



Mayors Room
Hastings District Council
Private Bag 9002
Hastings 4156
Telephone: (06) 871 5073

Mayors Room
Wairoa District Council
PO Box 54
Wairoa 4160
Telephone: (06) 838 7309

Mayors Room
City of Napier
Private Bag 6010
Napier 4142
Telephone: (06) 835 7579

Central Hawke's Bay District
Council
PO Box 127
Waipawa 4240
Telephone: (06) 857 8060

**Submission of the Hawke's Bay Councils to the
Ministry of Business, Innovation and Employment regarding
Economic Regulation and Consumer Protection for
Three Water Services**

Introduction

This is a collective submission on behalf of the five councils within the Hawke's Bay Region including Central Hawke's Bay District Council, Hastings District Council, Hawke's Bay Regional Council, Napier City Council and Wairoa District Council ("the Councils").

Following the Havelock North water contamination event of 2016, the New Zealand Government embarked on a major programme of reform of the delivery and regulation of three waters services in New Zealand.

The Councils have been at the forefront of water reform since then. First, through the creation of the Hawke's Bay Drinking Water Governance Joint Committee to initially implement recommendations from the Government Inquiry, then to undertake the first regional study on options for three waters service delivery ('The Hawke's Bay review/the review'). The review concluded that the status quo was not an option.

That collective, agreed position of the Councils on the issues and their depth of understanding of current and future challenges with service delivery means the Councils are in a unique position to understand the benefits and challenges of economic and consumer regulation.

It must be noted that while the Councils acknowledge that the status quo is not an option, they do not accept the creation of four Water Services Entities as proposed by the Government as the solution. Nor do they accept some of the premise of what that decision is based on, and in particular they challenge the WICs modelling and estimated investment requirements for each Council and stated efficiency gains. This submission should not be seen as supporting the current reform. Notwithstanding that position, the Councils agree that economic and consumer regulation is fundamental to three waters reform and protecting the interests of communities of Hawke's Bay requires the Councils to respond.

This submission focusses on responding to key themes rather than answering individual questions. The Councils submission on elements of more technical policy design or implementation are that







Government should follow best practice, learn from successful economic regulators (not just Scottish Water) and if using international examples ensure they recognise the unique characteristics of New Zealand, three waters services in New Zealand and the communities served by Councils.

Objectives & principles

Guiding the Hawke's Bay review were:

- six investment objectives developed and agreed through a series of workshops with council leaders, employees and Māori committee representatives
- principles developed through engagement with the Māori committees

This submission has also been developed with reference to those objectives and principles.

Investment objectives	Principles
<p>To provide three water services in a way that is affordable and effective</p>  <p>The three waters service's model must address the challenge of providing for an effective, affordable service in a fiscally responsible way.</p>	<p>Value Te Ao Māori</p> <p>Incorporating and implementing mātauranga Māori, culture and values (i.e. Te Aranga Design Principles) are a core element for any potential framework to realise and enhance the region's commitment to Māori to protecting/enhancing water.</p>
<p>To provide services that are safe, reliable and resilient</p>  <p>Access to safe and reliable three waters services are fundamental to all the urban and rural communities of Hawke's Bay.</p>	<p>Value water</p> <p>Wai is the essence of all life and the world's most precious resource. It is of high importance to Māori, as it is the life giver of all things, a precious taonga, part of our whakapapa.</p>
<p>To provide services through a model that enables a meaningful role for Māori</p>  <p>The Local Government Act requires a local authority to provide opportunities for Māori to contribute to its decision making processes.</p>	<p>Whakapapa – genealogical links</p> <p>Recognise and respect the relationship and whakapapa (genealogical link) that mana whenua has with water.</p>
<p>To provide services through a model that has the value of water at the centre</p>  <p>Water is vital to community life and as such three water services are part of a holistic water system.</p>	<p>Te mauri o te wai – the life force of water</p> <p>Mauri is the integrated and holistic well-being and life support capacity of water. The well-being/healthiness of the water, the land and the people are intrinsically connected.</p>
<p>To provide three waters services in a way that supports our urban and rural communities</p>  <p>The services influence how people across Hawke's Bay live, work, gather, socialise, recreate and value environmental amenity.</p>	<p>Holistic approach to water</p> <p>Although the project is based around the review of the service and delivery of the three waters (infrastructure), the proposed model needs to take into account a holistic water approach: there is only one water.</p>
<p>To provide three waters services that build enduring capability and capacity</p>  <p>The three waters model must be capable of, and have the capacity to, deliver quality sustainable planning, management and operation of three water services now and into the future.</p>	<p>Enabling of Te Tiriti o Waitangi</p> <p>Involving mana whenua in governance and decision making required to ensure Te tiriti o Waitangi obligations are met, as well as making sure they are able to actively exercise kaitiakitanga in a practical way.</p>
	<p>Mana motuhake - identity, self-determination</p> <p>The identity of mana whenua in Hawke's Bay should not be lost in any potential model. But inclusion and co-governance whilst keeping their identity is an opportunity.</p>

The Hawke's Bay review

The review concluded that an asset owning CCO best meets the review's investment objectives and principles. There are some key findings of the review that are relevant to highlight here as the Councils believe the economic regulator has a key role to play in ensuring that the three waters reform addresses these issues for the benefit of all communities in Hawke's Bay and New Zealand:

- Affordability of three waters services was identified as a key issue. There is currently a stark difference between the cost of the three waters services in the cities and the rural councils and this is only likely to increase over time.
- There was an increasing need to recognise the environmental impacts and use of water generally by the communities and the role required of the three waters services to mitigate these impacts.
- There was a need to recognise Treaty of Waitangi partnership obligations and that the current approach does not sufficiently provide for Māori to participate in decision making.
- There is a shortage of specialist resources for three waters across New Zealand and internationally.

Economic Regulation

Proposed scope/extent of economic regulation

The Councils generally support the proposition of economic regulation as an important part of the overall three waters reform package (assuming reform progresses and noting that the Councils do not support the current WSE model nor the proposed number of WSEs). The Councils note that the detail of economic regulation needs to be worked through with the sector for it to be successful and avoid unintended consequences. The reform process to date and the information disclosure process from the December 2020 RFI has highlighted gaps in understanding by the Government of key three waters service delivery and community issues; and inconsistent and incomplete data. These will all need to be resolved during implementation for an economic regulator and economic regulation to be successful.

Responds to question - 1

Who is regulated and to what extent

The Councils agree that if implemented then it should be the Water Services Entities that are subject to economic regulation and agree that economic regulation should not apply to private suppliers as the cost and burden imposed by it would be too great with little benefit to them. The Councils agree that information disclosure is a critical part of economic regulation.

However, there needs to be mechanisms that ensure that improvements in services, technology, assets, compliance, data and understanding of three waters service delivery generated in and through economic regulation are passed to all suppliers. Transparency of information is important.

The Councils also note that if it is WSEs that are regulated then there must be alignment with what comes out of the rural sector working group (i.e. we are aware that there are some large rural schemes in NZ, if they are made 'private' as a result of the working group or community desire then consideration of whether those are regulated will be important as some could contain thousands of customers).

Responds to questions – 3, 4, 5

What is regulated and to what extent

The Councils agree that stormwater services and assets should be covered by economic regulation to the extent that the services and assets are transferred to the WSE. In other words the regulation needs to be on the entirety of the WSEs, not component parts. The regulation should take a holistic view of the WSE functions.

Responds to question - 2

Price/Quality Regulation

In undertaking price /quality regulation the economic regulator must:

- Include the financial costs of WSE giving life to co-governance, providing for Te Mana o Te Wai and Treaty principles in their calculations. These are both statutory obligations of WSE and community expectations and meeting them has costs. The Hawke's Bay review and specifically the Cultural case that was part of the review (supported by the Councils' experience) demonstrated that in order to deliver effective co-governance and deliver on Treaty principles you have to operationalise Te Ao Māori throughout the organisation¹. These 'non-infrastructure elements' must be allowed for in the regulator's calculations of reasonable operating costs and should not be subject to any efficiency dividend or assumption about reduced operating costs.
- Water (and the impacts on waters) has particular importance in NZ and for iwi/Māori. A regulatory regime must understand that and recognise while it is regulating a service and WSEs, it is actually regulating a system that impacts "Mountains to the Sea"² and must be guided by that. Both regulatory regimes need to recognise that (economic and consumer).
- Equally, the price/quality calculation must allow (and require) the investment necessary to lift standards and services so that increasing regulatory and community standards are met. The Government's three waters reforms are predicated on the assumption that there is a significant infrastructure backlog and investment need, and the success of the proposed reforms relies on this investment being successfully delivered. While the economic regulator will have a role to drive capital and operational efficiency that must not come at the expense of meeting the standards.
- The regulator and regulatory regime must also recognise that:
 - there are existing differences in the services needed in different communities and not unduly force investment where it is not needed or wanted (noting that national standards must set clear minimum's that cover public health outcomes and environmental outcomes)

¹ Refer to appendix 1

² This concept came out of the engagement with the Council Māori committees and Post Settlement Group Leaders as part of the three waters review

- Some communities want higher levels of service (e.g. unchlorinated water) and that where there is a clear demonstration of community desire then the WSE entities should be obligated to provide this and given mechanisms to pass those costs to those consumers.
- Price pathways and the investment they are built upon must be long term and not short term focussed
- Price/quality regulation must take into account the different characteristics of each WSE. Entity C for example which the Councils are part of, covers a vast area from Tairāwhiti down through Hawke’s Bay, Wellington and to the top of the South Island. That is quite different in nature to Entity A which is predominantly Auckland. Regulation of these entities has to take into account these differences.
- The Councils agree that an economic regulator will have an important role to play in ensuring efficiency of service but more importantly ensuring that three waters services remain affordable for all communities in Hawke’s Bay. While the financial modelling in the Hawke’s Bay review did not specifically allow for economic regulation, many of the cost efficiency gains of economic regulation were indirectly provided for through the estimated savings developed by Morrison Low & WSP Opus who relied on international examples. This has been recently confirmed in a peer review of the Hawke’s Bay review by Farrierswier.

Responds to questions – 6, 7, 10(c), 13 (c)

Price (to consumers)

Regulation and control over the prices to consumers will be critical to the success of the reforms. In the initial transitional phase though, transparency and driving improvements in the sector will be core role of the regulator.

In the transitional period WSEs will inherit myriad different charging mechanisms from councils (including for example volumetric based charges, special rates, standard/fixed rates, rates based on capital value).

Transitioning these into a coherent or aligned approach for each WSE, whether that is a single standard charge or not, will likely create some significant changes for some consumers. So there need to be some mechanisms to manage impacts on individual consumers e.g. limiting the max increase or decrease for any individual consumer or limiting by reference to previous price paths “no more than would have been paid under 2021/31 LTP”. Setting transitional price paths based on impacts to individual consumers may negate the need to also set transitional revenue caps for the entity.

Over time the WSE must have the flexibility to manage costs across its service area and the charges that flow from that. Is the WSE in conjunction with its owners (Councils) and consumers who need to be responsible for prices – individual needs and circumstances of communities, different LoS (low and high) etc.

The Hawke’s Bay review highlighted the affordability challenge for three waters services by using international benchmarks on the proportion of average household income required to pay for water and drinking water services³. These objective benchmarks were very useful in highlighting issues as it

³ Water NZ benchmarking survey 2017/18 identified a range of benchmarks that fall within a range of 2% and 5%

not only takes account of cost of the service but also ability to pay. The Councils believe the economic regulator should similarly consider not just costs but ability to pay.

There is a need to balance level of service benchmarks and standards with price for consumers to recognise differences in services, also to allow for communities to receive higher (or indeed lower) levels of service where agreed with them (e.g. Napier and non-chlorinated water). The regulator could also have a role in reviewing any pricing differential arising from a communities desire for a higher level of service and that information and ensuring that costs are appropriately allocated and community decisions about higher levels of service are and continue to be sufficiently informed decisions.

There needs to be a clear nexus between any pricing structures and the levels of service received by consumers and mechanisms to ensure that minimum service levels don't become targets resulting in degradation in levels of service in some areas and in particular in the rural areas as has happened under other industry reforms.

Responds to questions – 8 (a), 8 (b), 13(b)

Introduction of regulation/transition process

There is a significant amount of work for the Councils to support the transition of three waters to the WSEs while remaining responsible for delivering three waters services until 2024. In addition, local government is faced with other major reform processes at the same time with the RMA reform and the reform of local government. Additional information disclosure requirements should be held back until the WSE are created or aligned with the transition process so that no additional requirements are put on councils.

The councils do not believe that the one year of information disclosure available now is sufficient for the development of specific price-quality paths by the regulator and more generalised guidance on price paths, likely with reference to impacts on individual consumers, that will be necessary during the transition.

It is important to highlight that any delay in implementing the economic regulation flows on to extend the time when benefits will be delivered by the three waters reforms. The Government modelling assumed significant efficiencies would be gained as a result. We note the discussion paper highlights that these are likely to take 5 to 10 years to arise from when price quality regulation is implemented (2026 or 2027), whereas the government modelling on three waters has those benefits being modelled from the creation of the WSEs. That is clearly not going to happen now.

The understanding and expectations of how/what the regulator should do and be capable of doing needs to be able to evolve as knowledge, data, capacity and capability within the regulator and the wider sector improves. Regardless of what is put in place there should be review points built into the system at which time industry wide feedback is sought and changes made as necessary.

Responds to question - 8

Transparency

The economic regulator should be open and transparent with its methodologies and expectations. These should be published so the WSEs have the opportunity to understand what is expected and

have a better chance to achieving that. The system should be focussed on improving services and efficiencies, not on punishing non-performance. Any fines for non-performance or under-performance under the current model will be borne entirely by consumers, there are no owners or shareholders to bear the cost.

Transparency should extend to the ability to appeal the application of price-quality regulation.

Responds to questions – 13(b), 15

Who bears the costs?

The Councils agree that the cost of economic regulation should be borne by WSEs, noting that ultimately that cost will be passed onto the customers of the WSE who should also benefit from the efficiencies and improvements created by economic regulation.

The Councils acknowledge that some of the benefits of three waters reform that will in part, be realised as a result of economic regulation (as well as the introduction from national standards), flow to everyone (e.g. stormwater improvements, water quality benefits (fresh and marine) and public health benefits) and that some beneficiaries could therefore be said to not bear any of the costs. The Government could look at how wider beneficiaries could also contribute to the costs of regulation. The Councils do also recognise though that many of these benefits could also be said to come from Taumata Arowai and its role rather than the economic regulator.

Responds to questions – 14(b)

Where does regulator/s reside

The Councils acknowledge the government analysis in the discussion paper and recommendation around where the regulator resides and make the following comments:

- Taumata Arowai is not appropriate to be both environmental and economic regulator due to the different interests likely to be represented by the environmental/service regulator and an economic regulator.
- There is unlikely to be sufficient capability and capacity in NZ in either water expertise or economic regulation to have a separate/dedicated water economic regulator.
- Effective regulation of three waters will need to develop sector specific expertise but there must be a balance between leaving resources within service delivery and having sufficient expertise in the regulator.
- Consider whether having the Commerce Commission do both economic and consumer regulation as well as customer complaints is appropriate given the inherent tension between those, could:
 - separate economic regulator aspect (across sectors) from the consumer aspects (across sectors); or
 - separate all aspects of water
- Coordination of the different regulatory roles will be challenging, and success will be contingent on all roles interacting together to ensure that WSEs are empowered and

required to fulfil all of the objectives of reform. For example, if Taumata Arowai uses a risk based approach and effectively requires certain investment or operational changes which the economic regulator does not provide for or does not allow for in their price or revenue calculations, who pays for that or who is liable?

- Support information sharing between regulators but only with appropriate protections regarding the sharing of information pertaining to individual customers.
- The introduction of the regulator/s needs to ensure that there are no gaps in the system. Failures of regulation and regulators was acknowledged by the Minister at the start of the three waters reform as a key part of why we needed reform.

Responds to questions – 17, 30, 36, 46

Consumer protections and regulation

Critical importance of consumer protections of reform progresses

Experience in parts of Hawke's Bay suggests that aggregation of services can lead to a loss of levels of service or loss of connection for smaller/rural communities.

- The drive for efficiency by an economic regulator may lead to centralisation/ cost reductions etc. that may be disproportionately borne by rural NZ.
- Replicating the electricity sector structure will not be supported (examples of where that has failed, e.g. the perception that Aurora energy was allowed to extract profit at the expense of investment in its infrastructure and concerns that entities may extract efficiencies or savings the same way).
- Consumer protection and minimum standards have to recognise reform predicated on a new/improved set of standards.
- Any minimum standards that are set must be mandatory or else won't be recognised but there is a need to make sure the minimum standard does not by default or design become the target and give rise to service level degradation for rural communities.
- Have to recognise differences in services that exist now, and in some cases should continue to exist. Some communities/consumers don't want or need elevated service levels (and the associated cost). Noting that national standards must set clear minimum's that cover public health outcomes and environmental outcomes

Responds to questions – 21, 22, 25

Who is regulated and to what extent

The Councils support a strong consumer protection system with regulatory provisions, a regulator and dispute resolution system and in particular note that:

- It is almost impossible for a consumer to change supplier (the only realistic option, where exists, is to change to self-supply) so the three waters regulatory regime is different to other consumer services where most customers/consumers at least have that avenue available.
- Consumers will need strong protections against WSE or private suppliers ceasing supply.
- Consumer protections & regulatory role needs to cover a broader group than just WSEs and

that is different to the case for the economic regulator.

- There is a need for consumer protection provisions to apply almost universally to any consumers, even those where supply is not by a WSE. The indicative threshold of 500 connections is far too high. There is a need to protect the groups of consumers who fall between the WSE and being self-suppliers as they who have no ability to change supplier and could be left with no protections.

Responds to questions – 26, 28, 34, 35, 36, 38

Protections for vulnerable people and vulnerable communities

Consumer protection for vulnerable people and communities is critically important to the success of three waters reform. The Councils note that:

- Three waters are essential public health and life supporting services:
 - Typically in international regulator regimes there are similar customer protections and these could be used as a starting point but there is a need to recognise the specific NZ characteristics of three water services and the communities as well as individuals that are served. Including, but not limited to Māori land and marae.

Responds to question - 26, 40

Who bears the costs?

The Councils' submission is that the cost of consumer regulation should be borne by WSEs, noting that ultimately that cost will be passed onto the customers of the WSE who should also benefit from the efficiencies and improvements created as a result.

The Councils also support consumer regulation and customer dispute resolution schemes applying to suppliers beyond the WSEs but submit that any levy system should not be imposed on small private schemes as this would be a disproportionate burden on what are private systems, not commercial ones.

Responds to question - 26, 41

Appendix 1 – Implementing Co-Governance

