// SUBMISSION

WATER SERVICES LEGISLATION BILL AND WATER SERVICES ECONOMIC EFFICIENCY AND CONSUMER PROTECTION BILL

// Local Government New Zealand's submission

// FEBRUARY 2023

Ko Tātou LGNZ.

Local Government New Zealand (LGNZ) provides the vision and voice for local democracy in Aotearoa, in pursuit of the most active and inclusive local democracy in the world. We support and advocate for our member councils across New Zealand, ensuring the needs and priorities of their communities are heard at the highest levels of central government. We also promote the good governance of councils and communities, as well as providing business support, advice, and training to our members.

Glossary

ERB – Water Services Economic Efficiency and Consumer Protection Bill (Economic Regulation Bill)

DIA – Department of Internal Affairs

IFF – Infrastructure Funding and Financing Act 2020

LGA – Local Government Act 2002

NTU – National Transition Unit

RM – resource management

RRG – Regional Representative Group

WSE – Water Services Entity

WSEA – Water Services Entities Act 2022

WSLB – Water Services Legislation Bill

Executive summary

Local government agrees how we deliver three waters services to New Zealanders must change. Broader system failure has created longstanding issues, negatively affecting many communities now and even more in the future. Climate change-related extreme weather events will continue to compound that impact on communities' wellbeing, as we have seen in recent floods.

While all our members want better outcomes for communities through three waters reform, they are not unified in their views on the Government's model. LGNZ has encouraged every council to make a submission that reflects their communities' unique circumstances and perspectives.

Three waters reform threatens councils' vital role as leaders in placemaking and community wellbeing outcomes. LGNZ interrogates those implications in this submission, as we did in our earlier submission on the Water Services Entities Act 2022 (WSEA), as well as providing other feedback on three waters services delivery as set out in these two new bills.

We have drafted this submission on the basis of the legislation on the table and the presumption that the Government will progress it. In early February, the Government indicated the shape of the reform might change. This is a separate conversation for local government to have with the Government: this submission is not the right vehicle.

Like our previous submission, this submission tests the Government's preferred approach to three waters reform and makes specific suggestions for change to the legislation under consideration. We've focused on areas where the Government's model and approach can be improved in response to local government's commonly held concerns. If this legislation is implemented, we want it to be as workable as possible.

As three waters reform shifts from design to implementation, councils need certainty that their relationship with a Water Services Entity (WSE) will support and enable council functions, placing communities first.

Our detailed submission sets out key concerns with both bills and suggested changes to the legislation and the broader reform programme, with specific suggested wording changes in Appendix 1.

Councils' key concerns with the Water Services Legislation Bill

// Councils are much more than just another three waters stakeholder. The proposed relationship agreement will be critical to the relationship between councils and the water services entities – and its current framing fails to acknowledge that relationship's criticality and complexity.

// Councils are already stretched responding to other reform and frequent emergency management events. We are concerned about the practical implications of transfer provisions set out in the WSEA and the WSLB, including how much council resource these could consume on top of councils' BAU work.

- // Some councils are shocked that council-controlled organisations (CCOs) now appear to be captured by reform. We are surprised and concerned by the number and type of council organisations (including CCOs and their subsidiaries) that would be treated as a "local government organisation" or a "mixed shareholder CCO" for the purpose of the WSEA. This even includes CCOs where the provision of water services is not their primary or predominant business.
- // Many councils are strongly against collecting water charges on behalf of WSEs.
- // There is too much uncertainty around the charging regime (including the scope of geographic averaging). This includes the need for limits/regulations on the charges that a receiver will be able to collect in respect of unpaid debt of a WSE.

Councils' key concerns with the Water Services Economic Efficiency and Consumer Protection Bill (referred to as the Economic Regulation Bill)

- // The core problem definition is wrong. It approaches the water services sector as if it was any other natural monopoly utility. We find the reference to WSEs' ability to "extract excessive profits" inflammatory and inaccurate.
- // Information disclosure should be the primary focus for economic regulation, at least initially. Implementing quality regulation and price-quality regulation in the first regulatory period doesn't make sense.

Part 1: Water Services Legislation Bill

General relationship between councils and WSEs

1. The relationship between councils and the WSEs will be critical for both parties. The relationship needs to be set up in a way that enables (rather than undermines) the ongoing role and functions of councils. This needs to be better provided for in the legislation. At the moment, the WSLB treats councils as "just another stakeholder" for a WSE to engage with, which undermines the broader focus councils have on local communities' needs.

Councils remain central to the broader system that services community

2. The legislation needs to reflect the fact that the water services entities will operate within a broader system that services communities. Councils remain central to that overall picture, as well as being democratically accountable when the system does not operate effectively. Councils' existing relationships, capabilities and responsibilities extend beyond three waters service delivery and need to be respected (and may need to be leveraged) by the WSEs if the overall system is to operate well at the local level. Communities should expect both their council and their WSE to work together for their benefit. While the WSLB signals the need and opportunity for operational/planning integration and partnering, it does little to actually direct or mandate it.
3. However, there is an alternative view expressed by some councils. If this reform progresses as proposed, councils will lose control over their water assets and lose their three waters knowledge base. This should mean that councils don't retain any responsibility for water service delivery.

Councils face engagement challenges, particularly during transition and establishment

4. The expectations placed on councils and their CCOs need to be carefully managed, particularly during the transition and establishment phase. If the process proceeds as outlined in the WSEA, both councils and their CCOs will lose their three waters capability. This will have a direct impact on councils' and CCOs' ability and capacity to engage with the water services entity.
5. Councils' capacity to engage needs to be considered against a backdrop of resource and financial constraints. At the moment, councils are working through annual plans and doing early work on Long Term Plans, dealing with delayed audits (due to the auditor shortage),

facing comprehensive resource management reform, delivering their BAU work and responding to increasingly frequent severe weather events.

WSEs now have to "partner and engage" with councils but what does that mean?

6. The WSLB will give WSEs a number of new "functions" (in addition to those set out under the WSEA). Consistent with our points above, we support the intent to "partner and engage" with councils. But it is unclear what "partner and engage" with councils will mean in practice, including how it will be applied in the context of councils' placemaking and community wellbeing functions. No expectations are set nor any guidance provided in the WSLB and WSEA (see also our comments on 'relationship agreements' below).
7. It's not currently clear whether the term "partner and engage" requires the WSEs to take into account or give effect to councils' placemaking and wellbeing objectives, or whether there's just an obligation to listen to and understand what those objectives are without any obligation to actually support them. Conversely, as noted above, there is a view that if councils are losing their three waters assets and knowledge base, the obligation to "partner and engage" shouldn't amount to an expectation that councils will be involved in three waters service delivery if the reform proceeds as proposed.
8. The meaning of the requirement to "partner and engage" needs to be clarified.

Where's the alignment of purpose between councils and WSEs?

Lack of shared purpose

9. We are concerned the lack of shared purpose between councils and WSEs will create tension. Under the Local Government Act 2002 (LGA), councils are required to promote the social, economic, environmental and cultural wellbeing of communities both now and in the future. WSEs do not share this purpose. This lack of clear alignment could create tension and result in the plan implementer (WSEs) acting in ways that do not support or integrate well with the plans of the plan maker (councils) – more on this below.
10. Our view is that the WSLB (and the LGA) should expressly recognise that councils' ability to influence three waters services is limited to the tools and processes available under the new legislation. the WSLB (and an amendment to the LGA) should expressly recognise that a council's ability to achieve some aspects of its broader purpose will heavily depend on decisions made by the WSEs, over which the council has limited or no control. Decisions made by WSEs may not align (in substance or timing) with the council's broader planning frameworks. As such, the LGA duties of a council should expressly reflect those limits.
11. The WSEs must pursue statutory objectives focused on efficiency, financial sustainability, and best commercial practice with respect to funding and managing water service delivery without sufficient regard for councils' broader focus, which encompasses placemaking and community

wellbeing. For example, how will tension between a council's community-endorsed view on growth (type, where and when) be reconciled with WSE's concerns about affordability and its own financial sustainability, especially where the position of the WSE will be determined by reference to what is happening across its entire service area? WSEs may end up making investment decisions and trade-offs that dictate outcomes for communities without direct accountability to those communities. What happens if a WSE limits or stops the provision of services to an area because, in its view, climate change or natural hazard risks means further investment is uneconomic? What happens if the WSE's actions do not align with a council's broader plans to build resilience to, or respond to, climate change/natural hazard risks in a certain area? The potential outcomes of these types of conflict are unclear, and the process to resolve them needs to be clarified.

12. As it stands, individual councils will be limited to resolving these tensions via escalation to their Regional Representative Group (RRG) or a Regional Advisory Panel (RAP) and providing input on relevant planning/policy documents. It is unclear whether the RRG/RAP forum could be used to respond to specific individual conflicts, and whether there would be a response in the timeframes needed by councils. We discuss other potential solutions in the relationship agreement section below.

Role conflict in place-making and providing for growth

13. One area where councils are particularly concerned about alignment of purpose is growth planning and infrastructure provision for urban development. This includes the roles of the WSEs as plan implementer and the councils as plan maker. Councils are looking for assurance that growth planning and infrastructure provision will be joined up and aligned after the reform has taken place.
14. We acknowledge that the resource management reform is happening in parallel with three waters reform. However, the WSLB should be amended to provide for the respective roles of WSEs and councils in growth planning and infrastructure provision for urban development, with suitable supporting statutory rights and responsibilities. In particular, there should be an obligation for WSEs to have regard to (including, to deliver infrastructure for) the growth plans and strategies developed by councils.

Can councils shed political accountability?

15. In reality, councils will retain both real and perceived responsibility for the three waters system even when assets and responsibility for service delivery shift out of their hands. Councils will remain obligated to look out for community interests. Communities will assume a council still has significant sway, especially given councils will potentially collect water charges during the initial period of reform. This assumption could be expressed at the ballot box, even though an individual council and its councillors (including those on an RRG) will have limited control over actual service delivery.

16. Given an element of political accountability is inescapable, the model must recognise this. We suggest the following changes:

    16.1. Give councils a louder voice on key topics that WSEs must listen to. This is particularly important for place-making and master planning. A council could set some operating parameters that a WSE must respond to, consistent with its duties and objectives; and

    16.2. Subject to a suitable threshold, expressly empower councils so they can challenge (and seek reconsideration of) any decision made by a WSE that would negatively impact a council's ability to deliver a key element of an approved Long Term Plan. As the resource management reform becomes embedded, this could extend to an approved Regional Spatial Strategy.

Relationship agreements need more rigour

17. We think agreements between WSEs and individual councils (as opposed to agreements with multiple councils) are the best way to ensure individual council needs are met. However, some elements of these relationship agreements should be standard. This would ensure all councils/WSEs take a best-practice approach to universal issues, develop consistent engagement processes and reduce the need to develop and apply bespoke arrangements.
18. It is unclear what status the proposed relationship agreements will have. While clause 469(1) of the WSLB imposes an obligation on parties to act in good faith in giving effect to the relationship agreement, we are concerned that clause 469(2) of the WSLB provides that a relationship agreement is not enforceable in any civil proceedings. If relationship agreements are not legally enforceable, the WSLB should do more to frame up the context of the special role and nature of the relationship agreement between a WSE and a council. This is critical if the concerns we have raised above regarding the relationship between councils and the WSEs end up being dealt with through the relationship agreement rather than amendments to the legislation (as we request). In our view, there should be an express statutory basis and mandate that gives effect to the relationship agreements and provides councils with more meaningful recourse should a WSE fail to meet its commitments.
19. Relationship agreements could create an expectation of joint stewardship and care for all relevant systems, for the benefit of local communities. They could also require parties to create synergies that enable each organisation to succeed and avoid duplication of resource and cost. For example, by engaging with consumers/communities once on the full range of topics requiring consultation by both parties. This would lower cost, create efficiencies and develop expertise – as well as making much more sense to the public.
20. There are multiple touchpoints for the relationship between councils and WSEs, all of which need to be identified and managed in the relevant relationship agreement. Relationship agreements will cover the operation of stormwater, land drainage, or related services and the interface between three waters and council planning systems. In time, relationship agreements could be entered into with the regional planning committees that will be

established following the resource management reforms. Relationship agreements with regional councils should be more limited, given they will continue to have regulatory functions.

21. We think some of the planning interface arrangements used in the Scottish Water model could be adopted in Aotearoa New Zealand's water services legislation (i.e. similar requirements could be included as specific examples in clause 468(1)(c)(iv) of the WSLB). For example:

    21.1. WSEs should contribute to the writing of "main issues reports" (which are front-runners to local development plans);
    21.2. WSEs should contribute to the writing of any proposed local development plans;
    21.3. WSEs should contribute to the writing of an "action programme", which supports delivery of local development plans; and
    21.4. WSEs should comment on all outlines or full planning applications referred to by local authorities.

The Government Policy Statement potentially adds an unfunded mandate

22. The areas of influence under the Government Policy Statement have been expanded to include statements in relation to geographic averaging, redressing inequities in servicing of Māori, and redressing historic service inequities.
23. Consistent with our previous recommendations, we see this as adding to an unfunded mandate for WSEs and local government. If central government is able to exercise control and influence through the Government Policy Statement, and this results in local priorities being sacrificed to deliver on central government priorities, we think the communities should not be required to fund that cost and that central government should fund WSEs or councils to deliver those priorities (as appropriate).

Serious consequences for CCOs

24. Some CCOs may cease to be viable if employees and assets they use in connection with (but not exclusively for) water services transfer to the WSEs. Many such employees also perform other roles, including non-water related activities (such as roading and construction). They may also work on water services that councils will retain responsibility for (such as rural stormwater, flood protection works and transport corridor stormwater systems). This transfer would have material, adverse flow-on impacts for the councils who depend on those CCOs for other services and as a source of revenue.

Asset transfer provisions affect CCOs as well as councils

25. The asset/liability transfer provisions set out under the WSLB apply to "local government organisations". The term "local government organisation" captures local authorities, CCOs and subsidiaries of CCOs, if they provide water services. CCOs with a mixed shareholding (i.e. where one or more shareholders are not a local government organisation) are subject to a more restrictive transfer regime, under which the shares in the mixed ownership CCO may be transferred to the WSEs (and the usual asset and employee transfer provisions do not apply).
26. In our view, the definition of local government organisation is too broad. It is unclear whether the implications of the transfer provisions when applied to the full range of CCOs are fully understood by the Government. We make some recommended drafting changes to address our concerns in Appendix 1. These changes will provide clarity to all parties (including the National Transition Unit) on what organisations are covered, without needing to wait for decisions to be made by the Minister (in connection with the allocation schedule) or Governor-General some time prior to 1 July 2024.

CCOs that do more than water are still captured and this will negatively affect ratepayer interests

27. Some CCOs provide water-related-services as their core (or only) function (e.g. Watercare). Our understanding is that councils had understood that the transfer provisions in the WSEA would apply to those organisations' assets, liabilities and employees. However, a number of CCOs operate as multi-purpose "ServiceCos", which provide a range of different services to their respective councils (and third parties, including other councils). These can include some three-waters-related services; for example, operations support, asset replacement, repairs and maintenance. Such ServiceCos are local government organisations for the purpose of the WSEA and the transfer provisions apply to them. We understand that these ServiceCos are highly integrated, and typically deploy the same assets and employees across a range of functions (i.e. they do not relate exclusively to the three waters service delivery function that a WSE will take over).
28. While councils had appreciated that existing water service contracts between these ServiceCos and councils would be novated from councils to the new three water entities, councils had not appreciated that the ServiceCos' water-related employees and assets would also be transferred to the WSEs. To date, there has been limited engagement with these ServiceCos' employees, many of whom are regionally based. If the reform progresses in its currently proposed form, we assume the NTU will consider what resources and support services the WSEs will need if the ServiceCos' employees transfer. Conversely, we also assume that the NTU is considering the risks to the continuity of water services post 1 July 2024 if those employees do not agree to transfer and prefer to remain with the ServiceCo, noting the labour constraints in the water sector that already exist. The potential risks would be eliminated if the reform did not define these ServiceCos as local government organisations and the only impact on ServiceCos was the novation of the existing contracts from councils to the WSEs (see more on this below).

29. We understand that councils and ServiceCos affected by these transfer arrangements will include details in their submissions regarding the type and value of the assets and the number of employees that would be transferred from these commercial organisations to the WSEs if the reform proceeds in its current form.
30. We have heard from these councils that removing a ServiceCo's three-waters-related assets and employees will compromise the ServiceCo's future commercial viability. ServiceCos are designed to provide competitive pricing to their council (and third parties) for both three waters services and non-three waters-related services. In order to obtain efficiencies, ServiceCos allocate a portion of their overheads to their three-waters-related functions. By removing a ServiceCo's three-waters-related functions, those overheads will need to be allocated to the ServiceCo's remaining functions. The ServiceCo will potentially need to charge increased prices for those remaining functions, undermining its ability to provide competitive pricing. As a result, ratepayers would need to pay increased rates to offset the cost of the increased charges paid by councils to ServiceCos. This applies not just to the ratepayers of the council that owns the CCO but to any other neighbouring councils that use its services. If councils must source those services elsewhere, any "profit" earned by the service provider will not be applied for the benefit of ratepayers but belong to a private company. If a WSE were to take over this service delivery capacity, the WSE should be obliged to keep providing those services that a council will still need on no less favourable terms and conditions (including pricing) than is currently the case.
31. Even if a ServiceCo remains commercially viable post transfer, there are consequential risks from the loss of its key experienced operators to the WSE. In combination with its inability to provide competitive pricing, there is a concern from affected councils that this loss of experienced operators will significantly limit the ServiceCo's ability to perform the water-related aspects of its current contracts (which it will remain responsible for performing) and attract contracts with third parties going forward. Again, this is also likely to reduce the ServiceCo's revenue, with negative downstream consequences for ratepayers.
32. The transfers of assets and people from ServiceCos to WSEs would also impact councils as ServiceCo owners, and consequently ratepayers. ServiceCos, as commercial CCOs, are a source of revenue for councils, and our understanding is that the dividends received from these ServiceCos are used to offset the general rates borne by councils' ratepayers. Now councils are concerned that rates will need to be increased to offset the loss of that dividend. This would potentially compound the increase in rates referenced above to offset increased charges for the ServiceCos' non-water services.
33. If ServiceCos have been included in the staff/asset transfer provisions because there is a concern that a novation of existing ServiceCo contracts is not sufficient to change the way in which water services are delivered, we note the Minister has significant powers to amend novated contracts and could use these powers to address these concerns. For example, the Minister could include a review right in the existing ServiceCo contract whereby the agreement is reviewed in three to five years' time once the risk of continuity of service has passed and the arrangements between ServiceCos and WSEs are more settled. We also understand there are concerns around the amount of profit councils make from ServiceCos.

However, we think the benefit for councils and their ratepayers of receiving this dividend stream has been underappreciated. The alternative would direct the dividends to private companies (as the potential alternative providers of services), rather than to the community as a whole.

34. If existing water service contracts between ServiceCos and councils are novated by the relevant WSE, then the WSLB should also be amended to accommodate that such contracts are between two local government organisations. This could be done through amendments to the proposed new clause 52 of Schedule 1 to the WSEA.
35. As a separate point, we understand some council-controlled ServiceCos may be structured as joint ventures. This means the shares in those joint venture ServiceCos that are owned by local government organisations (i.e. councils) may transfer to the new WSEs. We question why the WSEs should become an owner of commercial organisations where water services are only one aspect of a broader business. Again, if the reform is to proceed in its current form, then councils would need to be appropriately compensated for this (including any consequential effects in respect of the removal of the dividend stream).
36. If the reform is to proceed in its current form the "no worse off funding" from the Crown will need to compensate councils and the relevant CCOs for the transfers and their consequential impact.
37. In our view, the definition of a local government organisation should and can be drafted to recognise the distinction between a multi-purpose ServiceCo and a CCO that owns three waters delivery infrastructure or has been set up to exclusively support the three waters service delivery functions that will be taken over by the WSEs. We suggest drafting changes in Appendix 1. As stated above, by removing ServiceCos from the definition of local government organisation, clause 49 of schedule 1 to the WSLB can be used to transfer specific assets if all interested parties agree it is desirable.

Other public infrastructure providers

38. We also question whether the asset transfer provisions in the WSLB are intended to apply to other public infrastructure providers currently owned (wholly or jointly) by councils and which may involve – as an ancillary matter – the delivery of three waters services. Our understanding is that in certain cases, council-owned airports and ports provide water services to their users using self-contained assets (or have water assets on their sites). Under the current drafting, these providers of other infrastructure would be caught by the definition of a local government organisation. It would be inappropriate to subject these infrastructure providers' water-related assets, or the shares in the provider themselves, to the transfer provisions under the WSEA and WSLB. The infrastructure providers are likely to continue to be best placed to manage their own water assets, and would still be subject to their obligations under the Water Services Act 2021.
39. In our view, it is not enough to simply include these entities in the allocation schedule designation process on the assumption that they will be carved out of the actual transfer later. For certainty, we make some recommended drafting changes in Appendix 1 that would exclude these entities from the definition of a local government organisation. We also note

that excluding other infrastructure providers from the definition of local government organisation would mean clause 49 of schedule 1 to the WSLB could be used to transfer specific three-waters-related assets held by those infrastructure providers if all interested parties agree it is desirable.

Mixed-shareholder CCOs

40. The definition of a "mixed-shareholder CCO" in the WSEA currently seems to capture any CCO with a mixed shareholding if the shareholder (e.g. a territorial authority) provides water services, regardless of whether the CCO itself provides water services and the context in which they might provide water services. To provide certainty and avoid unnecessary concern and wasted effort, we think a mixed shareholder CCO must also be a local government organisation, which would limit the definition to CCOs that actually deliver three waters services.
41. To qualify as a mixed-shareholder CCO (i.e. a CCO in which a third party also holds shares), the council-affiliated shareholder must be a "local government organisation". To be a local government organisation, it must "provide water services". This means a CCO with mixed ownership will *not* satisfy the definition of "mixed shareholder CCO" if the council's shareholding is held through a council-owned holding company that *only* holds shares/investments (i.e. does not provide water services). This appears to unintentionally narrow the scope of entities treated as mixed-shareholder CCOs. It means a CCO excluded in this way will be treated as a standard CCO under the WSEA for the purposes of the WSLB asset transfer provisions. In addition, the WSLB provides that council-affiliated shares in any mixed-shareholder CCO involved with the provision of water services automatically transfer to the WSE. There must be an ability to consider the circumstances of a mixed-shareholder CCO before determining that the council-affiliated shares should transfer to the WSE. Such a transfer should not be automatic, and the ongoing relationship between the mixed-shareholder CCO and its WSE may be best addressed through a "relationship agreement". We make some recommended drafting changes in Appendix 1 to address the above points.
42. Under the proposed clause 45 of schedule 1 set out in the WSLB, the shares held by a local government organisation in a mixed-shareholder CCO involved in the provision of water services appear to automatically vest in the relevant WSE. Further, clause 45(2)(a) appears to override clause 42 of schedule 1 to the WSLB, which sets out the Governor-General's power to specify assets, liabilities and other matters which should not vest in the WSE. In our view, this automatic vesting provision is inappropriate, and we assume it is a drafting error. For example, if a council-controlled airport or port was operated under a mixed ownership model, and it also provided water services as part of its principal business operations, clause 45 would mean the WSE automatically receives ownership of the council's shares in that airport or port. For obvious reasons, this would be problematic and cannot be what is intended. We recommend that any automatic vesting of shares should remain subject to the Governor-General's powers to remove those shares from transfer or, preferably, subject to the Governor-General's power to vest shares where it is agreed that is necessary and appropriate. We provide recommended drafting in Appendix 1. From a drafting perspective, we also

suggest that clause 45(1) should refer to a mixed-shareholder CCO, noting our suggested changes to this definition. It is not clear to us why this defined term should not be used in this clause.

Some rural supplies should be able to opt out

43. The Bill says that local government-owned mixed-use rural water supplies that provide both drinking water (to 1000 or fewer non-farmland dwellings) and water for farming-related purposes (where 85% or more of the water supplied goes to agriculture/horticulture) will be transferred to the WSEs. These supplies could subsequently be transferred to an alternative operator (for example, the local community served by the supply).
44. This position is different from the recommendation of the Rural Supplies Working Group, which promoted a regime where the rural community could opt out from the initial transfer. In our view, the process required to subsequently transfer the service to an operator is too high a bar. There should be an opt out option available to communities that can demonstrate they satisfy the transfer requirements set out under the WSLB. We strongly support the Rural Supplies' Working Group's recommendations and are disappointed to see this one ignored.

Council planning during establishment period

45. Under clause 27 of schedule 1AA to the LGA (as amended by the WSEA), any long-term planning during the establishment period must exclude content relating to water services. This includes any amendments to councils' existing Long Term Plans.
46. The term "water services" is not defined under the LGA. Presumably, the definition of water services is intended to be carried over from the WSEA, and therefore means "any services relating to water supply, wastewater and stormwater".
47. The broad definition of water services captures services that will be provided by the WSEs after 1 July 2024 and *services that will remain the responsibility of councils* (e.g. transport stormwater functions). This is problematic. Councils will continue to provide these functions during the establishment period (and after), and may need to amend their Long Term Plans for valid reasons relating to those functions.
48. Clause 27 also fails to recognise that councils will continue to provide *all* water services during the establishment period, until they are transferred to the WSEs. Again, councils may need to amend their Long Term Plans to reflect valid changes related to those services, bearing in mind the DIA oversight provisions contained in Subpart 4 of schedule 1 to the WSEA (which provides an adequate protection mechanism and expressly applies to a decision to amend a Long Term Plans if the amendment relates to or affects the provision of water services). If clause 27 applies as drafted, Long Term Plans could never be amended in a way that affects the provision of water services.

49. As an example, councils will continue to collect development contributions until the establishment date, after which those contributions will be transferred to the WSEs. Development contributions can only be levied where the associated capital expenditure is reflected in councils' Long Term Plans. If councils are prohibited from updating that capital expenditure to reflect valid changes during the establishment period, it will limit their ability to correctly levy those contributions.
50. We think the reference to amendments of Long Term Plans should be removed from clause 27. We suggest drafting in Appendix 1 to address this issue.

Councils should not collect water services charges

51. We are concerned about the provisions relating to councils collecting water charges on behalf of the WSEs. Councils oppose being compelled to collect revenue for a service they no longer control and deliver, partly because it will exacerbate public confusion about who is accountable for water services. Councils also say this would not be feasible without significant investment in IT systems, given the complexity involved. Council financial and billing systems are not designed to collect third party charges.
52. Under the WSLB, the chief executive of a WSE may authorise local authorities to collect charges on behalf of the WSE until 1 July 2029, in exchange for a reasonable payment for providing the service. To facilitate the process, a WSE would enter into a charges collection agreement with the council. If a charging agreement is not agreed upon (or particular terms are not settled), the Minister has power to impose binding terms. The use of the term "authorise" suggests that it follows a request being made by the local authority. However, the WSLB regime contains no prior step whereby the local authority first determines that it wishes to provide the service to the WSE. As such, the use of that term is misleading because the council appears to have no choice in the matter.
53. If it is not possible for the WSEs to stand up their own billing/collection systems on 1 July 2024 (which is our preference), any interim arrangement should be supported by agreed principles and limits to protect councils' interests (including potential legal liability), as well as sufficient central government investment to ensure the success of the arrangements. The WSEs should carry the risk of council resources and systems not being able to do what the WSE may want, especially as councils will lose some resource capacity due to the reform.
54. The charges collection provisions in the WSLB are based on provisions set out under the Infrastructure Funding and Financing Act 2020 (IFF) for collecting IFF levies. However, these circumstances are different, and there are a range of other matters that need to be recognised:

    54.1. The WSLB contains a diverse range of charges. It is unclear whether councils will be expected to invoice and collect the full range of charges, as and when requested by the WSEs. Requiring councils to collect a diverse range of charges increases work, complexity and risk, and would have implications for existing processes/IT systems,

creating additional costs and resource requirements for councils. Councils need to be reimbursed for the full cost of any required enhancements, and their obligation to do so should be limited to reasonable endeavours;

54.2. Alternatively, it should be very clear that each council must only do what its current systems are capable of doing, which may fall short of what the WSEs require. Three waters billing will not be councils' core business, nor a priority in terms of the performance of their continuing functions. Again, councils should be fully insulated from any risk associated with these functions, and not liable for failures if they exercise reasonable endeavours;

54.3. A small number of councils will need to collect charges on behalf of two WSEs. This will add material complications to invoicing and will be confusing for these council's ratepayers, who could have different types of water service charges (as determined by the relevant WSEs) included on their bills;

54.4. Councils should be entitled to favour their own financial requirements. Unless payments are directed to the WSE itself (i.e. the ratepayer makes a separate payment to a WSE's bank account), all amounts received into a council bank account should first be applied to council rates (i.e. the WSE wears the risk of any shortfall). The WSLB should also provide for the position where a council is also collecting IFF levies. For the purpose of our submission, we have assumed that the billing and collection of these charges will be done through the same bank account that councils use to collect rates, in order to ensure that the invoicing is seamless for consumers. However, if the intention is for there to be a separate bank account for water charges, then this will increase demand on staff and councils will need to be resourced and compensated accordingly (and WSEs should not assume that councils will have this additional resource on 1 July 2024);

54.5. To aid efficiency, has consideration been given to including a process for councils to combine to deliver the water service billing and invoices from a dedicated shared services unit? For example, Tasman and Nelson. We note there may need to be sharing of information;

54.6. The WSLB should contain a requirement for WSEs to develop and deliver a communications programme to ratepayers. Pre-empting potential confusion and providing information in advance should smooth the transition.

55. Finally, the WSLB should also specifically address (and insulate councils from) compliance risk associated with the Anti-Money Laundering and Countering Financing of Terrorism Act 2009, and responsibility for accounting for GST.

Geographic averaging

Geographic averaging – clause 334 of the WSLB

56. According to the WSLB, a WSE's board may charge geographically averaged water prices for different service types and consumer groups. The explanatory note to the WSLB suggests averaging will be used as a tool to protect vulnerable consumers by smoothing prices and sharing costs, ensuring consumers in similar circumstances across a service area will pay the same price for an equivalent service.
57. The WSLB does not direct how or when geographically averaged prices should be applied by the WSEs. Instead, the WSLB leaves this to the WSEs' boards, which will need to act consistently with the general charging principles, including the Commerce Commission's input methodologies and determinations (which will not be in place on 1 July 2024).

General charging under the WSLB

58. The transitional provisions under the WSLB contemplate a WSE carrying forward existing tariff or charging structures until (as late as) 30 June 2027. Supporting cabinet papers released by the Minister indicate that moving to harmonised pricing will inevitably take several years, to smooth the impact of changes on individual customers and avoid price shocks.
59. A core pricing principle (which, if not brought forward by regulations, will apply from 1 July 2027) is that charges should 'reflect the costs of service provision'. Given the way the principle is expressed, and then qualified, it suggests a starting point of standardised user pricing by reference to the WSE's total cost base. The qualification is that a group of consumers may only be charged differently if the group receives a different level (or type) of service, or the cost of providing services to that group is different. Even then, a WSE's board may decide not to apply a 'costs fall where they lie' approach and may set lower charges when remedying inequities in the provision of services to a certain area. The WSE chief executive may also discount charges that would otherwise apply.
60. Our understanding is that geographic price averaging may then apply in addition to the above principles/considerations.

Councils are concerned geographic price averaging may create new inequities

61. Geographic price averaging of residential water supply/wastewater services is a sensitive issue (recognised by its inclusion in government policy statements), as is defining and addressing historic service inequities. Councils have expressed concern that geographic averaging of water charges may create new inequities. For example, should residential consumers in a metropolitan area (who benefit from the cost efficiencies gained by operating at scale in a defined location) share in the (naturally) higher costs involved in delivering a similar level of service to a rural and provincial residential consumers? This issue becomes even more complex where there are strongly held views about the level and quality of previous investment in the water services assets.
62. Conversely, using metro areas' scale to subsidise costs for smaller, rural areas was understood by a number of councils to be an underlying principle of the reform. Some members believe the WSLB does not go far enough to entrench this principle, and leaves too much decision-

making responsibility to the Commerce Commission and WSEs' boards. If standardised pricing (for the same level of service) is not enshrined in legislation, some councils will feel misled by the dashboards provided by the Government in 2021, which gave every council in an entity's service area the same cost per household for water services post-reform. These were also highlighted in the Government's public-facing communications.

63. Individual councils will need to assess how this might apply to them and their communities, after a WSE has indicated how it will apply geographic averaging in practice. This needs to be a decision made by councils in collaboration with their community, not by WSEs unilaterally. We recommend that an RRG should have to endorse or mandate a geographic averaging policy before it can be implemented, especially if the funding and pricing policy that permits it only provides high-level guidance.

Water infrastructure contribution charges

64. WSEs will have the power to set water infrastructure contribution charges if new development or increased commercial demand means the WSE must provide additional or new water services assets.

Water infrastructure contribution charges

65. We are concerned that not all of the provisions in the LGA that regulate how and when a council can charge development contributions have been carried over to the WSLB. Examples are sections 198(2A) and 209 of the LGA, and the reconsideration and objection provisions for development contributions. It is not clear to us why such provisions have not been included in the WSLB as such protections would seem to be even more important in relation to WSEs than they currently are for councils. That's because councils are more directly accountable to their local communities for decisions than WSEs will be.
66. Our view is that the WSLB should give greater clarity on the interaction between development contributions and water infrastructure contribution charges post 1 July 2024. This includes councils' role (if any) in connection with water infrastructure contribution charges. For example, there needs to be clarity on what happens post 1 July 2024 if a developer requests a refund of a development contribution and this development contribution has been passed on to the WSE. In addition, the WSLB provides for water infrastructure contribution charges to be levied when people are granted a resource or building consent. We are assuming that councils are not expected to administer this on behalf of the WSE but merely obliged to forward to the WSE notification of new consents – but this needs to be clarified in the WSLB.
67. The provisions of the WSLB expand on the concept of a "development" by also referring to instances of "increased commercial demand". In our view this is sensible but, where appropriate, the term needs to be used consistently where the term "development" is used. For example, the term "increased commercial demand" is absent from 344(1)(a) the WSLB.

Crown as a payer of water infrastructure contribution charges

68. We note the Crown is exempt from paying water infrastructure contribution charges. This is a concern, as Crown agencies are often major developers, and can exacerbate issues that are the responsibility of the WSE or local council. Such an exemption should be something the Crown applies for and needs to justify. These applications should reference the benefits derived for a particular community from the Crown agency's project, and those benefits need to be sufficient to justify the associated water services-related costs that will be borne by all consumers across the service area.

Combined cost to ratepayers

69. The reform assumes the combined costs of water bills and rates bills will not change when the WSEs stand up. We're not sure this is correct. Although this outcome may be forced in the short term, there will be a point of material adjustment down the track.
70. To date, and for a variety of reasons, councils have taken a long-term, portfolio view of their finances and activities. Taking this approach means there may be a level of under-rating or cross-subsidising at any particular point in time. When economies of scale and scope are lost as a result of three waters services ceasing to be part of the portfolio of council/CCO activities, councils (and their CCOs, as discussed above) may need to increase their general rates to cover the real costs associated with their remaining functions. It is also unclear whether the Department of Internal Affairs (DIA) has a plan to address situations where council rates do not drop by an amount equal to what the relevant WSE is charging for water services and a council and DIA/WSE have different views on the portion of current rates that relates to three waters service delivery. If they do have a plan, councils need clear (and early) visibility of this.

Appointing receivers

71. According to the Bill, in situations where a WSE has granted a security interest over its charging revenue as security for its borrowing from a third party lender, and a receiver has been appointed in respect of such loan, the proposed section 137A empowers this receiver to assess and collect (in each financial year) a charge to recover sufficient funds to meet the payment of the WSE's commitments in respect of the loan in that year. A charge under this section must be a uniform charge in the dollar on the rateable value of property from some or all consumers in a WSE's service area.
72. This provision has been directly adopted from the LGA (where it currently applies to councils), and on that basis is seen as a continuation of the status quo. Our understanding is that the comparable section in the LGA (section 115) has never been used in relation to councils. In our view, it needs to be tested whether such a provision is appropriate for consumers of WSEs

given differences between a WSE and a council and what limits/constraints may be necessary or desirable to protect consumers.

WSEs are different from councils

73. The structure of the WSEs (and their internal decision-making processes) do not provide the same constraints and accountability mechanisms that apply to councils. WSEs boards (i.e. the decision makers) are appointed by a body formed out of the RRG. While consumers have some influence (and can provide feedback on the WSEs' activities during engagement opportunities), these levers are several steps removed compared to councillors' accountability to their ratepayers and the other limitations that apply to council borrowing as well as the nature and type of financial exposure councils are permitted to have.
74. We are concerned that consumers are the ultimate guarantor/backstop of debt incurred by a WSE in circumstances where the WSE's finance-related options are relatively unconstrained. Consumers have no direct influence over the makeup of the entity's board (nor by extension over its fiscal decision making). Unlike WSEs, councils' ability to incur debt is subject to certain caps. Councils can take proactive steps to recover unpaid rates, including ultimately selling a ratepayer's home. These factors not only limit the potential liability of other ratepayers, but they also materially reduce the prospect of a receiver ever being appointed. The same factors are not necessarily in place for consumers of water services.
75. If there is no recourse to the Crown for a failure by a WSE to repay its borrowed money indebtedness, then other solutions to limit the amounts that receivers are able to charge under section 137A need to be considered. We elaborate on this below.

The regulation of the charge imposed by the receiver

76. We are concerned that any charge assessed and collected by a receiver under clause 137A is not limited or regulated in any form. If the relevant lenders have accelerated the loan, the amount of a "WSE's commitment in respect of the loan" in the relevant financial year is likely to be significant. We acknowledge that the receiver will be subject to specific duties (like the duties of a receiver to a local authority) but in our view, there should be express limits on the amount that the receiver is able to assess and collect under this provision.
77. Our understanding is that where a receiver assesses such a charge, consumers would need to pay this in addition to the water service charges charged by the WSE. We also understand that the amount assessed by the receivers will not be regulated by the Water Services Economic Efficiency and Consumer Protection Bill. The amounts to be assessed by the receiver should be regulated in some form (through the WSLB or otherwise) in order to protect consumers. In the situation where a receiver is appointed and the WSE has granted a security interest over the water revenue, the receiver will be receiving these amounts (see section 40C of the Receiverships Act, which we assume will be amended to apply to a WSE). In our view, this is the key protection for a receiver in this situation and as such, a limit on or regulation of the assessment of this additional charge is not unreasonable.

78. We note that, and think further explanation is required for why, the charges under this section are set by "rateable value of the property" given this is not a concept that exists in the charges regime for WSEs.

Receivership Act

79. Clause 137A cross references the Receivership Act. Amendments will need to be made to the Receivership Act so that it contemplates the appointment of receivers to the WSEs.

Rating WSEs' assets

80. Our understanding is that WSEs will not pay rates on water infrastructure located in or under land they do not own, and will not pay rates on assets located on land they do not own. However, other utilities (such as electricity lines companies and telecommunications companies) contribute their share of rates related to the land and assets they benefit from.
81. Whether WSEs should be approached in the same way as other utilities depends on the nature of the relationship between councils and WSEs. Councils and other utility providers currently engage on an arm's-length commercial basis. If the relationship between councils and WSEs will be one of a partnership mandated by statute for the overall benefit of communities (as we have recommended), it may be appropriate that the WSE is exempt from paying rates. However, if councils will be treated as "just another stakeholder" (as the legislation currently suggests), we would expect the WSE to be subject to the same treatment as a standard utility provider.
82. If the relationship will not be one of partnership for community benefit, but councils will still be required to engage with WSEs on an ongoing basis, charging WSEs a share of rates is one way of ensuring councils can fund the resources required to support engagement with WSEs.

Stormwater remains problematic

83. The points we made in our submission on the WSE Bill regarding a phased transition of stormwater assets remain relevant. Our core position is that there is significant complexity associated with urban stormwater networks transferring to the WSEs while the "transport stormwater system" and mixed use assets remain with councils.
84. Even if the identification and transfer of stormwater assets during the allocation process runs smoothly, separating stormwater functions (i.e. between councils/corridor managers and WSEs) in a system designed to operate as a whole will create complexity. As raised above, relationship agreements will need to be given sufficient standing in order to manage the relationship between stormwater operators.

Management plans

85. WSEs will be required to produce stormwater management plans. When producing these plans, a WSE must engage with councils. According to the WSLB, councils must work with the WSE to develop the plan. But how WSEs and councils will work together on this remains unclear.
86. The operational interface and touchpoints will be many and varied. These need to be carefully managed as each council and WSE find their feet and set up channels of communication and processes to support their ongoing engagement and legal compliance obligations.

Charges

87. A WSE may charge a council for stormwater services between 1 July 2024 and 1 July 2027 if the WSE is not charging system users directly. It is unclear how councils will pay for stormwater services if they are not allowed to rate or charge for water services themselves.

Interface with councils' roles and functions

Carrying out works

88. WSEs will have the power to construct or place water infrastructure on or under land owned by councils. The WSE only needs to provide 15 days' notice. We question how this will work cohesively with council planning and processes, and whether the 15-day notice period is sufficient warning for councils.

Sharing rating information

89. The Act will require local authorities to share rating information kept under the Local Government (Rating) Act 2002.
90. While we are pleased to see councils will be compensated for the work required to share this information:

    90.1. Councils need to be insulated from any risk associated with complying with a WSE's request (cl 319(2)) and should be free from any risk/obligation to assess and verify that a WSE's request is lawful; and
    90.2. Councils' obligation needs to be subject to what their existing systems are capable of producing. This means the resources they have available, recognising that this will not be their core business nor a priority in terms of the performance of their continuing functions.

Councils' three waters debt

91. We are concerned about the process for determining the quantum of a councils' debt (both external and internal) that is attributable to three waters. The WSLB says the DIA Chief Executive will assess the total debt amount. Councils have no recourse to the Minister if they disagree with the amount assessed by DIA. They only get a chance to agree the date and manner of payment. We believe this needs to be viewed in conjunction with the "no worse off" commitments referenced in clause 26A of schedule 1 to Part 1, subpart 6 of WSEA.
92. In addition, the WSLB anticipates that a council may keep holding its existing three waters debt for a period of up to five years following 1 July 2024. This may be to accommodate instalment payments over time to match an existing debt repayment profile, but more detail is required from DIA about what is actually contemplated here and the nature/quality of the financial claim the council will have that corresponds to a debt for which they no longer hold an asset nor right to collect rates revenue.

WSE financial reporting

93. We question whether there should be an extension of, or inclusion of an equivalent to, the Local Government (Financial Reporting and Prudence) Regulations 2014 for the WSEs.

WSE subsidiaries

94. The added provisions in relation to WSE subsidiaries in this Bill have surprised councils. They are materially different from our current understanding of the three waters model, and appear to be based substantially on the CCO provisions in the LGA. While we acknowledge that this introduces flexibility, it also creates a whole new layer of operational activity below the WSE board that is even more removed from direct RRG oversight and democratic accountability. The obligations placed on the WSEs' boards do not appear to be replicated at the subsidiary level.
95. Contemplating "listed subsidiaries", a "subsidiary of a subsidiary" and operating for profit seems wholly out of place with the policy settings originally promoted by the Government. We are very concerned about this new focus in the WSLB and no explanation has been provided in the materials accompanying the WSLB.
96. Any proposal to establish a subsidiary should be regulated by the WSEs' constitutions and be subject to a process that requires the proposal to be endorsed by the RRG. This process needs to take into account the rationale and purpose (and the risks and mitigations) involved in devolving matters from the direct control of the WSE board appointed by (and accountable to) the RRG.

97. Even though the legislation says that significant water assets must remain with the WSEs, it is expressly contemplated in the WSLB that a subsidiary may be formed by more than one WSE (possibly with other investors). This would be to undertake borrowing or manage financial risks that involve a risk of loss, which the WSE may guarantee, indemnify or grant security for. This would appear to suggest that the consumers within the service area of one WSE could become liable for the financial risks of another WSE. It is not clear whether the restrictions that apply to WSEs also apply to subsidiaries. The language used in clause 9, schedule 5 of the WSLB refers to situations where a subsidiary "undertake[s] an activity on behalf of a WSE". It is not clear whether this captures a subsidiary undertaking activities on its own behalf nor whether "water services infrastructure" captures infrastructure that is owned or operated, or used or proposed to be used, by any subsidiary.
98. More detail/clarity is required about what is actually under contemplation here.

Legal claims and liability

99. We are concerned about who will be exposed to legal liability when things go wrong. This includes what legal remedies will (and should) be available. For example:

    99.1. What happens if water controlled by a WSE damages council assets?
    99.2. What will the consequences be if a council or WSE fails to act consistently with the terms of their relationship agreement? Should the non-defaulting party be granted statutory relief if this situation results in them failing to comply with a legal duty or requirement?
    99.3. Will councils or landowners be able to bring judicial review proceedings against WSE decisions on policies/plans that adversely impact the value of their property or other aspects of their economic interests?
    99.4. Will councils continue to be liable for past breaches and failures relating to water infrastructure, which they may not now be able to fund given they are not receiving any water-related revenue?

100. These matters need to be clarified in a way that protects the interests of councils.

General comments

101. Most of the detail around asset and contract transfers, and establishing the WSEs, has been lifted from previous statutory reorganisations. Councils would benefit from:

    101.1. A guide to the legislation that clearly identifies the points of difference from current LGA positions, to assist councils with understanding and planning for the change management involved with implementing the reforms.

102. We think it would be beneficial to clearly map out the LGA content pre-and post-impact of the WSLB, taken together with the WSEA. This should include what stays, goes, changes and where there is a clear need to manage an interface between council and WSEs' powers.
103. Under clause 76 of schedule 1 to the WSLB, any engagement taking place between councils and DIA/the National Transition Unit (NTU) before 1 July 2024 will count as engagement or consultation for the purposes of the legislation. This should be qualified by a need for DIA/NTU to clearly identify and communicate when particular contact and content counts and for what particular purpose. This cannot be asserted after the event. Councils need to know when to bring their issues/concerns to the table with DIA/NTU.

Public Works Act

104. We think council land transferred to a WSE that later becomes "surplus" should be returned to the original council owner, so it can be made available for alternative community use or sold. This means any proceeds would be made available for use in the relevant community. "Surplus" land should not be retained or sold by the WSE for its own purposes or benefit.

Mana whenua arrangements

105. We think arrangements between mana whenua, councils and WSEs should become tripartite agreements. This means the WSE and council work together to ensure mana whenua can easily engage with them both. Mana whenua should not have to find resources to support the management of two separate relationships.

Councils as road controlling authorities

106. The WSLB says that if a council needs to move three waters assets to carry out other functions, it has to pay. The same applies to the WSEs in reverse. We think WSEs and councils should collaborate to reduce costs where either party has to undertake activities that interfere with the other's assets.
107. Currently, councils can create efficiencies, as they own both sets of assets. We want to ensure these cost savings are not lost by a separation of functions.

Part 2: Water Services Economic Efficiency and Consumer Protection Bill (Economic Regulation Bill)

The problem definition is problematic

108. We do not think the Economic Regulation Bill (ERB) approaches the core problem definition from the right perspective. The ERB approaches the water services sector as if it was any other natural monopoly utility, without recognising the unique ownership model that will apply. In particular, the ERB includes amongst its purposes limiting WSEs' ability to "extract excessive profits". To imply that WSEs will be creating or pursuing profit is inflammatory, inaccurate and unnecessary given the proposed public ownership and governance model. We are concerned that this unhelpful phase will dominate the narrative around the ERB and WSEs and distract from the fundamental issues.
109. The real challenges the water services sector faces are different in scope than those for other utilities. The policy work supporting the ERB suggests the focus of economic regulation should be:

    109.1. Supporting high-quality asset management information and strategies;
    109.2. Incentivising efficiency; and
    109.3. Creating transparency and accountability for investment choices and service outcomes.

110. The purpose of economic regulation, and the choice of regulation, should reflect these particular needs. In our view, information disclosure (discussed below) should be the primary focus of economic regulation, at least in the first instance. Quality regulation and price regulation should follow later and only if demonstrably necessary to achieve the desired policy goals.

What type of regulation should apply when?

111. As currently drafted, the ERB provides for information disclosure and quality-only regulation to apply from the first regulatory period, and price-quality regulation to apply from the second regulatory period. In our view, information disclosure should apply from the first regulatory period and quality-only regulation from the second regulatory period. Price-quality regulation should not enter into force by default from the second regulatory period, but rather be subject to a further decision by the Minister. This would be more proportionate and cost-effective, while still delivering on the Government's policy objectives and ensuring water assets are efficiently managed in the interests of consumers.

Why information disclosure should be prioritised

112. Information disclosure will deliver most of the regulatory policy outcomes the Government has targeted for improvement. In particular, information disclosure will support accountability and transparency, incentivise efficiency, and support development of high-quality asset management data, systems and processes. That's why we're suggesting the form of regulation is limited to information disclosure, at least initially.
113. Information disclosure has been successfully applied in other regulated sectors. For example, the airport sector is regulated solely via information disclosure. The Commerce Commission's monitoring and evaluation of airports' disclosures has resulted in a high level of transparency and accountability in the provision of aeronautical services. Similarly, in the electricity distribution sector, which – like the water sector – has been historically highly fragmented, the Commission's dashboard approach to reporting annually on key financial and asset management metrics has been very successful.
114. Imposing only information disclosure in the first regulatory period would provide clarity in the early stages of reform. It would be simple to explain and understand. It would also:

    114.1. Avoid creating on day one a medium/long term source of regulatory risk that is impossible to accurately predict and factor in at a time (both by the WSE itself but also third parties entering into long-term contractual arrangements with a WSE) when key WSE systems (including funding arrangements and long term planning) need to be put in place;
    114.2. Ensure councils (and communities) are not required to accept a delivery model with a key element still undecided. By creating clarity at the start of reform, councils would be able to give their communities a clear, simple outline of what to expect. Conversely, adopting an incomplete regulatory regime will mean New Zealand's communities are committing to potentially negative future outcomes, without an ability to turn back; and

114.3. Ensure that, if additional forms of regulation are to be imposed at a later date, the Commission has a comprehensive and systematic set of information to support high quality regulatory decision-making.

115. In order for information disclosure to achieve the Government's objectives, the Government should provide the Commerce Commission with a clear (and focused) direction on the problem definition, which would then inform key elements that need to be covered in information disclosure. This would ensure information disclosure obligations do not end up being poorly fitted, overly prescriptive or onerous relative to the Government's objectives.

116. In addition, information disclosure should not duplicate other elements of the legislative framework. It appears the Government wants to increase information and transparency around assets held by the WSEs (and their condition), expenditure and revenue/charging. To a large extent this is already provided for in the WSEA (and the WSLB), and so we question whether there is any additional value to be obtained from adding a resource- and expertise-intensive regulatory reporting and compliance regime into the mix.

Quality regulation should not be applied in the first regulatory period

117. In our view, introducing quality regulation in the first regulatory period is an unrealistic target. We recognise quality regulation is already applied to other utilities. However, the conditions are not yet in place for three waters asset base and service delivery – and are unlikely to be in place by the first regulatory period – to support quality regulation.

118. The key to effective quality regulation is: (1) identifying aspects of service quality that are measurable, verifiable, and genuinely matter to consumers, and (2) calibrating quality standards to apply an appropriate level of challenge to regulated suppliers. If quality standards are too relaxed, the supplier is not incentivised to monitor and improve service quality. Conversely, if quality standards are not realistically achievable, the compliance incentive is ineffective, and in addition the supplier faces unjustifiable legal risk.

119. Effective quality regulation therefore requires:

119.1. A clear (and quantified) long-run view of current quality performance across the whole asset base (i.e. a historic baseline that allows the Commission to determine how the supplier is currently performing). Because assets are long-lived, and exogenous factors that affect service performance involve randomness and uncertainty, a significant time series is required to give an accurate view of the supplier's underlying' level of service reliability;

119.2. Information on the aspects of service quality that consumers value and the level of service quality that consumers support (and, critically, are prepared to pay for); and

119.3. An understanding of what level of quality performance is realistically achievable in the future, in what timeframe and at what cost.

120. Failure to comply with quality standards exposes both the WSE and individual directors and officers to civil and criminal liability. Other sectors (for example, electricity or telecommunications) implemented their quality regulation with an existing historic data set of network performance, which provided a clear baseline and supported a forecast of achievable future performance. Outside of the main metros, we doubt this would be the case for three waters.
121. The first regulatory period should instead be dedicated to information gathering to support quality regulation in the future. Quality regulation should be introduced, at the earliest, in the second regulatory period, utilising information obtained through information disclosure in the first regulatory period. This would also give WSEs a proper opportunity to engage with their consumer base to determine what consumers value and want to see in terms of service performance.
122. As stated above, information disclosure is likely to achieve most of the aims of economic regulation. Rather than an option to defer (which is the current approach), imposition of quality regulation should be deferred to the second regulatory period by default.
123. The ERB also significantly expands the scope of quality regulation in New Zealand through the introduction of regulated "performance requirements". This essentially allows the Commission to directly regulate the WSEs' approach to asset management. While it is important that WSEs are required to disclose information regarding their asset management plans, systems and processes, the Commission is not well placed to directly mandate asset management requirements. Asset management requires expert commercial and engineering judgement, informed by industry standards and sector expertise. The WSE board also has a critical role in supervising an entity's asset management system. As currently drafted, the ERB would allow the Commission to substitute its own view for the engineering judgement of the WSEs. This goes beyond the incentives-based regulation that has traditionally (and effectively) applied in New Zealand. Not only is the Commerce Commission not well placed to carry out this role, but it would compromise the ability of the WSE board to discharge its duties.

Price-quality regulation should also be put off

124. Price-quality regulation should similarly be deferred and, rather than entering into force by default, should be made subject to a further recommendation by the Minister.
125. Price-quality regulation is an extremely costly and complex form of regulation. It is not realistic to roll out price-quality regulation just three years into the new regime. It is also likely to represent a disproportionate regulatory burden in light of the gains that can be made with information disclosure alone.
126. The principal aims of price-quality regulation – over and above information disclosure and quality-only regulation – are to prevent suppliers extracting excessive profits and incentivise

cost-savings. As discussed above, excessive profit taking is not an issue in the three waters sector, and efficiency would be addressed through information disclosure regulation. We think the information disclosure regulation should be given a chance to do its work, before we move to a more complex, onerous, and costly form of regulation.

127. Information disclosure also doubles as a soft form of price control, because financial returns can be exposed to scrutiny. Similar to quality regulation, price-quality regulation is more effective with better data. If price-quality regulation becomes necessary down the track, the regulator would be better placed to implement it with two or more regulatory periods of data.
128. Price-quality regulation does not come at zero cost to consumers. The complexity of price-quality regulation requires a substantial investment both by the Commission and by suppliers, both to set price-quality paths and to monitor compliance. That additional cost is ultimately borne by consumers. Before price-quality regulation is imposed, it would be appropriate to make a cost-benefit assessment to ensure that the imposition of this additional form of regulation actually delivers value to consumers. If – as we anticipate – information disclosure and quality regulation achieves the Government's regulatory policy objectives, the additional burden of price-quality regulation is unlikely to be justifiable or in consumers' interests.

Debt capacity and financial concerns

129. We are concerned about the potential impact economic regulation could have on the short/medium term debt capacity of the new WSEs. In particular, we are unsure of the impact this regulation would have on the WSEs' ability to meet their share of the "better off" funding commitment to councils without using debt capacity needed to meet three waters compliance costs (including regulation) and fund existing or expected future investment requirements. This is contrary to all parties' intentions when the "better off" funding model was designed.
130. If WSEs could not fund their mandatory commitments, we think the Crown should fund an interim solution. The Crown should only look to recover that cost when the WSEs can handle it without compromising their operations. We also think the WSEs should only make financial support package payments out of excess borrowing capacity, and so long as that debt burden does not result in a materially increased cost to consumers.
131. If the economic pricing and transitional arrangements create abnormal financial circumstances for the WSEs, we think the Government should provide additional financial support to the entities to bridge the gap between:

    131.1. The 'known realities' the entities will face during the transition phase and
    131.2. The financial position the modelling assumes the entities will be in to start delivering on the benefits intended to arise under the new model.

132. This may mean the Government will need to make a short-term compromise on one or more of its policy bottom lines during this initial period of fragility.

Te Mana o te Wai and Te Tiriti obligations

133. It is unclear how the Commission will account for the WSEs' obligations under Te Tiriti, Te Mana o te Wai, and Treaty settlements. Particularly, how will these aspects be reconciled with the Commission's well-established economic/input data-based approaches for regulating other utilities? In our view, the Commerce Commission should have regard to Taumata Arowai's position on these matters, it being better placed to address them.

Appendix 1: Changes to statutory clause wording

Suggested wording changes are in **bold**

134. Clause 6 of the WSEA: amend the definition of "water services" as follows:

> Water services means services relating to water supply, wastewater, and stormwater **and in respect of stormwater, does not include any services relating to the transport stormwater system**.

135. Clause 1 of schedule 1 to the WSEA: amend the definition of "local government organisation" as follows:

> Local government organisation:
>
> (a) means any of the following that provides water services:
>
> (i) a local authority;
> (ii) a council-controlled organisation;
> (iii) a subsidiary of a council-controlled organisation;
>
> **and in the case of (ii) and (iii), only if (and to the extent that) the organisation has a proprietary interest in, or ownership of, water services infrastructure [to be defined to reference water services infrastructure of these entities] or if the primary or predominant business of the organisation is the provision of water services, [but excludes any such organisations specified in schedule 5 to the WSLB or in regulations]**, and/or
>
> **(b) excludes airports and ports and other major infrastructure providers which would otherwise be captured by this definition.**
>
> *[Note: We think that there is benefit in including a new schedule which lists those entities whose assets/personnel (excluding water service related contractual obligations owed to councils) should not be transferred as part of this reform, for example, the ServiceCos and major infrastructure providers that would otherwise by a "local government organisation". If this approach is adopted then there would not be a need for paragraph (b).]*

136. Clause 1 of schedule 1 to the WSEA: amend the definition of "mixed shareholder CCO" as follows:

Mixed-shareholder CCO:

(a) means a council-controlled organisation or **a subsidiary of a council-controlled organisation that is a local government organisation for the purposes of Schedule 1** in which-

(i) 1 or more of the shareholders is a **local authority, council-controlled organisation or a subsidiary of a council-controlled organisation**; and

(ii) at least 1 of the shareholders is not a **local authority, council-controlled organisation or a subsidiary of a council-controlled organisation**;

137. Clause 45, Part 2 of schedule 1 to the WSLB: amend as follows:

(1) This clause applies to any **mixed-shareholder CCO**.

(2) If this clause applies,-

(a) clause **43** does not apply; and

(b) on the establishment date, the shares in the **mixed-shareholder CCO** that a local government organisation holds vest in the relevant WSE **except to the extent that an Order in Council made under this Part provides otherwise**.

138. Clause 27 of schedule 5 to the WSEA: amend as follows:

(1) This clause applies to the following long-term planning:

(a) a draft or final long-term plan ~~or an amendment to a long-term plan~~ (under section 93 and Part 1 of Schedule 10), or associated material or documentation: