not reflect these high-level pricing principles.

### 4.4.2 Pricing principles for mandated schemes

In developing the set of pricing principles for mandated schemes, the Commission will be considering, and seeking feedback on, consistency with relevant national pricing principle frameworks and regulatory practices adopted across regulated essential services in South Australia and practices in other jurisdictions.

For example, the Commission will seek to align the pricing principles for mandated water recycling schemes with those developed for water and sewerage services (refer to section 3.3.1) as much as practically possible.

***Box 2 – NWI Recycled Water Pricing Principles[49]***

1. Light-handed and flexible regulation (including use of pricing principles) is preferable, as it is generally more cost-efficient than formal regulation. However, formal regulation (e.g. establishing maximum prices and revenue caps to address problems arising from market imbalance) should be employed where it will improve economic efficiency.
2. When allocating costs, a beneficiary pays approach – typically including direct user pay contributions – should be the starting point, with specific cost share across beneficiaries based on the scheme's drivers (and other characteristics of the recycled water/stormwater reuse scheme).
3. Prices should contain a volumetric component to address consumption based pricing.
4. Regard to the price of substitutes (potable water and raw water) may be necessary when setting the upper bound of a price band.
5. Prices should be flexible enough to provide for differentiation on quality, reliability etc.
6. Where appropriate, pricing should reflect the role of recycled water as part of an integrated water resource planning system.
7. Prices should recover efficient, full direct costs with system-wide incremental costs (adjusted for avoided costs and externalities) as the lower limit, and the lesser of stand-alone costs and willingness to pay as the upper limit:
    a. any full cost recovery gap should be recovered with reference to all beneficiaries of the avoided costs and externalities
    b. subsidies and community service obligation payments should be reviewed periodically and, where appropriate, reduced over time
8. Prices should be transparent, understandable to users and published to assist efficient choices.
9. Prices should be appropriate for adopting a strategy of 'gradualism' to allow consumer education and time for the community to adapt.

### 4.4.3 Price monitoring

In accordance with the Commission's Final Advice, a price monitoring approach would only apply to mandated water recycling schemes in the first instance. This is because voluntary schemes service consumers are typically able to access drinking water as a product substitute. Therefore, the Commission considers that the

[49] Refer National Water Commission, *Pricing* principles *for recycled water and stormwater reuse*, Waterlines Report Series No 31, October 2010, available http://www.nwc.gov.au/resources/documents/Waterlines_31_pricing_principles.pdf.

extent of market power is not as great as that observed for consumers connected to mandated recycled water recycling schemes.

In contrast, the mandatory nature of mandated water recycling schemes confers a degree of market power to providers of those services. In the absence of effective economic regulation, there is the potential for market power to be misused. However, due to the diverse nature of recycled water and the different infrastructure requirements, the Commission recognises that the choice of economic regulation for these services must still be sufficiently flexible to accommodate these differences.

The Commission therefore considers that the pricing principles being developed for mandated water recycling schemes should be complemented by an annual price monitoring framework, on the basis that this would not only provide flexibility for providers to develop charges that fully reflect their individual circumstances (e.g. differing cost pressures), but would also enhance the level of transparency in relation to how charges are developed and provide an effective deterrent against providers increasing prices higher than would otherwise be the case.

The operation of such a price monitoring framework would be underpinned by the set of implementation principles set out in section 3.3.2 of this paper.

## *4.5 Final Advice*

***Final Advice 10.***

- ***The Commission's Final Advice is that the Commission will apply a pricing principles/price monitoring framework to mandated water recycling schemes for non-SA Water providers.***
- ***Further, the Commission will apply a pricing principles approach to voluntary recycling schemes for non-SA Water providers, consistent with the pricing principles developed by the NWC.***
- ***The Commission will undertake a separate review to determine the precise form of the pricing principles/price monitoring framework, including the duration of the first regulatory period.***

## *4.6 Other non-drinking water services*

In addition to recycled stormwater and recycled wastewater, there are various other non-drinking water operations in South Australia, provided by different operators. The quality of such water services is of non-drinking standard, but can be used for other purposes (e.g. washing).

At the time of preparing its Draft Advice, the Commission was aware that non-recycled, non-drinking water was being provided to residents at Skye. The Commission has subsequently become aware of a number of other non-recycled, non-drinking water operations. These include operations in various outback and regional communities.

Further, the Commission understands that a relatively very small number of customers (estimated at less than 1,500) receive these services across the State. These operations are provided under various legislative, contractual, and ownership arrangements.

Where water services are supplied to customers for use through local reticulation, the Commission understands that these services may be considered a water retail service under the *Water Industry Act*.

The Commission recognises that the supply of non-drinking water is not as critical as the supply of drinking water, however customers are still largely reliant on a continuous supply of non-drinking water and have few alternative options. This is a key difference to the supply of recycled water, which can generally be substituted by drinking water.[50]

As a result, there is a case for some form of price regulation of non-recycled, non-drinking water services, given the monopoly characteristics of the service.

## *4.7 Draft Advice*

The Commission's Draft Advice was that it would apply a pricing principles/price monitoring framework to non-recycled, non-drinking water.

The Commission appreciates that, under the price monitoring/pricing principles approach, the application of statewide pricing to many of the communities receiving non-drinking water supplies need not continue.

The Commission's Draft Advice also noted that it would undertake a review of statewide pricing for those communities which receive non-drinking water at statewide prices as part of the first determination of SA Water's prices.

## *4.8 Summary of submissions*

None of the Submissions received by the Commission in response to the Draft Advice commented directly on issues relating to non-recycled, non-drinking water services provided by operators other than SA Water.

[50] There is a strong degree of substitutability between drinking water and recycled water from a voluntary scheme, as a customer can elect not to connect to recycled water and instead rely on drinking water. There is a lower degree of substitutability between drinking water and recycled water from a mandated scheme, as the customer is required to connect to the recycled water mains. However, a customer may still elect to use drinking water even though direct access to recycled water is available.

## *4.9 Commission's consideration*

As stated previously, it is the Commission's view that customers of non-drinking supplies are largely reliant on a continuous supply of these services and have few alternative options. Therefore there is a case for some form of price regulation for these services.

Consistent with the proposed approach for SA Water non-drinking water services, the Commission will adopt a pricing principle/price monitoring framework for these services where they are provided by a non-SA Water provider, if they constitute a retail service under the Water Industry Act.

The details of this framework will be developed through targeted consultation.

## *4.10 Final Advice*

***Final Advice 11.***

***The Commission's Final Advice is that:***

- ***The Commission will apply a pricing principles/price monitoring framework to non-recycled, non-drinking water services for non-SA Water suppliers if they constitute a retail service under the* Water Industry Act.**
- ***The details of this framework will be developed through targeted consultation.***

# 5 PRICE REGULATION OF OTHER SERVICES

In addition to the provision of core services (supply of water and sewerage services), licensed providers may also provide a range of other retail services such as connections and disconnections, the installation of additional water meters to community/strata units, and special meter readings. While revenue derived from the provision of such services generally makes up a small proportion of the water business' total annual revenue, charges for those services can be significant for individual users.

The Commission understands that there are a number of practical difficulties with regulating prices associated with the provision of such services. For example, the range of services offered by providers, and the terminology used to describe those services, differs substantially among businesses. On that basis, economic regulators in other jurisdictions have tended to implement a light-handed form of economic regulation for miscellaneous services, through the development of pricing principles.

At present, the provision of such retail services is not subject to any form of price regulation. While SA Water publishes an annual price schedule for these services, the prices charged by third parties are predominantly determined on an individual basis.

This Chapter discusses the miscellaneous services provided by non-SA Water providers.

## *5.1 Draft Advice*

The Commission's Draft Advice noted that the regulation of miscellaneous services included a number of regulatory challenges and complexities and varied considerably between the individual service providers. Further, such services only apply to a small group of consumers.

In light of the above, the Commission determined that price regulation of such services should be based initially on a "light-handed" approach (pricing principles).

## *5.2 Summary of submissions*

The Commission received three written submissions commenting on the Commission's Draft Advice to implement a pricing principles form of price regulation for miscellaneous services.

The SACOSS submission expressed the view that such a 'light-handed' regulatory approach is acceptable in the developmental years of the new water regulatory regime, but not in relation to residential customers.

The Joint Councils submission expressed support for a pricing principles approach to be applied for regulating miscellaneous water services.

In its submission, the Ai Group supported the Commission's proposed light-handed approach to the regulation of other providers, on the basis that it would minimise the regulatory burden on smaller providers.

## *5.3 Commission's consideration*

As the majority of these miscellaneous services are also provided for the sole benefit of the recipient, the Commission believes the principle of user pays should apply. That is, the the beneficiary should pay the full cost of the service and that other consumers (who do not benefit from the service) should not be required to contribute to the cost of the service through water tariffs. As these services are provided under differing circumstances (e.g. geographical location and the extent and design of infrastructure required), the associated costs should therefore differ between consumers.

The form of price regulation that should be applied to such services must therefore be sufficiently flexible to reflect the different circumstances in which these services are being provided. The Commission believes a pricing principles approach will provide such flexibility, as it will allow regulated operators to develop prices for individual consumers, in a manner that reflects their specific circumstances and risks.

It should be noted, however, that if any evidence of material misuse of market power comes to light, the Commission will reserve the right to consider a "heavier-handed" form of price regulation.

In light of the above, the Commission reaffirms its Draft Advice that a pricing principles approach is the preferred form of regulation for such services in the first instance. As noted in section 3.3 of this advice, the precise form of the pricing principles, including the duration of the first regulatory period, is to be dealt with as part of a separate public consultation process to provide stakeholders with the opportunity for input.

## *5.4 Final Advice*

***Final Advice 12.***

- ***The Commission's Final Advice is that it will apply a pricing principles approach to the regulation of miscellaneous water services.***
- ***The Commission will undertake a separate review to determine the precise form of the pricing principles, including the duration of the first regulatory period.***

# 6 NEXT STEPS

This Final Advice sets out the broad regulatory policies and principles which will underpin the Commission's new regulatory regime for the South Australian retail water and sewerage services industries.

Having provided this Final Advice, and with the passage of the Water Industry Act, the Commission now moves to the final preparatory stages of the development of that new regime.

For the reasons identified in section 1.2, this Final Advice does not include consideration of the Commission's approach to the price determination for SA Water, which will take effect from 1 July 2013. Nor does it include operational details regarding licences, various industry codes or regulatory guidelines, or the detailed price regulation requirements for non-SA Water service providers.

These are, of course, important matters and the Commission is mindful of the need to commence its independent public consultation processes on them quickly.

The Commission's issue a Statement of Approach on the price determination for SA Water in early July this year. That Statement will set out the specifics of the principles and processes to be adopted by the Commission, including process requirements to apply to SA Water, in making a price determination.

The Statement will reflect the terms of the Pricing Order which the Treasurer will issue to the Commission shortly. While the operational details of that order are not yet know, the Treasurer has advised that the order will limit the Commission's price determination processes by requiring it to:

- adopt a regulatory period of 1 July, 2013, to 30 June, 2016;
- comply with the National Water Initiative pricing principles;
- adopt a revenue cap or average revenue cap as the form of price regulation for SA water's drinking water and sewerage services;
- adopt a specified initial regulated asset base;
- treat identified non-commercial activities, externalities and water and planning management charges in a specified manner.

While the Commission would likely have adopted the first two of those matters in any event, it would not necessarily have adopted the final three in the absence of a Pricing Order. Therefore, the Commission will not adopt the regulatory approach that it proposed in its Draft Advice. Nevertheless, working within the framework which the Treasurer will establish through the Pricing Order, the Commission will provide stakeholders with information as to how it will conduct and make the price determination.

In terms of the operational detail of licences, various industry codes and regulatory guidelines, now that the Commission has finalised its regulatory policies and principles on the content of those instruments, it is appropriate (and in any event necessary under the provisions of Part 4 of the Essential Services Commission Act 2002) for it to seek stakeholder comment on their terms. This will also occur from early July this year, with draft instruments released at the same time as the Statement of Approach described above.

The Commission looks forward to working with stakeholders in the finalisation of the regulatory regime.

***Table 6-1: Timetable for finalisation of regulatory regime and price determinations***

| DATE | DELIVERABLE |
|---|---|
| Early July 2012 | Publicly release Draft Licences, Codes & Guidelines (Non-Price), Discussion Paper (Non-SA Water Pricing), Statement of Approach (SA Water Pricing) |
| July – August 2012 | Consultation period (six weeks), including public workshops (if sought by stakeholders) |
| August – September 2012 | Start accepting and assessing licence applications (from the end of the consultation period) |
| End September 2012 | SA Water submits Water Plan to commence Price Determination Process |
| October 2012 | Consultation on Water Plan |
| October 2012 | Non-SA Water Draft Price Determination |
| October – November 2012 | Consultation on Non-SA Water Draft Price Determination |
| End October 2012 | Make and issue Final Codes & Guidelines (Non-Price) |
| December 2012 | Non-SA Water Final Price Determination (**to take effect from 1 January 2013)** |
| **1 January 2013** | **Economic regulation regime commences (requirement to be licensed)** |
| February 2013 | SA Water Draft Price Determination |
| February – March 2013 | Consultation period (six weeks) |
| May 2013 | Final Price Determination for SA Water |
| May – June2013 | SA Water develops and implements its prices |
| **1 July 2013** | **Start of 3 year price control period for SA Water** |

# APPENDIX 1 – TREASURER'S LETTER

The Hon. Jack Snelling M.P.

Government of South Australia

Treasurer
Minister for Workers' Rehabilitation
Minister for Defence Industries
Minister for Veterans' Affairs
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T&F12/0872
TF12D01656

23 May, 2012

Dr P. Walsh
Chairperson
Essential Services Commission of South Australia
G.P.O. Box 2605
ADELAIDE S.A. 5001

Dear Dr Walsh Pat

The *Water Industry Act 2012* (the Act) received Royal Assent on Thursday 19 April, 2012. This marks the achievement of the important *Water for Good* action of appointing the Essential Services Commission of South Australia (ESCOSA) as the independent regulator for the water industry. This is an important step in reform of the water industry outlined in *Water for Good.*

I look forward to ESCOSA, in the coming months, formally commencing independent economic regulation of the water industry with the objective of protecting the long term interests of South Australian consumers with respect to the price, quality and reliability of water and sewerage services.

I would like to take this opportunity to set out my policy views on continuing the reform in *Water for Good*. The actions set out in *Water for Good* retained a strong role for Government in the direction of the water industry. In addition to the regulatory functions, it is my view that ESCOSA will have the lead role in examining options for future reform, conducting public consultations, and making recommendations to the relevant Minister.

It is my intention to request that ESCOSA undertake a broad ranging public inquiry that would address:

- merits of alternative price structures that benefit economic efficiency and water security;
- costs and benefits of:
  - individual metering;
  - reforming the SA Water customer relationship (i.e. away from the landowner and property based charges);
  - smart metering; and
  - scarcity pricing.
- an approach to implementing water supply charges based on the number and size of customers' meters; and

- impact of state-wide pricing.

It is proposed that the inquiry would report to Government with sufficient time to allow the Government to consider recommendations and implement changes before the second price determination period commences in 2016-17.

From the outset, it was not expected that all of the details of the regulatory framework would be set in the Act. To allow for changing circumstances, the Act provides a range of statutory instruments to establish the detailed regulatory framework.

In relation to price determinations, the Act provides the Treasurer with the power to issue pricing orders. My objective for issuing pricing orders is to achieve continued reform of the water industry, in the manner outlined above, and to transition economic regulation to ESCOSA while minimising price shocks to customers and State Budget shocks arising from changes in methodology. It is my expectation that customers should benefit from on-going scrutiny by ESCOSA of SA Water's costs.

I intend to issue pricing orders that, for the first price determination, require ESCOSA to:

- adopt a regulatory period of 1 July, 2013, to 30 June, 2016;
- comply with the National Water Initiative pricing principles;
- adopt a revenue cap or average revenue cap as the form of price regulation for SA Water's drinking water and sewerage services;
- adopt a specified initial regulated asset base; and
- treat identified non-commercial activities, externalities and water and planning management charges in a specified manner.

The Department of Treasury and Finance, with advice from the Crown Solicitor's Office, is currently preparing the pricing orders and the terms of reference for the inquiry. I request that ESCOSA and my Department work closely together to ensure that the terms of reference and pricing orders provide a solid platform for future drinking water and sewerage services pricing reform. I would appreciate ESCOSA including details of the proposed inquiry and pricing orders in the forthcoming Final Report on Economic Regulation of the South Australian Water Industry.

I look forward to the successful implementation of the economic regulation of water by ESCOSA.

Yours sincerely

Jack Snelling M.P.
Treasurer