



Submission on Economic Regulation and Consumer Protection for Three Waters Services in New Zealand

Federated Farmers of New Zealand

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SUBMISSION ON ECONOMIC REGULATION AND CONSUMER PROTECTION FOR THREE WATERS SERVICES IN NEW ZEALAND

TO: Ministry of Business, Innovation & Employment

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ABOUT FEDERATED FARMERS

Federated Farmers of New Zealand is a membership organisation, which is mandated by its members to advocate on their behalf and ensure representation of their views. Federated Farmers does not collect a compulsory levy under the commodities levy act and is funded from voluntary membership.

Federated Farmers represents rural and farming businesses throughout New Zealand. We have a long and proud history of representing the needs and interests of New Zealand's farmers.

Federated Farmers aims to empower farmers to excel in farming. Our key strategic outcomes include provision for an economic and social environment within which:

- Our members may operate their business in a fair and flexible commercial environment;
- Our members' families and their staff have access to services essential to the needs of a vibrant rural community; and
- Our members adopt responsible management and sustainable food production practices.

SUBMISSION ON ECONOMIC REGULATION AND CONSUMER PROTECTION FOR THREE WATERS SERVICES IN NEW ZEALAND

1. INTRODUCTION

- 1.1 Federated Farmers of New Zealand welcomes the opportunity submit to the Ministry of Business, Innovation & Employment on the consultation document Economic Regulation and Consumer Protection for Three Waters Services in New Zealand.
- 1.2 Federated Farmers opposes the establishment of four water services entities to operate water infrastructure currently the responsibility of local government. While supporting the establishment of Taumata Arowai, the water services regulator, and while acknowledging the need to invest to upgrade three waters infrastructure, we are concerned about many aspects of the proposed water services entities. Our concerns, which are shared by many councils, include:
- Governance and accountability: Arms-length, complex governance arrangements will weaken the accountability of water service entities to local communities.
 - Local voice and prioritisation: Super-regional entities will see the needs of smaller communities crowded out when setting investment priorities and plans.
 - Integration with the planning system: The parallel Resource Management reforms are creating great uncertainty and concern.
 - Rural Water Schemes: The complexity of rural water scheme ownership and operations is creating significant uncertainty and anxiety in many rural communities. This is arising from a lack of clarity about these reforms. The role of Taumata Arowai and the water services entities, particularly for hybrid schemes (where there is community ownership and governance, but operation and billing are managed by the local district council) needs to be properly explained.
 - Costs and benefits: Many councils are questioning the robustness of the Government's estimates of the costs and benefits from moving to four entities. Economic consultancy Castalia has been critical of modelling from Water Industry Commission for Scotland underpinning the Government's decisions¹.
- 1.3 Although the Minister of Local Government has set up working groups to investigate some these concerns, the Government remains determined to proceed despite the strong opposition the proposals have generated. This is disappointing.
- 1.4 Although we are opposed to the proposed new water services entities, Federated Farmers wishes to offer some high-level comment on economic regulation in the event the entities proceed. We believe many of these proposals could also benefit current service delivery arrangements.

2. SUMMARY OF RECOMMENDATIONS

- 2.1 Federated Farmers **opposes** the establishment of four water service entities, and we submit that they should **not** proceed.
- 2.2 However, the following recommendations are submitted in the event the entities are established and we note they could also benefit current service delivery arrangements:
- Municipal water services (whether delivered by councils or water services entities) should be funded by volumetric charges and not through property-based rates.

¹ For example, refer to this blog post of 23 September 2021. <https://castalia-advisors.com/blog/>

- Municipal water services (whether delivered by councils or water services entities) should not be subsidised by general rates or by general taxation. This would mean consumers on private rural schemes paying twice.
- Economic regulation should not be applied to stormwater. It is difficult to define where these networks begin and end, and the weaker lines of accountability that come with centralisation will ultimately reduce, not improve, their performance.
- Economic regulation should not be applied to small community or privately owned water infrastructure. Local accountability is already strong in these settings.
- Economic regulation should include information disclosure and price-quality regulation. We are open-minded as to whether it should be generic or individually tailored. More analysis on whether there would be additional benefit from a more tailored approach is required.
- A sector specific economic regulation regime will be necessary, with key rules, requirements, and processes specified up-front.
- The Commerce Commission should be the economic regulator of the proposed water services entities. It would be more efficient to the extend work of the Commission to include water services, building on its experience and knowledge in other sectors.
- The economic regulation regime should be funded by levies once it is in place.
- The Commerce Commission should be the consumer protection regulator.

3. COMMENTS ON CONSULTATION DOCUMENT

3.1 Economic regulation of three waters services will be necessary if the reforms proceed. This is because the new much larger entities risk being less responsive to consumer and community needs, as the local element will be substantially diluted. A regulatory backstop is certainly required to mitigate this risk. Economic regulation could also benefit current service delivery arrangements: such a framework should have been considered before these reforms were advanced.

3.2 Economic regulation should make the charging for water services more efficient and transparent. A major problem with the status quo is the funding of council water services. Federated Farmers has two main concerns with current funding arrangements:

- (i) Far too many councils fail to use volumetric user charges for municipal water services, relying instead on property-based targeted rates (either uniform targeted rates or targeted rates based on property value). Use of property-based rates means amounts paid have absolutely no relationship to water use, resulting in people paying too little or too much for the water they use. This is not only unfair, but it discourages people to use water carefully and efficiently. In contrast, by providing a strong pricing signal, volumetric charging encourages people to use water carefully and to repair damaged or leaky pipes on their properties. By ensuring efficient use and demand, volumetric charging helps councils manage their water assets more efficiently.
- (ii) A growing number of councils have been moving to supplement volumetric charging and/or targeted rates by mandating general rate contributions on the grounds of the 'affordability' needs of urban residents. This results in many farms and rural residents who are not connected to council municipal water services paying large amounts on top of the costs they incur providing their own water (e.g., self-supplying or being part of private water scheme) and/or disposing their own wastewater (e.g., through septic tanks). This is grossly unfair.

- 3.3 Economic regulation needs to address these two issues if it is to result in efficient and transparent pricing. It needs to mandate volumetric user charging for municipal water services and although a fixed per connection component might be appropriate (as per electricity line charges), it should prohibit the use of property-based rates to fund municipal water services.

Which Services or Entities Should be Regulated?

- 3.4 Federated Farmers believes that economic regulation should be applied to drinking water and wastewater but should **not** be applied to stormwater. We agree with the paper that stormwater has very different physical and economic characteristics to drinking water and wastewater networks, with stormwater often integrated into roading networks with the topography of an area often making it difficult to identify and separate out. We also agree that stormwater networks also have a strong public good element making it difficult to identify and charge consumers.
- 3.5 Federated Farmers also believes that economic regulation should **not** be applied to small community or privately owned water infrastructure. We note the paper's estimate of between 75,000 and 130,000 unregistered drinking water suppliers. As the paper concedes there would be a heavy compliance burden for little or no benefit. We therefore agree that the application of economic regulation should be restricted to the new water services entities. They should be able to maintain their existing charging arrangements.

What should the key features of any economic regulation regime be?

- 3.6 Federated Farmers contends that, due to their strong natural monopoly characteristics, at a minimum water services entities should be subject to information disclosure regulation. Beyond that, we agree that price-quality regulation should also be employed. We note that the proposed water services entities would meet most of the criteria for price-quality regulation.
- 3.7 Individual price-quality regulation specific to each entity would provide for more tailored scrutiny but would be a higher cost regime, both for administration and compliance. A lower cost generic or default form of regulation would be more appropriate for a larger number of smaller entities but would necessarily be a one-size-fits all approach. That might be acceptable if the entities have similar characteristics meaning less additional benefit from taking an individual approach. If that is the case, we would prefer the lower cost option. The consultation document prefers an individual approach but we believe more work is needed on this point. Under current service delivery arrangements, a generic approach would be needed.
- 3.8 Another factor worth careful consideration is that even within the proposed new entities there will be numerous discrete (i.e., not joined-up) water and wastewater networks. New Zealand's geography (long distances between population centres), rugged topography, and low population densities mean it is uneconomic for there to be a main trunk line with branches going off in various directions to towns and cities. The form of economic regulation will need to be able to cater for the reality of numerous discrete networks.
- 3.9 Given the unique characteristics of the water services entities we believe a sector specific economic regulation regime will be necessary, rather than generic provisions under Part 4 of the Commerce Act. To provide greater certainty and transparency, the

regulator should specify key rules, requirements, and processes up-front. This should include pricing methodologies.

Who should the economic regulator be?

- 3.10 Federated Farmers believes the Commerce Commission should be the responsible agency for economic regulation of water service entities. As the paper notes the Commerce Commission meets all the necessary criteria for an economic regulator, except expertise on three waters - but this can be addressed. The other options, Taumata Arowai and a new specific water economic regulator, would not meet as many of the criteria.

How should any economic regulation regime be funded?

- 3.11 Federated Farmers believes that beyond transition costs, which should be funded by the Crown through general taxation, economic regulation of water service entities should be funded by a levy on those entities. The regulator-led levy would provide greater accountabilities and political independence.

Consumer protection

- 3.12 Federated Farmers notes that generic legislation such as the Consumer Guarantees Act and Fair Trading Act, economic regulation of water services entities, and Taumata Arowai's regulation of drinking water safety should all combine to protect consumers. The consultation document refers to potential gaps around customer/quality of service which might require additional mechanisms like minimum service level requirements or codes of practice, customer charters, consumer contracts, consumer voice arrangements, consumer advocacy arrangements, dispute resolution mechanisms, and billing transparency requirements.
- 3.13 Federated Farmers would support further consideration of these mechanisms. As with the question of who the economic regulator should be, we believe the Commerce Commission would be the appropriate consumer protection regulator.

ENDS