



# ECONOMIC REGULATION OF THE SOUTH AUSTRALIAN WATER INDUSTRY STATEMENT OF ISSUES

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## REQUEST FOR SUBMISSIONS

The Essential Services Commission of SA (the Commission) invites written submissions from interested parties in relation to the issues raised in this paper. Written comments should be provided by **28 January 2011**. It is highly desirable for an electronic copy of the submission to accompany any written submission.

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

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

Responses to this paper should be directed to:

### **Economic Regulation of the South Australian Water Industry**

#### **Statement of Issues**

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#### **Public Information about the Commission's activities**

Information about the role and activities of the Commission, including copies of latest reports and submissions, can be found on the Commission's website at [www.escosa.sa.gov.au](http://www.escosa.sa.gov.au).

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# 1 INTRODUCTION

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The Essential Services Commission of South Australia (**Commission**), established under the Essential Services Commission Act 2002 (**ESC Act**), is an 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 Australia consumers with respect to the price quality and reliability of essential services.

This Statement of Issues on the Economic Regulation of the South Australian Water Industry has been prepared by the Commission as a first step in its public consultation process on the nature and form of the new water industry economic regulatory regime under the proposed new Water Industry Act. All stakeholders with an interest in that regime, including consumer groups, SA Water, local councils and independent providers of water and sewerage services, are invited to consider the issues raised by in this Statement and are encouraged to provide submissions to the Commission on those, and any other relevant, matters.

This consultative process will be a key driver of the form of economic regulatory regime to be developed and implemented by the Commission in accordance with the framework established by the Government of South Australia (**Government**). That economic regulatory regime will need to meet the needs of South Australian consumers and water industry participants into the future and therefore the contributions made to this Statement of Issues are vitally important to the Commission.

In 2009, the Government announced a framework of reforms and commitments to address water security issues for South Australia's environmental, economic and social benefit. That framework was embodied in Government's comprehensive plan entitled "*Water for Good: a plan to ensure our water future to 2050*" (**Water for Good**).<sup>1</sup>

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. One of those actions, action 70, 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.*<sup>2</sup>

To give effect to action 70 (and other related actions set out in Water for Good), the Government has prepared, and is presently consulting on, a Draft Water Industry Bill

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<sup>1</sup> Refer the Water for Good website at <http://www.waterforgood.sa.gov.au>.

<sup>2</sup> Water for Good, Government of South Australia, Part 7, Table 12 Summary of Actions, page 170. Available at <http://www.waterforgood.sa.gov.au/water-planning/the-plan/>



**(Bill).**<sup>3</sup> Amongst other things, the Bill establishes an economic regulation regime for the water and sewerage services industry which encompasses licensing, consumer protection, performance monitoring, compliance and pricing matters. The Bill further establishes the Commission as the entity with statutory responsibility for developing, implementing and regulating those matters once the Bill is enacted.

On 23 November 2010, the Government tabled the Bill in Parliament, signalling the commencement of a public consultation period. As a part of its consultation program, the Government has released an Explanatory Paper, which provides an overview of the key areas of the Bill.<sup>4</sup>

This Statement of Issues should be read in conjunction with both the Bill and the Explanatory Paper.

It is the Commission's understanding that the policy intention is for the Bill to be enacted with effect from 1 July 2011. Given that timing, the Commission's powers to establish the proposed regulatory regime so that it can take effect on 1 July 2011 are limited, as it cannot formally exercise any of its proposed powers in respect of the water industry prior to the Bill passing both houses of the South Australian Parliament.

As a result, and with the policy intention that the proposed regulatory regime will be able to commence on and from 1 July, the Treasurer has sought advice from the Commission on the proposed form of the economic regulation regime, notwithstanding that the Bill has yet to be formally introduced into Parliament.<sup>5</sup> Specifically, by way of letter dated 27 September 2010, the Treasurer sought the following advice:<sup>6</sup>

*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:*

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<sup>3</sup> Water Industry Bill 2010, available at <http://www.waterforgood.sa.gov.au/wp-content/uploads/2010/11/water-industry-bill-2010.pdf>

<sup>4</sup> 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](http://www.waterforgood.sa.gov.au/wp-content/uploads/2010/11/dfw_explanatorypaper_wib.pdf)

<sup>5</sup> The Treasurer has sought this advice pursuant to section 5(f) of the ESC Act, which permits the Treasurer to seek the advice of the Commission on any matter.

<sup>6</sup> Letter from Treasurer to the Essential Services Commission, dated 27 September 2010. Available from the Commission's website at <http://www.escosa.sa.gov.au/library/100927-RequestForAdviceonWaterEconomicRegulation-TreasurerLetter.pdf>



- *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.*

*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.*

In accordance with the Treasurer's request, this Statement of Issues has been prepared to facilitate public consultation on many of the detailed aspects of the regulatory arrangements that the Commission will need to develop for the water and sewerage industry. The Statement of Issues covers a wide range of matters, relating to licensing, consumer protection issues, compliance frameworks, performance monitoring, and pricing.

In preparing this Statement of Issues, the first stage of the advice to be provided to the Treasurer, the Commission has been guided and informed by the matters set out in the Treasurer's letter, as well as by the scope and content of the Bill. The Commission would, however, note that there may be changes in the final form of the Bill as it passes through the parliamentary process.

The Commission is requesting written submissions to this paper. It will also be meeting directly with key stakeholders to discuss the key issues. Details on the manner in which submissions may be provided to the Commission are set out on the inside front cover of this document.

The Commission will be taking into account relevant matters raised during public consultation in preparing its draft advice to the Government on the regulatory framework, which is to be provided to the Treasurer by March 2011. A further round of public consultation on the Draft Advice will occur at that time, following which the Commission will prepare a Final Report to be provided to the Treasurer by June 2011.



## 2 THE COMMISSION AND ITS APPROACH

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Integral to a proper understanding of the issues facing all stakeholders in the development of the economic regulatory regime under the Bill is an understanding of the nature, functions and objectives of the Commission as established under the ESC Act. Those statutory requirements will fundamentally inform and guide the Commission in its development of the economic regulatory regime.

However, it is also important for stakeholders, particularly new stakeholders for the Commission in the water and sewerage industries, to understand how the Commission goes about meeting those statutory requirements at a practical and operational level.

This Chapter, therefore, provides stakeholders with an overview of the Commission, its statutory functions and objectives and its approach to the task of economic regulation.

### ***2.1 The Essential Services Commission, its functions and its objectives***

The Commission is a statutory authority established under the ESC Act, which took effect on 12 September 2002.<sup>7</sup> The Commission is constituted of a Commissioner appointed by the Governor as Chairperson and other additional Commissioners as appointed by the Governor from time to time.<sup>8</sup> Staff of the Commission are appointed on terms and conditions determined by the Commission, to progress the work of the Commission.<sup>9</sup>

The ESC Act repealed the Independent Industry Regulator Act 1999 (**IIR Act**) which had established the South Australian Independent Industry Regulator (**SAIIR**) as a general independent economic regulator in 1999.<sup>10</sup> The ESC Act specifies that the Commission is the same body corporate as the SAIIR, and that decisions made under a provision of the IIR Act continue, where relevant, under the corresponding provision of the ESC Act.

### ***2.2 Functions and Objectives of the Commission***

As with all statutory authorities, the powers of the Commission are defined by statute. The establishment of a body such as the Commission represents a significant loss of powers and control by the Government and the executive, and, as a result, there is a presumption that the body will only have such powers as are expressly or impliedly granted.<sup>11</sup>

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<sup>7</sup> SA Government Gazette, 12 September 2002, p. 3393. The ESC Act is committed to the Treasurer.

<sup>8</sup> ESC Act, section 13; available at the South Australian Legislation website at: <http://www.legislation.sa.gov.au/LZ/C/A/ESSENTIAL%20SERVICES%20COMMISSION%20ACT%202002.aspx>

<sup>9</sup> ESC Act, section 15.

<sup>10</sup> ESC Act, Schedule 2 (Repeal and Transitional Provisions).

<sup>11</sup> *Byrnes v. R; Hopwood v. R* [1999] HCA 38.

It follows from this presumption that the body may only exercise the powers given in furtherance of the purposes for which the body was created. In general, courts have tended to define the powers of statutory bodies such as the Commission narrowly (particularly where those powers interfere with proprietary rights).

### 2.2.1 The functions of the Commission

As established under the ESC Act, the Commission is a general economic regulator of specified essential services in South Australia. The general functions of the Commission are defined at section 5 of the ESC Act as follows:

#### *5—Functions*

*The Commission has the following functions:*

- (a) to regulate prices and perform licensing and other functions under relevant industry regulation Acts;*
- (b) to monitor and enforce compliance with and promote improvement in standards and conditions of service and supply under relevant industry regulation Acts;*
- (c) to make, monitor the operation of, and review from time to time, codes and rules relating to the conduct or operations of a regulated industry or regulated entities;*
- (d) to provide and require consumer consultation processes in regulated industries and to assist consumers and others with information and other services;*
- (e) to advise the Minister on matters relating to the economic regulation of regulated industries, including reliability issues and service standards;*
- (f) to advise the Minister on any matter referred by the Minister;*
- (g) to administer this Act;*
- (h) to perform functions assigned to the Commission under this or any other Act;*
- (i) in appropriate cases, to prosecute offences against this Act or a relevant industry regulation Act.*

These functions, and their associated terms, represent the complete scope of matters with which the Commission may deal in the course of its activities. It is important to note that section 5 specifically contemplates that the Commission's role extends beyond the ESC Act itself: for example, the Commission is to perform discrete roles in relation to industry regulation Acts (section 5(1)(a)); and, the Commission must perform any function given it under any Act.

The concepts of "essential service" and "regulated industry" are important to an understanding of the role of the Commission. Currently, the specified essential services under the ESC Act are:

- ▲ electricity services;
- ▲ gas services;
- ▲ water and sewerage services;
- ▲ maritime services; and
- ▲ rail services.<sup>12</sup>

It is to be noted that, while these powers are relatively broad in nature, the majority of them do not relate specifically to “essential services” but rather to “regulated industries” (refer, for example, sections 5(a), (b) and (c)). In that regard, that Act further defines a “regulated industry” as a specified industry, or specified activities, concerning the provision of essential services, declared by another Act (a relevant industry regulation Act) to constitute a regulated industry for the purposes of the ESC Act.<sup>13</sup>

Under the Bill, the water industry will be declared to constitute a regulated industry for the purposes of the ESC Act.<sup>14</sup> That declaration will enliven the Commission’s broad regulatory powers and functions under the ESC Act.

## 2.2.2 The Commission’s statutory objectives

In the performance of its statutory functions under section 5 of the ESC Act, the Commission is required to meet the statutory objectives set out for it at section 6 of the ESC Act, which includes a paramount statutory objective of protecting the long-term interests of South Australian consumers with respect to the price, quality and reliability of essential services:

### *6—Objectives*

*In performing the Commission’s functions, the Commission must—*

- (a) have as its primary objective protection of the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services; and*
- (b) at the same time, have regard to the need to—*
  - (i) promote competitive and fair market conduct; and*
  - (ii) prevent misuse of monopoly or market power; and*

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<sup>12</sup> Refer ESC Act, section 3. It is noted that the definition of “essential services” permits other services to be added by regulation made under the ESC Act. At the time of writing, no such regulation had been made.

<sup>13</sup> Refer ESC Act, section 3. To an extent, the Commission’s functions are not limited to activities in relation to regulated industries, such as the broader functions envisaged by section 5(f) & (h). Indeed, it is possible for the Commission to perform functions that do not involve any essential service or regulated industry as defined under the ESC Act. For example, s. 35(1) of the ESC Act provides that the Commission must conduct an inquiry into any matter that the Minister, by written notice, refers to the Commission.

<sup>14</sup> Refer Water Industry Bill, clause 17. For the avoidance of doubt, the term “water industry” is defined in clause 4(1) of the Bill to mean any operations associated with the provision of water services or sewerage services.

- (iii) *facilitate entry into relevant markets; and*
- (iv) *promote economic efficiency; and*
- (v) *ensure consumers benefit from competition and efficiency; and*
- (vi) *facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment; and*
- (vii) *promote consistency in regulation with other jurisdictions.*

The Commission's paramount statutory objective set out in section 6(a) captures three elements of service delivery – price, quality and reliability. These objectives of the Commission are similar to those that applied to the SAIR under the IIR Act. A crucial difference, however, is in the elevation to a *primary* objective of the protection of the long-term interests of consumers.

That paramount statutory imperative is necessarily interpreted in an economic context of efficiency, particularly so in light of the fact that sections 6(b)(iv) and (v) expressly refer to efficiency considerations. Furthermore, the second-reading speech for the ESC Act makes it clear that the terms used in section 6 are economic terms relating to efficiency and therefore that economic concepts should be used in analysing and applying the provision:

*...a major element of the Bill is the introduction of a new primary objective. The Commission must protect the long term interests of South Australian consumers with respect to the price, quality and reliability of essential services. The long term interests of consumers are consistent with efficient and financially viable regulated industries, that have incentives for long term investment. Accordingly, the Commission must also have regard to these matters in its regulatory decisions.<sup>15</sup>*

In the context of the water and sewerage industries, the Commission interprets its primary objective as requiring it to ensure efficiency so as to best serve the needs of consumers over the long-term, in terms of both the price and non-price aspects of service.

In considering the concept of the “long-term”, the Commission notes the following statement made by the Australian Competition Tribunal:

*In terms of commercial reality, the long term is but an iteration or evolution of successive short terms. While in economic theory the long term is a blueprint of sorts, embodying the current most efficient outcome in a theoretical “what if” sense given current technology, end-user demands and preferences (and what these are today could be quite different in a month or a year's time), in practical business terms the long term evolves as market conditions change and as firms adapt to changing pressures of market supply and demand.*

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<sup>15</sup> Hansard, SA House of Assembly, 10 July 2002.

*Regulation of existing assets seeks to achieve a progression towards theoretically optimum levels of efficiency and competition. Regulation cannot start with a clean slate and engineer the long-term ideal. It has to do the best it can at any given time with the assets in place and with a realistic assessment of future commercial and social likelihoods and their impact on economic efficiency, broadly defined.*

*Accordingly, measurement of the effect of a regulatory change on the [long-term interests of consumers] in a practical sense necessitates consideration of the likely series of short-term outcomes as the market evolves over time, responding to changing market forces of supply and demand. This may well require an examination of the existing nature and level of competition in the market and the impact of the matter in question in both the near future as well as in the longer term.<sup>16</sup>*

This provides some guidance to the Commission in its consideration of the concept of “long-term” in relation to South Australian consumers’ interests in respect of the price, quality and reliability of water and sewerage services.

Whatever the precise meaning of the term, it is clear that the requirement to protect “long term” interests means that the Commission’s attentions cannot be limited to immediate impacts on price, quality and reliability of service. For example, if the impact of reducing prices for an essential service was such that investment in maintaining the infrastructure became inadequate, resulting in longer term deterioration, this would not be in consumers’ long term interests.

Furthermore, the Commission’s primary objective does not extend beyond the interests of *South Australian* consumers. It is likely, however, that while there may be divergences of the interests of consumers from different jurisdictions in the short term, those interests would increasingly converge in the longer term.

The various factors specified at section 6(b) of the ESC Act emphasise economic efficiency, market competition, and the financial viability of regulated industries. Each of those factors must be considered whenever the Commission is performing a function, and the Commission is required to demonstrate that it has had real regard to those factors.

Nevertheless, the factors do not each have to be “attained”. The terms of section 6(b) are generally not of an absolute nature; the Commission is required to, variously, “promote” and “facilitate” certain matters. Furthermore, there is a degree of conflict between certain of the clauses (e.g. between those that emphasise the welfare of regulated industries or of consumers), and it has been argued that this may lead to regulatory uncertainty.

While the “attainment” of potentially conflicting factors (or objectives) might be problematic, the Commission does not believe that the existence of such conflicts

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<sup>16</sup> Application by Telstra Corporation Limited [2009] ACompT 1, at paras 79 to 81.

is of concern. This is because factors such as those set out in section 6(b) of the ESC Act are matters which are to be considered, weighed and *balanced* in the performance of the Commission's functions, with the aim of "attaining" the Commission's primary objective; it is not the factors per se which are to be "attained"; it is the primary objective which must be "attained".

Making discretionary "tradeoffs" between the various factors permits a more flexible approach to regulation than might otherwise be the case. Indeed, it is the Commission's position that a system permitting a degree of flexibility in the approach to regulation is likely to be more beneficial to both the industry and consumers. In submissions to the Ministerial Council on Energy on proposals for modifications to the national gas access regime, the Utility Regulators Forum (consisting of Commonwealth, State and Territory regulatory agencies, including the Commission) argued that retention of subordinate objectives will assist the regulatory process, by providing guidance to the regulator and interested parties on matters to be taken into account and in exercising any discretion.<sup>17</sup>

Finally, the Commission observes that, in the absence of strict statutory guidance as to what consumers' long-term interests might be, the factors set out at section 6(b) do provide a significant insight into that matter. It is the Commission's position that, all else being equal, having a balanced regard to those factors in decision making ought to lead to decisions which facilitate achievement of the Commission's primary objective.

The objectives at section 6(a) and (b) thus need to be read as a whole. Given the emphasis in the section 6(b) factors on economic efficiency, it is the Commission's position that the long-term interests of South Australian consumers will be enhanced, and the economic welfare of such consumers maximised, through regulatory outcomes that emphasise economic efficiency. This is consistent with the sentiments of the Government in introducing the ESC Act to Parliament.

In reaching this conclusion, the Commission notes that there may be a need for it to consider distributive effects arising from market-based outcomes under some circumstances (e.g. the impact of energy retail market competition on vulnerable customers). Such consideration is consistent with section 6(b)(v), i.e. the need to have regard to ensuring that consumers (including particular groups of consumers) benefit from competition and efficiency.

### 2.2.3 Approach to considering the Commission's objectives

The Commission has developed a general approach to application of the section 6 requirements, which it adopts when undertaking its functions. This approach, as it

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<sup>17</sup> Refer, Paper to the Ministerial Council on Energy by the Utility Regulators Forum, April 2005, available at [www.accc.gov.au](http://www.accc.gov.au).

applies to the primary objective and each of the various factors that must be considered, is set out in detail below.

*Section 6(a): The Commission must 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*

The primary objective of the ESC Act requires the Commission to look beyond the short-term interests of South Australian consumers (which might, for example, be the lowest possible price) and consider instead how a Commission decision might impact on price, quality and reliability of essential services in the longer term (the next few years or even decades). This includes the need to ensure that the relevant services:

- ▲ continue to be available;
- ▲ are delivered efficiently;
- ▲ are delivered to appropriate standards; and
- ▲ keep up with changes in demand, technology and preferences over time.

In a price determination, for example, the focus on long-term interests ensures that the consumer protection aspect of price regulation is not used to force short-term, but unsustainable, price reductions.

*Section 6(b)(i): Have regard to the need to promote competitive and fair market conduct*

Promoting competitive and fair market conduct requires that regulation should seek to:

- ▲ encourage competitive conduct, for example, by avoiding excessive price outcomes (while leaving room for competition to evolve) or predatory pricing;
- ▲ encourage fair conduct by improving transparency and having an informed market; and
- ▲ in the case of price regulation, have regulated prices and conditions reflective of those that would arise in a competitive market.

*Section 6(b)(ii): Have regard to the need to prevent misuse of monopoly or market power*

This objective focuses on avoiding the downside or costs of monopoly markets, and is one of the most basic premises for regulation. That is, industries should only be regulated where effective competition cannot be achieved and monopoly or market power exists and is being misused or has the potential to be misused.

*Section 6(b)(iii): Have regard to the need to facilitate entry into relevant markets*



Earlier objectives have dealt with promoting competitive markets. One means of achieving this is to ensure that regulation (such as that provided by industry codes) does not establish barriers which prevent new participants entering into relevant markets.

*Section 6(b)(iv): Have regard to the need to promote economic efficiency*

Economic efficiency is a complex concept that looks at the broad dynamics of markets, economies, businesses and consumers, and the way economic resources are allocated. Efficiency means an economy using the right mix of resources, producing the right goods and services and keeping this up over time. The Commission has regard to the various aspects of efficiency in its decision-making processes.

*Section 6(b)(v): Have regard to the need to ensure consumers benefit from competition and efficiency*

This objective requires that the benefits of competitive and efficient markets flow through to customers and are not captured solely by regulated service providers. Thus, for example, in a situation in which the Commission is contemplating the use of price regulation, it should be designed to encourage the distribution and sharing of benefits.

*Section 6(b)(vi): Have regard to the need to facilitate maintenance of the financial viability of regulated industries and the incentive for long term investment*

This requires that regulation should not threaten the financial viability of the providers of essential services. Further, it recognises the need for an appropriate return on investment if the industry is to continue to invest in its operations and deliver services to customers over time.

*Section 6(b)(vii): Have regard to the need to promote consistency in regulation with other jurisdictions*

This objective seeks to avoid the emergence of varying and disjointed regulatory systems across Australia (and beyond). It is not a call for blanket uniformity, but rather seeks to streamline regulation where possible, appropriate and allowable in law. This can be important for the businesses involved in regulated industries as it can be costly to comply with different systems in different states (and countries).

## 2.3 The challenge for regulation – the “ABC”

*Reform is not just about getting a new set of regulations in place. It is the task of building new capacities and institutions to straddle a new State/market relationship - a new capacity for governance. .... The public needs to see that important public interests are safeguarded.<sup>18</sup>*

In the context of the legislative reforms in the water and sewerage industries in South Australia, this is the challenge for the Commission: to manage the balance between the interests of the investors (be they private or public) and those of consumers and the public interest. It is not good enough just to put regulations in place and monitor compliance; it is a more active role in making the system work for the benefit of all participants. Fundamental to the overall effectiveness of the reformed water and sewerage industries is the manner in which the Commission, as the independent economic regulator of those industries, works with licensees and other stakeholders.

As noted above, the formal role of the Commission as the independent economic regulator is set out in the ESC Act. Section 5 sets out the functions (or roles) of the Commission, with section 6 setting out the factors the Commission must have regard to in carrying out these activities. Further criteria are established in the Bill and the other documentation such as the proposed Pricing Order and licences and codes. By their very nature, these are legal requirements and non-negotiable: they must apply and be applied.

However, there may be different ways in which this role can be undertaken. The Oxford English Dictionary defines regulator in two ways:

- ▲ to control, govern or direct by rule or regulation; and
- ▲ to adapt to circumstances or surroundings; to bring or reduce to order.

In other words, there are two possible interpretations of how the role could be conducted: to enforce compliance with the rules, or to make the system work. Since its establishment, the Commission has decided to attempt to develop a system of regulation based on the latter approach.

That approach has been termed by the Commission as the *ABC of Regulation*, as it comprises three key elements:

- ▲ To achieve the objectives of the **A**ct, and
- ▲ To balance the regulatory **B**argain,
- ▲ Within a climate of regulatory **C**ollaboration.

### 2.3.1 Achieving the objectives of the Act

The first element is fundamental, as the Commission has no choice but to comply with the legislation and its objectives. This is “**what**” the Commission is trying to

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<sup>18</sup> Varley, C, *Incentive Regulation and Overseas Developments: An Introduction*, Paper delivered to the ACCC Regulatory Conference, Sydney, 18-19 November 1999, pp 3-4.

achieve through its regulatory arrangements. Everything the Commission does must stand the ultimate test of legal compliance, so there are no grounds for compromise or ignoring requirements. This approach is not a licence for second best, or arbitrary exemptions, or condoning non-compliance.

However, the Commission believes it is possible to develop an approach which seeks mutual understanding of each others' objectives: a cooperative approach to information sharing, dispute resolution, issue identification and planning. The Commission seeks to adopt a collaborative approach with the key stakeholder groups comprising consumers, government and licensees. The Commission will wherever possible seek to achieve balanced outcomes which satisfy the at times conflicting objectives of the stakeholders through a clearly defined system of clarification of objectives and process, early and open consultation, and opportunities for resolution of disputes.

### 2.3.2 The "regulatory bargain"

The second element, the so-called "regulatory bargain" is critical to understanding the Commission's role and functions. The bargain underpins the relationship between the licensee and consumers, with the regulator as umpire or facilitator: it is "**why**" there are regulatory arrangements.

The term "regulatory bargain" is long-standing in the field of economic regulation, albeit that it is of uncertain origin (although it is reported in a 1993 text on incentives and regulation<sup>19</sup>).

The regulatory bargain refers to the situation where the two parties (monopoly licensee and consumers) agree to a deal which balances their objectives. Consumers agree to guarantee a reasonable return to the licensee, and to support the granting of a monopoly to the licensee, in return for a commitment from the licensee for provision of services at an agreed standard. The licensee could seek higher prices, but could lose their monopoly status and customers. Customers could seek lower prices, but this would result in the licensee having fewer funds to invest in infrastructure, such that the quality of services would deteriorate.

Hence there is an implied "deal" or "bargain" struck between the licensee and their customers.<sup>20</sup> It balances price and service standards: the licensee gains a set price level in exchange for a fixed level of service, and consumers gain a set service level in exchange for an agreed price. Each party will forgo the potential for gain in exchange for the certainty of another benefit. It is a fine balance, and requires monitoring to ensure that both parties' interests remain protected. If set at

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<sup>19</sup> Refer Laffont, Jean-Jacques and Jean Tirole, 1993, *Theory of Incentives in Procurement and Regulation*, Cambridge, MA: MIT Press.

<sup>20</sup> Perhaps the deal could be considered as a Pareto Optimal outcome.

an inappropriate level, one party will feel aggrieved and the basis for the bargain is at risk.

The role of the Commission as the independent economic regulator is to manage this balance. It is to monitor the trade-off, to ensure that each party receives and delivers what is expected, to ensure that the monopoly power is not abused and that consumers receive the service standards commensurate with the price. Over time, the Commission will be required to ensure that the licensee is continually searching for improved ways of delivering the service and securing efficiencies which can be shared with the consumers. The Commission is the balancer, the maintainer of the bargain: the role requires a fine knowledge of the system and the ongoing trust of the two parties.

The regulatory bargain is an important concept in the ABC of regulation. Without an understanding of it as the basis of the arrangement, it is difficult at times to explain certain decisions which may seem to be illogical or unfair. All decisions need to be considered in the context of the bargain, the necessity of balancing the interests of the parties rather than allowing the interests of one party to prevail.

### 2.3.3 Regulatory collaboration

The concept of the regulatory bargain supports the approach of regulatory collaboration, as it is only through such an approach that the regulator can hope to be able to fine tune the balance and satisfy both parties' objectives.

Regulatory collaboration is "**how**" the Commission implements the regulatory arrangements. There are obvious difficulties faced by a regulator attempting to administer regulatory arrangements: there are very many regulatory requirements and obligations, their inter-relationships may at times be unclear, and the Commission is disadvantaged in terms of knowledge and access to information. An approach is needed which is focussed not so much on ensuring strict compliance at all times with all rules and standards, as with making the system work.

To do that in an efficient and effective way requires collaboration with licensees, a joint effort to understand each others' objectives and to work to ensure that all are achieved. This involves a cooperative approach to information sharing, dispute resolution, issue identification and planning. It involves a collaborative approach with the key stakeholder groups comprising consumers, government and licensees.

The approach is based upon the concept of "partnering", used in the construction and service industries, modified to reflect the unusual elements of a regulatory environment.

Partnering has been defined in those industries as a formalised process that establishes a moral contract which commits project stakeholders to act in the best interests of the project and the stakeholders.

Partnering is not a legal contract; it is not a partnership or a joint venture. Partnering does not replace the Act or the licence. It is a moral contract, a commitment to work in a particular way to achieve agreed outcomes. The key elements of a Partnering or Collaboration Agreement are:

- ▲ Commitment;
- ▲ Equity;
- ▲ Trust;
- ▲ Mutual goals and objectives;
- ▲ Helpful systems and procedures;
- ▲ Joint review process;
- ▲ Issue resolution process;
- ▲ Timely responsiveness;
- ▲ Good communication;
- ▲ Non-adversarial relationships; and
- ▲ Co-ordinated resource planning.

A Collaboration Charter, developed in a joint workshop, might include a commitment to work together in a spirit of trust, co-operation and open communication to satisfy the needs of the stakeholders, provide quality services to customers and achieve the agreed objectives. The Charter would include not just procedures to resolve disputes, and to plan for future events, it would also include a joint review procedure to evaluate on a regular basis the Collaboration relationship itself.

The features of a collaborative relationship would therefore include a high level of trust, aligned objectives, a more co-ordinated approach, open communication ('no surprises'), greater sharing of information, less duplication and a focus on the customer, rather than on the Commission as the independent economic regulator.

The benefits of this approach should include a less adversarial relationship, improved resource utilisation and planning, improved quality of service, improved productivity and greater efficiency. This should result in improved service to customers, greater profitability for licensees, lower costs and prices, and fewer disputes.

Experience in the construction industry has shown that there are a number of key ingredients for long term success of partnering or collaboration. They include:



- ▲ Absolute and continuing commitment from CEO down;
- ▲ Frequent and open communication;
- ▲ On-going recognition and consideration of other parties' objectives and goals; and
- ▲ Hard work – partnering is a structured process that must be followed.

There is no guarantee that this approach can work in the context of the water and sewerage industries in South Australia. Some may argue that it cannot work because of the information asymmetry between the regulator and the licensee, the incentive for management of licensees to withhold information or be selective in reporting, and the need for the regulator to be firm in implementing the legislation. However, these problems exist with other approaches to regulating, and are not exclusive to a system based on a collaborative arrangement: indeed, such an arrangement might overcome some of these difficulties.

Naturally the Commission will always be on guard to avoid regulatory capture, whereby the regulator through continuous dealings with the regulated body becomes 'captured' by the views and representations of the regulated body.

## **2.4 Conclusions**

The regulatory system for the water and sewerage industries in South Australia is new, which provides the opportunity to observe experiences in other jurisdictions and attempt to develop a system here which incorporates the elements of best practice identified elsewhere. It also is an opportunity to implement a system which best meets the unique South Australian situation.

The Commission would be misleading if it were to claim the system as described above has already been implemented: it has not. However, it is the basis of discussions within the Commission (and with stakeholders) as it begins to establish its new operations. It may be changed, even significantly, as these discussions lead to implementation, but it is a strong statement about how the Commission sees its role.

In the meantime, the Commission has a large number of things to do, including interpreting the legislative and licence provisions and identifying the information requirements for its performance monitoring and pricing responsibilities. It would be easy to be overawed by these tasks but, starting with this Statement of Issues, the Commission is approaching them systematically and integrating the work into the development of its approach to regulating the water and sewerage industries.

The Commission believes the collaborative approach will help it implement efficient processes more quickly, by benefiting from the insights of its stakeholders, and enable it to inform them on the overall approach and where they can input into that.

### 3 THE WATER INDUSTRY BILL

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The Bill represents a significant legislative reform. While acknowledging that the Government is consulting separately on the form and content of the Bill, and therefore that the content of the Bill may change following the release of this Statement of Issues, nevertheless the Commission is obliged to adopt the proposed legal architecture as set out in the Bill in seeking to provide advice to the Treasurer on the economic regulatory regime for the water and sewerage industries in South Australia. It is therefore convenient, at this point, to set out a summary of the provisions of the Bill insofar as they are relevant to the development of the economic regulatory framework so as to provide a context within which this Statement of Issues may be understood.

As is indicated by the long-title of the Bill, it deals with an array of issues:

*An Act to facilitate planning in connection with water demand and supply; to regulate the water industry, including by providing for a licensing regime and providing for the regulation of prices, customer service standards, technical standards for water and sewerage infrastructure and installations and plumbing, and by providing performance monitoring of the water industry; to provide for other measures relevant to the use and management of water; to make amendments to various related Acts; to repeal the Sewerage Act 1929, the Water Conservation Act 1936 and the Waterworks Act 1932; and for other purposes. (emphasis added)*

For the purposes of this Statement of Issues, however, the focus is on the elements of the Bill which deal with regulation of the water industry.

#### **3.1 Declaration of the water industry as a regulated industry**

Clause 17 of the Bill provides that the water industry is declared to constitute a regulated industry for the purposes of the ESC Act. As shown in Chapter 2 above, this declaration serves to enliven the Commission's general regulatory powers under the ESC Act. The question arises, 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?

Clause 4 of the Bill sets out definitions of the various terms used within it. In that clause, 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 clause 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 -*

- (a) a service constituted by the collection, storage, treatment, conveyance or reticulation 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, as noted above, the effect of the definitions as established under clause 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.

### ***3.2 Powers and objectives of the Commission in the water industry***

Clause 7 provides the Commission with a broad range of powers and functions in respect of the water industry as established under the Bill. Those functions replicate with specificity certain of the general powers and functions of the Commission under section 5 of the ESC Act.<sup>21</sup> In particular, the Bill provides that the Commission has, in addition to its general powers and functions:

- (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.<sup>22</sup>*

This approach, whereby an industry specific Act provides the Commission with enumerated additional functions and powers is not unusual – the same approach is adopted within, for example, the Electricity Act 1996 (**Electricity Act**) and the Gas Act 1997 (**Gas Act**) – and is expressly contemplated within the ESC Act itself. Section 5(h) of that Act provides that the Commission has the function of performing any additional functions assigned to it under any Act (including regulations made under such Acts).

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<sup>21</sup> Refer section 2.2.1 of this Statement of Issues.

<sup>22</sup> Water Industry Bill, clause 7(1). These provisions replicate section 5(a) of the ESC Act.



These broad powers which are to be granted to the Commission are not unfettered. As explained in Chapter 2, 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 as established under the Bill, the Commission is required to meet its primary statutory objective. In the case of those industries, this means that 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.

In seeking to satisfy that primary objective, the Commission is, of course, required to have regard to the factors specified at section 6(b) of the ESC Act. In addition, to the extent that additional factors are expressly established under the Bill (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.

### **3.3 Specific functions and powers**

Generally speaking, the Bill 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 Statement of Issues 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.

#### **3.3.1 Licensing**

The use of licensing as a means of regulatory control is neither new nor unique to the field of essential services. In fact, it might be argued that the licensing of essential services in South Australia is a relatively new phenomenon, with other industries, professions (medical, legal, architectural and dental, for example), occupations (plumbing, gas fitting, building, conveyancing and land agency, for example) and general undertakings (such as driving motor vehicles) all having been subject to licensing arrangements for a significant time.

In terms of the licensing of essential services, there are perhaps two key matters which warrant consideration.

First, in the past, essential services were, in general, provided by the State itself. While this may have been done through statutory corporations or other statutory entities, ultimately it was the State which was providing services to its citizens. In that environment, there was little need or incentive for the introduction of a licensing regime, as it would simply have resulted in the State licensing itself.

With the economic reforms of the past two and a half decades, it has become recognized that there are benefits to be gained from corporatising, liberalising and introducing competition in relation to essential services. Of course, there are myriad ways in which actions of that nature can be applied by governments to their essential services business.

However, not all reform needs to be of the same nature. As is proposed in Water for Good and as has been encapsulated within the Bill, in reforming the water industry in South Australia the government has assessed the best means by which economic benefits can be gained. This has resulted in the State retaining ownership and control of the monopoly service provider, SA Water, while at the same time allowing for the introduction of competition in various sectors by private enterprise. As a result, in this changed environment, the drivers for control by the introduction of a licensing regime are, for reasons which are set out below, greatly enhanced.

Second, it must always be borne in mind that essential services are inherently those which our society generally relies upon for its proper functioning. A failure (of whatever type) by a provider of such a service is likely to have dramatic consequences for our societal well-being. It is therefore considered appropriate that the State should maintain control over the ability of a person or entity to provide those services. One means by which such control may be maintained is by making the provision of the relevant service or services illegal in the absence of some positive authority granted by the State permitting a person or entity to provide that service (or services).

The granting of such an authority is known as a “licence” (a term which has a specific legal meaning over and above a mere reference to the particular document that licence is contained within). Generally speaking, the State does not grant a licence to a person or entity without undertaking some form of probity check to ascertain whether or not that person or entity is fit and proper to provide the services.

Furthermore, in the majority of cases the State retains control over the grant of the licence, such that the licence can be suspended or even removed should circumstances require. This ability is enhanced by the means of including, within the grant of licence, various requirements to comply with other matters. For example, in the case of essential services, this generally entails compliance with industry codes, rules and guidelines made by the Commission. Such subsidiary instruments are generally of a consumer protection nature (such as codes regulating the contractual relationship between service providers and consumers) and can be of great detail and impose significant obligations on licensees (where this is necessary to ensure the protection of consumers).

It is in this general environment that the Bill establishes, at Division 2 of Part 4 (clauses 18 to 35) a licensing regime for those who provide retail services to South Australian consumers. The model which has been adopted within the Bill is based in large measure on the model established under the Electricity Act and the Gas Act.

Under the proposed model in the Bill, any person or entity wishing to provide retail services to South Australian consumers will be required to obtain a licence from the Commission authorizing those operations. The licence issued (in the event that the applicant satisfies the Commission that the statutory assessment criteria are met) will require the licensee to comply with a number of 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.

The licence itself will represent a form of property right, which can be removed from a licensee in the event that a proper cause for such action is established in court, and which will be transferable to a third party (with the approval of the Commission). Of note, the State-owned water service provider, SA Water, is entitled under the Bill to the issue of a licence without application and the resulting licence cannot be transferred, suspended or cancelled.

### **3.3.2 Consumer protection and service standards – industry codes**

The protection of consumers' interests is of paramount importance in the provision of any essential service. While it is clearly the case that those who are in the business of providing essential services have an interest in protecting consumers, those businesses also (in general) have other competing interests, such as providing adequate returns to shareholders.

One of the key roles of the economic regulator is, therefore, to establish a regime which, as demonstrated in Chapter 2, balances the economic interests of the business providing essential services with the interests of the consumers of those services – the regulatory bargain.

Under section 26 of the Bill, 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. As is discussed in section 3.3.3 below, and in greater detail later in this Statement of Issues, 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.

As both the consumer protection framework and the service standards framework contemplated under the Bill are to be established through industry codes made by the Commission, it is useful at this point to discuss briefly the legal and regulatory architecture of industry codes.

As noted, clause 26 of the Bill requires licences issued by the Commission to include conditions obliging compliance by the licensee with industry codes. The matters which are to be dealt with by those industry codes are (without limitation) also prescribed in clause 26.<sup>23</sup> In addition, clause 26 sets out a number of other mandatory conditions (for example, relating to standard contractual terms and conditions, regulatory accounting, dispute resolution and performance monitoring)<sup>24</sup> which would also be appropriate to be dealt with through the use of an industry code.

The industry code (or codes) themselves which are made by the Commission are made pursuant to its general powers under the ESC Act. In particular, Part 4 of the ESC Act sets out a regime for the making of industry codes as follows:

*Part 4—Industry codes and rules*

*28—Codes and rules*

- (1) The Commission may make codes or rules relating to the conduct or operations of a regulated industry or regulated entities.*
- (2) The Commission may vary or revoke a code or rules made under this section.*
- (3) The Commission must, before making, varying or revoking a code or rules, consult with the industry Minister and such representative bodies and participants in the regulated industry as the Commission considers appropriate.*
- (4) A code or rules may apply or incorporate, wholly or partially and with or without modification, a document referred to in the code or rules, as in force from time to time or as in force at a particular time.*
- (5) The Commission must—*
  - (a) give notice of the making, variation or revocation of a code or rules—*
    - (i) to the Minister and the industry Minister; and*
    - (ii) to each regulated entity to which the code or rules apply; and*
  - (b) ensure that copies of the code or rules (as in force from time to time) are available for inspection and purchase by members of the public.*

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<sup>23</sup> Refer, for example, clauses 26(1)(a), (b) and (d).

<sup>24</sup> Refer, clauses 26(1)(c), (e), (g) and (k) respectively.

- (6) *Notice of the making of a code or rules, or the variation or revocation of a code or rules, must be published in the Gazette.*
- (7) *A code or rule, or variation or revocation of a code or rule, takes effect on the date on which it is notified in the Gazette or a later date specified by the Commission in the code or a rule.*
- (8) *The Commission must keep the contents and operation of codes and rules under review with a view to ensuring their continued relevance and effectiveness.*

This scheme is a mechanism for ensuring that the text of the industry codes is developed by the Commission in an open, transparent and consultative manner.

Therefore, while the Bill itself does not prescribe the particular form or scope of any given industry code, the requirement that the Commission make such a code in accordance with the ESC Act scheme allows for stakeholder consideration of, and comment on, the specifics of the code to be made.

Once an industry code has been made in accordance with the ESC Act scheme, compliance with the terms of that code becomes a condition of licence for each licensee. A number of things flow from that requirement, with the following two matters of particular note:

- ▲ A failure to comply with the terms of the code is a breach of the code which, in turn is a breach of licence condition. Pursuant to clause 28 of the Bill, a breach of a licence condition is also a breach of the Bill, punishable as an offence with a maximum penalty of \$1 million.
- ▲ To avoid breaching the terms of an industry code, a licensee will need to develop a robust internal compliance system, which has the ability to ensure compliance by that licensee and to report to the Commission on the levels of that licensee's compliance.

Chapter 5 of this Statement of Issues deals with the details of the content of the consumer protection and service standard elements of any industry codes to be made by the Commission in accordance with the requirements of the Bill.

### 3.3.3 Pricing

A key element of the Bill is the proposal, set out in Division 3 of Part 4 (clause 36), to introduce independent price regulation of water and sewerage services, with the Commission to be appointed as the price regulator.

The establishment of independent price regulation is intended to further promote best practice water pricing in South Australia, in line with the State Government's

commitments under the National Water Initiative.<sup>25</sup> In 2004, the Council of Australian Governments (COAG) agreed to implement the National Water Initiative (NWI), which is aimed at increasing the efficiency of Australia's water use, leading to greater certainty for investment and productivity, for rural and urban communities, and for the environment.

There is a strong alignment between the pricing principles set out in the NWI, and the Commission's own objectives under the ESC Act. While the details of these principles and objectives are discussed later in this Statement of Issues, a common theme between the two is the need to promote economic efficiency.

Water for Good provides a strategy for managing South Australia's water resources, in the context of a prolonged drought in this state. Increased scarcity of water sourced from rainfall highlights the importance of maintaining security of water supply, while ensuring that it is done at least overall cost. By promoting greater innovation in the water supply industry and by encouraging more efficient operation of our water and sewerage infrastructure, the cost of meeting consumers' water needs can be minimised.

Economic efficiency doesn't just extend to the costs of delivering water services. Consumers should also be provided with the right signals to ensure the efficient use of water. Prices can play a central role in signalling to customers the cost of providing water, and encouraging better consumption decisions. Where prices do not reflect the true cost of providing water services, decisions about how much water to consume are distorted, which may lead to inefficient allocation of the resource and compromise water security objectives.

Independent price regulation is often established in industries where natural monopolies exist (e.g., electricity, gas, telecommunications and water industries), where it is uneconomic to duplicate network infrastructure and have competing network operators. In this case, the absence of competition may lead to potential market failure, where prices may not reflect the efficient cost of service delivery or where services valued by customers are under-provided. Independent regulation is intended to promote greater economic efficiency in service delivery and in the allocation of resources between customers.

The establishment of independent price regulation in the water sector can facilitate greater economic efficiency through:

- ▲ providing independent scrutiny over the costs of service delivery, to ensure that expenditure remains efficient;
- ▲ providing greater confidence to investors in the industry, by ensuring that pricing decisions are made subject to clear economic objectives (as opposed

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<sup>25</sup> The NWI pricing principles are available at <http://www.environment.gov.au/water/policy-programs/urban-reform/nwi-pricing-principles.html>

to social or other objectives), and by providing greater transparency in the decision making process - with the potential for greater competition within the water industry, promoting investor confidence will be critical;

- ▲ addressing in a transparent manner any situations where revenues are insufficient to meet efficient costs, which may result in inefficient consumption decisions; and
- ▲ providing predictable regulatory outcomes, where decisions are made subject to a stable set of economic objectives, providing greater certainty to consumers and regulated businesses.

Under the scheme of the Bill, the Commission will be empowered to use its general price determination powers under the ESC Act to make a price determination in respect of retail services (as defined in clause 4). In making a determination, it is proposed that, in addition to the various factors set out in Part 3 of the ESC Act, the Commission will also be bound by the terms of a pricing order to be made by the Treasurer.

That pricing order will set out various matters which the Commission must either adopt or have regard to (as the case may be) in making its determination. The pricing order model is consistent with the model which was, and continues to be, used in the electricity supply industry.<sup>26</sup>

It is expected that, having regard to the proposed repeal of the current water industry Acts (the Sewerage Act, the Waterworks Act and the Water Conservation Act), the pricing arrangements and structures under those Acts will be the subject of transitional arrangements up to, and perhaps for a period after in some aspects, the time at which the Commission makes its first price determination.

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<sup>26</sup> Refer Electricity Act 1996, section 35B. The electricity pricing order made under that section may be accessed from the Commission's website at <http://www.escosa.sa.gov.au/library/030514-EPO.pdf>

## 4 LICENSING AND EXEMPTION FRAMEWORK

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Part 4 of the Bill sets out a licensing regime that is to apply to water industry entities in South Australia. Pursuant to clause 18 of the Bill, a person must not provide a “retail service” unless the person holds a licence authorising the relevant services, operation or activity. In terms of categories of licence, the Bill states that there will be a “retailer’s licence”, which will relate to the provision of a “retail service” and one or more other categories (if any) as prescribed by regulations.

In summary, the Bill defines a “retail service” to include the provision of a “water service” through “water infrastructure” or a “sewerage service” through “sewerage infrastructure”. Entities that provide either a water service or a sewerage service (or both) through the relevant infrastructure will need to apply to the Commission for a retailer’s licence.

While the licensing regime for retail services will clearly apply to SA Water, it is also the Commission’s understanding that it will apply to local councils (particularly in respect of Community Wastewater Management Systems) and to the various private water and sewerage service providers operating in South Australia.

### 4.1 What is a “retail service”?

To consider the potential coverage of the licensing regime, it is important to examine the definition of “retail service” as set out in the Bill.

The Bill defines a “retail service” as 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 (whether or not by the seller) by a reticulated system; or
- ▲ the sale and supply of sewerage services for the removal of sewage, being a service constituted in whole or in part by the collection, storage, treatment or conveyance of sewage through the use of a reticulated system,

but does not include any service, or any service of a class, excluded from the ambit of the definition by regulations. Further services can, however, be brought within the ambit of the above definitions by regulation.

Water services and sewerage services are provided to consumers through separate infrastructure. Water service infrastructure includes any infrastructure that is, or is to be, used for the storage, treatment and reticulation of water and sewerage service infrastructure includes any infrastructure that is, or is to be, used for the collection, storage, conveyance or treatment of sewage.

Water infrastructure terminates at the customer’s water connection point so it does not include any pipe, fitting or apparatus that is situated downstream of a customer’s connection point to a water main or upstream of a customer’s connection point to a



stormwater drain, In addition, water infrastructure that is situated entirely within one site and not connected to any infrastructure situated within another site is not considered “water infrastructure” for the purposes of the Bill.

Similarly, sewerage infrastructure commences at the customer’s sewerage connection point so it does not include any pipe, fitting or apparatus that is situated upstream of a customer’s connection point to a sewer main. As is the case with water infrastructure, infrastructure that is situated entirely within one site and not connected to any infrastructure situated within another site is not considered “sewerage infrastructure”.

In essence, water and sewerage infrastructure does not extend to any infrastructure located within a customer’s premises.

## **4.2 Who must apply for a licence**

It is fair to say that the range of activities that are captured by the definition of “retail service” is very broad. It will not only cover the operations of SA Water, South Australia’s major provider of water and sewerage services, but will also include the following activities that may be undertaken by local councils or small private enterprises:

- ▲ the operation of small scale Community Wastewater Management Systems;
- ▲ the provision of small volumes of drinking water to persons in remote areas; and
- ▲ the provision of re-use or recycled water for use.

Entities providing retail water and/or sewerage services will be required to obtain a licence from the Commission as set out below.

## **4.3 Applying for a licence**

Pursuant to clause 20 of the Bill, a water industry entity that is covered by the Bill must apply to the Commission for the issue of a licence. Clause 18(2) of the Bill contains a carve-out for SA Water, which, by the force of clause 18, is entitled to be issued with a licence for the services, activities and operations it undertakes from time to time. SA Water’s licence cannot be suspended, varied or cancelled.

Pursuant to clause 21 of the Bill, upon receiving an application, the Commission is required to consider that application 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, (described in detail in section 2.2.2 of this Statement of Issues), which the Commission must have regard to when considering an application, clause 21(2) of the Bill provides that the Commission may only issue a licence if 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 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 is of the view that the Bill sets out a comprehensive list of matters that the Commission must consider when determining whether an applicant will be issued with a licence. In addition, the factors set out in the Bill are consistent with the factors set out in the licensing provisions of the other industry Acts in which the Commission has a licensing function. Further, the criteria for determining whether a water licence should be issued in other jurisdictions, such as Victoria and NSW, are similar to those set out in the Bill.<sup>27</sup>

As provided by clause 21(3)(d) of the Bill, in determining whether an applicant is a suitable person, the Commission is able to take into account other matters that it considers relevant. It is likely the Commission would consider other matters on a case by case basis but would be interested in receiving comments from stakeholders on whether there are matters not set out in clauses 21(2) and (3) that would be relevant for the Commission to consider in this context.

*Issue 1.*

*Are there any matters in addition to those set out in clauses 21(2) and (3) of the Bill which the Commission should consider when assessing a licence application?*

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<sup>27</sup> Refer Water Industry Act 1994 (VIC), section 6(2) and Water Industry Competition Act 2006 (NSW), section 10(4).

#### **4.4 Licence conditions**

Clause 26 of the Bill sets out the mandatory licence conditions to be imposed on any water industry entity that is issued with a licence. Those licence obligations are:

- ▲ the requirement to comply with applicable codes or rules made by the Commission under the ESC Act;
- ▲ the requirement to comply with code provisions relating to designated customers (i.e., customers or classes of customers designated by the Minister by notice in the Gazette);
- ▲ 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 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 compliance with specified technical or safety requirements or standards;
- ▲ requiring the water industry entity to prepare and periodically revise a safety, reliability, maintenance and technical management plan which is to be approved by the Commission upon a recommendation from the Technical Regulator;
- ▲ 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 provide and maintain fire plugs, maintain various standards, and comply with other requirements relating to the provision of water for fire-fighting purposes, in accordance with any scheme determined by the Minister;
- ▲ 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 the provision by the State of customer concessions or the performance of community service obligations by water industry entities;
- ▲ any further conditions that the Commission is required by regulation to impose on the issue of such a licence;<sup>28</sup> and
- ▲ any further conditions considered appropriate by the Commission.

Pursuant to clause 26(3) of the Bill, the Commission has a discretionary power to make a licence subject to further conditions considered appropriate by the Commission. In the energy industry, the Commission has utilised a similar power granted to it under the Electricity Act to attach special conditions to wind generation licences.<sup>29</sup> While the Commission would only seek to use the discretionary power provided by clause 26(3) if, after considering its primary objective, it determines it would be appropriate, it seeks comments from stakeholders on what additional licence obligations may be suitable.

*Issue 2.*

*Taking into account the licence conditions already mandated by clause 26 of the Bill, are there any additional licence conditions that may be appropriate to apply to entities providing water and/or sewerage services?*

## **4.5 Exemptions**

Pursuant to clause 106 of the Bill, the Commission may, with the approval of the Minister, grant an exemption from Part 4, or specified provisions of Part 4, on terms and conditions it considers appropriate. Notwithstanding the Commission's power to grant an exemption, a person exempted from the requirement to hold a licence is, if the Commission determines, to be treated as a water industry entity for the purpose of specified provisions of the Bill or another relevant Act.

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<sup>28</sup> The Commission notes that the Regulations have not been prepared at the time of writing.

<sup>29</sup> Refer to the Commission's Final Decision on Licence Conditions for Wind Generators dated May 2010 in which the Commission concluded, taking into account its primary objective to protect the long term interests of South Australian consumers of electricity services with respect of the price, quality and reliability of those services, that special conditions relating to technical standards for reactive power and fault ride through should be imposed on wind generation licences. Available from the Commission's website at <http://www.escosa.sa.gov.au/projects/15/2010-wind-generation-licensing.aspx>

In terms of the energy industry, the Commission has exercised its power under the Electricity and Gas Acts to grant exemptions in certain circumstances. In deciding whether to grant an exemption, the Commission must consider the impact of the proposed exemption on the achievement of the various factors specified in section 6 of the ESC Act (as set out in section 2.2.2 of this Statement of Issues), 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 scope of the proposed operations is also a key issue for the Commission to consider. For example, the Commission has determined that entities that intend to provide very limited energy supply or retail services or intend to provide services to a very restricted group should be exempted from the requirement to hold a licence. In these circumstances, the regulatory burden of being licensed would far outweigh any benefits the wider community would receive.

It has been the Commission's approach to carefully consider the granting of an exemption on a case by case basis and it does not consider there to be any reason why it should depart from this approach in undertaking its licensing role in the water industry.

Finally, it is worth noting that, pursuant to clause 111 of the Bill, the Governor may make such regulations as are contemplated by, or necessary or expedient for the purpose of, the Act. Specifically, clause 111(2)(g) of the Bill 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.*

In the energy context, the Governor has made statutory exemption frameworks pursuant to this power which are set out in the Electricity and Gas Regulations.<sup>30</sup> 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. As the regulation of the water industry progresses, it may become necessary for statutory exemptions to be created to ensure the effective operation of the Water Industry Act.

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

#### **4.6 Other powers of the Commission**

The Commission has other powers granted to it under the Bill such as the power to vary, transfer and suspend or cancel a licence (refer clauses 28, 29 and 34 respectively). In

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<sup>30</sup> Refer to regulation 6 in the Electricity (General) Regulations 1997 and regulation 6A in the Gas Regulations 1997.



considering the exercise those powers, should the occasion arise, the Commission would 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 Bill.

## 5 CONSUMER PROTECTION FRAMEWORK

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As noted in Chapter 3, under the Bill the Commission is required to establish a consumer protection framework through the use of industry codes made under Part 4 of the ESC Act. The Commission regards the concept of a consumer protection framework as being very broad, capturing not only the regulation of retailer behaviour when dealing with customers (such as information provision, billing and dispute resolution) but also customer contracts, service standards and issues of metering.

### **5.1 What is an industry code?**

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 such an industry code or rule, which requires consultation with key stakeholders, including consumers, industry participants and relevant Ministers. Compliance with any industry codes or rules which might be made by the Commission 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.

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 – licensees. Importantly, 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 use of a system 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 matters of technical complexity such as metering and network reliability standards.

### **5.2 A water retail services industry code**

The Bill 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.<sup>31</sup> The Commission must, therefore, develop water industry code/s outlining the requirements for water industry entities licensed to undertake retail services in South Australia.

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<sup>31</sup> Clause 26(1)(a) of the Water Industry Bill 2010.



Of relevance to the development of the consumer protection framework, clause 26(1) of the Bill 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 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 Commission's water industry code/s must contain provisions dealing with the above issues. However, it is also relevant to consider some of the other licence conditions contained in the Bill and whether or not they should be covered in the Commission's water industry code/s. For example, the Bill also makes it a condition of licence that the water industry entity licensed to undertake a retail service must:

- ▲ include information on each account for services (as prescribed by regulation);
- ▲ 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 classes of designated customers);
- ▲ comply with specified technical or safety requirements or standards;
- ▲ prepare, periodically revise and comply with, a safety, reliability, maintenance and technical management plan, to be approved by the Commission on the advice of the Technical Regulator;
- ▲ monitor and report on indicators of service performance, as determined by the Commission; and
- ▲ 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.



The Bill also provides that the Commission's codes or rules 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.<sup>32</sup>

The Commission notes that the consumer protection requirements in other codes developed for the regulation of the electricity and gas industries in South Australia are broadly consistent with the requirements of the Bill and may, therefore, serve as a useful model for the development of a consumer protection industry code for water retail services.<sup>33</sup>

Ultimately, any industry code would be the principal consumer protection document for water customers, setting out the standard terms and conditions for the sale and supply of water retail services and could include a standard form customer sale contract.

*Issue 3.*

*Based on its experience in the regulation of other essential services, the Commission considers that a water retail services industry code 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 Bill, 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);*

*- facilitate consistency with consumer protection measures that apply in other essential services regulated by the Commission.*

*Are there any additional matters which should be dealt with in the development of the consumer protection framework under a water retail services industry code?*

### **5.3 Application of a water retail services industry code**

The Bill provides for the Minister for Water to designate customers or classes of customers with respect to the obligations contained in different sections of the Bill, by notice in the Government Gazette. This provision would allow the Minister for Water to determine that various requirements (given effect through the Commission's industry

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<sup>32</sup> *Water for Good* notes "while water conservation can best be encouraged through cost-reflective pricing, equity can best be delivered through targeted income support (concessions) measures". Refer *Water for Good*, Department for Water, available <http://www.waterforgood.sa.gov.au/wp-content/uploads/2009/06/complete-water-for-good-plan.pdf>, p. 139.

<sup>33</sup> In particular, the Energy Retail Code, Electricity Distribution Code and Gas Distribution Code may provide some guidance for formulating applicable regulatory requirements for the water industry. The contractual arrangements in the water industry are more akin to the gas market than the electricity market as there are no separate contracts between customers and distributors in the water industry, with vertically integrated businesses providing "retail" and "distribution/network" services to customers. It is, therefore, important to consider the key consumer protection provisions in both the Energy Retail Code and the Electricity and Gas Distribution Codes.

code) would only apply to particular customer segments, rather than having universal application for all South Australian water customers. For example, the consumer protection framework for other utility service industries regulated by the Commission applies only to “small customers” within the broader market.<sup>34</sup> The small customer market is further disaggregated into residential and small business customers.

### 5.3.1 Residential versus small business segregation

In other industries regulated by the Commission, there are some differences in the consumer protection provisions applying to residential and small business customers, with more onerous obligations usually in place for residential customers to redress the balance of power in the consumer-supplier relationship. In practical terms, this means that the types and levels of protections extended to customers are generally limited based on the ability of the customer (or the class of customers) to participate in that market and protect their own interests.

For example, while an energy retailer may have overall obligations to satisfy prior to being able to disconnect (or restrict) any customer’s energy supply, that energy retailer may also be required to offer residential customers an instalment plan or access to a hardship program prior to disconnecting (or restricting) supply.<sup>35</sup> Similarly, while an energy retailer may be required to offer residential customers instalment payment plans, it could be at the energy retailer’s discretion as to whether or not it offers a small business customer an instalment plan.<sup>36</sup>

### 5.3.2 Customers versus consumers under the Bill

It is also important to note that, unlike other utility industries regulated by the Commission, not all consumers of retail services will be customers of water industry entities. The Bill provides that a customer can be:

- ▲ the owner of the land in relation to which the retail service is provided;
- ▲ the consumer or user of retail services (in prescribed circumstances); or
- ▲ a person of a class declared by the regulations to be customers.

In some cases, the customer will be the owner and occupier of the land to which the retail service is provided; however, in other instances, the owner of the premises (the landlord) will be the customer while the occupier of the premises (the tenant) will not be considered a customer for regulatory purposes. In those cases, other legal mechanisms, such as landlord and tenant legislation, will govern the relevant retail service arrangements.

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<sup>34</sup> A “small customer” in the energy industry is defined as a customer with an annual electricity consumption of less than 160 MWh, or annual gas consumption of less than 1 TJ.

<sup>35</sup> Refer, for example, clauses 9.2.2(b) and (c) of the Energy Retail Code.

<sup>36</sup> Refer, for example, clause 7.7 of the Energy Retail Code.

The rates and charges for water supplied to residential premises under a tenancy agreement are governed by the Residential Tenancies Act 1995.<sup>37</sup> In general terms, the payment of rates and charges for water supplied to residential premises are as agreed between the landlord and the tenant. In the absence of an agreement, the landlord is currently required to pay the rates and charges for water supply up to a limit prescribed under the Residential Tenancies Regulations 2010, with any amount in excess of this limit to be paid by the tenant.<sup>38</sup> Therefore, while tenants are required to pay their landlord for water supplied to their premises, the tenant does not have a direct contractual relationship with a water industry entity and may therefore fall outside of any consumer protection framework designed by the Commission.

However, as the Bill provides for the Minister for Water to declare classes of persons to be customers of retail services, various provisions of the Commission's water industry codes could apply to all South Australian consumers. The nature and coverage of any such declaration by the Minister for Water is unclear at this point.

### 5.3.3 Different application based on the type of undertaking

There is also likely to be some difference in the application of any industry codes developed by the Commission to the various water industry entities undertaking retail services in South Australia.

While SA Water is a vertically-integrated water business providing the full suite of water retail services envisaged by the Bill, there are also other water industry entities providing one, or a combination of, the elements of the water and sewerage sale and supply chain. As noted in Chapter 4 of this Statement of Issues, the operation of small scale Community Wastewater Management Systems by local councils and the provision of small volumes of drinking water to remote locations by government or private enterprises would also appear to be captured by the definition of retail service contained in the Bill.

As the retail service provided by each water industry entity to be licensed by the Commission could vary significantly, the Commission's consumer protection framework must be flexible enough to apply to water industry entities undertaking all (or any combination of) the following services:

- ▲ the storage, treatment or conveyance of water; and/or

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<sup>37</sup> Section 52(b) of the Residential Tenancies Act 1995 provides that a landlord may require a tenant to reimburse the landlord for rates and charges for water supply that are to be borne by the tenant under the residential tenancy agreement or a collateral agreement.

<sup>38</sup> Regulation 12 provides that, in the absence of an agreement under section 73(2) of the *Residential Tenancies Act*, the limit up to which the landlord will bear the rates and charges for water supply will be comprised of the supply charge for the premises (under Part 5 of the *Waterworks Act 1932*) and the water rate for the supply of 136 kilolitres of water to the premises for each financial year.

- ▲ the conveyance, storage or treatment of sewage; and/or
- ▲ the treatment, storage or sale/supply of recycled (reuse) water.

The Commission needs to consider whether or not the substantive consumer protection requirements should differ based on the size and nature of the water industry entity undertaking the retail service.

In some instances, it may not be appropriate to require all licensees to comply with the same consumer protections. For example, the operators of small-scale electricity operations in remote areas of South Australia are only required to comply with key consumer protection obligations relating to billing, disconnections and special needs, rather than with the Commission's broader suite of industry codes in full. Such an approach could serve as an appropriate model to facilitate the different nature of the water retail services provided by licensees.

#### 5.3.4 The form of water industry codes

The Commission also needs to consider the form of any water industry codes.

At this stage the Commission prefers the concept of a single Water Retail Service Code, capturing the requirements of the consumer protection framework for the water industry within a single comprehensive document detailing requirements for each component of the water retail service, with various sections applying to each licensee only in respect of the relevant aspects of the retail service provided. Alternatively, the Commission could develop separate regulatory instruments to detail the requirements for each key function within the retail service as disaggregated above.

Another model would be to develop several water industry codes to cover the consumer protection arrangements to apply to different types of water industry entities, such as one code to apply to SA Water as the main Adelaide metropolitan water retail service provider and another code to apply to other water industry entities providing water retail services, in whole or in part.<sup>39</sup>

The Commission notes that in the case of small-scale operations, it may be appropriate to include the relevant consumer protection requirements in a licence, rather than attempting to exclude licensees from the main water industry code.

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<sup>39</sup> For example, in Victoria, the Essential Services Commission has developed two separate water industry codes: one to apply to metropolitan and regional water business and another to apply to rural water businesses. Each water customer service code contains schedules outlining the approved service standards for each water business. The Commission notes that this approach to regulation is, in part, driven by the different water industry structure in Victoria, but could be used as an alternative model in South Australia. Refer <http://www.esc.vic.gov.au/NR/exeres/70FEED56-8ACE-477B-A0D4-7B2987D8AC0C.htm>.

*Issue 4.*

*Given the Commission's understanding that the nature of the water retail service will vary by water type (drinking water, recycled or reuse water) and customer type (residential, commercial, industrial (light and heavy)) does any water industry code need to be tailored in application?*

*What key distinctions give rise to differences across the various water industry entities that the development of any industry codes should consider? How should differences between the retail services provided by different licensees be reflected in any industry code arrangements?*

*Should the Commission make a single Water Retail Services Code or develop a discrete series of separate industry codes to establish its consumer protection framework?*

#### **5.4 What should be covered by a water retail services industry code?**

The Commission is proposing to develop a consumer protection framework covering the following key areas:

- ▲ obligation to supply/pre-conditions for connection;
- ▲ applications and connections;
- ▲ customer charter;
- ▲ enquiries, complaints and dispute resolution;
- ▲ billing;
- ▲ payment and payment difficulties;
- ▲ security deposits;
- ▲ disconnections and reconnections; and
- ▲ customers with special needs.

The following section provides discussion of the key issues identified by the Commission in relation to each of the key areas to be covered in a water retail services industry code. In addition to these consumer protections, the Commission notes that it is important to also consider the development of appropriate customer service, reliability and quality of supply service standards. These issues are discussed in section 5.5 below.

##### **5.4.1 Obligation to supply/pre-conditions for connection**

Clause 26(1)(c) of the Bill provides that a licensed water retail service provider must, at the request of a designated customer, provide designated services at the licensee's standard contract price and subject to the licensee's standard

contractual terms and conditions. A water retail services industry code could set out the standard contractual terms and conditions to apply to the supply of designated services. This obligation to offer to supply is fundamental in a regulatory regime for water services – customers and consumers must have a supply of water available at all times.

While licensees would be required to provide designated services to a designated customer on request, a water retail services industry code could require that a designated customer provide a range of basic information to the designated retailer, prior to being provided with the retail service. For example, it could require designated customers to provide the following:

- ▲ acceptable customer identification and credit history information;
- ▲ contact details for billing purposes;
- ▲ payment of any relevant fees and charges for connection;
- ▲ payment of any security deposit, as required (and in accordance with consumer protections provided in the water retail services industry code); and
- ▲ safe and convenient access to the meter at the supply address.

The inclusion of these provisions would mean that if the designated customer provided such information and met the pre-conditions for connection, the designated retailer would be required to provide that customer with the designated retail service, in accordance with the requirements of a water retail services industry code.

*Issue 5.*

*While the Bill indicates that each licensed water industry entity will have an obligation to provide designated services at the request of a designated customer (on standard contract price and terms and conditions), should such an obligation be subject to the customer meeting certain pre-conditions?*

*If so, should any supply pre-conditions be limited to: the customer identifying themselves, providing name and address, contact details for billing purposes, fees and relevant charges for connection, payment of any security deposit and providing safe and unhindered access to their water meter?*

## 5.4.2 Connections

In addition to any pre-conditions which might be established as a part of the regulatory framework applying to the obligation to supply, a further issue arises in relation to any works required to be completed to allow a connection to water or

sewerage infrastructure to be effected in order that the relevant service can actually be provided to the customer. This could take the form of a new connection or a replacement or upgrade of an existing connection.

Requirements in this area are likely to have two elements:

- ▲ that information which is required from customers prior to a new or upgraded water retail service being provided, such as volume and capacity-related information; and
- ▲ that information which must be provided to customers prior to a water retail service being provided, such as: the process and timing requirements for licensees to connect customers within a certain timeframe once any necessary preconditions are met; and the cost of any necessary extension, augmentation or other works to be performed in relation to relevant infrastructure to effect the necessary connection.

In relation to the cost information to be provided, the Commission notes that the current legislative arrangements for the costs of new or upgraded connections<sup>40</sup> will be repealed following the commencement of the proposed Water Industry Act<sup>41</sup>. The manner in which such prices will be set in the future is an issue yet to be determined. For example, will the prices be fixed by the Commission or instead be set by the relevant licensee on a “fair and reasonable basis”, with a dispute resolution mechanism to deal with instances where that requirement has not been met?

Whatever the outcome, the issue of information provision in respect of the processes and costs of, and associated with, connection are important in the context of a water retail services industry code.

*Issue 6.*

*For the purposes of any water retail services industry code, what information should be sought from, and provided to, customers in relation to requests for new or upgraded connections to the network?*

### 5.4.3 Customer charter

A customer charter is a document developed by a licensee that summarises the key obligations and protections afforded to a customer by a retail service provider under its standard contractual terms and conditions. Under some regulatory regimes (such as that administered by the Commission for the energy supply

<sup>40</sup> For example, under both the Sewerage Regulations 1996 and the Waterworks Regulations 1996, the charges payable to SA Water for matters such as the standard capital contribution for works and the installation of various elements of infrastructure are set out in full. Refer Sewerage Regulations 1996, regulation 36; Waterworks Regulations 1996, regulation 29.

<sup>41</sup> Refer Water Industry Bill, Schedule 2, Part 3.

industry), a positive obligation is placed upon licensees to develop customer charters and provide those documents to their customers. This is seen as an important consumer protection measure as it assists in addressing consumers' key information needs.

While the Bill provides that the Commission must make an industry code outlining the standard terms and conditions on which designated services must be provided to designated customers, it does not specifically require a water retailer to develop and provide a customer charter to its customers.

The Commission understands that SA Water currently has a Customer Service Charter that outlines the key customer service standards to be delivered to customers by SA Water.<sup>42</sup> SA Water's Customer Service Charter covers:

- ▲ *Enquiries, complaints and disputes* - calls generally answered within 20 seconds; written enquiries responded to within 10 business days; disputes can be escalated within SA Water to a senior customer contact centre manager; if the customer is not satisfied, SA Water will assist the customer to refer the matter to the State Ombudsman;
- ▲ *Entry to property* - will be conducted during normal business hours, except in case of emergency; SA Water will advise customers in advance of all planned work; in an emergency, SA Water will advise the occupier of the property of work being undertaken, or leave an information card;
- ▲ *Unplanned interruptions* - SA Water will respond to urgent water service faults and sewerage blockages as soon as possible on a priority basis; SA Water commits to attend within two hours and will generally attend within the hour; SA Water will respond to sewer overflow at a customers' property due to its system failure as a priority;
- ▲ *Water quality* - water provided to meet standards agreed with the Department of Human Services; SA Water continually monitors and assesses the quality of drinking water supplied;<sup>43</sup> SA Water responds to reports of poor water quality within two hours.

It is unclear whether any other water industry entities providing water retail services currently have customer charters, or the extent to which other basic information about water retail services is provided to their customers.

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<sup>42</sup> Refer SA Water's website at:  
[http://www.sawater.com.au/NR/rdonlyres/858E7CBE-2250-479B-9DF5-8E84F9435587/0/Customer\\_Service.pdf](http://www.sawater.com.au/NR/rdonlyres/858E7CBE-2250-479B-9DF5-8E84F9435587/0/Customer_Service.pdf).

<sup>43</sup> Refer SA Water's website at:  
[http://www.sawater.com.au/NR/rdonlyres/A38B1BCF-4DB9-44D1-B2BF-1B167E926DB2/0/DWQR\\_0809.pdf](http://www.sawater.com.au/NR/rdonlyres/A38B1BCF-4DB9-44D1-B2BF-1B167E926DB2/0/DWQR_0809.pdf).



As a water retail services industry code would establish requirements for each of the issues outlined above, were the regulatory regime to include a requirement for licensees to develop customer charters, those charters would need to be consistent with the relevant provisions of that industry code.

*Issue 7.*

*Should all licensed entities be required to develop a customer charter and provide a copy to their customers? If so, what basic information should other water industry entities be required to provide to their customers?*

*Should a water retail services industry code only set out "benchmark" or "minimum" requirements that each of the businesses must comply with in relation to customer charters, or should it be more prescriptive?*

#### 5.4.4 Enquiries, complaints and dispute resolution

It is important for customers to have clear and accessible information about how to make an enquiry or complaint about their water retail service. Customers need to be able to contact their water retail services provider to enquire about the sale and supply of water and sewerage services; report problems with the quality and reliability of those services; the payment options available; what they can do if they are experiencing payment difficulties to avoid disconnection/restriction; and how to lodge a complaint.

A complaints handling procedure should provide an efficient, fair and accessible mechanism for resolving customer complaints, including the ability for escalation of a dispute both within the business and then to an external independent party for resolution in the event that the complaint remains unresolved.

Clause 26(1)(g) of the Bill requires licensees to have specified processes to be followed to resolve disputes between the licensee and its customers. In addition, clause 26(1)(h) of the Bill requires licensees providing designated services to designated customers to participate in an ombudsman scheme determined or approved by the Commission.

The Commission understands that SA Water currently responds to customer enquiries, complaints and disputes in person, in writing or by telephone; allows for customer disputes to be escalated within the business; and, if the customer is not satisfied, assists the customer to refer the matter to the State Ombudsman.<sup>44</sup>

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<sup>44</sup> The functions and powers of the State Ombudsman are set out in the Ombudsman Act 1972. The Ombudsman is an independent statutory officer with the power to investigate complaints about government departments and authorities and local government councils; review decisions made about the supply of public information in accordance with the Freedom of Information Act 1991; conduct investigations when the public have been refused access to local council meetings; and receive information confidentially

In other utility industries regulated by the Commission, licensees are required to participate in an industry ombudsman scheme approved by the Commission. The scheme currently approved by the Commission is that provided by the Energy Industry Ombudsman (SA) Ltd (**Energy Industry Ombudsman**).<sup>45</sup> The Energy Industry Ombudsman can investigate and resolve disputes between customers and the electricity and gas companies regulated by the Commission. The services provided by the Energy Industry Ombudsman are industry funded and provided free of charge to customers. Any decisions made by the Energy Industry Ombudsman are binding on the energy companies licensed by the Commission.

The Commission notes that it has been proposed that the role of the Energy Industry Ombudsman be extended to include the water industry.<sup>46</sup> This is consistent with the arrangements in other jurisdictions, where the same independent industry ombudsman provides dispute resolution services for both the water and energy industries.<sup>47</sup>

Due to the importance of effective customer complaint handling procedures, a water retail services industry code could require all licensees to have customer complaint and dispute resolution procedures to be followed to resolve disputes between the water industry entity and its customers, including:

- ▲ how the customer can make a complaint;
- ▲ how complaints will be handled, including the ability for complaints to be escalated within the business if the customer is dissatisfied with the response;
- ▲ response times and methods of response; and
- ▲ the procedure for referral of unresolved disputes to the independent industry ombudsman scheme.

To ensure that customers are aware of the processes for making an enquiry or complaint, licensees could be required to provide information to customers about their complaints handling processes, including the ability for customers to access the industry ombudsman scheme free of charge, through, for example, their customer charters.

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from a person who wishes to inform it about possible improper or illegal actions, without disclosing that person's identity. Refer <http://www.ombudsman.sa.gov.au/>.

<sup>45</sup> The Energy Industry Ombudsman (SA) Ltd is a not-for-profit public company limited by guarantee and governed by a Board of Directors. Refer <http://www.eiosa.com.au/>.

<sup>46</sup> Refer *A South Australian Water Industry Bill: Explanatory Paper*, Department for Water, available [http://www.waterforgood.sa.gov.au/wp-content/uploads/2010/11/dfw\\_explanatorypaper\\_wib.pdf](http://www.waterforgood.sa.gov.au/wp-content/uploads/2010/11/dfw_explanatorypaper_wib.pdf), p. 19.

<sup>47</sup> Refer Energy and Water Ombudsman Victoria, <http://www.ewov.com.au/>; Energy and Water Ombudsman of NSW, <http://www.ewon.com.au/>.

*Issue 8.*

*Should all licensees be required to have complaints handling procedures, including the allowance for escalation of disputes, in place?*

*Should all licensees be required to participate in an independent industry ombudsman scheme?*

*Are there other enquiries or complaints handling issues that a water retail services industry code should cover?*

### 5.4.5 Billing

Customers need to be provided with 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 is important for customers to have certainty that their bills are accurate and based on a meter reading of their actual consumption on a regular basis.

It is generally accepted in other utility industries regulated by the Commission that an actual meter read may not be available for each billing period and that in such circumstances, an estimated bill must be permitted. However, the basis for such estimations must also be relatively accurate and bills must be able to be adjusted for actual use when an actual read becomes available. Where a customer has been undercharged (for any reason), the licensee should be permitted to recover that amount from that customer.<sup>48</sup> Similarly, where a customer has been overcharged, the retailer should be required to refund that amount to the customer as soon as they become aware of the issue.

Clause 26(1)(e) of the Bill requires licensees to include specific information (to be prescribed by regulation) on each water account issued to designated customers. However, as it is unclear what information will be required by regulation, the Commission proposes that, as a minimum, the following matters should be addressed by a water retail services industry code:

- ▲ when bills are issued;
- ▲ how bills are issued;
- ▲ meter reading;
- ▲ undercharging;
- ▲ overcharging;

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<sup>48</sup> In other utility industries regulated by the Commission, licensees are limited to recovery of undercharged amounts occurring as a result of the licensee's error for a maximum period of 12 months. Refer clause 6.5.2 of the Energy Retail Code, available <http://www.escosa.sa.gov.au/library/101102-EnergyRetailCode-ERC03.pdf>.

- ▲ processes to be followed where a tariff rate or tariff type has changed during a billing cycle; and
- ▲ details for any alternative tariffs or tariff options available to customers.

The Commission understands that, in addition to this basic information, SA Water currently provides residential customers with detailed information about their water use (including a comparison with other SA Water customers); water and sewerage charges and possible water conservation measures on each bill.<sup>49</sup> The Commission notes that this requirement does not currently extend to all water industry entities.<sup>50</sup> While it may not be practical to require this level of comparative information from all licensees in the future, the Commission considers it important that the basic information outlined above should be included on all bills for water retail services.

*Issue 9.*

*Should all billing requirements apply only to SA Water or should they apply to all licensees? If not, what billing information should other water industry entities be required to provide?*

*Are there other billing and billing information issues that a water retail services industry code should cover?*

#### 5.4.6 Payment, payment difficulties and customer hardship

Customer hardship in relation to essential services continues to be an issue which is at the forefront of the Commission's thinking. It is generally considered that the costs of essential services will continue to rise for the foreseeable future. In that context, matters relating to hardship, payment, security deposits, disconnections and restrictions are of fundamental importance in a water retail services industry code. This section, and the sections immediately following, raise for consideration various issues which relate to those matters.

It is important to ensure that customers have a range of accessible payment options. Mandated minimum payment methods ensure that all customers are able to pay accounts through no cost or low cost methods, irrespective of their location.

<sup>49</sup> Refer [http://www.sawater.com.au/NR/rdonlyres/EE675983-EB22-4EE6-AB0E-D7E8ECA71335/0/NewAccountFlyer\\_Jul09.pdf](http://www.sawater.com.au/NR/rdonlyres/EE675983-EB22-4EE6-AB0E-D7E8ECA71335/0/NewAccountFlyer_Jul09.pdf).

<sup>50</sup> The "National Guidelines for Residential Customers' Water Accounts" have been developed to facilitate NWI paragraph 66(iv): "development of national guidelines for customers' water accounts that provide information on their water usage relative to equivalent households in the community by 2006". The Guidelines apply to Australian Water service providers that have a customer base of greater than 50,000 separately metered water customers. The Guidelines are voluntary, recognising that each state and territory and each water service provider will have different billing systems in place and face different customer expectations. While the Guidelines initially apply to larger businesses, all water service providers are encouraged to apply the Guidelines and form the basis for improvements to billing systems over time. Refer National Resource Management Ministerial Council, "National Guidelines for Residential Customers' Water Accounts", 2006, available [http://www.ephc.gov.au/sites/default/files/WO\\_AGWR\\_GL\\_WaterRecyclingGuidelines\\_Residential\\_Final\\_200611.pdf](http://www.ephc.gov.au/sites/default/files/WO_AGWR_GL_WaterRecyclingGuidelines_Residential_Final_200611.pdf).

It is important to note that minimum payment methods do not restrict a licensee's ability to provide additional payment methods.

It is also important to ensure that there are adequate protections in place for customers who are experiencing payment difficulties, such as the provision of instalment payment plans (determined on the basis of the customer's capacity to pay); referral to State Government assistance programs and information about independent financial and other relevant counselling services. The existence of such protections ensures that customers are only disconnected (or have their supply restricted) as a last resort.

The Bill does not prescribe any requirements around payment or payment difficulties; however, based on experience in other utility industries regulated by the Commission, a water retail services industry code could contain provisions relating to the following issues:

- ▲ minimum time for payment of a bill;
- ▲ payment methods (mail, direct debit, in person);
- ▲ direct debit;
- ▲ long absence or illness;
- ▲ concessions, rebates or grants;
- ▲ payment difficulties (instalment payment plans, referral to hardship programs);
- ▲ paying by instalments;
- ▲ review of a bill;
- ▲ shortened collection period;
- ▲ charge for dishonoured payments; and
- ▲ payments in advance.

In relation to customer hardship, clause 26(4) of the Bill provides that the Minister for Water may require the Commission to include provisions in a water retail services industry code to assist customers who may be suffering specified types of hardship.

It is the Commission's understanding that SA Water has a Customer Assist Program to provide assistance to customers who are willing to pay their water bills but do not have the financial capacity to do so.<sup>51</sup> On referral to SA Water's Customer Assist Program, customers are:

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<sup>51</sup> Refer [http://www.sawater.com.au/nr/rdonlyres/0f7b89a5-bd51-4fe9-9e58-8f77f9658f11/0/customer\\_assist\\_program.pdf](http://www.sawater.com.au/nr/rdonlyres/0f7b89a5-bd51-4fe9-9e58-8f77f9658f11/0/customer_assist_program.pdf).

- ▲ offered flexible payment arrangements;
- ▲ referred to external community financial counselling services;
- ▲ assessed for eligibility for applicable concessions;
- ▲ provided with home visits (if requested);
- ▲ provided with assistance with water and sewer connections;
- ▲ removed from normal debt collection processes; and
- ▲ allocated a personal case manager.

To the extent that utility prices continue to increase, there is the potential for more customers to experience financial difficulties from time to time. It is therefore important for the Commission to ensure that those customers experiencing financial hardship are provided with appropriate protections.

*Issue 10.*

*Should the payment and payment difficulty requirements apply only to SA Water or should they apply to all licensees?*

*Should a water retail services industry code prescribe the minimum requirements for a customer "hardship" program?*

*Are there other payment, payment difficulty or hardship issues that a water retail services industry code should cover?*

#### 5.4.7 Security deposits

Where a licensee has reasons to believe a customer presents a risk of non-payment it should be allowed to require upfront payment from a customer in the form of a "security deposit". Security deposits can be an important credit management tool for suppliers but can compound an already difficult situation for customers in financial distress by requiring them to find an additional sum of money over and above that required to make payments for water supplied.

A water retail services industry code could include provisions setting out the circumstances in which a security deposit will be required and to place a cap on the amount that can be required so that a licensee cannot require a security deposit from any customer for any amount. For example, it may be reasonable for a licensee to require a security deposit where a customer:

- ▲ has left a previous address without settling an outstanding debt to that retailer, and refused to make arrangements to pay the debt;
- ▲ has been responsible for illegal water use in the past;

- ▲ is a new customer and has refused or failed to produce acceptable identification;
- ▲ has not provided credit history information;
- ▲ where the licensee has reasonably formed the view that customer has unsatisfactory credit rating, and

the retailer has offered the customer an instalment plan or other payment option and the customer has refused, or failed to agree to, the offer.

In considering customer equity concerns, under such arrangements, a person with an unsatisfactory credit rating would not have to pay a security deposit (which they might not be able to afford) if they agreed to pay by instalments or through another payment option.

A water retail services industry code would also need to set out the circumstances in which a security deposit must be returned to the customer. For example, in other utility industries regulated by the Commission, if the customer demonstrates satisfactory payment over a 12 month period, the licensee is required to return the security deposit (plus interest) to the customer.

*Issue 11.*

*Should licensees be permitted to require security deposits in certain limited circumstances?*

*If so, in what circumstances should licensees be able to require security deposits?*

#### 5.4.8 Disconnections, restrictions and reconnections

Disconnection (or restriction) of a customers' essential services should be the last resort for a licensee attempting to recover debt. Unlike other essential services regulated by the Commission, the disconnection of water and sewerage services is not feasible for public health reasons. However, the flow-rate for the water services provided to customers can be restricted to provide for basic public health requirements rather than disconnecting a customer's service altogether.<sup>52</sup>

Clauses 26(1)(b)(iii) and (iv) of the Bill provide that a water retail services industry code must include limitations on the grounds on which the supply of designated services may be discontinued or disconnected and the processes to be followed before designated services can be discontinued or disconnected. The Commission

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<sup>52</sup> It is important to make the distinction between restriction of water services for non-payment of amounts owed by customers and the restriction of water when the quantity of water available for supply is insufficient to meet the demand for that water. Section 61 of the Bill provides for the power to restrict or discontinue the water where the supply of water is insufficient to meet demand. The Commission is proposing that a water retail services industry code would cover restrictions for non-payment only.

is interpreting these clauses of the Bill to refer to restriction of supply for non-payment.

In other utilities regulated by the Commission, the requirements on licensees prior to performing a disconnection for non-payment are greater where a residential customer is unable to pay a bill due to lack of sufficient income. In such circumstances, a licensee must have exhausted all other options, including offering multiple instalment payment plans (determined on the basis of the customer's capacity to pay); issuing reminder notices and written disconnection warnings; and offering entry to a hardship program.

A water retail services industry code could contain provisions relating to:

- ▲ the circumstances in which a licensee can disconnect (or restrict) a customer;
- ▲ limitations on disconnection of customers (e.g. customers experiencing financial hardship; if there is an unresolved dispute about the disconnection/restriction with the industry ombudsman; on a Friday, weekend or public holiday);
- ▲ obligations on licensees prior to disconnection (e.g. notification methods and timeframes; offer of instalment payment plans; referral to Government assistance); and
- ▲ circumstances in which a licensee can disconnect a customer *immediately* (e.g. once all obligations have been satisfied; repeated denial of access to water meter; illegal use).

It is also important to ensure that customers can be reconnected (or have their supply un-restricted) as soon as practicable after meeting any reconnection requirements. A water retail services industry code could also establish the timeframes within which customers should be reconnected.

*Issue 12.*

*Should protections around restriction of supply for non payment apply only to residential and small business customers, with large customers subject to normal credit procedures?*

*Are there other disconnection related issues that a water retail services industry code should cover?*

#### 5.4.9 Customers with special needs

The key consumer protections afforded to customers with special needs are to facilitate notification about planned network outages (to allow the customer to



make alternative arrangements for the duration of the outage) and to prohibit disconnection (or restriction) of supply while the customer continues to reside at those premises.

It is also important to ensure that customers are provided with access to multilingual services and large print versions of key regulatory documents.

*Issue 13.*

*Are there any special needs requirements that need to be addressed in a water retail services industry code?*

*If so, what are the relevant special needs requirements? Could they be addressed through supply being restricted as an alternative to permitting disconnection where permitted to do so under a water retail services industry code?*

#### 5.4.10 Price disclosure

Clause 26(1)(d) of the Bill requires licensees to provide price information to designated customers or designated classes of customers.

To facilitate effective choice in the competitive electricity and gas retail markets, the Commission has developed a price disclosure code requiring licensed electricity and gas retailers to provide energy price information to allow customers to compare competing market contracts.<sup>53</sup> While the Bill requires licensees to provide pricing information to designated customers or designated classes of customers, in a market with vertically integrated monopoly businesses, the Commission is of the view that the focus of a water retail services industry code should be on facilitating price transparency for customers.

*Issue 14.*

*Does the Commission need to have a separate price disclosure code for the water industry, or should provisions be included in a broad-based water retail services industry code?*

*What price information should be included? Should all water industry entities be required to provide price information?*

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<sup>53</sup> Refer <http://www.escosa.sa.gov.au/library/041223-EnergyPriceDisclosureCode.pdf>.

## 5.5 Service standards

In addition to the consumer protection measures outlined above, which are behavioural standards regulating water retailers' interactions with their customers, there are a further set of requirements which need to be considered – service standards.

In general terms, the concept of service standards for utilities which provide essential services can be disaggregated into technical service standards (reliability and quality of supply) and consumer service standards (telephone/written responsiveness and the like).

While the need to comply with all consumer protection requirements is fundamental to the operations which are authorised by a water retail licence, the nature of the 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. In addition, specific service standards are amenable, in a way in which the more generic consumer protection framework is not, to having specific financial penalties and rewards associated with them.

### 5.5.1 Quality and reliability of supply standards

It is the Commission's understanding that, in the water industry, the following are the generally accepted categories for quality of supply service standards:

- ▲ **Product quality** - a water entity must provide a product in accordance with any commitments specified in the water entity's approved service standards. This is in addition to complying with applicable requirements of health and environmental regulation and legislation.
- ▲ **Delivery quality (flow rates)** - a water entity must ensure that a customer's water supply (and recycled water supply) is at least equal to minimum flow rates specified in the water entity's approved service standards.
- ▲ **Rectification** – a water entity must rectify any deficiency in satisfying product quality requirements as soon as possible, or within a time agreed with the customer.

The categories of service standards relating to the reliability of service to customers are as follows:

- ▲ **Obligation to provide reliable services** - a water business must develop and implement plans, systems and processes to manage its assets to provide reliable services.
- ▲ **Unplanned interruptions – response** - a water entity must comply with standards specified in its approved service standards for such things as the number of unplanned water supply interruptions and sewer blockages for each customer in any 12 month period and time to restore interruptions to water services. A water entity must also have policies and procedures to minimise

the impact of interruptions and to provide emergency supplies of drinking water in the event of an unplanned interruption to water services.

- ▲ **Bursts, leaks, blockages and spills** - a water entity must have policies, practices and procedures to deal with a burst, leak or blockage in its system including prompt attendance, action to rectify, 24-hour telephone advice to customers and the minimisation of impact on others and the environment.
- ▲ **Planned interruptions information and response** - a water entity must inform affected customers in writing of the time and duration of any planned interruption to a service in advance. A water entity must also have policies, practices and procedures in relation to providing customers with access to emergency supplies of drinking water in the event of a planned interruption to water services.
- ▲ **Special needs** – a water entity must maintain a register of special needs customers who require water for the operation of a life-support machine; or other special needs. A water entity must contact customers registered as soon as possible in the event of an unplanned interruption to a service; and give advance notice before a planned interruption. In all cases a water business must endeavour to minimise inconvenience to these customers.

The Commission is of the view that the above quality and reliability categories of water and sewerage service provision are sufficiently comprehensive to form a sound basis for a South Australian customer code for service providers.

*Issue 15.*

*Is the list of the above basic components for quality and reliability for the provision of water and sewerage services comprehensive enough to satisfy the needs of customers in South Australia?*

*Are there any other basic components of service that should be included?*

*Should these provisions only apply to SA Water being the major provider of water and sewerage services in SA?*

*Are the provisions considered too onerous to be considered for smaller service providers? If so, what provisions should apply?*

## 5.5.2 Quality and reliability service standards – performance measures

Under present arrangements, SA Water reports various performance measures in its Annual Efficiency Report<sup>54</sup> which is a key component in the Government's

<sup>54</sup> Available from the Commission's website at [http://www.escosa.sa.gov.au/library/100630-TransparencyStatement\\_2010-11-PartA-SAWaterEfficiencyReport.pdf](http://www.escosa.sa.gov.au/library/100630-TransparencyStatement_2010-11-PartA-SAWaterEfficiencyReport.pdf)

annual determination of SA Water's water and sewerage pricing. SA Water also reports publicly through its Annual Report<sup>55</sup>.

In addition, SA Water's Customer Charter outlines its service standards to customers providing details on what it will do and how it will respond in providing services to customers and responding to enquiries.<sup>56</sup>

SA Water's reporting is divided into metropolitan and country areas, with separate performance measures established for water and sewerage services. The Commission does not know the particular reasoning for each of the differing measures for metropolitan and country areas but expects that, in a similar manner to the energy sector, customer density and degree of remoteness play a part in determining the value of service delivery to customers.

There are, of course, water and sewerage service providers other than SA Water operating in this State. However, SA Water is clearly the largest operator, with the remainder being best classified as small-scale operations by comparison. A question therefore arises as to whether or not there is a need for different standards to be set between the areas and/or the various providers and, if so, how they should differ.

### 5.5.3 Quality and reliability service standards – targets

The further question to be considered is the target which will be set for each of the performance measures. That question will need to be addressed by the Commission once the specific individual indicators are determined, which will be done through further stages of this public consultation process.

In considering that matter, however, the following (non-exhaustive) general lines of inquiry are relevant:

- ▲ what has historical performance been – actual and average?;
- ▲ what is the level of any pre-existing target?;
- ▲ what are community expectations or future performance and to what extent should those expectations be reflected in targets?; and
- ▲ what are emerging trends or technologies that may have an impact on the level of any target?

### 5.5.4 Quality and reliability service standards – nature of obligation

The final matter to be considered is the nature of each performance measure and target – that is, what is the standard of effort required to be expended by a water

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<sup>55</sup> <http://www.sawater.com.au/NR/rdonlyres/CE4FB619-F76F-4B44-A368-D2CCF1145677/0/SAWaterAR0809.pdf>

<sup>56</sup> [http://www.sawater.com.au/NR/rdonlyres/858E7CBE-2250-479B-9DF5-8E84F9435587/0/Customer\\_Service.pdf](http://www.sawater.com.au/NR/rdonlyres/858E7CBE-2250-479B-9DF5-8E84F9435587/0/Customer_Service.pdf)

entity in striving to meet the target. In that context, there are two options for consideration:

- ▲ the setting of a mandatory obligation, such that the water entity must meet the target for each performance measure and a failure will be considered a breach; or
- ▲ the setting of a “best endeavours” target, where the water entity will only be considered to have failed to meet the requirements of a performance measure where:
  - a target has not been met; and
  - the entity cannot demonstrate to the Commission’s satisfaction that it used its best endeavours to meet the target (that is, if it can so satisfy the Commission, then it will be considered to have met the requirements of the performance measure, even though the target itself has not been met).<sup>57</sup>

The issue which the Commission must consider is whether standards of a “best endeavours” nature are appropriate, or if a stricter “must achieve” test should apply.

In the Commission’s experience, the use of annual “best endeavours” standards represents the most common type of performance standard applied to energy utilities in Australia. This may suggest that such a standard is also appropriate in the water industry in this State.

This standard places a high onus on the regulated business to do everything it can to achieve a standard or outcome, but allows for some flexibility around the standard to be met; flexibility cannot be built into absolute standards. It is, important, however, to note that this flexibility in no way diminishes the accountability of the water entity for its actions.

In the energy sector, the Commission has defined the term “best endeavours” (for example in the Electricity Distribution Code and other regulatory documents issued by the Commission) as “*to act in good faith and use all reasonable efforts, skill and resources*”.<sup>58</sup>

This definition is based on judicial decisions which have considered the interpretation of the requirement to use best endeavours. “Best endeavours” are something less than 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 reasonably could do in the circumstances: an

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<sup>57</sup> For further discussion of this particular matter, refer section 2.2.2, page 13, of the 2006/07 Annual Performance Report, Performance of South Australian Energy Networks. Available from the Commission’s website at [http://www.escosa.sa.gov.au/webdata/resources/files/071128-AnnualPerfReport\\_Networks-Final.pdf](http://www.escosa.sa.gov.au/webdata/resources/files/071128-AnnualPerfReport_Networks-Final.pdf).

<sup>58</sup> Available from the Commission’s website at <http://www.escosa.sa.gov.au/library/101102-ElectricityDistributionCode-EDC09.pdf>

obligation to use "best endeavours" means a party is required to act honestly, reasonably and make a positive effort to perform the relevant obligation.

*Issue 16.*

*Should a series of performance measures be newly established or should the existing reporting and performance methodology be maintained?*

*Should the performance standards differentiate between Country and Metropolitan areas as is the current practice or should the same service standards apply on a State-wide basis?*

*Should various regions be established as a refinement to the separation between Country and Metropolitan areas and acknowledgement of smaller service providers and if so, on what criteria should performance measures be set?*

*Should a "best endeavours" performance standard or a minimum service standard with appropriately targeted performance levels be introduced for entities providing water and sewerage services?*

*Should a transitional minimum service standards framework be introduced for later review, with the objective of moving to differential service standards in a subsequent Price Determination to reflect the different costs of delivering the regulated services to different geographical areas?*

### 5.5.5 Customer Service Standards

The current customer service standards adopted by SA Water in South Australia include:<sup>59</sup>

- ▲ the answering calls to the customer contact centre within an average of 20 seconds;
- ▲ responding to any general written enquiries within 10 working days; and
- ▲ responding to written complaints within 5 working days and, where investigation is required, aim to resolve them within 21 days.

The Commission notes that, in general terms, those customer service standards are broadly consistent with those applied to the energy sector in South Australia, where the following annual standards apply:

- ▲ an entity must use its best endeavours to respond to 85% of telephone calls within 30 seconds; and

<sup>59</sup> Refer SA Water Customer Service Charter, available [http://www.sawater.com.au/NR/rdonlyres/858E7CBE-2250-479B-9DF5-8E84F9435587/0/Customer\\_Service.pdf](http://www.sawater.com.au/NR/rdonlyres/858E7CBE-2250-479B-9DF5-8E84F9435587/0/Customer_Service.pdf).

- ▲ an entity must use its best endeavours to respond to 95% of written enquiries within 5 business days.

The National Performance Reports for the water industry also use the measure of percentage of calls answered within 30 seconds.<sup>60</sup>

Several issues arise in this area.

First, there is a question as to whether or not standards of this nature should apply to all water entities or simply to SA Water (or at least simply to SA Water in the first instance)? For example, it is not presently clear to the Commission that entities other than SA Water would have the systems, controls and processes to enable them to not only report on, but also to comply with, such service standards. Of course, to the extent that standards of this nature were not required to be delivered by a water entity, then it would be expected that the prices charged for those services would reflect that fact.

Second, it is relevant to consider whether or not there is merit in setting the same customer service standards across the energy and water sectors in this State. On one view, consumers of essential services might expect to receive the same levels of service in respect of telephone and written responsiveness, regardless of the specific essential service they are purchasing. While it is undoubtedly the case that the physical products being supplied are very different in nature, there is nothing in those difference which ought to impact in any way whatsoever on the provision of the services under consideration.

Finally, as is the case for quality and reliability service standards, the question arises as to the nature of the obligation to be imposed: should the relevant standards be mandatory or best endeavours in nature?

*Issue 17.*

*Are telephone and written responsiveness performance standards important to customers?*

*Are there any other customer service standards that should be applied?*

*Should such standards apply to all licensed water industry entities, or initially confined to SA Water?*

*Should consistent customer service standards be adopted across the energy and water sectors in South Australia?*

<sup>60</sup> Refer, for example, *2008-2009 National Performance Report – Urban Water Utilities – Part A Comparative Analysis*, National Water Commission, available <https://www.wsaa.asn.au/Publications/Documents/2008-09%20National%20Performance%20Report%20-%20Urban%20water%20utilities%20-%20PART%20A%20Comparative%20analysis.pdf>.

## 5.6 Customer contracts

A feature of the energy supply industry in South Australia is the nature of the contractual arrangements in place between retailers and customers. Unlike the current arrangements in the water industry, in the energy supply industry retailers have contracts in place with each of their customers in accordance with which the retailers undertake to provide services and are entitled to receive payments. This model provides both parties with a legal means of enforcing their rights – particularly in the event of some default by the other party.

In the water industry, there are no such arrangements in place as a rule. For the majority of customers who receive services from SA Water, it is simply the case that SA Water is entitled to issue rating notices to those customers to recover prices (set by the Minister of Water) relating to the services provided.<sup>61</sup> There does not appear to be any legal right or obligation which positively requires SA Water to provide specific services to a customer, nor any commensurate rights vested in a customer to insist on services being provided or to take action for a failure to provide.

This situation will be remedied under the Bill, through the establishment of a mechanism for the formation of deemed statutory contracts between water entities and customers. Under clause 37 of the Bill, water entities are to be given the power to develop standard form contracts which will, by force of law, apply to designated classes of customers. This model, adopted from the Electricity Act, allows for binding and valid contractual relationships to be established between water entities and customers in respect of the sale and supply of services.

### *37—Standard terms and conditions for retail services*

- (1) A water industry entity may, from time to time, fix standard terms and conditions governing the provision of services by the entity to customers of a designated class.*
- (2) A water industry entity must publish in the Gazette a notice setting out any standard terms and conditions fixed by the provider.*
- (3) A water industry entity must, when it publishes a notice in the Gazette under subsection (2), also publish a notice in a newspaper circulating generally in the State describing the general nature of the standard terms and conditions and advising where a person may read or obtain a copy of the standard terms and conditions.*
- (4) Standard terms and conditions fixed under this section—*
  - (a) must comply with the conditions of any relevant licence; and*
  - (b) must not fix prices that exceed maximum prices fixed under this Act; and*
  - (c) come into force on the day specified by the provider in the notice of the standard terms and conditions published in the Gazette under this section, being a day not earlier than the day on which the notice is published; and*

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<sup>61</sup> Refer, for example, Part 5 of the Waterworks Act.



- (d) when in force are contractually binding on the water industry entity and the class of customers to which the terms and conditions are expressed to apply.*
- (5) Subject to the conditions of a licence, a standard term or condition fixed under this section may be modified or excluded by express agreement between the water industry entity and a customer of the entity.*
- (6) A water industry entity that has fixed standard terms and conditions under this section must—*
  - (a) supply a copy of the standard terms and conditions, without charge, on request made to the entity at a place approved by the Commission; and*
  - (b) publish the standard terms and conditions on a website maintained by the entity.*

*Maximum penalty: \$2 500*

Given the binding statutory nature of the contract arising under this clause, and the associated potential for “unfair” terms to be imposed on customers by water entities, the Government has introduced a measure of regulatory oversight and control in clause 37(4), by providing that the terms and conditions, including as to price, must comply with relevant regulatory requirements.

As to the terms and conditions, this is given expression through the requirement that those matters must comply with the conditions of the water entity’s licence. This gives rise to a number of options as to if and how the Commission must exercise regulatory powers in this area.

For example, the Commission may choose to place no regulatory restrictions on the nature, form and scope of standard contractual terms and conditions. Alternatively, it may 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). In yet another form, the Commission may, as is the case for standing contracts in the electricity and gas sectors, prescribe the terms and conditions which must be adopted.<sup>62</sup>

As 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 Bill itself, this does not mean that all prices charged under that contract need to be fixed under the Bill. It is the Commission’s position that the obligation only has effect where there are, in fact, prices which have been fixed by the Commission using the pricing powers given to it under the Bill. Where the Commission has not exercised those powers, or where those powers simply do not arise, then the prices which may be charged by an entity are those which would otherwise apply.

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<sup>62</sup> Refer, for example, Part B of the Energy Retail Code, available from the Commission’s website at <http://www.escosa.sa.gov.au/library/101102-EnergyRetailCode-ERC03.pdf>

For example, in the case of local councils, this may mean that the prices which would apply under current arrangements can continue to apply in a contractual scenario – it is simply the case that a standard form contractual agreement would be in place once the Bill is passed into law and the council completes the other elements of clause 37.

For the sake of completeness, it is noted that this latter model persists in the electricity supply industry where, for electricity undertakings in remote areas, licensees have published standard form contracts (under exactly the same terms as proposed under clause 37) but, as the Commission has not exercised any pricing powers in relation to those entities, the maximum clause has no work to do.

*Issue 18.*

*As the Bill gives the Commission the power to regulate the standard terms and conditions to be established under deemed statutory contracts between water entities and customers, what form should that regulation take?*

*For example, should the Commission simply require terms and conditions to be consistent with specified matters or principles, or should the Commission require compliance with a set of specified terms and conditions contained within an industry code?*

## **5.7 Metering**

While SA Water is currently the primary water and sewerage service provider in South Australia, there are other water and sewerage service providers in South Australia that provide services to customers. For the purpose of this Statement of Issues, the Commission will assume that the customer metering, billing and associated information requirements for these water entities are the same as those that apply to SA Water.

SA Water is responsible for metering customer's water consumption, billing and issuing the associated accounts. Accurate metering and billing systems are essential to ensure that customer's costs are in accordance with the services provided. As such, SA Water is responsible for the installation and maintenance of all domestic and commercial water and trade waste metering equipment in accordance with relevant Australian standards (for example, AS 3565 *Meters for cold and heated drinking and non-drinking water supplies*). SA Water also measures trade waste from businesses that are required to install an effluent flow meter as a condition of its trade waste discharge permit. These meters provide accurate information regarding the rate, and volume of discharge to the sewer.

It is noted that a single meter is generally installed at a property even when there is more than one "customer" at that property. For example, one meter is generally provided to measure the total water consumption in multi-story buildings, in retirement villages or for properties with multiple tenants. Such metering arrangements, where the total cost is

divided between the customers at that connection point may not be equitable. Clearly this raises a number of issues with respect to the water metering requirements for such “inset networks”.

For the South Australian gas and electricity supply industries the Commission has prepared detailed metering codes which the gas and electricity distributors, retailers and persons exempt from holding a licence are required to comply with. One of the key requirements of those codes is an obligation that requires the person responsible for the metering installation to prepare a Meter Testing and Maintenance Plan. Such plans provide an overview of the systems, procedures and processes that the responsible person has put in place to ensure compliance with the requirements of the codes.

It appears that no such regulatory requirements apply to the water industry in any Australian jurisdiction. The Commission notes that the “*Customer Service Code – Metropolitan Retail and Regional Water Businesses*” published by the Essential Services Commission of Victoria includes a number of consumer protection requirements associated with reading water meters, billing and dispute resolution. The key code requirements with respect to metering are detailed below:

- ▲ water businesses must use reasonable endeavours to ensure that all customers’ water meters have an actual meter reading every billing cycle, or otherwise at least once every 12 months;
- ▲ special meter readings at the request of customers must be provided at reasonable cost to the customer;
- ▲ the billing cycle should be at least quarterly, unless otherwise approved by the Essential Services Commission.

Although the Victorian code contains very limited information with respect to actual water and waste water metering, the code is quite prescriptive in the area of customer billing, payments and payment difficulties.

The proposed changes in the South Australian water regulatory environment raises a number of issues with respect to the provision of metering services.

*Issue 19.*

*Should the Commission develop a Water Metering Code? That is, specify the requirements for services such as :*

- the provision of metering installation, meter reading and the associated data services;*
- meter certification, accuracy and testing;*
- meter reading, data validation and substitution; and*

*- the requirements of a Water Measurement Management Plan?*

*Is the metering information currently available from SA Water adequate for customers?  
If not, what additional information should be provided to customers?*

*Should all customers have a separate (individual) water meter?;*

*If it is thought desirable for all customers to have an individual water meter then it is important to determine who should be responsible for installing the meter, reading the meter and issuing the bills, including who should pay?*

## 6 PERFORMANCE MONITORING

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As noted in Chapter 3, one of the purposes of the Bill is to provide for performance monitoring of the water industry. The Bill requires water industry entities to monitor and report as required by the Commission on indicators of service performance determined by the Commission.

### 6.1 Performance reporting framework principles

Performance monitoring and reporting is a useful tool for:

- ▲ informing customers about the level of service they are receiving and identifying reasons for performance;
- ▲ comparing businesses by gauging relative performance within an industry (comparative competition) or with businesses performing comparable operations in other industries;
- ▲ identifying baseline performance of individual businesses and providing incentives for improvement;
- ▲ providing information and data for developing regulatory standards (or targets) where required and for ongoing assessment of compliance with such standards; and
- ▲ informing the decision making processes of regulatory agencies, water businesses and the government.

There is a potentially unlimited amount of information that could be collected, however, only a subset is critical to the Commission's performance monitoring function. The collection and reporting of data is a cost to the entity (albeit marginal if the entity is already collecting it for its own monitoring purposes). Analysing, verifying and reporting the data is also a cost to the Commission. Ultimately, good regulatory practice requires that the only information collected is that which relevant and useful to the regulator and/or other participants.

*Issue 20.*

*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 business;*
- *performance indicators need to be meaningful and relate to key issues of importance to both businesses and their customers;*

*- performance indicators need to be defined and collected on a consistent basis across businesses 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.*

*What, if any, additional principles should guide the development of a performance reporting framework to apply to licensed water entities?*

## **6.2 Performance monitoring regime**

The performance monitoring regime will be targeted at monitoring performance of the water entities in meeting technical and customer service standards contained in a water retail services industry code. As a consequence, the measures to be monitored are dictated by those ultimately adopted in a water retail services industry code, as discussed elsewhere in this Statement of Issues.

The Commission has developed an effective performance monitoring regime for the energy industry. A key aspect of this is the development of reporting Guidelines (including definition of terms) to ensure consistency in the quality of the data collected and reported by the entities.<sup>63</sup> The development of such guidelines for water would follow finalisation of the relevant industry code.

The Commission's reporting of such performance is also important. The process adopted by the Commission in some of the other industries it regulates has been to release an Annual Performance Report,<sup>64</sup> supplemented by ad hoc reports released to respond to any significant events occurring throughout the year. Subject to stakeholder comment, the Commission intends to adopt this approach for reporting on the performance of the water entities it regulates.

Regulatory audits will be conducted to complement the performance reporting framework and provide independent assurance that key service obligations are being met, and that accurate and reliable information is being reported.

<sup>63</sup> For example, refer *Energy Retailer Operational Performance Information, Energy Industry Guideline No.2, EG2/03, July 2004 (As last varied on 1 July 2010)* located at: [http://www.escosa.sa.gov.au/library/100618-EnergyIndustryGuidelineNo2-V2\\_03.pdf](http://www.escosa.sa.gov.au/library/100618-EnergyIndustryGuidelineNo2-V2_03.pdf)

<sup>64</sup> Refer *2009/10 Annual Performance Report, South Australian Energy Supply Industry*, available from the Commission's website at [http://www.escosa.sa.gov.au/library/101124-AnnualPerformanceReport\\_2009-10.pdf](http://www.escosa.sa.gov.au/library/101124-AnnualPerformanceReport_2009-10.pdf)

It may be the case that SA Water has a broader collection of performance measures routinely reported compared to other water entities, as determined in the relevant industry codes, given the extent of its impact on most end use customers. If so, it may be appropriate to develop a separate guideline(s) for different water entities.

However, while it is important to allow for differences in the application of various performance measures, the Commission considers that it is appropriate for performance indicators to be consistent across all businesses at a broad level. In that context, the Commission notes that the National Performance Report (NPR) project, established as a part of the National Water Initiative, provides an appropriate basis upon which the Commission could establish broad level indicators. While the focus and purpose of the NPR is different to that of the Commission, with the NPR focussed on performance comparison between utilities across jurisdictions and the Commission focussed on economic regulatory matters, nevertheless there is likely to be sufficient commonality so that efficiency in performance monitoring can be achieved.<sup>65</sup>

*Issue 21.*

*Do stakeholders support the development of a comprehensive performance monitoring framework?*

*What sources of performance information should the Commission have regard to in developing the performance reporting framework? Are there any performance monitoring measures in addition to those identified in this Statement of Issues that warrant inclusion in the performance reporting framework?*

*Is annual reporting by the Commission on water entity performance, with ad hoc reports released to respond to any significant events, considered appropriate?*

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<sup>65</sup> For further detail on the National Performance Report process, refer the Water Services Association of Australia website at <https://www.wsaa.asn.au/Publications/Pages/PerformanceReports.aspx>

## 7 COMPLIANCE

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As previously noted, 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 clause 26(1)(a) of the Bill, each licence issued will include a condition requiring a water industry entity to comply with applicable industry codes or rules made by the Commission under Part 4 of the ESC Act. In addition, clause 26(1)(o) of the Bill requires that all, or part of, the services, operations or activities authorised by the licence are audited. The licensee is further required to report the results of such audits to the Commission.

In terms of enforcement, the Commission is given powers under the Bill 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, and take over licensed operations on specific grounds, including where a licensee contravenes legislation related to the licensed operations (it should be noted, however, that these powers do not extend to the licence proposed to be held by SA Water).

### ***7.1 How the Commission currently gives effect to its compliance role***

The Commission gives effect to its regulatory compliance role through a number of related actions. First, it is important that regulated entities are made aware of the regulatory obligations imposed on them and of the possible consequences of non-compliance. Secondly, compliance must be monitored, and a variety of strategies implemented to ensure that an effective monitoring regime is in place (e.g., regular compliance reporting by licensees). Finally, appropriate enforcement action must 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. A strong culture of compliance is likely to be consistent with protection of consumer interests, but it must not be such as to impose high levels of regulatory costs on regulated entities.

The Commission has sought to balance these needs through establishment of a collaborative compliance regime that:



- ▲ 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 wilful or systemic non-compliances 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).<sup>66</sup>

In summary, Guideline 4 establishes an exception 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 which meets the specifications of Australian Standard 3806 – Compliance Programs (AS - 3806).

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

- ▲ 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 by the licensee with applicable regulatory obligations during the relevant reporting period; and
- ▲ address the impact of such 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 procedure 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 is deemed by the Commission to require urgent reporting, and/or where the breach is of a material nature; and
- ▲ an annual compliance report relating to all applicable regulatory obligations for each year ending on 30 June.<sup>67</sup>

Immediate compliance reports must be signed by the licensee's Chief Executive Officer (CEO) or equivalent office holder, while annual compliance reports must be signed by

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<sup>66</sup> Guideline 4 may be accessed from the Commission's website at <http://www.escosa.sa.gov.au/library/100623-EnergyIndustryGuideline-V3.pdf>

<sup>67</sup> 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.



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).

Licencees 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 the relevant reporting period. From time to time, the Commission may also approve other sign-off arrangements in limited and exceptional circumstances.

Irrespective of the sign-off option selected, annual compliance reports must also 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.

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

- ▲ **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 SA 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 guidance on the criteria and processes it uses in determining the type of enforcement action required on a case-by-case basis.<sup>68</sup> In general terms, the exercise of the Commission's administrative process is the primary means of enforcement used by the Commission, with disciplinary and prosecutorial processes reserved for the more serious matters of non-compliance.

Finally, to assist it with its compliance and enforcement function, the Commission has statutory powers to request the production of information and documents from licencees under Part 5 of the ESC Act.

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

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<sup>68</sup> Essential Services Commission of SA, April 2009, Enforcement Policy, refer: <http://www.escosa.sa.gov.au/library/090402-EnforcementPolicy.pdf>.

## **7.2 SA Water**

The Commission understands that SA Water has established a legal compliance management system that is based on AS – 3806. Currently, SA Water is required to provide a legislative compliance report to the SA Water Board's Audit Committee twice a year. The report must summarise outcomes from each business unit within SA Water in terms of compliance (and non-compliance). In addition, reporting protocols have been established for incident based reporting and SA Water's internal audit function undertakes a review of its compliance management framework on a three year rotational basis.

## **7.3 Councils**

Local councils must comply with the relevant requirements of various legislative and regulatory obligations including, but not limited to, those set out in the Local Government Act 1999, Environmental Protection Act 1993 (EP Act), the Public and Environmental Health (Waste Control) Regulations 1995, Aquaculture Act 2001, Environment Protection Authority Guidelines for Wastewater and Evaporation Lagoons, Environment Protection (Water Quality) Policy 2003 and South Australian Reclaimed Water Guidelines, 1999.

The Commission does not have any information on the compliance frameworks Councils have in place but expects that some level of compliance reporting would be required. For example, the Commission is aware that some Councils that operate Community Wastewater Management Schemes are required to be licensed under the EP Act if they discharge waste into marine or inland waters and such licensees are required to provide Annual Returns to the Environmental Protection Authority.

## **7.4 Proposed compliance approach in the water industry**

It is clear to the Commission that there is a vast range of operations undertaken in South Australian by water entities of varying sizes, resources and capabilities. They do, however, all have to comply with various regulatory obligations. On this basis, the Commission is of the view that all water entities should be subject to a compliance regime.

However, a "one size fits all" approach to compliance may not deliver consumer protection at an appropriate level of regulatory cost to licensees. While the Commission is of the view that its current compliance framework should be applied to water industry entities such as SA Water which have established compliance programs, it may be unreasonable of the Commission to require the same level of compliance from small regional Councils that operate Community Wastewater Management Schemes which only service a small number of customers.

In the energy industry, the Commission takes a more light-handed approach to compliance with "off grid" licensees, 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 electricity network. For example, such licensees are only required to comply with a limited number of regulatory obligations and, as a result of



corporate structures, are not subject to the same sign off requirements.<sup>69</sup> This approach may be appropriate for the smaller entities operating in the water industry.

In terms of other jurisdictions, the compliance framework for the New South Wales water industries is very similar to the Commission's current approach. A standard condition of a licence is that the licensee must prepare and submit compliance reports in accordance with the applicable reporting manual. Where there is a breach that requires immediate notification, the licensees must inform the regulator (the Independent Pricing and Regulatory Tribunal) immediately. Licensees are required to submit an annual compliance report certifying that the licensee has complied with its licence obligations other than those identified in the report. The annual compliance report must be signed by the Chief Executive Officer (or equivalent) and the Chairman of the Board or a duly authorised Board member other than the CEO.

The key issues relating to the Commission's proposed compliance approach in the water industry are set out below.

*Issue 22.*

*Are there any aspects of the compliance regime that the Commission currently administers that would be problematic if implemented for all water industry entities? If so, how?*

*Should the Commission adopt a different compliance approach to licensees that provide limited retail services to only a small community or region? If so, to what extent?*

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<sup>69</sup> For example, remote area licensees providing retail services are only required to comply with the key customer protection obligations set out in the Energy Retail Code and Energy Distribution Code relating to billing, disconnections and special needs.

## 8 THE COMMISSION'S ROLE AS PRICE REGULATOR

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The remainder of this Statement of Issues relates to the final two aspects of the Treasurer's request for advice, which are:

- *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.*

The Commission interprets the Treasurer's request as relating specifically to advice on price regulation to be applied to the above services (hereafter referred to collectively as "retail services"), rather than economic regulation more broadly, which includes aspects of regulation that have been discussed previously in this Statement of Issues.

The Commission's consultation on the pricing of retail services in the water industry will provide a basis for developing its thinking on the key issues to be resolved in the Commission's first determination of SA Water's drinking water and sewerage prices, which is intended to apply from 1 July 2012. The Commission recognises that, in the absence of legislation, an initial pricing order, and other regulatory instruments, consideration of the many detailed issues that relate to price regulation is difficult. However, given that this will be the first independent determination of SA Water's prices, the Commission considers it important to commence public consultation on some of the key principles of water pricing as early as possible, to facilitate an informed decision making process.

The Commission's initial thoughts on the key issues surrounding price regulation of retail services are discussed in the following sections. Stakeholders are invited to comment on the key issues raised by the Commission, or any other key issues relating to price regulation in the water industry that the Commission should take into account in developing its advice to the Treasurer.

### **8.1 The Commission's power to make a price determination**

While the Commission has played a role in reviewing the Government's processes for setting SA Water's water and sewerage prices over several years, it has not had a direct role in the setting of water prices.



The Water Industry Bill will change the Commission's role, by applying the Commission's price regulation function under the ESC Act specifically to the water industry.

As discussed in Part A of this paper, the Commission is established as a general economic regulator under the ESC Act, with general powers under section 25 of the ESC Act to make a price determination for a “regulated industry”.

An industry Act must declare the industry to be a “regulated industry” for the purposes of the ESC Act, before the Commission’s price regulation powers are enlivened for that industry.

Section 17 of the proposed Water Industry Bill declares the water/sewerage industry to be a ‘regulated industry’ for the purposes of the ESC Act, and would therefore provide the Commission with the ability to make a price determination within the industry.

Section 36 of the Water Industry Bill grants the Commission the following power:

36(1)

*Subject to this section, the Commission may make a determination under the Essential Services Commission Act 2002 regulating prices, conditions relating to prices, and price-fixing factors for—*

- *retail services;*
- *other services prescribed by the regulations.*

Retail services are defined under the Water Industry Bill as a service constituted (in whole or in part) by:

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

*(b) the sale and supply of sewerage services for the removal of sewage, but does not include any service, or any service of a class, excluded from the ambit of this definition by the regulations;*

The Commission interprets this provision as allowing for price regulation to apply to retail services associated with the provision of:

- ▲ drinking water;
- ▲ domestic sewerage services;
- ▲ trade waste services;
- ▲ recycled water services, including stormwater reuse;
- ▲ other miscellaneous retail services and charges.

The above services may be provided by SA Water, other publicly-owned entities (e.g. council recycling schemes), and privately-owned suppliers/operators.

It does not extend to:

- ▲ water (including non-drinking water) that is not provided by a reticulated system;
- ▲ the supply of water infrastructure services where the water is not sold to a customer.

## **8.2 Matters the Commission must take into account**

In making a price determination, the Commission must have regard to its objectives under section 6 of the ESC Act, in particular its primary object to promote the long term interests of consumers of essential services with regard to price, quality and reliability of supply.

It must also have regard to the following matters set out in section 25(4) of the ESC Act:

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

In performing its price regulation function, the Water Industry Bill requires that, in addition to the requirements of section 25(4) of the ESC Act, the Commission must also:

- (a) comply with the requirements of any pricing order issued by the Treasurer under this section; and*
- (b) have regard to any exceptional or special circumstances applying to a particular water industry entity, or a particular group of water industry entities, as a result of decisions made or policies required or applied at the national level.*

The Water Industry Bill provides that the Treasurer may issue an order (a pricing order) that:

- (a) sets out any policies or other matters that the Commission must consider or take into account when making a determination contemplated by this section;*
- (b) specify various parameters, principles or factors that the Commission must adopt or apply in making a determination contemplated by this section;*

*(c) relates to any other matter that the Treasurer considers to be appropriate in the circumstances.*

The Water Industry Bill further provides that a pricing order:

*(a) takes effect on a date specified in the order; and*

*(b) cannot be varied (except as contemplated by the order) or revoked (but this paragraph does not prevent new pricing orders being made from time to time).*

*(c) has regard to NWI principles.*

In accordance with the Treasurer's terms of reference, the Commission's advice is to have regard to the NWI Pricing Principles. Those principles, which are summarised in Appendix 1, are discussed where relevant in the following sections.

### **8.3 Forms of price regulation**

The Commission's ability to make a price determination does not limit it to determining the maximum prices that a regulated business may charge. The Commission's power to "fix" a price is only one of several forms of price regulation that the Commission may apply under a price determination. Section 25(3) of the ESC Act specifies the range of regulatory approaches that the Commission can choose from, ranging from those that are not determinative in nature and are generally considered "light-handed" (e.g. price monitoring), to those that are considered more prescriptive or "heavy-handed" (e.g. price fixing).

Section 25(3) of the ESC Act provides that:

*A price determination may regulate prices, conditions relating to prices or price-fixing factors in a regulated industry in any manner the Commission considers appropriate, including—*

*(a) fixing a price or the rate of increase or decrease in a price;*

*(b) fixing a maximum price or maximum rate of increase or minimum rate of decrease in a maximum price;*

*(c) fixing an average price for specified goods or services or an average rate of increase or decrease in an average price;*

*(d) specifying pricing policies or principles;*

*(e) specifying an amount determined by reference to a general price index, the cost of production, a rate of return on assets employed or any other specified factor;*

*(f) specifying an amount determined by reference to quantity, location, period or other specified factor relevant to the supply of goods or services;*



*(g) fixing a maximum average revenue, or maximum rate of increase or minimum rate of decrease in maximum average revenue, in relation to specified goods or services;*

*(h) monitoring the price levels of specified goods and services.*

The ESC Act therefore allows the Commission to choose from a broad range of regulatory options when making a price determination. The Commission's decision on which of those options to apply must be made having regard to the Commission's statutory objectives.

The form of price regulation should be commensurate with the extent of the market failure which price regulation is intended to address. For example, for services where there is no scope for competition or bypass of the service, direct price controls may be appropriate. Where market power exists, but may be constrained due to the presence of limited competition, a lighter-handed form of price regulation may be appropriate.

Ultimately, the decision on which form of price regulation to apply should be based on maximising the net benefits of regulation. The decision to apply an intrusive, determinative form of price regulation should only be considered where the costs are offset by the benefits to consumers of that form of regulation.

#### **8.4 When should price regulation apply?**

It is important to note that while the Commission may have the power to regulate the price of any retail service, there are likely to be situations where it is not in the long-term interests of consumers for price regulation to apply, in any form.

As discussed previously, the extent to which price regulation should apply will primarily be determined by the extent of market failure. Price regulation is most commonly used to address the market failures arising from the existence of natural monopolies, where there is the potential for inefficient prices and/or service provision (e.g. through misuse of market power). The extent to which any operations exhibit natural monopoly characteristics, as opposed to there being scope for competition or bypass of that service, is an important consideration.

The existence of other regulation that may already address the market failure problem would also be considered by the Commission before deciding whether or not to apply price regulation. Where effective regulation already exists, whether it be through formal (legislative) means or less formal means, the imposition of additional price regulation by the Commission is unlikely to produce any additional net benefits.

The Commission notes that the Water for Good plan outlines the policy intention that price regulation only apply to SA Water's water and sewerage services in the first instance, but that a review of its application to other operators will need to occur at some point in the future, as the industry develops.

*Issue 23.*

*Are there any good reasons why the Commission shouldn't apply direct price controls to SA Water's drinking water and sewerage services?*

*What is the appropriate form of regulation for SA Water's other services?*

*Are there other providers of retail services for which price regulation of some form is required? If so, what form of price regulation should be applied?*

## 9 PRICE REGULATION OF DRINKING WATER AND SEWERAGE SERVICES

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Economic regulation of water utilities in Australia typically operates under an approach which has the following characteristics:

- ▲ The regulator establishes forecasts of efficient costs to be incurred by the business over the price path period (generally 3 to 5 years) and determines revenues/prices that will allow for the recovery of those efficient costs during the period.
- ▲ Revenues or prices are fixed during the period, and are only permitted to change under specified circumstances (e.g. where an event occurs outside the business' control that leads to a material change in costs). By keeping revenues/prices generally fixed, the business is provided with an incentive to incur costs that are below the cost forecasts determined by the regulator, as it is able to retain the amount of underspend for the remainder of the price path period (or a longer period, depending on the incentive mechanisms established by the regulator). By ensuring that prices do not simply follow actual costs, there is an incentive for the business to become more efficient over time.
- ▲ Importantly, there is an expectation that any efficiency improvements will ultimately be shared with customers. This is generally achieved by setting cost forecasts for the next price path period that are based, in part, on the efficiency gains made in the previous period.

The implication of the approach described above is that the regulator does not dictate how expenditure should be incurred once the price path is set. Indeed, there is an incentive for the business to reduce or defer expenditure during the period. While the cost forecasts may incorporate expectations about certain projects being undertaken, there is no requirement for the business to actually undertake them, provided that the business continues to achieve the regulatory obligations and service standards set by the regulator.

Regulation of this form can only work effectively where there are clear, binding service standards. An effective service standard framework is critical for the success of price regulation, as it ensures that services that are valued by customers are not compromised by the incentive for the business to continually reduce costs.

Economic regulation of this type generally works best during a stable environment, where past expenditure and performance can provide a useful guide to future expenditure and performance. In an environment where expectations of the outcomes to be achieved by the business are changing, and where significant new investment is required, it becomes more difficult to apply price regulation that is based on creating incentives for increased efficiency. The environment in which SA Water operates may be considered as relatively unstable at present, given the heightened focus on achieving greater water security, and the significant capital program that is being undertaken as a result.

*Issue 24.*

*A key issue for the Commission is whether or not the typical approach used by Australian regulators should be applied to SA Water, in the current context of significant increases in capital expenditure intended to increase the security of water supply in South Australia.*

## **9.1 The “building-blocks” approach**

For drinking water and sewerage services, price regulation is guided by the NWI, and is analogous to the building block methodology commonly applied to regulated utilities for the determination of their revenue requirements.

The pricing principles require that prices be set to achieve full cost recovery. This involves consideration of what should be included in the definition of full cost recovery.

The Expert Group on Asset Valuation Methods and Cost-Recovery Definitions for the Australian Water Industry (Expert Group) define full economic costs as:

- ▲ operating and maintenance expenses; plus
- ▲ administrative costs; plus
- ▲ externalities; plus
- ▲ depreciation on a replacement cost basis; plus
- ▲ the opportunity cost of capital.

The important feature of this definition is an acknowledgement that the appropriate revenue requirement for the achievement of full cost recovery is the ‘economic cost’ as compared to the ‘accounting costs’. This represented a significant departure from existing price setting practices at that time in the water industry.

In order to determine each of the cost “building blocks” described above, utility regulators generally adopt the following process:

- ▲ ensure that the service standards to apply during the price control period are established, to provide a basis for forecasting future expenditure (refer to section 5.5);
- ▲ determine a form of control to apply during the period (e.g. revenue cap, price cap or hybrid);
- ▲ establish forecasts of demand, which impact on expenditure forecasts and prices;
- ▲ assess the utility's proposed capital and operating expenditure for the price control period, to ensure that it is prudent and efficient;
- ▲ determine a return on assets and a return of assets (regulatory depreciation), along with an allowance for tax liabilities (or tax equivalent payments);

- ▲ determine an aggregate revenue amount to recover the efficient costs over the period, and set a price path to ensure the recovery of the aggregate revenue.

### 9.1.1 Establishing forecasts of demand

As discussed, the importance of demand forecasts will depend on the form of control. However, irrespective of the control chosen, forecasts of the volume of water to be sold and the number of connection points are necessary inputs to enabling a water business to determine expenditure that is required to support the delivery of the prescribed services over the regulatory period.

This section sets out the Commission's preliminary views on the key issues relating to the establishment of demand forecasts.

#### Importance of demand forecasts

Under the various forms of price regulation the Commission has at its disposal under section 25(3) of the ESC Act, demand forecasts will impact the following:

- ▲ operating cost – cost structure of the water business and the extent of the fixed/variable and volume/customer dependent components;
- ▲ capital costs – primary driver of the requirement for new investment (e.g. new connection points and augmented reticulation system);
- ▲ revenue and prices – allowing full-recovery of the costs incurred in the provision of prescribed services;
- ▲ risk management – planning to meet supply continuity and service standards imposed.

#### Key drivers of demand forecasts

There are numerous factors that can either directly or indirectly affect water demand. For the purpose of this Statement of Issues, the Commission has categorised those factors into the following broad categories:

- ▲ price – the effect of tariffs and tariff structures;
- ▲ weather – rainfall and climate change;
- ▲ demographics – population and residential development;
- ▲ water usage practices – government policies (e.g. water restrictions and recycling targets);
- ▲ technological innovation – greater water efficiency appliances; and
- ▲ source substitute – greater use of recycled water or an uplift in the installation of rainwater tanks.

*Issue 25.*

*The Commission requests comments on these key drivers and any other drivers that are influencing water demand in South Australia.*

*Principles for developing demand forecasts*

There is no specific guidance under the ESC Act, Water Industry Bill or NWI as to what form of forecasting methodology should be employed by a water business to develop demand forecasts. Nevertheless, the Commission expects that those forecasts should be developed based on a set of best practice principles. The Commission considers best practice demand forecasting to address the following matters:

- ▲ free from statistical bias;
- ▲ recognise and reflect key drivers of demand;
- ▲ based on sound assumptions using the best available information;
- ▲ consistent with other available forecasts and methodologies;
- ▲ based upon the most recently available data;
- ▲ reflect to the particular situation and the nature of the market for services; and
- ▲ based upon sound and robust accounts of current market conditions and future prospects.

*Issue 26.*

*In what form should demand forecast information be sought, having regard to the key drivers of demand (e.g. by customer group, by geographic basis)?*

*Is there a need to differentiate between average demand and peak demand, given that peak water demand impacts on the capacity requirements of the network infrastructure?*

### 9.1.2 Assessing efficient business costs

Efficient business costs are described in the 1994 CoAG Strategic Framework as being:

... the minimum costs that would be incurred by an organisation in providing a specific service to a specific customer or group of customers. Efficient business costs will be less than actual costs if the organisation is not operating as efficiently as possible.<sup>70</sup>

Principle 1 of the NWI principles for urban water tariffs relates to efficient levels of cost recovery and associated tariff structures. Paragraph 9 states that:

*Water business should be moving to recover efficient costs consistent with the National Water Initiative (NWI) definition of the upper revenue bound: 'to avoid monopoly rents, a water business should not recover more than the operational, maintenance and administrative costs, externalities, taxes or tax equivalent regimes, provision for the cost of asset consumption and cost of capital, the latter being calculated using a Weighted Average Cost of Capital (WACC)'.<sup>71</sup>*

The 1994 principles included a clear statement of the need to demonstrate efficient business costs. Added to this, clause 65 of the NWI, and Principle 1 for Urban Water Tariffs reaffirm the aim that water pricing should achieve various outcomes, such as avoiding monopoly rents. It is thus important that the information presented to the regulator on efficient business costs not only addresses these costs but does so in a manner which enables the regulator to conclude that the costs so included are efficient.

The Commission also notes that clause 75 of the NWI requires jurisdictions to report independently, publicly and on an annual basis, benchmarking of pricing and service quality for urban drinking water and sewerage service providers.

The Commission notes that the NWI pricing principles for recovering capital expenditure do not directly address the issue of the efficiency of capital expenditure forecasts, other than in paragraph 19 which provides that the Regulatory Asset Base (RAB) should only reflect "prudent" capital expenditure:

*The RAB comprising prudent new investments and legacy investments should be rolled forward each year in accordance with the following formula, which can be expressed in nominal or real terms:*

$$RAB_t = (RAB_{t-1} + Prudent\ Capital\ Expenditure_t - Depreciation_t - Disposal_t \text{ (discarded assets)}).$$

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<sup>70</sup> Refer to NCC website: <http://ncc.ncc.gov.au/docs/PIAg-001.pdf> pg 113

<sup>71</sup> Refer endorsed NWI Pricing Principles, page 10, available at: <http://www.environment.gov.au/water/publications/action/pubs/nwi-pricing-principles.pdf>

(Where  $t$  = the year under consideration).<sup>72</sup>

The Commission considers prudent capital expenditure to be capital expenditure that is required in order to meet the business' requirements, in accordance with good industry practice. The concept of “prudent” capital expenditure relates to the decision as to whether or not a capital project should be undertaken. If it is established that a capital project is prudent, determining the efficient cost of that project is the next step.

The efficiency of business costs (including both operating and capital expenditure) can be assessed in terms of:

- ▲ levels of expenditure;
- ▲ the creation and consumption of assets; and
- ▲ impacts on service levels.

One of the key reasons for considering the efficiency of business costs is to provide a foundation for explaining and justifying future actions and requirements. Particularly in the case of pricing proposals, it is necessary to establish a logical link between past performance, the factors influencing that performance and where the expected combination of movements in cost pressures/opportunities and management action will place the utility in the future. It is this future scenario that should be considered when assessing the level of revenue required from the pricing decisions.

The long asset life of the infrastructure employed in delivering drinking water and sewerage services means that improvements in capital performance can take a long time to achieve, and are seldom considerations in short-term management decisions. However, particularly as infrastructure assets age, it may be reasonable to expect to observe longer term relationships emerging between the level of operational expenditure and capital-based costs.

Performance comparison of the achievements by peer water service providers in recent years (both in terms of absolute cost levels as well as changes in costs) can provide useful insight into what constitutes efficient business costs. Performance comparison and benchmarking can also assist in identifying possible future cost pressures.

While SA Water will be required to prepare information in sufficient detail to enable the Commission to analyse the efficiency of forecast business costs, the Commission is also mindful of the need to minimise the burden of information

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<sup>72</sup> Refer endorsed NWI Pricing Principles, page 8, available at: <http://www.environment.gov.au/water/publications/action/pubs/nwi-pricing-principles.pdf> pg 8



provision where possible. In attempting to strike an appropriate balance between these objectives, regulators may choose to focus on:

- ▲ the key drivers of expenditure forecasts, rather than all drivers;
- ▲ assessing the costs of only major capital projects (above a predetermined threshold cost), rather than all projects;
- ▲ the business' internal reporting categories wherever possible;
- ▲ the extent to which forecast costs are determined by outsourcing arrangements resulting from competitive tender processes, which may reduce or eliminate the need to impose detailed scrutiny of the underlying costs; and
- ▲ the existence of other processes that may provide assurances that the proposed expenditure is efficient.

In relation to the final point above, the Commission notes that SA Water must comply with the South Australian Government's financial management requirements and that its proposed expenditure is subject to the State Budget process. In addition, the following checks and balances apply in relation to major capital projects:

- ▲ for projects over \$1.1m (including GST), approval from the Minister or Cabinet is required;
- ▲ for projects over \$4m, the project must be scrutinised by the Public Works Committee established under the South Australian Parliament; and
- ▲ for projects over \$11m, approval from the Cabinet is required.

*Issue 27.*

*How can the Commission best balance the need to undertake sufficiently robust scrutiny of business costs with the need to avoid undue reporting requirements on SA Water?*

The Commission is likely to assess costs associated with routine activities differently to those associated with non-routine activities. In particular, the following questions are relevant:

For non-routine activities (e.g. major construction projects):

- ▲ Is there a need to do something?
- ▲ Is there a need to do something now?
- ▲ Have all potential solutions been considered in selecting the preferred option (e.g. can the output be achieved with an innovative solution) ?

- ▲ Has the selected option been properly costed (e.g. by reference to external market)?
- ▲ Is the project achievable, given the business' available resources?

For routine activities:

- ▲ Do past cost trends provide an indication of future costs?
- ▲ Do external benchmarks form an appropriate basis for assessing efficiency (e.g. are corporate costs efficient when compared to organisations of a similar size/function) ?
- ▲ Are asset management activities optimised?
- ▲ Do contracting strategies drive efficient behaviour (e.g. alignment of contractors incentives to business incentives, driving appropriate behaviour) ?
- ▲ Are year on year efficiencies included in plans, to reflect improved productivity/improved technologies/optimisation of organisational design?
- ▲ What other factors are impacting on costs going forward (e.g. real price assumptions on materials and labour)?

*Issue 28.*

*What other factors should the Commission consider relevant in assessing whether forecast costs are both prudent and efficient?*

*How can SA Water best demonstrate that its expenditure forecasts are efficient?*

### *SA Water Metropolitan Adelaide Service Delivery Contract*

SA Water is currently going through a process to let a new service delivery contract for Metropolitan Adelaide, to commence from July 2011. Given that this contract covers many of the activities in maintaining drinking water and sewerage assets for metropolitan Adelaide, it is important that the efficiency of the arrangements are appropriately tested. It is proposed to carry out testing of the contract at two levels, as follows:

- ▲ use of a specialist procurement consultant to assess the terms and structure of the contract (including risk allocation between SA Water and the contractor), and the process followed in letting the contract; and
- ▲ a compliance audit of the handoffs between SA Water and the contractor, to assess efficiency in operating the contract.

*Issue 29.*

*Are the proposed measures appropriate to test the efficiency of the Metropolitan Adelaide Service Delivery Contract?*

*Supply mix –increased reliance on desalinated water*

Given recent drought conditions and the prospect of having fewer rainfall dependent water sources, many States have put increased reliance on desalination plants as a means of managing water security.

In South Australia, the State Government has decided to construct the Adelaide Desalination Plant (ADP) at Pt. Stanvac in order to ensure future drinking water supplies to metropolitan Adelaide. The ADP is scheduled to be commissioned in April 2011, and is planned to be fully operational, with a 100GL capacity, by December 2012. Once operational, the number of water supply options for Adelaide will increase.

It is generally accepted that desalinated water is more expensive to produce than other sources of drinking water. However, desalination plants are more efficient when run continuously as base load, and are not well suited to stop/start operations.

Consideration must therefore be given as to how to ensure optimal use of the desalination plant, given the other available sources of water.

*Issue 30.*

*How can the Commission be assured that the drinking water supply mix is optimised, given the additional supply resource of the Adelaide Desalination Plant?*

*Dealing with uncertainty*

In setting a four year price control, issues exist over how to deal with uncertainty or unforeseen events, which may lead to a material change in SA Water's costs relative to those forecast. To address this possibility, regulators typically incorporate pass-through provisions into a price determination, which allows the regulated business the opportunity to have a pass through amount incorporated into the price path, subject to the approval of the regulator. In order to maintain the appropriate incentives for efficiency, it is generally the case that the types of pass through events are predetermined and are caused by factors that are outside the business' control. Allowing for a pass through of costs arising from an event within the business' control would lead to consumers facing the risk of such an event, even though that risk is best able to be managed by the business.

Other options for addressing uncertainty include incorporating actual capital expenditure in the RAB at the time of the next price review, so that the risk of incurring materially different capital expenditure is only faced during the price path period. The decision to simply “roll-in” actual capital expenditure, as opposed to including only the capital expenditure that is deemed to be prudent and efficient (discussed in the following section), will depend on the extent to which the business has a sufficient incentive to incur efficient capital expenditure.

Finally, where circumstances change such that the basis of the entire price path is undermined, regulators may have the ability to re-open the price determination and make a new determination.

*Issue 31.*

*How should uncertainties associated with material unforeseen events be addressed?*

*Ex-post analysis of investment*

It is intended to collect historical actual information for a number of years as part of the price review process. This will allow analysis of expenditure trends over time, and is particularly useful in comparing trends of actual and planned expenditure.

There is also the potential to analyse historical investment, with a view to considering whether actual investments were both prudent and efficient. Care must be taken with such analysis to ensure that up to date information is not used to rationalise decisions that were made at some point in the past based on different information. Nevertheless, some utility regulators undertake such a review to ensure that customers are not paying for inefficient investment decisions taken in the past. This is typically done by disallowing from the RAB any investment or part of an investment that is considered to be inefficient.

*Issue 32.*

*Should consideration be given to assessing and potentially disallowing historic investment as part of this review process? Over what past period should any such assessment cover?*

*Scope for productivity improvements*

As with any business, water utilities should constantly be looking to drive productivity improvements through a range of initiatives and techniques (e.g. deploying new technology, adopting new operational techniques, sharing best practice, optimising business structures). This will typically drive incremental improvements in controllable costs.

Where the scope for productivity gains exists, consideration must be given as to how best to drive costs to an efficient level and over what time period businesses should be expected to make these savings.

Benchmarking productivity against companies of similar scope and scale can be useful in identifying those areas where the scope for productivity gains is greatest.

*Issue 33.*

*What information can the Commission draw upon to assess the productivity of SA Water relative to its peers? Over what period should any identified 'performance gap' be closed?*

### 9.1.3 Asset related charges

As discussed earlier, Section A of the April 2010 NWI Pricing Principles addressed the determination of asset related charges, which encompasses:

- ▲ determining the value of existing assets;
- ▲ determining the methodology for including new assets into the Regulated Asset Base (RAB), and updating the asset value over time;
- ▲ allowing for a return of the investment, either through an annuity charge or a depreciation charge;
- ▲ earning a return on the investment; and
- ▲ the treatment of assets that are funded by contributions from customers or from Governments.

#### Initial asset value

The Commission expects the Treasurer's Initial Pricing Order to establish the value of SA Water's initial asset base, with the Commission's task then being to roll forward the initial asset base to reflect regulatory depreciation, additions, disposals, and inflation.

The Commission notes that previous SA Water pricing decisions by the Government have been based on an initial asset value derived using a depreciated replacement cost approach, which is consistent with the requirements of Section A of the April 2010 NWI Pricing Principles.

#### Regulatory rate of return

The NWI pricing principles promote the recovery of the full economic cost of providing the service, which includes the opportunity cost of capital provided.

The regulatory rate of return is intended to provide investors (public or private) with sufficient motivation to invest in the business and attract the capital away from alternative investments. In this sense, the regulatory rate of return should reflect an opportunity cost of capital – the return on capital available to investors in the next-best investment opportunities, adjusted for the relative risk of the projects.

Utility regulators generally derive the rate of return through a Weighted Average Cost of Capital (WACC), which includes allowances for both the cost of equity and the cost of debt. The cost of equity is typically derived using the Capital Asset Pricing Model (CAPM), which is designed primarily for the purposes of valuing assets, although it is commonly used by regulators in Australia and the UK for deriving the equity component of the regulatory rate of return. This approach is consistent with Principle 1 of the NWI Pricing Principles, which promotes the use of WACC and CAPM.

SA Water's prices are currently set by the State Government using the following rates of return:

- ▲ for new and replacement assets, a 6% real pre tax real rate of return;
- ▲ for legacy water assets, a 3.1% real pre-tax rate of return; and
- ▲ for legacy sewerage assets, a 7.2% real pre-tax rate of return.

The application of different rates of return for new assets and legacy assets is permitted under the NWI pricing principles, which allows for a "line in the sand" to be drawn on historic rates of return. It recognises that, where past returns have been below the full regulatory rate of return, the pricing impact of moving to a full rate of return for the existing asset base would be undesirable. It therefore encourages prices that reflect the full regulatory rate of return on capital expenditure incurred past a legacy date (30 June 2006 in South Australia), while allowing pre-legacy date assets to continue to earn the historic return.

For SA Water, the historic return on water assets is significantly lower than its stated regulatory rate of return of 6%, while the return on sewerage assets is above the stated regulatory rate of return.

#### 9.1.4 Determining drinking water and sewerage prices

Price regulation of drinking water and sewerage services provided by major urban and rural water utilities in Australia typically involves implementing price or revenue limits that are reviewed over a defined period. Such prices or revenues will be derived to ensure the recovery of efficient costs.

Climate change, and indeed, more variable short to medium term rainfall levels have impacted upon water availability, leading to restrictions or permanent water conservation measures in many areas. As discussed earlier in this Chapter, the

NWI promotes more efficient pricing as a means of addressing water scarcity, by providing appropriate signals to customers about the cost of providing water.

The vast majority of water utilities in Australia have prices based on a two-part tariff<sup>73</sup>, comprising a fixed element and a variable element related to usage. This variable element ordinarily comprises the bulk of the annual charge to customers. Sewerage tariffs typically consist of a single fixed charge.<sup>74</sup> Typically, water prices have been rising in recent years, largely reflecting investment levels.

### SA Water - current pricing

From 1 July 2010, SA Water increased drinking water prices by 21.7% on average in real terms. Metropolitan sewerage charges rose by 0.8% and country sewerage charges rose by 1.3%. The drinking water price increase reflects the Government's commitment to South Australia's future water security by the:

- ▲ expansion of the capacity of the Adelaide Desalination Plant (ADP), to 100GL per year;
- ▲ Network Water Security Programme, aimed at improving connectivity between the northern and southern metropolitan water supply systems;
- ▲ purchase of water from the River Murray, to ensure the minimum supply of water required for critical human needs; and
- ▲ introduction of rebate systems, to encourage the purchase of water efficient products.

The price structures for residential customers are shown below.

**Table 9.1: 2010-11 Water Prices for Residential Customers**

| COMPONENT                         | 2009-10   | 2010-11   |
|-----------------------------------|-----------|-----------|
| WATER SERVICE AVAILABILITY        | \$137.60  | \$142.40  |
| WATER USAGE                       |           |           |
| - TIER 1 (0 – 30 KL PER QUARTER)  | \$0.97/KL | \$1.28/KL |
| - TIER 2 (30 -130 KL PER QUARTER) | \$1.88/KL | \$2.48/KL |
| - TIER 3* > 130KL PER QUARTER     | \$2.26/KL | \$2.98/KL |

\* - single residential dwellings only

SA Water has two categories of non-residential customers:

- ▲ commercial customers, including retail, wholesale, finance and insurance;

<sup>73</sup> 40 out of 61 utilities in Australia operate a two part inclining block tariff, the number of blocks varying between 2 and 11. WA being the only jurisdiction with more than 3 inclining blocks

<sup>74</sup> In 2008-09 53 out of 58 water utilities reporting in the NPR, had a single usage sewerage charge. 5 utilities operated a volumetric charge, with one abandoning this for 2009-10.

- ▲ other non-residential customers, including industrial and rural customers, hospitals and hotels.

The water price structure for commercial customers comprises a service charge, based on property value, and a two tier water usage charge, which is at the same levels and rates as for residential customers above. Other non-residential customers have a fixed service availability charge, and, again, the same two tier usage charge structure as above.

### *Drinking water price structures*

As discussed earlier, SA Water's current water prices consist of two elements:

- ▲ a fixed (supply) charge; and
- ▲ a volumetric (water usage) price, which rises with consumption under a three-tier inclining block structure.

One of the pricing related actions under Water for Good is the transition towards a single drinking water volumetric price for SA Water customers reflecting the long-run marginal cost (LRMC)<sup>75</sup> of supply on the basis that it provides the most economically efficient water use signal to customers. This action is consistent with the NWI Pricing Principles, although the Pricing Principles note water use prices may include more than one tier for policy reasons, but where more than one tier is adopted, prices should have regard to the LRMC of supply to promote sustainable water use.

Inclining block tariffs have commonly been adopted in the electricity and water industries, mainly as a demand management tool. Inclining block tariffs are designed to discourage high levels of consumption (particularly for discretionary purposes) by charging higher prices as consumption increases. Inclining block tariffs have also been justified as a means of protecting low-income consumers on the basis that they are more likely to use less water, although the relationship between income and water use can vary between consumers.

The fixed (supply) charge for water is important to ensure sufficient revenue is raised to fund efficient operating costs and investments. SA Water sets different supply charges for residential and non-residential customers. For all commercial customers, the proposed fixed charge is based on a percentage of property value.

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<sup>75</sup> The LRMC is an estimate of the long-run incremental cost of providing an additional unit of water or sewerage service, including the capital costs (in many cases) of the infrastructure required to deliver that service. In theory, setting volumetric water and sewerage prices at LRMC signals to consumers the cost incurred in providing the next unit consumed (opportunity cost) and, combined with a fixed charge, should result in a reasonably efficient level of consumption and sufficient revenue for the water utility. (Productivity Commission Issues Paper, Australia's Urban Water Sector, September 2010).



Water for Good announces a transition over the next five years towards the supply charge element of water bills being based upon size and number of meters (meters controlling the flow rate). This method is currently used in NSW, WA and NT and is designed to provide a better signal to customers of the fixed costs associated with their own capacity requirements.

The Commission does not intend to implement such a change for its first price determination, although it will examine the merits of such an approach prior to the commencement of the following price path period.

*Issue 34.*

*Views are sought on the appropriate tariff structure for SA Water drinking water charges.*

### Statewide pricing

Uniform water prices apply to SA Water's urban and regional customers through application of a state-wide pricing policy. Water for Good provides continued support for regional communities using SA Water's networks through state-wide pricing. The Government's 2010-11 pricing decision also confirmed continuation of its state-wide uniform pricing policy. Given higher costs in many regional areas, water and sewerage services are provided to many regional customers at less than total economic cost. Full cost recovery, and thus compliance with the NWI, has been achieved via transparently reported CSO payments. Drinking water and sewerage are essential services, and, as such, universal and affordable access is an important policy objective.

*Issue 35.*

*The Commission requests comments on issues surrounding universal access and how the requirement for cost reflective pricing and transparency can be best applied and reconciled with statewide pricing.*

### Low income households

The move towards cost reflective prices may need to be accompanied by measures to alleviate the impact of price increases on low income households.

Water policy issues will be considered separately to those of pricing, and are likely to be best met by targeted benefits. This distinction becomes increasingly important in a water market open to competition.

*Issue 36.*

*The Commission requests views on the issues surrounding protection of low income households during transitional moves to cost reflective pricing.*

*Sewerage prices*

In SA, for the vast majority of customers (residential and business), sewerage prices are currently based on property values (i.e. there is no volumetric component).

The very largest trade waste customers are metered (as discussed later). The costs of metering all sewerage customers would be significant.

Alternative arrangements for establishing sewerage prices exist, such as basing sewerage charges on the amount of water used by a customer. However, there are difficulties of using water usage as a proxy for sewerage use, although the recent sewerage price determination in Victoria did attempt to do this.

*Issue 37.*

*The Commission seeks views on the pricing of sewerage services along with the potential to more closely align pricing with usage moving forward.*

## **9.2 Other providers of drinking water and sewerage retail services**

The provision of drinking water and sewerage services in South Australia is regulated by multiple legislations. The principal legislations that relate to the safety of drinking water in South Australia are the *Food Act 2001* (Food Act) and *Food Regulations 2002* (Food Regulations). The Department of Health is the principal government agency responsible for working with drinking water suppliers to ensure that the water supplied is safe and suitable for human consumption. The principal legislation that relates to the provision of non-SA Water sewerage services is the *Public and Environmental Health Act (Waste Control Regulations) 1995* (Waste Control Regulations). It is estimated that around one third of South Australians are serviced by sewerage systems administered under this legislation.

In terms of drinking water, it is estimated that there are around 500 suppliers (non-SA Water) in South Australia. The majority of those suppliers are typically small in scale and are made up of small businesses such as bed and breakfast accommodations and caravan parks. Larger scale operations are those operated by councils or other third parties in regional South Australia. For example, the District Council of Coober Pedy

supplies drinking water to the township by producing and reticulating water that is piped in via an underground pipeline from a bore located 24 kilometres north of the township.

In terms of sewerage services, approximately 10% of South Australians are serviced via 172 individual Community Wastewater Management System (CWMS) schemes operated by 45 different local councils. A CWMS is a system designed to collect, treat, re-use and/or dispose of primary treated effluent from septic tanks on individual properties, with the collection system being made up of a network of pipes and pumping stations which transport the effluent from the septic tanks to the treatment site. The average size of a CWMS scheme is around 400 connections.

While it is evident that market power exists in instances where a township has few or no alternatives in their suppliers of drinking water and sewerage services, the Commission recognises that the majority of those operations are focused on meeting community service obligations, as opposed to earning a commercial rate of return. Indeed, a CWMS paper released by the Local Government Association in August 2006 drew attention to the lack of financial sustainability of most of the CWMS schemes operating in South Australia, recommending that councils seriously consider implementing a sustainable pricing regime.<sup>76</sup>

Further, the fragmented nature of both the drinking water and sewerage services industry precludes any single clear preferred form of economic regulation.

*Issue 38.*

*Having regard to the fragmented nature of both the drinking water and sewerage services industry, and issues such as Community Service Obligations, the Commission seeks comments on the most appropriate form of price regulation (if any) that should be applied to water retail services in South Australia.*

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<sup>76</sup> Local Government Association of South Australia (2006), *Community Wastewater Management Systems (CWMS) – Management Options*, August 2006.

## 10 REGULATION OF NON-DRINKING WATER PRICES

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### 10.1 Trade waste

The Water for Good Plan defines trade waste as the liquid waste from any industry, business, trade or manufacturing premise, other than domestic sewage, which is disposed of to the sewer. Broadly speaking, there are two types of trade waste – commercial trade waste and industrial trade waste. The former is typically generated from small businesses such as restaurants and dry-cleaners and the latter is generated from industrial users such as metal finishers and chemical manufacturers. It is estimated that trade waste makes up 25% of the sewer flow throughout metropolitan Adelaide.

Under the current arrangement in South Australia, SA Water administers the *Wastewater Act 1929* on behalf of the South Australian Government and is responsible for the collection, treatment and disposal of trade waste. In terms of inflows, any business that generates and discharges trade waste into the sewerage system is required to be issued with a discharge permit from SA Water, who is then responsible for conducting regular compliance audits to ensure any discharged trade waste is in accordance with the conditions of the permit. In terms of outflows, SA Water must ensure that any treated effluent meets standards set by the Environment Protection Agency (EPA), prior to it being reused for irrigation or returned to the environment.

SA Water's trade waste charges are currently set in accordance with a range of parameters, namely: volume, biochemical oxygen demand (BOD), total dissolved solids (TDS) and suspended solids (SS). In addition to those charges, there are also a number of other fixed charges associated with application for the discharge permit and the compliance audit.

Although the sewerage system operated by SA Water is an asset with monopolistic characteristics, the Commission recognises that there are alternatives available to businesses in relation to trade waste discharge (e.g. on-site treatment). In that regard, it is of the view that the form of price regulation should be able to send appropriate price signals and enable trade waste customers to assess the merits of discharging to the sewerage system, as opposed to investment in alternatives such as on-site facilities to minimise and/or treat trade waste discharge.

*Issue 39.*

*The Commission requests comments on the form of economic regulation that should apply to SA Water's trade waste services.*

## 10.2 Recycled water

The Water for Good Plan defines recycled water as water derived from wastewater systems or stormwater drainage systems that has been treated to a standard that is appropriate for its intended use. On the other hand, the National Water Commission describes recycled water as highly treated wastewater from a sewage treatment plant. Further, it may also refer to treated stormwater, groundwater or a mix of all three water sources.

In Australia, a convergence of inter-related factors such as climate change and below-average rainfall have resulted in increasing interest within the community for governments to explore alternative options that are less dependent on rainfall and the River Murray. Water recycling, particularly for non-drinking purposes, is therefore being increasingly pursued by governments as a genuine alternative option.

Broadly speaking, water can be commercially recycled for a variety of purposes, with the appropriateness of those uses dependent on the extent to which the water is treated. For example, recycled water used for agricultural purposes would need to be treated to a higher quality as opposed to that used for landscape irrigation. Based on data collected by the National Water Commission and Water Services Association, SA Water has the highest rate of water recycling (in the Adelaide metropolitan area) when compared to other large metropolitan service providers.<sup>77</sup>

**Table 5.2.3: W26 – Total recycled water supplied (ML) and W27 recycled water (% of effluent recycled)**  
For utilities with 100 000+ connected properties

| Utility                      | W26 Total recycled water supplied (ML) |         |         | W27 Recycled water (% of effluent recycled) |         |         |
|------------------------------|--|---------|---------|---|---------|---------|
|                              | 2006–07                                | 2007–08 | 2008–09 | 2006–07                                     | 2007–08 | 2008–09 |
| Sydney WC                    | 21 129                                 | 24 163  | 25 442  | 4   | 4       | 5       |
| WC – Perth                   | 6 958                                  | 7 947   | 7 635   | 6   | 6       | 6       |
| Yarra Valley Water           | 738                                    | 562     | 2 252   | 9   | 9       | 27      |
| South East Water             | 2 961                                  | 2 569   | 5 118   | 29  | 22      | 30      |
| SA Water – Adelaide          | 25 047                                 | 25 562  | 25 501  | 30  | 31      | 31      |
| Brisbane Water               | 5 697                                  | 5 931   | 9 055   | 7   | 6       | 8       |
| City West Water              | 0                                      | 73      | 539     | 0   | 0       | 3       |
| Gold Coast Water             | 7 990                                  | 6 927   | 6 437   | 15  | 14      | 17      |
| Hunter WC                    | 4 060                                  | 4 471   | 5 092   | 5   | 6       | 8       |
| ACTEW                        | 2 104                                  | 3 789   | 4 207   | 7   | 12      | 14      |
| Barwon Water                 | 3 697                                  | 2 776   | 3 158   | 18  | 13      | 17      |
| Melbourne Water <sup>1</sup> | 61 062                                 | 61 984  | 60 285  | 22  | 23      | 23      |

<sup>1</sup> Although Melbourne Water is a bulk utility, it treats the large majority of the sewage collected from households serviced by the three metropolitan Melbourne water utilities. Melbourne Water's recycled water results are therefore presented in the above table to present a more accurate overview of the recycled water supplied to Melbourne. Recycled water figures for the Melbourne retailers represent the recycled water supplied from the retailers' local sewage treatment plants.

There are many examples of commercially-generated recycled water that are currently operating in South Australia, including the following.

<sup>77</sup> National Water Commission and Water Services Association of Australia, *National Performance Report 2008-09: Urban Water Utilities*, April 2010, at page 32.

### 10.2.1 Residential third-pipe scheme

The Mawson Lakes Reclaimed Water Scheme is a project designed to supply residents with reclaimed water through a lilac coloured network pipe system. The supply of reclaimed water is achieved by treating waste water from the Mawson Lakes community and mixing it with recycled stormwater from the Parafield Wetlands prior to pumping back to Mawson Lakes development for domestic use (e.g. toilet flushing).

### 10.2.2 Irrigation

The Virginia Irrigation scheme is one of the largest water recycling scheme of its kind in Australia. This public-private partnership treats effluent from the Bolivar Wastewater Treatment Plant and distributes the treated water to horticultural areas in the Virginia and Angle Vale regions for irrigation purposes. An extension of this scheme was completed in May 2009 - providing for an additional capacity of 3 GL, taking the total to 18 GL of treated water to be supplied to the regions each year.

The Willunga Basin Water scheme is a privately-funded, owned and operated scheme that utilises effluent from the Christies Beach Wastewater Treatment Plant and distributes it to agricultural areas in the McLaren Vale region. It is noteworthy that the Willunga Basin Water Company is currently working with the local council on plans to extend the existing pipelines from the wastewater treatment plant into the southern suburbs of the metropolitan area for public space irrigation.

### 10.2.3 Public spaces

The Glenelg-Adelaide Parklands Recycled Water Project is a project jointly funded by the Commonwealth and South Australian Governments, and utilises effluent from the Glenelg Wastewater Treatment Plant to irrigate Adelaide Park Lands. This project has the capacity to provide up to 1.3 GL of recycled water each year, with the capacity to recycle a total of 5.5 GL of high quality recycled water annually.

### 10.2.4 Potential for growth in water recycling in South Australia

As noted, South Australia is leading the nation in water recycling, with more than 30% of its wastewater being reused from SA Water's wastewater treatment plant for a variety of domestic and commercial uses. Further, the extent to which wastewater is being recycled by the local government-operated CWMS is also increasing throughout the state.

Whilst there has been no legislative requirement for certain water recycling initiatives to be implemented, the Commission observes that there has been an increasingly emphasis placed by all three levels of government in Australia to encourage the uptake of water recycling for reasons relating to source diversification, below-average rainfall and community expectations.

The Water for Good Plan has, in particular, identified the potential for further growth in the use of recycled water in areas such as public open space and horticulture irrigation in South Australia.

*Issue 40.*

*What is the potential for growth in water recycling in South Australia? How does it impact on the Commission's price regulation function?*

### 10.2.5 Price regulation for recycled water

The Treasurer's request for advice requires the Commission to provide advice on the form of economic regulation that should be applied to recycled water in South Australia. Prior to giving that advice, the Commission believes that it is important to receive input from stakeholders who have had experiences with the water recycling industry in South Australia, or are expected to be involved with the industry at a future date.

To assist stakeholders in formulating their response to the form of economic regulation that should be applied to recycled water in South Australia, the Commission has identified below some of the key issues that it believes may be of relevance to stakeholders' considerations.

#### *Market power*

Market power generally exists where there are strong barriers to entry and few, if any, substitutes for the service or product. In that instance, an entity has a high degree of control over the price it charges, and can also increase those prices without losing any customers.

Price regulation is therefore imposed to prevent entities, particularly those operating in a monopoly environment, from misusing that market power to increase prices above efficient costs. Further, it is also used to achieve certain social objectives where they cannot be met through traditional means such as government subsidies.

The consequence of market power in the provision of recycled water is that prices could be higher than would otherwise occur. However, the Commission is mindful of the fact that the price of recycled water is primarily quality-driven. Whilst the quality for domestic use is largely uniform, the quality for commercial use is largely driven by its intended purpose (e.g. horticulture and open public space irrigation). In that context, a higher price does not necessarily indicate that market power has been misused. Further, the Commission understands that current prices for recycled water in South Australia are mainly negotiated on an individual basis and, in some cases, are not set at a cost-reflective level.

The extent to which market power is present is also driven by factors such as whether or not there is the potential for users to substitute the recycled water supplied via other means. In the case of large industrial users, there may be a potential for them to gain direct access to treated water from wastewater treatment plants via a third-party access regime or seek to undertake on-site collection and treatment of recycled water.

*Issue 41.*

*The Commission requests comments on the extent to which providers of recycled water have market power in the provision of recycled water in South Australia.*

*If providers of recycled water have market power, what is the most appropriate form of economic regulation that should be applied?*

*Policy settings and directions*

A key challenge in determining the form of price regulation that should apply to recycled water in South Australia is to ensure there is an appropriate trade-off between different objectives. In the case of recycled water, the methodology by which prices are set should not only be cost-reflective but should be sufficiently transparent to deliver effective price signals to users.

While the form of price regulation should take into account the circumstances of the particular industry and minimise compliance costs where possible, the Commission notes that both the Government's Water for Good plan and the National Water Commission guidelines have recommended that pricing principles should be developed both to provide a basis for ensuring prices do not exceed users' willingness to pay and to allow effective price signals to be delivered.

In a report released in October 2010, the National Water Commission proposed the following pricing principles for recycled water and stormwater reuse.<sup>78</sup>

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<sup>78</sup> National Water Commission (2010), *Pricing Principles for Recycled Water and Stormwater Reuse*, Waterlines Report Series No 31, October 2010.



Table 6: Proposed pricing principles for recycled water and stormwater reuse

| <i>Principle</i> |   |
|------------------|---|
| 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 (IWRP) system.  |
| 7                | Prices should recover efficient, full direct costs <sup>a</sup> —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: <ul style="list-style-type: none"> <li>• any full cost recovery gap should be recovered with reference to all beneficiaries of the avoided costs and externalities</li> <li>• subsidies and community service obligation payments should be reviewed periodically and, where appropriate, reduced over time.</li> </ul> |
| 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.   |

<sup>a</sup> This report adopts the definition of direct costs that has been employed by NSW IPART (see IPART2006, p. 24 and p. 30). That is, direct costs include any joint/common costs that a scheme imposes, as well as separable capital, operating and administrative costs. This definition of direct costs does not include externalities and avoided costs.  
Source: The Centre for International Economics

### *Experiences in other jurisdictions*

The Commission observes that economic regulators in other jurisdictions have also tended to implement a light-handed form of economic regulation for recycled water through the development of pricing principles. A table comparing the pricing principles developed by the Independent Pricing and Regulatory Tribunal of New South Wales (2006) and the Essential Services Commission of Victoria (2007), with that developed by the Water Services Association of Australia (2006) is shown below.<sup>79</sup>

<sup>79</sup> National Water Commission, Pricing Principles for Recycled Water and Stormwater Reuse – Waterline Report Series No 31, October 2010, at page 11.

**Table 3: Comparison of pricing principles—IPART, WSAA and ESC**

| <i>Issue</i>               | <i>IPART</i>   | <i>WSAA</i>   | <i>ESC (Consultation paper)</i>   |
|----------------------------|--|---|---|
| Regulatory framework       | Regulate prices only where opportunity for monopoly powers to be exercised and regulation could lead to greater economic efficiency  | Regulation should be light-handed and provide flexibility particularly for users with alternative supply or market power  | Residential customers—ESC proposes annual price approval for recycled water (as it is an 'homogenous' product in 'typical residential subdivisions')<br>Large non-domestic customers—ESC proposes pricing principles to ensure flexibility                    |
| Approach to pricing        | Prices should reflect specific market characteristics of recycled water and stormwater reuse schemes   | Prices set within a price band floor: covering system incremental costs (taking avoided costs into account) ceiling: WTP <sup>a</sup> (lesser of SAC <sup>b</sup> or network bypass price of alternative)<br>Commercial judgement as to where in the price band   | Proposed—prices for recycled water must be consistent with the overarching objective of satisfying demand supply balance.<br>Proposed—even where supply is mandated, the price of recycled water will be constrained by the substitutability of potable water |
| Approach to pricing        | Pricing arrangements consistent with maintaining current framework for water and sewerage pricing  | Prices should reflect longer term pricing reform  |   |
| Approach to pricing        | Pricing reflects recycled water's role as part of an integrated urban water system   |   |   |
| Approach to pricing        | Prices to have a usage charge component<br>Pricing should send appropriate signals to users (including about the price of substitutes) and entail appropriate allocation of risk<br>Pricing should reflect user pays and where appropriate the broader 'beneficiary pays'                  | Prices should reflect product differentiation (for example, different users, different products or locations)<br>Prices should broadly track prices of substitutes (but not lock in artificially low prices)  | Variable component of price to provide signal to customers on managing the resource sustainably   |
| Approach to cost recovery  | Prices recover full direct costs of implementation (at least the incremental costs and capped by WTP), except when:<br>avoided costs occur<br>broader external benefits occur for which external funding is received<br>formally directed to recover some costs from broader customer base | Cost recovery ranges from recovery of system incremental costs to an upper limit based on WTP.<br>mandated schemes: subsidies should be made transparent<br>mandated 'uneconomic' schemes: prices should be recovered via CSO <sup>c</sup> , from broader customer base, or as part of the cost of doing business | Proposed—cost reflectivity—prices must not exceed the full efficient cost of providing the service  |
| Pricing policy development |  | Policies should be developed by government and regulators in an integrated fashion  |   |

a WTP = willingness to pay, b SAC = stand alone cost, c CSO = community service obligation

Source: IPART (2006); WSAA (2005); ESC (2007)

**Issue 42.**

*Is a "pricing principles" approach the most appropriate form of economic regulation that should be applied to recycled water and, if so, what are the principles that should apply?*

### **10.3 Price regulation of other services**

In addition to the provision of water and services such as recycling of sewage, water businesses also provide a range of other retail services such as connections and disconnections, installation of additional water meters to community/strata units, special meter readings and installation of metal underground boxes. 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.

At present, the provision of such retail services, either by SA Water or other third parties, is not subjected to any form of price regulation. Whilst SA Water publishes an annual price schedule<sup>80</sup> for those services, the prices charged by third parties are predominantly determined on an individual basis. Further, there are a number of practical difficulties with regulating prices associated with the provision of such services. For example, differences in the terminology adopted and economies of scale between water businesses would make it difficult for the Commission to properly assess the cost basis of those charges.

The revenue generated from the provision of miscellaneous water retail services generally makes up a relatively small proportion of the total annual revenue generated by a water business, and it is likely that SA Water will remain the main provider of such services in South Australia. In that context, the Commission seeks comments from stakeholders on whether or not this effectively equates to a form of market power, with the potential for misuse in the absence of competition.

*Issue 43.*

*The Commission seeks comments on whether or not SA Water has market power in the provision of miscellaneous water retail services in South Australia and, if so, whether there is potential for that market power to be misused.*

*The Commission seeks comments on the potential for competition in the provision of miscellaneous water retail services in South Australia.*

The Treasurer's request for advice requires the Commission to provide advice on the form of economic regulation that should be applied to miscellaneous retail services in South Australia. Prior to giving that advice, the Commission believes that it is important to receive input from stakeholders who have had experience in receiving those services as to what form of price regulation should be applied.

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<sup>80</sup> Refer SA Water's 2010-11 Fees and Charges (available from SA Water's website at: <http://www.sawater.com.au/SAWater/DevelopersBuilders/ServicesForDevelopers/Customers+Connections+Centre.htm>)

To assist stakeholders in formulating their responses on this matter, the Commission has summarised some of the differing forms of price regulation adopted by regulators in other jurisdictions in regulating such services.

- ▲ Independent Competition and Regulatory Commission (ICRC) of ACT has adopted an approach whereby individual prices for water retail services change by CPI for each year of the regulatory period. This approach was adopted by ICRC on the basis that the costs incurred in the provision of those services are unlikely to vary materially year to year, and that it is simple to understand and apply. In the event that a water business wishes to introduce a new water retail charge, an application containing information such as the reasons and the direct efficient costs of providing the new service must be made to ICRC for assessment.<sup>81</sup>
- ▲ Independent Pricing and Regulatory Tribunal (IPART) of New South Wales adopted a two-stage approach, whereby a set of pricing principles was first developed to provide guidance to water businesses in the development of charges for water retail services.<sup>82</sup> A water business was then allowed to increase those charges in line with the annual change in CPI over the determination period. Similar to the rationale put forward by ICRC, IPART has adopted this light-handed form of price regulation on the basis that those charges are levied on a relatively small number of customers and that the approach is simple to understand and apply.<sup>83</sup>
- ▲ Essential Services Commission of Victoria (ESCV) adopted an approach whereby individual price caps are applied to a group of 'core' miscellaneous services to ensure prices do not vary significantly year-to-year. This core group is made up of miscellaneous services that the water businesses consider to be the most important and those that generate the bulk of the water retail services revenue. With respect to charges for water retail services that are considered to be 'non-core', prices are set in accordance with a set of pricing principles related to cost reflectivity.<sup>84</sup>

*Issue 44.*

*Having regard to the differing price regulation approaches that are applied to water retail services in other jurisdictions and, issues of market power and potential for competition in the provision of those services, the Commission requests comments on the most appropriate form of price regulation that should be applied to water retail services in South Australia.*

<sup>81</sup> Independent Competition and Regulatory Commission (2010), *Water and Wastewater Price Review – Final Report and Price Determination*, April 2008.

<sup>82</sup> Independent Pricing and Regulatory Tribunal (2005), *Final Report on the Review of Miscellaneous Charges Price Proposals for NSW Metropolitan Water Agencies – Prepared for IPART by RSM Bird Cameron*, May 2005.

<sup>83</sup> Independent Pricing and Regulatory Tribunal (2008), *Review of Prices for Sydney Water Corporation's Water, Sewerage, Stormwater and Other Services – Final Determination and Final Report*, June 2008.

<sup>84</sup> Essential Services Commission (2009), *Metropolitan Melbourne Water Price Review 2009 – Final Decision*, June 2009.

## 11 NEXT STEPS

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The Commission now seeks stakeholder comment on the various matters raised in this Statement of Issues. As noted at the beginning of the Statement, responses from consumers, industry participants and other stakeholders in the water sector will assist the Commission in developing a robust regulatory regime for the water supply industry. Details on the manner in which submissions may be made is contained on the inside front cover of this document.

While the Commission strongly encourages written submissions, it is also keen to discuss relevant issues with stakeholders in other formats. As such, should any stakeholder wish to hold discussions with the Commission on any matters raised in this Statement of Issues, or other relevant issues, please feel free to contact the Commission to arrange such discussions. The Commission notes that while it will endeavour to satisfy all requests, it may not be possible to do so in the time available to it for consultation under the Treasurer's Request for Advice.

Following the receipt of submissions on this Statement of Issues, the Commission will prepare Draft Advice to the Treasurer by March 2011. As a part of that Draft Advice, the Commission intends to provide to the Treasurer a suite of draft regulatory instruments, such as licensing documents and an industry code. It is the Commission's expectation that the provision of draft instruments for consultation will provide for greater certainty in the lead-up to the provision of final advice to the Treasurer in June 2011 in anticipation of the commencement of the new water industry regulatory regime from 1 July 2011.

The Commission looks forward to working with all water industry stakeholders as a part of this important reform process.

## APPENDIX 1 – NATIONAL WATER INITIATIVE PRICING PRINCIPLES

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In 2004, the Council of Australian Governments (COAG) agreed to implement the National Water Initiative (NWI), which is aimed at increasing the efficiency of Australia's water use, leading to greater certainty for investment and productivity, for rural and urban communities, and for the environment.

The Treasurer has requested that the Commission's advice on the framework for economic regulation of water have regard to the NWI Pricing Principles. The NWI Pricing Principles are the combined pricing principles that are articulated in Clauses 64 to 77 of the NWI, and the subsequent NWI Pricing Principles approved by the Resource Management Ministerial Council in April 2010.<sup>85</sup>

### *National Water Initiative, clauses 64 to 77*

Clauses 64 to 77 of the NWI contain a set of principles aimed at promoting best practice water pricing, which include the need to:

- ▲ promote economically efficient and sustainable use of water resources, water infrastructure assets, and government resources devoted to the management of water;
- ▲ ensure sufficient revenue streams to allow efficient delivery of the required services;
- ▲ facilitate the efficient functioning of water markets, including inter-jurisdictional water markets, and in both rural and urban settings;
- ▲ give effect to the principles of user-pays and achieve pricing transparency in respect of water storage and delivery in irrigation systems and cost recovery for water planning and management;
- ▲ avoid perverse or unintended pricing outcomes;
- ▲ provide appropriate mechanisms for the release of unallocated water.

The NWI sets out some specific actions designed to achieve these outcomes, including:

- ▲ consumption-based pricing;
- ▲ full cost recovery for water services to ensure business viability and avoid monopoly rents, including recovery of environmental externalities, where feasible and practical;

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<sup>85</sup> The NWI pricing principles are available at <http://www.environment.gov.au/water/policy-programs/urban-reform/nwi-pricing-principles.html>

- ▲ consistency in pricing policies across sectors and jurisdictions where entitlements are able to be traded;
- ▲ development of pricing policies for recycled water and stormwater that are congruent with pricing policies for drinking water, and stimulate efficient water use regardless of the source;
- ▲ review and development of pricing policies for trade wastes that encourage the most cost-effective methods of treating industrial wastes, whether at the source or at downstream plants;
- ▲ development of national guidelines for customers' water accounts that provide information on water use relative to equivalent households in the community.

### *April 2010 NWI Pricing Principles*

The NWI pricing principles approved in April 2010 are intended to expand upon and provide practical guidance for implementing the pricing principles already contained in clauses 64 to 77 of the NWI.<sup>86</sup> The expanded NWI pricing principles cover:

- ▲ The recovery of capital expenditure;
- ▲ Urban water tariffs;
- ▲ Recovering the costs of water planning and management activities; and
- ▲ Recycled water and stormwater reuse.

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<sup>86</sup> The NWI pricing principles are available at <http://www.environment.gov.au/water/policy-programs/urban-reform/nwi-pricing-principles.html>

### ***Recovery of capital expenditure***

Section A of the NWI Pricing Principles relates to the treatment of new and existing assets. In summary, the principles require:

- ▲ full cost recovery for new and replacement capital expenditure following a “legacy date” (in the case of South Australia, the legacy date that has been applied in the Government's previous pricing decision for SA Water is 30 June 2006);
- ▲ new and replacement assets should initially be valued at efficient actual cost;
- ▲ existing assets (assets that existed as at the legacy date) should be valued based on a recognized valuation method, such as Depreciated Replacement Cost (DRC), Depreciated Optimised Replacement Cost (DORC), Optimised Replacement Cost (ORC), indexed actual cost or Optimised Deprival Value (ODV);
- ▲ cost recovery for legacy assets should be achieved by way of a depreciation charge or annuity charge and a positive return on an asset value used for price setting purposes as at the legacy date. If assets are to be sold then they are to be valued at their net realisable value.
- ▲ The regulatory asset base should be rolled forward (in either nominal or real terms) by including prudent capital expenditure and deducting depreciation and asset disposals. Where a renewals annuity is used, asset values should not also be depreciated.
- ▲ New contributed assets (i.e. grants/gifts from governments and contributions from customers (e.g. developer charges)) should be excluded or deducted from the Regulated Asset Base (RAB) or offset using other mechanisms so that a return on and of the contributed capital is not recovered from customers. If a renewals annuity is used, it should include provision for replacement of contributed assets.

### ***Urban Water Tariffs***

Section B of the NWI Pricing Principles sets out the following relevant principles for the design of urban water tariffs:

- ▲ Water tariffs should recover forecast target revenue, which should not exceed the Upper Revenue Bound (the maximum amount of revenue beyond which the utility would earn monopoly rents);
- ▲ Two-part tariffs, comprising of a service availability charge and a usage charge, should be used to recover the revenue requirement from retail residential, non-residential and bulk customers;



- ▲ The water usage charge should have regard to the long run marginal cost of supply of additional water;
- ▲ The revenue from the service availability charge for water should be calculated as the difference between the target revenue and the revenue recovered through water usage charges and developer charges;
- ▲ Urban water tariffs should be set using a transparent methodology, through a process which seeks and takes into account public comment, or which is subject to public scrutiny;
- ▲ Where water usage charges lead to revenue recovery in excess of the upper bound in respect of new investments, the over-recovery is to be addressed, ensuring that revenues are not permanently withheld from customers;
- ▲ Water charges should differentiate between the cost of servicing different customers where the benefits of doing so outweigh the costs of identifying the differences and the equity advantages of alternatives;
- ▲ Revenue from developer charges should be offset against the total revenue requirement either by deducting the contributions from the RAB, or through some other offset mechanism.

### ***Water Planning and Management***

The NWI Pricing Principle 3 contains a framework for the identification of water planning and management activities undertaken by, or performed on behalf of, Government. Having identified the relevant activities, the associated costs are to be allocated between Governments and water users on the basis of an “impactor pays” approach, which allocates costs between those parties that create the need for the costs to be incurred.

Where full cost recovery for these activities is not achieved, any subsidies or CSOs are to be transparently reported.

### ***Pricing Principles for Recycled Water and Stormwater Reuse***

The following set of principles have been established for pricing of recycled water and stormwater reuse:

- ▲ Light handed and flexible regulation (including use of pricing principles) is preferable, although more formal regulation should be employed where it will improve economic efficiency.
- ▲ When allocating costs, a beneficiary pays approach should be the starting point.

- ▲ Prices to contain a water usage (i.e. volumetric) charge.
- ▲ Regard to the price of substitutes (drinking water and raw water) may be necessary when setting the upper bound of a price band.
- ▲ Pricing structures should be able to reflect differentiation in the quality or reliability of water supply.
- ▲ Where appropriate, pricing should reflect the role of recycled water as part of an integrated water resource planning (IWRP) system.
- ▲ 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 (WTP) as the upper limit. Any full cost recovery gap should be recovered with reference to all beneficiaries of the avoided costs and externalities. Subsidies and Community Service Obligation (CSO) payments should be reviewed periodically and, where appropriate, reduced over time.
- ▲ Prices should be transparent, understandable to users and published to assist efficient choices.
- ▲ Prices should be appropriate for adopting a strategy of 'gradualism' to allow consumer education and time for the community to adapt.