



Economic Regulation and Consumer Protection for Three Waters

Local Government New Zealand's submission on the Government's Economic Regulation and Consumer Protection for Three Waters discussion document.

December 2021

We are. LGNZ

LGNZ is the national organisation of local authorities in New Zealand and 77 councils are members. We represent the national interests of councils and promote the good governance of councils and communities. LGNZ provides advocacy and policy services, business support, advice, and training to our members to assist them to build successful communities. Our purpose is to deliver our Vision: “*Local democracy powering community and national success.*”

Introduction

Local Government New Zealand (LGNZ) thanks the Government for the opportunity to submit on the *Economic Regulation and Consumer Protection for Three Waters* discussion document.

LGNZ has for a long time acknowledged the need for greater regulation over the provision of three waters services in New Zealand, and the infrastructure that supports water service delivery. This includes economic regulation.

The merits we see in economic regulation of large water service providers are largely aligned with those identified by the Ministry for Business, Innovation and Employment (MBIE), namely it:

- promotes the interests of consumers;
- creates strong incentives on utilities with monopoly characteristics to seek efficiencies in their operations and to innovate;
- provides transparency into the operations and service provision of utilities that would otherwise be challenging to achieve; and
- holds entities to account to a far greater degree than otherwise would be the case.

In stating this position, we recognise that the fragmented structure of public water service provision is not well-placed to support the establishment of an economic regulation regime in New Zealand, making it overly onerous and costly to administer.

Our sector is firm in its position that other forms of regulation, such as water quality regulation through Taumata Arowai, should be the driver by which public water provision is structured.

Once entities of sufficient scale have been established through voluntary aggregation or other arrangement such as shared services, then an appropriate economic regulatory regime needs to be developed and applied to those entities.

The Government has made directive policy decisions that will see the mandatory aggregation of all local government three waters provision assets and functions into four statutory entities, namely the Water Services Entities (WSE).

Noting that this direction is not our preferred reform path, we see it as entirely appropriate (if not outright desirable) that an economic regulation and consumer protection regime be developed in tandem with the work to establish the WSEs.

This will allow for the development of a consistent framework that can be factored into the design of the WSEs and their operating systems to make activities like information disclosure and price-

quality regulation that much easier to achieve compared to bolt-on/ex-post approaches that have been taken in other sectors.

Beyond these opening comments, the bulk of our submission is framed within the context of the questions posed in the discussion document. Where questions have been omitted from this submission they are to be taken as areas where LGNZ has no view on the matter.

Comments on key questions

Question 1: What are your views on whether there is a case for the economic regulation of three waters infrastructure in New Zealand?

Given the direction of three waters policy reform taken by the Government, we support the establishment of economic regulation and consumer protection regimes.

Question 2: What are your views on whether the stormwater networks that are currently operated by local authorities should be economically regulated, alongside drinking water and wastewater?

Unlike waste and drinking water, where the assets and services are well-defined and the beneficiaries clear, stormwater is a more complex area. Stormwater systems are comprised of more than just pipes, and includes roads, private swales, and public reserves, etc. with multiple owners and are governed under multiple pieces of legislation (as noted in the discussion document).

How provision of stormwater will operate in practice is still being developed from scratch and is creating a high level of uncertainty among councils. In addition, we acknowledge some of the pure public-good characteristics of stormwater, and these need to be carefully considered when developing a charging regime.

We see merit in economically regulating stormwater but note that the policy design and operational complexities must be resolved first.

As such we recommend that stormwater be grandfathered into the regulatory regime after a minimum period (say 10 years), but that the intention to do so is made clear so that the WSEs can structure their operations to meet these requirements during the early establishment phase.

Question 3: What are your views on whether the four statutory Water Services Entities should be economically regulated?

We strongly support the WSEs being economically regulated. Noting the monopoly characteristics of the WSEs (as laid out in the discussion document), as statutory entities they are likely to be subject to extensive political pressure from both local and central government to keep prices low, and potentially below sustainable levels.

It is well-established that charging below cost does not help consumers in the long-term and can drive poor service, asset deterioration, and limit the ability to invest to meet growing demand.

In our view economic regulation can result in much-needed service level improvements, funded by

appropriate revenues, and will provide an institutional framework that is more removed from political influence. We accept that the WSEs are not profit seeking, but this further sharpens the case for economic regulation in our view.

Question 4: What are your views on whether economic regulation should apply to community schemes, private schemes, or self-suppliers? Please explain the reasons for your views.

We do not support the economic regulation of community and private schemes. This is largely due to onerous compliance costs and the regulatory burden it would place on these parties. Were it to apply to these parties it is foreseeable that those who are unable to support these costs, the responsibility for providing safe water would fall on the water entities, adding additional burden to operations.

Furthermore, the non-public water provision landscape in New Zealand is highly fragmented (estimate range between 75,000 and 100,000) and is predominantly made up of small schemes, which are largely owner operated. Most of these entities (below 500 people served) do not have the scale to cope with the cost burden of full quality regulation, let alone economic regulation.

We also note that private networks would not sufficiently meet all the tests put out in the discussion document, namely that:

1. suppliers have the ability and incentive to charge higher prices, or provide lower quality services, than would be possible in a workably competitive market. (*LGNZ: largely unmet*)
2. the governance arrangements of the supplier are complex, do not involve a significant overlap between owners and consumers, or there are questions about the incentives of the supplier to be responsive to consumer demands. (*LGNZ: largely unmet*)
3. suppliers are not subject to normal governance and capital market disciplines that promote efficiency (*mostly met, but poor quality and price outcomes are generally internalised by the owners*)
4. suppliers are of sufficient scale to be able to bear the administrative and compliance costs that come with an economic regulation regime (*LGNZ: largely unmet*)
5. the consequences of poor supplier performance are likely to be large for consumers (*met, but poor quality and price outcomes are generally internalised by the owners*)

Question 5: What are your views on whether the Water Services Entities should be subject to information disclosure regulation?

We support the inclusion of information disclosure regulation, as price and quality regulation are not sufficient in our view to protect consumers and ensure that customers receive high quality service, particularly in rural areas. We note the experience in the electricity distribution sector, where information disclosure on matters such as unplanned outages, has provided a strong incentive on these utilities to improve performance over time.

Question 6: What are your views on whether Water Services Entities should be subject to price-quality regulation in addition to information disclosure regulation?

We support the price-quality regulation, not just quality or information disclosure, noting that the tests stated in the discussion paper (as canvassed in our answer to Question 4) are all met by the WSEs.

Question 7: What are your views on the appropriateness of applying individual price-quality regulation to the Water Services Entities?

We support individual price quality regulation for each of the entities. This reflects the fact that the four WSEs will be very different from each other given that they will be constituted by the publicly owned three waters assets and populations in their geographic catchment.

Entity A, for example, benefits from the scale and sophistication of Watercare in Auckland, as well as the small population of non-Auckland areas. This is not matched anywhere to the same degree in the other three entities, and so a custom price-quality yardstick should be developed for each.

Question 8A: Do you consider that the economic regulation regime should be implemented gradually from 2024 to 2027, or do you consider that a transitional price-quality path is also required?

In our view economic regulation should be grandfathered in after a period of time. This is to give the WSEs the opportunity to establish themselves and their operations in a sufficiently robust manner to manage the requirements imposed by the regulatory regime.

We also consider that the four-year hiatus (2024-2027) may be too short of a time, given that as of 1 July 2024 the entities are likely be operating on a minimal viable basis, and will immediately face a backlog of drinking and wastewater investment requirements to meet water quality regulations. We are concerned at a high level that if economic regulation is imposed too soon it could make for a significantly difficult operating environment.

Question 9A: What are your views on whether the Minister of Commerce and Consumer Affairs should be able to reduce or extend the application of regulation on advice from the economic regulator?

We have no strong views in this area, other than to note that if the regulator and Minister responsible for the regulator are given these powers then clear thresholds need to be set and established upfront, and signalled to scale players in the water sector (e.g. developers) early.

Question 10A: What are your views on whether the purpose statement for any economic regulation regime for the water sector should reflect existing purpose statements in the Telecommunications Act and Part 4 of the Commerce Act given their established jurisprudence and stakeholder understanding?

LGNZ has no strong views in this area and support the preliminary position put out in the discussion document.

Question 10B) What are your views on whether the sub-purpose of limiting suppliers' ability to extract excessive profits should be modified or removed given that Water Services Entities will not have a profit motive or have the ability to pay dividends?

LGNZ has no strong views in this area but sees merit in adapting the sub-purpose clauses to match the nature of the WSEs.

Question 10D) What are your views on how Treaty of Waitangi principles, as well as the rights and interests of iwi/Māori, should be factored into the design of an economic regulatory regime for the three waters sector?

Other than the broad and general alignment with the Treaty of Waitangi and Treaty Principles common in most modern legislation, we do not see any merit in incorporating bespoke arrangements into the economic regulation regime. We believe these are better suited to consumer protection arrangements.

Question 11: What are your views on whether a sector specific economic regulation regime is more appropriate for the New Zealand three waters sector than the generic economic regulation regime provided in Part 4 of the Commerce Act?

We accept the argument put forward in the discussion document and support the preliminary view that a sector-specific regime would be a more appropriate vehicle to achieve the Three Waters Reform objectives.

Question 12: What are your views on whether the length of the regulatory period should be 5 years, unless the regulator considers that a different period would better meet the purposes of the legislation?

We believe the regulatory period should be aligned with the planning cycles of local government, which will largely dictate the planning timeframes that the WSEs operate in. Given three years is likely to be too short, we recommend extending this to six years, mainly due to administrative efficiency considerations.

Question 13A: What are your views on whether the economic regulator should be required to develop and publish input methodologies that set out the key rules underpinning the application of economic regulation in advance of making determinations that implement economic regulation?

LGNZ supports the preliminary position in the discussion document, namely that the “economic regulator should be obligated to develop and publish input methodologies that set out the key rules underpinning the application of economic regulation in advance of making determinations that implement the economic regulation regime.”

Question 13B) What are your views on whether the economic regulator should be able to minimise price shocks to consumers and suppliers?

We support measures, such as setting a maximum allowable revenue path, that would minimise price shocks to consumers.

Question 13C) What are your views on whether the economic regulator should be required to set a strong efficiency challenge for each regulated supplier? Would a strong ‘active’ styled efficiency challenge potentially require changes to the proposed statutory purpose statement?

From our understanding of other jurisdictions we note that a strong efficiency challenge has been a driver of performance in the water sector, most notably Scotland. As such we support their development for each entity, provided they reflect the operating environment of each entity.

Question 14A: What do you consider are the relevant policy objectives for the structure of three waters prices? Do you consider there is a case for parliament to directly control or regulate particular aspects in the structure of three waters prices?

It is LGNZ’s strong view that the role of the regulator should be clear and simple, allowing it to stay focussed on a specific set of outcomes, as opposed to a more challenging mandate of having to consider outcomes or objectives that conflict with one another. In this case we believe that role is to solely focus on efficiency, noting the Government has other mechanisms to deal with equity considerations (transfer through the welfare system, Winter Energy Payment etc).

Question 14B) Who do you consider should have primary responsibility for determining the structure of three waters prices?

The economic regulator.

Question 15: What are your views on whether merits appeals should be available on the regulators decisions that determine input methodologies and the application of individual price-quality regulation?

LGNZ supports the preliminary position in the discussion document, namely that a “merits review

should be available on the input methodologies developed by the economic regulator, and determinations that implement individual price-quality regulation. However, we do not consider merits reviews should be available on the regulator's determinations that implement procedural processes, such as information disclosure regulation."

Question 16: Do you broadly agree that with the compliance and enforcement tools proposed above? Are any additional tools required?

LGNZ broadly agree with the framework proposed in the discussion document.

Question 17: Who do you think is the most suitable body to be the economic regulator for the three waters sector? Please provide reasons for your view.

We note the analysis in the discussion document, which matches our own understanding of the relative merits. As such, we favour the Commerce Commission as the best placed to undertake economic regulation of the WSEs.

Question 18: What are your views on whether the costs of implementing an economic regulation regime for the three waters sector should be funded via levies on regulated suppliers?

We support a levy approach, noting that it aligns incentives within the system and ensures that those directly charged the levy will have the most interest in ensuring that those fees are appropriate to the level of regulatory oversight given.

Question 19A and 19B: Do you think that the levy regime should A) Require the regulator to consult on and collect levy funding within the total amount determined by the Minister OR B) require the Ministry to consult on the levy (on behalf of the Minister) and collect levy funding within the total amount determined by the Minister?

LGNZ supports a regulator-led approach.

Question 21A: What are your views on whether additional consumer protections are warranted for the three waters sector?

Noting the monopoly characteristics of the WSEs, we support the addition of consumer protections to the regulatory regime.

Question 21B: What are your views on whether the consumer protection regime should contain a bespoke purpose statement that reflects the key elements of the regime, rather than relying on the purpose statements in the Consumer Guarantees Act and Fair Trading Act? If so, do you agree with the proposed limbs of the purpose statement?

We support a bespoke purpose statement and agree with the proposed limbs set out in the discussion document.

Question 22: What are your views on whether the consumer protection regulator should be able to issue minimum service level requirements via a mandated code that has been developed with significant input from consumers?

We support the establishment of minimum service level requirement but view it as reasonable to include WSEs in the initial development of a code. This is to prevent customer expectations outstripping the ability of the WSEs to meet these expectations while they are still establishing their operations. We accept that this will change over time. We support a mandatory code, noting that less stringent codes tend to be less effective at shaping positive behaviour.

Question 25: What are your views on whether minimum service level requirements should be able to vary across different types of consumers?

LGNZ supports the preliminary position in the discussion document, namely that “there is a strong case for minimum service level requirements to be able to vary across different types of consumers. We also consider that there should be a positive obligation on the regulator to consider interests of vulnerable consumers, and that minimum service level requirements are flexible enough to be able to accommodate a wide range of approaches to addressing consumer harm and vulnerability.”

Question 27: What are your views on how Treaty of Waitangi principles, as well as the rights and interests of iwi/Māori, should be factored into the design of a consumer protection regime for the three waters sector?

We support a Treaty-led approach being taken to the design of the consumer protection regime, noting that historic underinvestment in Māori communities should be addressed to level off quality of service matters.

Question 28A: Do you consider that the consumer protection regime should apply to all water suppliers, water suppliers above a given number of customers, or just Water Services Entities? Could this question be left to the regulator?

We believe that consumer protection should apply to water suppliers who serve a population of users above a specific threshold, and suggest that this be aligned with Taumata Arowai’s regulatory threshold for simplicity, provided the costs and benefits align.

Question 29: Do you broadly agree that with the compliance and enforcement tools proposed? Are any additional tools required?

We support the preliminary views on the toolkit required for the consumer protection compliance and enforcement regime, as set out in the discussion document.

Question 30: Do you agree with our preliminary view that the Commerce Commission is the most suitable body to be the consumer protection regulator for the three waters sector?

We support the preliminary view.

Question 31: What are your views on whether the regulator should be required to incentivise high-quality consumer engagement?

Question 32: What are your views on whether there is a need to create an expert advocacy body that can advocate technical issues on behalf of consumers?

Question 33: What are your views on whether the expert body should be established via an extension to the scope of the Consumer Advisory Council's jurisdiction?

We are largely neutral or hold no strong views on Questions 31, 32, and 33, other than to say where there is an inclination to establish these bodies we support using existing structures, such as the Consumer Advocacy Council, to minimise costs on the regulated entities, which are ultimately passed through to consumers (reflecting our view in respect of Question 41 that the consumer protection regime should be funded by those who use and benefit from it, namely consumers).

Question 34: What are your views on whether there is a need for a dedicated three waters consumer disputes resolution scheme?

We support the preliminary view set out in the discussion document, namely that "a dedicated consumer dispute resolution scheme for the three waters sector is required. This could be operated by Utilities Disputes Ltd or another disputes resolution provider such as Fairway Resolution Ltd."

Question 41: What are your views on whether the costs of implementing a consumer protection regime for the three waters sector should be funded via levies on regulated suppliers?

We support a levy approach, noting that it aligns incentives within the system and ensures that those directly charged the levy will have the most interest in ensuring that those fees are appropriate to the level of regulatory oversight given.

We hope that this response is useful in your deliberations. LGNZ staff are happy to continue to work with the Government in relation to the discussion document. If you would like to engage further, please contact Grace Hall, LGNZ Policy Manager, at grace.hall@lgnz.co.nz