

Gaby Jaksa
Commercial Consultant

Strategy Negotiation Documentation

9 October 2019

Mr Adam Wilson
Chief Executive Director
Essential Services Commission of S.A.
Level 1
151 Pirie Street
Adelaide S.A. 5000

Gaby Jaksa
Commercial Consultant

✉ P.O. Box 347
Unley Annexe
Mary Street
UNLEY SA 5061
📧 gaby@jaksa.net.au
☎ 0401 122 795

ABN 88 150 306 644

Dear Adam,

Re: SA WATER REGULATORY DETERMINATION 2020 NEGOTIATION FORUM – PROBITY REPORT

The purpose of this letter is to provide my probity report in relation to the Negotiation Forum established by ESCOSA for the purpose of the 2020 SA Water Regulatory Determination (“**Determination**”) in my role as the probity adviser to the Negotiation Forum.

1. BACKGROUND

The Negotiation Forum was governed by a Charter that specified its role, purpose and objectives of the various parties involved.

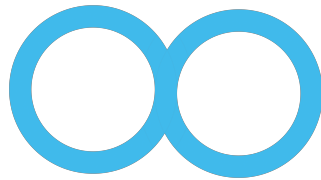
SA Water is a statutory corporation with a legislative obligation to provide water, sewerage and other retail services to its customers.

ESCOSA’s primary objective is to protect the long term interests of consumers in relation to price, quality and reliability of essential services.

ESCOSA and SA Water are currently engaged in a process that will culminate in ESCOSA making the Determination that will apply to SA Water for the period 1 July 2020 until 20 June 2024.

As stated in Section 1 of the Charter, the aim of the Determination is to charge SA Water to deliver its essential services “at the lowest sustainable price for the quality and reliability levels valued by customers” and also to have “sound” supporting business, management, operational and financial policies underpinning that purpose.

The process involves SA Water preparing a business plan for the relevant Determination period. This business plan is then reviewed by ESCOSA by reference to those long term interests of consumers and balances various competing considerations to strike that “lowest sustainable price” as well as entrenching other non-price benefits or protections for consumers given the strength of SA Water as the predominant market supplier. Issues and changes are no doubt discussed,



tested and negotiated with SA Water. Ultimately, ESCOSA makes its determination as required by the Essential Services Act

For the current Determination, ESCOSA wanted to involve representatives of consumers earlier in the process. This is the genesis of the CNC and the Negotiation Forum. As the Charter states on page 2, the Negotiation Forum will:

- put “customers’ interests and the consumer voice at the centre” of the regulatory process;
- provide an opportunity for early identification of issues;
- obtain a wider range of customer views earlier in the process;
- introduce direct customer challenge and negotiation into the preparation of SA Water’s draft business plan

The Negotiation Forum was comprised of three elements: the Customer Negotiation Committee, the SA Water Negotiation Committee and the Probitry Adviser. Furthermore, the CNC was led and managed by the Independent Chairperson.

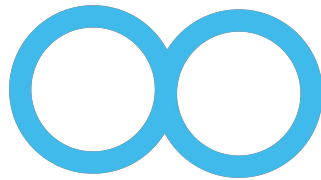
The Forum’s overall purpose was to raise issues early and introduce a greater level of direct customer challenge and negotiation into the preparation of SA Water’s draft business plan. Furthermore, the Negotiation Forum would ensure that the business plan submitted to the Commission has been thoroughly tested by a wide range of stakeholders.

In this context, the CNC’s primary role was to be a representative of SA Water’s customers. It was to be the “customer voice” of challenge to, and negotiation with, SA Water in the preparation of the next iteration of its business plan with a view to agreeing matters to be included in the business plan so as to provide these essential services at the lowest sustainable price.

The extent of this role should not be underestimated. It was a significant role as it required the CNC members to come to a thorough understanding of both SA Water’s large and sophisticated business as well as the proposed projects which together are to constitute the proposed new business plan. The business plan and its components, and their underlying business rationales, had to then be critically analysed and tested to ensure that the projects represented value for money for consumers, essentially in terms of their cost and the concomitant benefits generated. The CNC was reliant on SA Water providing relevant clear and accurate information about the business plan to perform this task.

The Charter recognized that “significant weight will be given to the matters that the Negotiation Forum has successfully negotiated”.

The third component of the Negotiation Forum was the SA Water Negotiation Team. Its purpose was to explain the business plan and its component projects, as well as their respective underlying business rationale, costing and financial analysis. This is a crucial component to the Negotiation Forum being successful given the information asymmetry between SA Water and the CNC. There must be fulsome disclosure and explanation of SA Water’s business and the future business plan.



Furthermore, SA Water was asked to listen to and understand the “voice”. The SA Water Negotiation Team was also obliged to negotiate in good faith and also charged to “have regard to relevant feedback and preferences” of the CNC when finalizing its business plan.

The business of the Negotiation Forum was conducted by way of meetings and discussions. There were some 20 meetings which can be divided into three sets. All of these meetings were interactive so questions could be asked of SA Water by the CNC. A programme for the meetings was agreed by the parties. An agenda was agreed for all meetings.

First, these was a series of presentations concerning various aspects of SA Water’s business and the current business plan. The CNC were given the presentation slides. Senior executives and employees of the relevant SA Water business unit presented and took questions.

Secondly, there was a series of meetings with the same format concerning projects forming part of SA Water’s new business plan. At times, a follow up meeting was held on the topic of a meeting. Often the CNC would request additional information or ask questions. The requested information and answers were invariably provided promptly by SA Water.

The final set of meetings concerned the detailed analysis and discussion of some of the proposed projects of SA Water’s business plan. These meetings focused on those projects or evidence that the CNC found problematic. Again, the same format was followed.

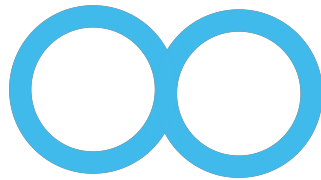
2. ROLE & PURPOSE OF THE PROBITY ADVISER

My role as the Independent Probity Adviser is described in section 6 of the Charter. Its purpose is to “provide oversight of the integrity and fairness of the process and information exchange in the Negotiation Forum.”

3. RESPONSIBILITIES OF THE PROBITY ADVISER

My responsibilities are listed in section 6.3 of the Charter, and I summarize them below.

- Ensure that the discussions in the Negotiation Forum are within the scope of the matters as agreed between ESCOSA, the Independent Chairperson and SA Water.
- Ensure the parties conduct themselves ethically, negotiate in good faith and act fairly.
- Identify and ensure that any perceived or actual conflicts of interest are managed appropriately.



- Provide advice to the Independent Chairperson on areas where further information, research or analysis may be required in order to allow the CNC to effectively participate in the negotiations.
- Identify, resolve or escalate issues requiring resolution to ESCOSA, in consultation with the Independent Chairperson, as soon as possible.
- Liaise with the Independent Chairperson outside of the Negotiation Forum to ensure any issues of probity or process are identified and addressed as soon as possible.
- Provide timely updates on the status of the negotiations to the Commission, that might include the Independent Chairperson, including identifying any issues with the negotiation process that cannot be resolved between the parties to that negotiation.

4. PROBITY REPORT

Section 5 of the Charter requires that I provide a report on the probity of the negotiation process for ESCOSA, together with a discussion of at least the following specified matters.

- a high-level assessment of the effectiveness of the process;
- a summary of any probity issues that arose during the process and the actions taken to ensure that the issues were appropriately resolved; and
- observations or recommendations on areas where the process could be refined or enhanced in the future.

- **Probity of the Negotiation Forum Process**

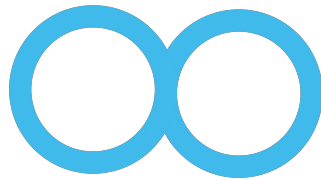
I consider that the Negotiation Forum process was conducted with due probity. Furthermore, it was conducted with integrity and fairness.

In my view, the essence of probity is about fairness. As such probity entails various rights and obligations to the extent they impinge on fairness.

There are two types of relevant fairness: procedural and substantive fairness.

Procedural fairness focusses on the fairness of a process with the goal of giving a participant an “equal opportunity” to participate in a process. Substantive fairness is primarily concerned with the evaluative and decision making phases of a process. This is to ensure that decisions relying on a process are made on the basis of relevant and appropriate reasons or evidence.

The usual example is that of a procurement. Procedural fairness is generally the main consideration during the tender stage to ensure “equality of opportunity”. Substantial fairness or “equality of treatment” is relevant during evaluation so that decisions are made based on the fair and consistent application of evaluative criteria.



In my opinion the entire negotiation process was conducted with both procedural and substantive fairness.

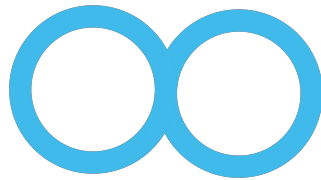
Probably the most important potential probity issue at the outset of the Negotiation Forum was that of the information asymmetry between the parties. In my view, this never became an issue. SA Water prepared detailed presentations on the various topics or projects. Meetings were then held with the CNC at which the relevant SA Water executive and employees presented the information. Requests for additional documents, evidence, information were promptly provided by SA Water. Questions were answered in the same manner. My understanding is that the CNC was satisfied with the information provided by SA Water, while it did at times critique its substance or effects.

In terms of my responsibilities in section 6.3 of the Charter, my opinion is as follows.

- The discussions were within the scope of relevant matters.
 - All parties conducted themselves appropriately at all times.
 - An agenda was prepared for each meeting.
 - Summary “records of outcome” were prepared of all meetings, and their content agreed at the next meeting.
 - No material conflict of interest arose in my view.
 - Only one probity matter arose that necessitated discussion with the Independent Chairperson and the Chief Executive of SA Water which is discussed below.
 - I provided advice on a couple of occasions to the Independent Chairperson on areas where further information could be sought.
 - No issues need to be escalated to ESCOSA due to probity concerns.
 - ESCOSA was updated on the process as required.
-
- **Effectiveness of the Negotiation Forum Process**

Turning to the effectiveness of the Negotiation Forum process, in my view it was to a great extent successful and worthwhile. This is evidenced by the quality of the report prepared by the Independent Chairperson and the CNC which should prove to be a valuable analysis and discussion of SA Water’s business plan for both ESCOSA and SA Water. The CNC’s analysis of the business plan is targeted at particular projects

As I have said above, SA Water’s business operations are large, diverse and relatively complex while also subject to a quite sophisticated regulatory regime. SA Water had to present information to the CNC about its operations and business plan in a clear, succinct and easily digestible form. The CNC had to then understand the business and its regulation, as well as analyse the new business plan, its component projects and their underlying costs and benefits. This allowed the CNC to evaluate whether projects were justified as economically efficient inclusions in the business plan.



Overall, the Negotiation Forum worked effectively as a forum for the presentation of information and its discussion. The process was tweaked at the request of the CNC so that the CNC received presentations or papers in advance of meetings. This was a benefit to the process as the CNC could prepare for the topics to be discussed in a meeting.

Futhermore, the overall effectiveness of the process alleviated any material concern about the initial information asymmetry between the two participants. The CNC did not raise any issue with me about not being provided with sufficient relevant information by SA Water or upon the CNC's request. Of course, the CNC did, at times, question the quality or applicability of the information given the purpose for which it was being used. This applied particularly to data about customer preferences from SA Water's programme of customer engagement.

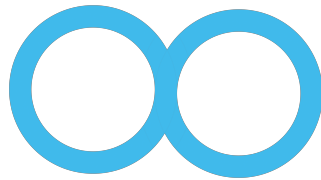
Negotiations between the CNC and SA Water were clearly an important objective of the process. I do not think substantive negotiations on the business plan occurred. The CNC report forcefully makes this point. A major cause seems to have been lack of time in the process.

Another possible contributing factor in this context is that negotiations might have been easier if the CNC had the benefit of the provisional business plan currently being finalized by SA Water for submission to ESCOSA. Saying this, I note that SA Water did, however, give a detailed "overview" of its "Our Plan 2020" that quantified various types of expenditure and effects on revenue and prices.

For me, it is likely that negotiations on the business plan would focus on the cost-benefit analysis justifying the individual projects constituting the business plan, including their opportunity costs as well as questions of selection and timing among competing projects etc.

The Charter does propose that the CNC would "constructively challenge and negotiate" with SA Water "with a view to agreeing on the matters to be included in SA Water's proposed business plan". The CNC certainly did effectively challenge aspects of the business plan, even without negotiation. The evidence for this is in the detailed analysis and critique of various projects in the CNC's report. Furthermore, there is also extensive agreement on many aspects of the business plan between these parties. Consequently, the matters to be included in the CNC's report set out in section 5.3 of the Charter have been addressed and discussed in detail.

Therefore, given that the CNC was constituted "solely" to be the customer's voice to challenge the business plan from their perspective and also that the CNC took up the customers' concerns, the Negotiation Forum was still very effective, via the CNC's report, in providing valuable advice to ESCOSA as to a range of issues concerning various projects included in the business plan as well as indicating a broad level of agreement on the business plan for it to



“inform” its determination. All of this is entirely consistent with and satisfies the objectives of the Negotiation Forum.

For me, this makes the Negotiation Forum an overall success. The Negotiation Forum is a “non-binding” process as ESCOSA must still make its decision in accordance with the Act. The aim of the process was to introduce direct consumer challenge and negotiation. The overriding objective, however, was for the CNC to provide advice and information for ESCOSA to consider in making its determination. It does not really matter that this happened to occur more by challenge than negotiation.

- **Probity Issues**

My view is that there is no probity issue associated with the Negotiation Forum process or the manner in which it was conducted of which I am aware.

During the process only one probity issue arose concerning a breach of confidentiality. This matter was handled very quickly and the effects of the breach contained to only one person. Both the Independent Chairperson and SA Water’s Chief Executive were satisfied with the resolution of this issue.

- **Future Processes**

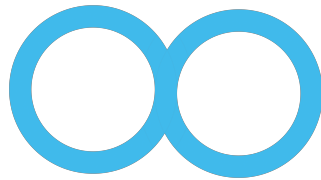
As I have said above, I think the Negotiation Forum was a useful and valuable process and satisfied its purposes and objectives.

The current process operated effectively to put the consumers’ voice to SA Water. The CNC was able, in short time, to critique and challenge multifarious aspects of the business plan.

For the future, I think greater time should be allowed for the Forum. This seems to me to be necessary for effective negotiations to occur.

I also think that negotiations are more likely to be effective if they occur after SA Water has settled on its provisional business plan but before it has gone to ESCOSA. This seems to me to entail a three stage process. The first stage is one where the CNC understands and challenges SA Water’s business and the proposed business plan. SA Water then finalizes its business plan and provides it to the CNC for negotiation. The business plan that then goes to ESCOSA is one that has been amended by agreement in the negotiations.

Unsurprisingly, the nature and quality of SA Water’s customer engagement processes was a subject of keen interest to the CNC. Evidence as to consumers’ preferences and willingness to pay was given substantial scrutiny by the CNC. In the future, consideration could be given to ESCOSA commissioning its own customer surveys. Alternatively, the responsibility could be delegated to a future embodiment of the CNC to gather its own evidence.



Gaby Jaksa
Commercial Consultant

Strategy Negotiation Documentation

In conclusion, my opinion is that the Negotiation Forum process was very well run and managed, both from a probity perspective and generally. The business plan was rigorously tested, and this has led to the desired outcome of providing relevant information to SA Water in relation to its business plan and to ESCOSA to consider in the Determination process as adumbrated in the Charter.

I congratulate ESCOSA, the CNC and SA Water and all the Negotiation Forum's participants on a very good process. The Negotiation Process has generated a report by the CNC containing very valuable analysis, commentary and information for ESCOSA and SA Water to consider, by the latter for its business plan and by the former in the next phase of the Determination process.

I trust the foregoing is sufficient for your present purposes. Please do not hesitate to contact me to discuss this matter.

Yours sincerely,

Gaby Jaksa
Commercial Consultant