

# Submission on economic regulation and consumer protection for three waters services in New Zealand

## This submission is made on behalf of councils in the Wellington region

- Carterton District Council
- Greater Wellington Regional Council
- Hutt City Council
- Kapiti Coast District Council
- Masterton District Council
- Porirua City Council
- South Wairarapa District Council
- Upper Hutt City Council
- Wellington City Council

**We would welcome the opportunity to discuss this submission with Ministry of Business, Innovation, and Employment and be involved in ongoing policy development processes.**

### Our contacts for service and further discussions:

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## Executive summary of our submission

- 1. Support for economic regulation:** The Wellington councils support the need for economic regulation and consumer protection as part of the Government's wider three waters reforms. We see that economic regulation and consumer protection in relation to the proposed Water Services Entities (WSE) is important to ensure:
  - fair and transparent pricing
  - incentivisation and transparency of performance
  - increased efficiencies, over time
  - an investment pathway for addressing long-term issues (rather than ad-hoc and reactive decision making)
  - consumers have clear channels for raising issues and can have confidence in fairness of pricing
  - effective resolution of disputes.
- 2. Local Government feedback:** Through the 8-week engagement process, led by the Department of Internal Affairs (DIA) councils have each raised a number of issues and concerns in relation to water reforms which are relevant to economic regulation.

*We recommend that the feedback received from local government through the DIA engagement process is closely considered as part of determining options for economic regulation.*
- 3. Integrated and bespoke approach:** Economic regulation for water must be carefully designed as part of the wider three waters reforms. This includes how it relates to the wider design of legislation and

system stewardship arrangements; representation and governance; planning integration processes; how economic regulation works with the other water regulators to give economic effect to their requirements; and transition processes and timing, (this has a direct bearing on the capacity and capability of WSEs to meet economic regulation requirements).

*We recommend that MBIE continues to work closely with DIA and local government to ensure economic regulation will be fully integrated and aligned with the design and policy decisions of the water reforms. Particular attention should be given to the wider community benefits and environmental outcomes expected.*

4. **Focus economic regulation on the WSE:** Our view is that revenue control and investment scrutiny should focus on the four proposed WSE, rather than other smaller rural and community-based providers and schemes. This is to ensure that the regulation model focuses on where it can have the greatest benefit, is cost effective and can be effectively resourced. We note that economic regulation for water will require a different approach to that seen in other regulated sectors. The three waters are inherently more complex than those utilities currently regulated by the Commerce Commission.

*We recommend that economic regulation focuses on WSEs and is designed to respond to the specific issues relevant to water.*

5. **Consumers:** The discussion document does not adequately define the range of consumers, services provided to each consumer group, and whether these services are supplied by a WSE or another body. Defining what is meant by a consumer and understanding the range and variability of water consumers will be critical to successfully developing a regulatory framework that advances the long-term interests of consumers.

*We recommend that further consideration and focus is given to defining consumer groups, services, and the role and statutory powers of WSE and economic regulation in relation to each group.*

6. **Broader outcomes:** In addition to efficiency, investment by the WSE must also balance meeting regulatory requirements and delivery of broader social, cultural and environmental outcomes. There needs to be more recognition of climate change, resilience and the costs and service levels that this will require. There are also cost and service level implications for meeting specific environmental and social expectations.

*We recommend that further consideration is required for how the economic regulation can recognise the importance of broader social, environmental and cultural outcomes; this may require a specific statutory objective.*

7. **Te Tiriti:** Economic regulation will also need to consider how to give effect to the principles of Te Tiriti o Waitangi. This includes recognition of co-governance of the WSE and how economic regulation reflects and recognises the principles and outcomes sought through Te Mana o te Wai which puts the health of a waterbody first, human health needs second, followed by recreational, economic and other needs.

*We recommend that further consideration is required for how economic regulation can give effect to Te Tiriti o Waitangi and the principles and outcomes sought through Te Mana o te Wai. This may require a specific statutory objective.*

8. **Types of economic regulation:** We consider that the economic regulator has an important role to help reassure consumers that there has been proper scrutiny of costs for water services through the range of controls set out in our submission.

*We recommend that a range of economic regulation is appropriate for water, including: information disclosure, price-quality, pricing, consumer protection and dispute resolution.*

9. **Accountable organisation:** Water regulation is a substantial accountability which will require a bespoke approach.

*We recommend that further consideration should be given whether the Commerce Commission is the best placed organisation to be the regulator. This might include what structural or cultural change might be required in order for Commerce Commission to take on such a substantive new accountability.*

10. **Statutory Objective:** Our view is that the objective statements used in Part 4 of the Commerce Act and Part 6 of the Telecommunications Act provide a good starting point for economic regulation of WSE services. However, complementary objective statements may be required to cover all the relevant characteristics for WSE services.

*We recommend a modified version of the objective statement from Part 4 of the Commerce Act should be developed, which balances a workably competitive market with community and environmental outcomes, and the principles of Te Mana o te Wai.*

11. **Approach to regulation:** Water reforms will take time to embed and mature. In this environment, it will be vital that economic regulation plays a constructive and proactive role to support and work with WSE and Taumata Arowai to meet bottom lines and regulatory requirements. The discussion document appears to be based on existing regulatory ‘propose and respond’ dynamic, where suppliers develop investment plans for scrutiny and approval by the regulator. This approach requires a degree of sector maturity. Establishment and transition will require a learning culture and an approach based on sharing of lessons and raising sector capability.

*We recommend that a strong focus is placed on the culture and behaviours to ensure economic regulation plays a constructive and proactive role to support and work with WSE and Taumata Arowai to meet bottom lines and regulatory requirements.*

12. **Transition:** Water reforms will result in significant disruption and change across the water sector which will take at least 5-10 years to fully embed. Economic regulation also places a lot of demands on an organisation in terms of reporting and long-range planning. We therefore consider that it will be important to take a transitional approach to economic regulation while also ensuring that the pathway is clear and achievable so that this can be planned for and resourced.

*We recommend that further consideration is given to transition pathway including the time, resources and capacity to enable economic regulation.*

13. **Costs:** Our view is that the cost of economic regulation, both set up and ongoing costs, is significantly underestimated and will require further consideration.

*We recommend further consideration is given to the costs and resource requirements for establishment and operation of economic regulation.*

14. **Pricing:** Specific considerations for pricing and investment will include a range of factors. These do not all need to be resolved through legislation and should be phased in over time linked to regulatory control periods.

*We recommend that clear direction on pricing and a realistic transition pathway will be required from the outset to guide pricing and revenue over time.*

15. **Planning cycles:** Setting the optimal planning horizon and cycles are critical to ensure longer term innovation and investment planning to address complex issues. As noted above, these ideally need to align with broader spatial and investment planning by local government. The timing and alignment of these cycles will require further consideration through the Resource Management Act reforms and review local government processes.

*We recommend that the planning cycles and control periods take a transitional approach and consideration is given to how these can be aligned with broader investment planning cycles of local government.*

## **This submission is set out in two parts:**

**Part A** focuses on key matters and issues relevant to the consideration of economic regulation and consumer protection of water services. This includes:

1. Support for economic regulation
2. The development of economic regulation needs to consider broader feedback from local government on water reforms
3. Integration with wider water reforms
4. Focus of economic regulation and approach to water
5. Consumers and services
6. Broader outcomes
7. Iwi / Māori and Te Tiriti
8. What types of economic regulation are appropriate for water?
9. Who should provide economic regulation?
10. Statutory objective
11. Approach to regulation – culture and behaviour
12. Importance of the transition process
13. Costs of economic regulation
14. Pricing, investment and efficiency
15. Planning cycles
16. Other considerations

**Part B** provides responses to specific questions in the MBIE consultation document.

## Part A: Key matters relevant to the consideration of economic regulation for water services

### 1. Support for economic regulation and consumer protection

The Wellington councils support the need for economic regulation and consumer protection as part of the Government's wider three waters reforms. We see that economic regulation and consumer protection in relation to the proposed Water Services Entities (WSEs) is important to ensure:

- fair and transparent pricing
- incentivisation and transparency of performance
- increased efficiencies, over time
- an investment pathway for addressing long-term issues (rather than ad-hoc and reactive decision making)
- consumers have clear channels for raising issues and can have confidence in fairness of pricing
- effective resolution of disputes

### 2. The development of economic regulation needs to consider broader feedback from local government on water reforms

Recognising that the Government has decided on a legislated 'all-in' approach to water reforms, the Wellington councils hold a range of positions on various aspects of the proposed reforms model.

Through the 8-week engagement process (led by DIA), councils have each raised a number of issues and concerns which are relevant to economic regulation. Consistent themes include:

- The need for clear and effective representation, governance and accountability to enable local voice and influence.
- A desire for sub-Water Service Entity (WSE) representation and processes to support alignment and integration of planning and investment processes for water with other planning processes.
- The need to balance efficiency with local social and well-being outcomes, (including potential variation and influence over levels of service). Examples include Te Mana o te Wai statements, climate change and resilience requirements.
- Ensuring opportunities for community and council input to priorities, planning processes, pricing and service levels. This includes alignment with urban planning processes and planning for community facilities such as parks.
- Clarity of how disputes will be managed and how consumer needs will be met.
- Further clarity of how water reforms will apply to community and rural water schemes – this is of particular concern for consumer protection.

Consideration should also be had of the Wellington City Mayoral taskforce on water [report](#).

*We recommend that the feedback received from local government through the DIA engagement process is closely considered as part of determining options for economic regulation.*

### 3. Integration with wider water reforms

Economic regulation for water must be carefully designed as part of the wider three waters reforms. This includes how it relates to the wider design of:

- Legislation and system stewardship arrangements set by the Crown – this includes the Government Policy Statement for water services which should be co-developed between the

Government, councils and Iwi / Māori. This is key to ensure a focus on longer term outcomes such as water quality, climate change, and support for housing.

- Representation and governance (noting the Minister of Local Government has established a working group to consider this matter).
- Planning integration processes – including documents the WSEs will be required to produce and the process, input and consultation requirements for these. These are likely to include longer term strategic plans, asset management plans, pricing and investment plans, and service level plans. This is a two-way process as WSE will also need to input into the planning of councils (district / regional plans, spatial planning) to ensure that the future needs are understood and can be accommodated.
- Planning processes and cycles – local authorities currently undertake 30-year infrastructure strategies, and 10-year investment planning with a 3-year review cycle, (this may however change depending on the outcomes of the various Government reforms). It will be important for the regulator to design regulatory process that ensures reasonable integration with relevant planning cycles, for example, on land use, roading, community facilities, and flood control.
- How economic regulation works with the other water regulators in order to give economic effect to their requirements.
- How economic regulation and in particular consumer protection will apply to community and rural water schemes. While we consider economic regulation focus should be on the 4 WSEs, we think further consideration should be given to a consumer protection regime that covers all water schemes - especially where consumers have no alternatives. This should be explored as part of the proposed DIA working group on community and rural water schemes.
- Transition processes and timing – this has a direct bearing on the capacity and capability of WSE to meet economic regulation requirements. In addition:
  - There should be coherence between asset valuations, depreciation and asset life assumed in setting up the WSEs and those used by the regulator to set revenues (these will vary across councils).
  - Similarly, there should be coherence between funding assumed to be lost to local government and permitted to be recovered by WSEs ahead of their first full revenue path determinations.
  - Existing asset owners and WSE establishment entities will have to represent the interests of the WSEs in any policy and regulatory process ahead of the WSE go-live date.

*We recommend that MBIE continue to work closely with DIA and local government to ensure economic regulation will be fully integrated and aligned with the design and policy decisions of the water reforms. Particular attention should be given to the community benefits and outcomes expected.*

#### **4. Focus of economic regulation and approach to water**

Our view is that revenue control and investment scrutiny should focus on the four proposed WSE, rather than other smaller rural and community-based providers and schemes. This is to ensure that the regulation model focuses on where it can have the greatest benefit, is cost effective and can be effectively resourced.

We note that economic regulation for water will require a different approach to that seen in other regulated sectors. The three waters are inherently more complex than those utilities currently regulated by the Commerce Commission. Reasons for this include:

- The WSEs differ from the other regulated monopolies in their degree of vertical integration and complexity – spanning from bulk water supply, to reticulation, servicing households and businesses across three waters, and the billing and customer relationship with end users. They must also grapple with security and scarcity constraints.

- The WSE will offer a fully integrated service – collection, treatment and distribution of three waters. There’s no separate retail layer (as in electricity, gas and telecommunications), so the firms will have to manage billing, revenue assurance, infrastructure planning and investment.
- The WSE will be subject to Government stewardship arrangements, including a Government Policy Statement.
- The WSEs will be bigger (by value) than any network the Commerce Commission currently regulates, and this will only grow based on the renewal, growth, service improvement and climate change adaptation investment anticipated. Investment will include significant CAPEX programmes across multiple projects in each WSE.
- Economic regulation for water will be closely interlinked with wider regulation and governance / representation. Roles, responsibilities and decision-making accountabilities need to be clear.
- In addition to economic regulation, WSE will be regulated by Taumata Arowai and by environmental planning controls (primarily through regional councils). These will directly drive investment requirements. Economic regulation needs to accommodate other regulatory requirements and how these will impact on costs, quality and management practices.
- Water is essential for the well-being of people. Water services cannot simply be disconnected if there are issues of non-payment or debt. This includes statutory requirements under the Health Act.

*We recommend that economic regulation focuses on WSEs and is designed to respond to the specific issues relevant to water.*

## 5. Consumers and services

The discussion document does not adequately define the range of consumers, services provided to each group and whether these services are supplied by a WSE or another body. Defining what is meant by a consumer and understanding the range and variability of water consumers will be critical to successfully developing a regulatory framework and consumer protection systems that advance the long-term interests of consumers. Consumers will include a range of types of users:

- households
- schools, hospitals and other social / community institutions
- Iwi / Māori
- local and regional councils
- land and property developers
- a range of corporate and commercial users, including very large industrial consumers
- rural consumers
- vulnerable consumers
- private and community water schemes and self-suppliers

Consideration of consumers also needs to take into account that there will be connected and non-connected beneficiaries of services. For example some properties will be directly connected to services, while other properties will directly benefit from the services (but are not directly connected) such as flood or stormwater protection. This includes private property, roads, parks and other public spaces.

Further clarity of what these different consumers mean for economic regulation is required. For example:

- Will the WSE contract with each consumer? If so how, what is the timeline and resource requirements? This might include a supply contract, like the one WaterCare deems connected drinking and wastewater parties to have accepted ([see here](#)). The regulator may oversee different versions of the contract for large vs. small entities, (or urban vs. rural consumers) but it doesn’t seem unreasonable for oversight to apply to all non-self-supply arrangements.

- Transition processes from councils (or any other special purpose entity) to WSE for charging consumers.
- What allowance, protections or tools will there be for vulnerable consumers or to recognise issues of deprivation and affordability? This is critical given the importance of access to clean drinking water and sanitation for community wellbeing and health.
- How will issues of unpaid debt be managed by or recovered by a WSE? Does this require amendments to the Local Government (Rating) Act 2002?
- Who is defined as the consumer – landlord, tenant? This might vary for different consumers and different services.
- Different classes or types of consumers may have differing interests, and different considerations in terms of how services should be priced and whether suppliers have an open-ended obligation to supply. This may have major implications for business investment decisions and some existing consumers may need to be excluded from services over time in order to comply with wider environmental outcomes.

What are the channels for different consumers and how will these be managed? How might these apply to different scales or types of water suppliers beyond the 4 WSE. For example:

- Extending the mandate of the consumer advisory council to include water seems wise to have a suitably resourced entity able to advocate at a policy and regulatory design level as well as helping to set performance expectations. This would strengthen any regulatory system.
- The consumer protection and dispute resolution components to address connected (and non-connected e.g. those impacted by stormwater services) consumer aspects of the service – ie, these need to address issues at an individual customer level
- how the WSEs will bring community preferences into their performance target setting, solution design, workplan prioritisation, and delivery. This will include both:
  - planned, such as through strategic asset management processes; and
  - unplanned, such as for a new development e.g. how does the 'consumer' once defined, work their way through all the other legislation and agencies to get approval for new developments, particularly given the housing crisis and changes that are being made to the consent process for development.

*We recommend that further consideration and focus is given to defining consumer groups, services, and the role and statutory powers of WSE and economic regulation in relation to each group.*

## **6. Broader outcomes**

In addition to efficiency, investment by the WSE must also balance meeting regulatory requirements and delivery of broader social, cultural and environmental outcomes.

There needs to be more recognition of climate change and resilience and the costs and service levels that this will likely require. There are also cost and service level implications for meeting specific environmental and social expectations e.g. how wastewater is treated and how drinking water is disinfected. The new freshwater regulations will also require significant investment into wastewater treatment and retention ponds.

Such considerations are outside of a focus on efficiency and need to include thinking around resilience, (increased stormwater capacity, redundancy of pipe networks e.g. duplicated mains, wastewater sumps for overflows, and bigger water storage). Such matters will need to be factored into any price / quality regulations.

Clarity on the importance of these broader outcomes and expectations needs to sit as part of the statutory purpose of the WSE and objective of economic regulation as well as through the GPS for water. The GPS



should be co-developed between Government, councils and Iwi / Māori to ensure buy-in. This will inform longer term / strategic planning and flow through into regulatory investment plans.

*We recommend that further consideration is required for how the economic regulation can recognise the importance of broader social, environmental, and cultural outcomes, this may require a specific statutory objective.*

## 7. Iwi / Māori and Te Tiriti o Waitangi

Economic regulation will also need to consider how to give effect to the principles of Te Tiriti o Waitangi, including Article 3. This includes recognition of co-governance of the WSE and how economic regulation reflects and recognises the principles and outcomes sought through Te Mana o te Wai which puts the health of a waterbody first, human health needs second, followed by recreational, economic, and other needs<sup>1</sup>.

Te Mana o Te Wai requires the integrated management of freshwater in line with the principle of ki uta ki tai (from the mountains to the sea). This goes beyond the alignment of storm, waste and drinking-water management and must include flood management practices that shape our waterways, commercial allocation, changing land use, water sensitive urban design, the active role of Mana Whenua, and many other critical elements.

Giving effect to these principles may require a specific statutory objective. See section 10 below.

*We recommend that further consideration is required for how economic regulation can give effect to Te Tiriti o Waitangi and the principles and outcomes sought through Te Mana o te Wai. This may require a specific statutory objective.*

## 8. What types of economic regulation are appropriate for water?

We consider that the economic regulator has an important role to help reassure consumers that there has been proper scrutiny of costs for water services through the range of controls below. These types of scrutiny should all apply to the WSE.

Consideration needs to be given as to what extent the same controls should apply to rural and community-based schemes. This should be given consideration through the proposed DIA working group.

Our view is that the types of regulation listed below would be appropriate for water.

- **Information disclosure:** Yes - this is a bare minimum for large network monopolies providing essential services. However, information disclosure may have to start simple and grow in scope and depth as the new entities mature. Integrating donor financial and asset information systems is likely to take some time, as will developing clear information strategies and then bringing data completeness and quality up to standard.
- **Price-quality:** Yes – the entities are big enough and won't have competition, equity market or local democracy forces to discipline their performance. The reforms place significant focus on the benefits of efficiency gains and lower costs, but the entities will also have to lift investment to make sure they're managing long-term lifecycle costs and delivering acceptable service quality. It will be important for the regulator to understand this context and not look to efficiency gains as their primary measure of success.
- **Pricing:** Yes - pricing will be a big part of the transition. WSEs will have tough choices to make about geographic cost equalisation, allocating costs between consumer groups, (eg, residential vs. commercial), allocating costs between services and structures (eg, fixed vs. usage-based components). It would make sense for the Government Policy Statement to provide direction to the economic regulator on pricing principles and priorities. There will also be value in the

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<sup>1</sup> Refer: <https://archive.gw.govt.nz/whaitua-te-whanganui-a-tara/>

economic regulator to provide oversight of pricing methodologies and monitoring for pricing issues.

- **Consumer protection:** Yes – this needs to be well integrated with price-quality regulation and oversight of pricing methodologies. If WSE are to contract with connected parties, then it would make sense for consumer protection regulation to focus on the form and operation of those contracts. This could include links to mechanisms such as customer charters, though it does not seem necessary for this to be resolved in primary legislation.
- **Dispute resolution:** Yes – this should be achievable from the outset. It would make sense to mandate membership of an approved scheme. Presenting the scheme with some risk of losing its mandated status, while not enabling WSEs to forum-shop would be ideal. A legislative framework for electricity, gas and broadband already exists as examples of the approach that can be taken. The framework is based on the principles found in the Australian *Benchmarks for Industry-based Customer Dispute Resolution*.

*We recommend that a range of economic regulation is appropriate for water, including information disclosure, price-quality, pricing, consumer protection and dispute resolution.*

## 9. Who should provide economic regulation?

Our view is that further consideration should be given to which entity is best placed to provide economic regulation. We agree that Taumata Arowai should not be the economic regulator – this organisation will already have considerable challenges which require focus and time to work through.

We also consider that further assessment should be undertaken of whether Commerce Commission is the best placed organisation. This might include what structural or cultural change might be required for the Commerce Commission to take on such a substantive new accountability. This includes the behavioural and collaborative approach required during establishment of regulation for water. Building on the issues outlined in section 4 above, reasons for considering a new entity or changes to Commerce Commission to enable it to succeed include:

- Adding WSEs would roughly double the regulatory asset base (RAB) value regulated by the Commerce Commission – ie, the WSEs are massive in terms of the scale of the assets.
- The Commerce Commission already has challenges balancing its resourcing across the sectors it regulates and scaling to meet peaks and troughs in workload.
- Concerns in the discussion document about economy of scope may be overstated – both regulators would be big enough to sustain expertise and ‘overhead’ costs would not be large.
- A water economic regulator could encompass price / quality, pricing and consumer protection. This would provide a wider sector mandate than the Commerce Commission has, (setting aside its generic pan-sector activities). The synergies of having all those functions in a dedicated water regulator may be more important than the cross-sectoral synergies the Commerce Commission could bring.
- There are potential benefits in having another major economic regulator attracting and developing the pool of economic regulatory staff which will in turn develop the capability of the water sector in relation to regulation.
- It could also be good for the Commerce Commission to have a comparator organisation. Good practice should develop more quickly with two sizeable organisations learning in parallel.
- WSE capacity, capability and maturity will be the limiting factors for the transition to economic regulation. There should be sufficient time to establish and grow a new regulator. The scale of the task relative to the Commerce Commission’s existing workload is such that allocating the role to the Commerce Commission will not greatly reduce the resourcing challenge. A new entity would add to New Zealand’s capacity to attract and grow suitable talent, including from the UK and Australia.

- In terms of breadth of functions and single-sector focus the new regulator would be similar to the UK's Water Services Regulation Authority (Ofwat), Communications Regulator (Ofcom), and Office of Gas and Electricity Markets (Ofgem).

*We recommend that further consideration should be given whether the Commerce Commission is the best placed organisation to be the regulator. This might include what structural or cultural change might be required in order for Commerce Commission to take on such a substantive new accountability.*

## 10. Statutory objective

Our view is that the objective statements used in Part 4 of the Commerce Act and Part 6 of the Telecommunications Act provide a good starting point for economic regulation of WSE services. However, complementary objective statements may be required to cover all the relevant characteristics for WSE services.

The Part 4 and 6 objectives seem a reasonably good fit for most aspects of drinking water services – these are consumed by connected parties and can be thought of as ‘rivalrous and excludable’ to some extent. This means that the idea of ‘consumers’ makes sense, and outcomes produced in ‘workably competitive markets’ can provide a relevant touchstone when thinking about quality of service, investment, efficiency and pricing structures. The same may also be true for the reticulation part of wastewater services.

It's less clear that the Part 4 and 6 objectives are a good fit for stormwater services, or for the treatment part of wastewater services. They mostly provide their services, such as property and environmental protection, to the community rather than connected consumers – they are more like public, or quasi-public goods. Stormwater protects roads, utilities, buildings, parks, and manages impacts on receiving environments. The assets that are protected are not the same as the properties that are connected. Stormwater management and wastewater treatment protects our freshwater and marine environments – again, not the properties or consumers who are connected to the network. This makes ‘consumers’ a less relevant focus for the objective statement and may make workably competitive markets a less apt touchstone for desirable outcomes.

The other aspect of WSE services that the objective does not address is Te Mana o te Wai. This goes beyond being a compliance obligation or service quality dimension for WSEs so may not be adequately addressed by an objective statement focussed on consumer outcomes.

From above, we think it may be best to develop three complementary objective statements rather than a primary objective with two secondary objectives. These would need to be aligned with the statutory objectives of WSE (this may require amendments to the Water Services Entities Bill). The three objectives would be:

1. Outcomes for consumers consistent with workably competitive markets – i.e., consistent with Part 4 and 6 and relevant to services provided to connected parties.
2. Outcomes for communities and the environment consistent with a well performing local authority. This part of the objective statement could borrow from s14 of the Local Government Act 2002, and most of the matters there are relevant to the provision of public or quasi-public services.
3. Outcomes consistent with Te Mana o te Wai. The part of the objective statement could borrow from section 3.2 of the National Policy Statement for Freshwater Management 2020.

The subclauses of the Part 4 and 6 objective statements would remain relevant to the task of the economic regulator – i.e., innovation and investment, efficiency, consumer focus, price levels and profits – and would work as subclauses for the first two objectives above.

We think the subclause relating to excessive profits remains relevant, in the sense that the WSEs will need to produce an operating surplus (profit) each year to ensure their investments programmes can be financed, even if they cannot distribute profits to their owners. It may be worth replacing “extract excessive profits” with “produce excessive profits” to reflect that the WSEs will retain profits rather than distribute them

externally. A core part of the regulator's role will be to calibrate operating profits such that they are sufficient to support efficient investment over time, but not higher than they need to be.

*We recommend a modified version of the objective statement from Part 4 of the Commerce Act should be developed, which balances a workably competitive market with community and environmental outcomes and the principles of Te Mana o te Wai.*

## **11. Approach to regulation – culture and behaviour**

Water reforms represent a substantive change process across multiple organisations, with the establishment of new accountabilities. This system will take time to embed and mature. In this environment, it will be vital that economic regulation plays a constructive and proactive role to support and work with WSE and Taumata Arowai to meet bottom lines and regulatory requirements. This will require a learning culture and approach based on sharing of lessons and raising sector capability.

The consultation paper assumes approaches to regulation modelled on the Commerce Commission's existing regulatory practices. These include a 'propose and respond' dynamic, where suppliers develop investment plans for scrutiny and approval by the regulator. This is a well understood approach to regulation, but it does assume significant maturity on the part of the supplier and tends to operate in a relatively low-trust and non-collaborative style – i.e., with the regulator assuming that a profit-driven supplier will want to maximise the commercial value of their business.

The context for the WSEs will be unique, so it would be desirable to provide the economic regulator with more latitude to craft fit-for-purpose approaches to regulation. The WSEs will be new entities, without profit motive, delivering a mix of private, public and quasi-public services with unique governance and accountability arrangements. These factors mean that regulatory innovation should be encouraged, and it may be effective for the economic regulator to combine traditional tools of revenue building blocks and asset management scrutiny with a more collaborative style of developing and sanctioning investment plans and quality objectives.

This potential to develop a fit-for-purpose approach should be recognised in the legislation and could be supported by establishing a new water economic regulator.

As part of this, it will be important to:

- build in as much role clarity as possible,
- design economic regulation arrangements to be workable within this operating environment,
- allow time for the WSEs to digest and make sense of their operating environment before expecting them to lock in long-term revenue paths and quality standards,
- establish strong relationships and systems of working together across the WSE and with Taumata Arowai.

This needs to recognise that the WSEs will have to navigate a complex operating environment in terms of the number of agencies who have input or control of their strategies, plans, investments, and operations, including:

- Governance entities and mechanisms, which (in the current blueprint) includes a representation-based governance group who will issue strategic and performance expectations.
- A Government Policy Statement. This is a critical document for setting clear direction and expectations for water and will need to be jointly developed between Government, councils and Iwi / Māori.
- Consumer forums, and potentially other community and customer engagement channels.
- Tightly linked infrastructure planners, including roading authorities and local government.
- Taumata Arowai setting drinking water and occupational competency standards and providing oversight of wastewater and stormwater performance.

- New environmental regulation arrangements.

*We recommend that a strong focus is placed on the culture and behaviours to ensure economic regulation plays a constructive and proactive role to support and work with WSE and Taumata Arowai to meet bottom lines and regulatory requirements.*

## **12. The transition process is important**

Water reforms will result in significant disruption and change across the water sector which will take at least 5-10 years to fully embed. At the same time the WSE will also need to respond to:

- new governance arrangements.
- increased drinking water regulation.
- increased regulation of stormwater and wastewater.
- capacity and capability challenges of scaling up investment to address regulation as well as historical under-investment.
- a pressing need to adapt to the impacts of climate change on water supply, receiving environment capacities, flooding severity, inundation risk, and physical threat. The current level of service for stormwater will decline without large increases in capacity.
- changes to relationships between consumers and water service providers.

Economic regulation also places a lot of demands on an organisation in terms of reporting and long-range planning. Achieving net gains from the reforms and beginning to demonstrate ongoing efficiency gains are likely to take years to manifest.

We therefore consider that it will be important to take a transitional approach to economic regulation while also ensuring that the pathway is clear and achievable so that this can be planned for and resourced. This requires further consideration in the discussion document.

Further issues we consider important in relation to transition are:

- The ability (and relative importance) of realising efficiency gains may be overstated in early years for the WSE. It will initially be more important to ensure effective transition and establishment of the new WSEs and the economic regulator, including clear processes and channels for consumers.
- Coherent long term investment plans will take time for the new WSEs to collate and refine. This requires aggregation of data and investment plans, and harmonisation of strategies, planning tools, delivery processes and operations across multiple councils.
- Aggregation of pricing and charging models from existing councils will be complex and take time to work through.
- Any process to move towards consistent and/or equalised tariffs and consumer outcomes (quality, service levels, relationships) will raise a range of challenges and significant changes for some consumers. How issues of fairness, equity and affordability are managed will need to be carefully considered.
- The process of change for consumers will be significant in terms of not only billing but also communications and engagement to ensure that consumers understand the change in service provider and what this means for them.
- There is limited regulatory system capacity, and time will be required to build human resource and expertise.
- It also takes management time and resource to engage with economic regulation, which has an opportunity cost given those people will have their hands full with amalgamation and associated changes processes. Economic regulation requirements should be aligned to match expected organisational maturity and capacity of the WSE.

- The costs of transition need to be further considered. These appear to be understated in the discussion document.

*We recommend that further consideration is given to transition pathway including the time, resources and capacity to enable economic regulation.*

### 13. Costs of economic regulation

Our view is that the cost of economic regulation, both set up and ongoing costs, is significantly underestimated and will require further consideration. For example:

- In 2020 the Commerce Commission budgeted just under \$20m for its energy and telecommunications regulation work – and water will be broader in scope compared to other regulated sectors.
- The availability of expertise and staffing will potentially be a constraining factor and impact on costs.
- The discussion document underestimates the complexities for the three waters, which will push up costs.
- The discussion document potentially overestimates the level of local input that will be feasible through the proposed representation and governance structures (noting that this is still being considered through the Minister of Local Government’s Working Group). This will result in the need for robust complaint processes at the sub-regional level, especially for vulnerable people. Currently every Council has systems for people to contest decisions, input into planning and follow through to elected members. A centralised internet-based system for complaints will not work for all communities and consumers.

*We recommend further consideration is given to the costs and resource requirements for establishment and operation of economic regulation.*

### 14. Pricing, investment and efficiency

Specific considerations for pricing and investment will include a range of factors. These should not all need to be resolved through legislation and should be phased in over time linked to regulatory control periods. Clear direction on pricing and a realistic transition pathway will be required from the outset to guide pricing and revenue over time.

- **Equalisation:** Our view is that legislation should not prescribe geographic averaging or equalisation of tariffs. We suggest a better model would be for the regulator to develop pricing principles, (this might include transition pricing methodology – how will prices be standardised, over what time, minimum / maximum movements) and review pricing methodologies. This would allow a more nuanced development of pricing arrangements as the WSE are established and a move towards equalisation over time.
- **Local conditions and historic investment:** Pricing will need to take into account the different cost pressures between the 4 WSEs, and within each WSE footprint. This will include different factors such as climates, soils, wealth, asset quality and historical investment and regional council regulation. This will drive different demands for investment, which can have implications for how much equalisation can be considered equitable or efficient.
- **Other pricing matters:** there are a range of other pricing matters that the economic regulator should address through pricing principles and oversight of supplier’s pricing methodologies such as:
  - **Differential pricing for use:** to what extent pricing should be usage based, how usage charges should be set, and how they should vary for different types of consumers, time of use, and service etc.

- **Ability to pay:** how suppliers should manage affordability and handle non-payment, including through tools such as social tariffs, vulnerable consumers and coordination with social agencies.
- **Development contributions:** How development contributions are set and managed, including any process for these to be challenged.
- **Revenue and assets:** Entities would benefit from early clarity on revenue input methodologies, (including depreciation rules) and the opening value of their regulatory asset bases (RABs) – ie, the information they will need to model how their investment will translate into revenue. This will be essential for managing their financing arrangements, including understanding their ability to borrow and their need to retain cash reserves. Developing the input methodologies and fixing the opening RAB value will be complex and will require participation from the WSEs to represent their interests and to bring together relevant information. The process will include working through a variety of legacy valuation models, ensuring coherency with methods and assumptions used when establishing the WSEs, ensuring rules will enable WSEs to finance large investment programmes without access to equity markets, and working through the role that financial incentives and penalties can play in non-profit entities.
- **Depreciation:** How will these be standardised, agreed / disputed given the potential for impacting the “cost” of investment and the asset useful life (AUL). This is one of the largest drivers of Opex costs, and if increased, will result in substantial cost increases. Economic regulation will need to define how this is calculated. Most Councils do fund depreciation (to varying levels vs actual need) with excess income in any year going into depreciation reserves to fund renewals in later years driven by the asset age profile. Insufficient funding over time results in the reserve accounts declining into deficits.
- **Expenditure plans:** Entities are unlikely to have enough clarity about their long-horizon planning to be able to propose Capex and Opex plans within their first few years of existence. Consumers are looking for certainty of costs, affordability and fairness. That means it would make sense to:
  - start with a transitional price path based on existing council rates and fees and charges.
  - defer engagement on price-path rules until after the entities have formed.
  - not require a first regulatory proposal until several years in. This should be based on clear guidance about pricing, revenue and levels of change that are acceptable to consumers across any investment period.
  - have a short first regulatory period (two or three years).
  - provide flexibility for the duration of the second (and probably ongoing) regulatory periods (3-6 years, at the WSE’s option).
- **Level of service:** The price / quality regime needs to consider the different service levels that should apply, for example central Wellington vs a small rural community. The residents of small rural towns may not expect a similar level of service when they may generally be willing to cope with occasional ponding on roadsides or water restrictions in summer.
- **Use of surpluses:** Will this be restricted to re-investment in three waters assets and repayment of debt, or will WSEs be allowed to re-invest surpluses into non-regulated activities?
- **Non-regulated activities:** Because the WSEs are unable to pay dividend or raise equity, they are likely to build up substantial cash reserves. If the WSE are investing in non-regulated activities, will these be limited in scope to be in the same industry (such as electricity providers remaining in the same industry) or not? To what degree will economic regulation apply to these activities?

*We recommend that clear direction on pricing and a realistic transition pathway will be required from the outset to guide pricing and revenue over time.*

## 15. Planning cycles

Setting the optimal planning horizon and cycles are critical to ensure longer term innovation and investment planning to address complex issues. As noted above, these ideally need to align with broader spatial and

investment planning by local government. The timing and alignment of these cycles will require further consideration through the RMA reforms and review local government processes.

Price / quality regulation usually involves having to submit plans and expenditure forecasts covering years 3 to 7 (for a five-year regulatory period). The regulator scrutinises those plans and approves a funding envelope that the supplier can then use as they see fit – ie, they can reprioritise within the envelope, but aren't funded to exceed the assumed levels of expenditure.

The fixed envelop forces the supplier to prioritise when new spend pressures arise, which can be for unforeseen circumstances such as responding to a new development. This needs to be allowed for.

The regulator will need to design suitable arrangements for the WSEs that create cost discipline, while not stifling growth investment. This will require a transitional approach, potentially based on:

- starting with transitional revenue paths.
- after approximately 3 years, have the first proper control period (but make sure the regulator can defer this).
- make the first proper control period only 2-3 years in duration.
- allow subsequent periods to be between 4-6 years.
- allow for flexibility in plans, investment required and pricing to respond to changes in context or new demands for investment.
- The regulator may practically need to have “resets” between periods staggered so that only one WSE resets each year so the regulator can rotate its resources from one WSE review to the next. Resets usually consume 12-18 months of intensive resourcing, so one WSE per year would fit neatly into a 5-year cycle (with the ‘slack’ year focussed on input methodology (IM) reviews, etc).

*We recommend that the planning cycles and control periods take a transitional approach and consideration is given to how these can be aligned with broader investment planning cycles of local government.*

## **16. Other considerations**

The discussion document discusses the administrative costs of the regulation, but there are some other important costs too:

- Regulatory error – regulators can get things wrong, which can be costly. They never have as much information as management, and they can have their own incentive challenges. The risk of error is higher when the regulator isn't well resourced, so WSE will want a good, capable, well-resourced regulator that won't make bad mistakes.
- Loss of agility – the flip-side of control is always some loss of agility. Good regulation tries to mitigate this problem, but the residual risk can be high if the regulated entities are not in a steady-state situation.



## Part B: Specific matters

The table below contains our brief comments on topics covered in the MBIE briefing paper or refers to our more comprehensive feedback in part A of this submission.

MBIE Q #	Topic	Our comment
<b>ECONOMIC REGULATION</b>		
1	Case for economic regulation of three waters infrastructure.	Support. See section 1.
2	Regulation of stormwater network.	Support. Needs to include stormwater. Wastewater and stormwater management are difficult to separate – some systems are physically interconnected, the two systems often directly impact one another, and frequently they are managed by the same staff. Stormwater critical for water quality.
3	Economic regulation of WSEs.	Support. Focus should be on WSE for price quality. Information disclosure could apply to other large suppliers, and consumer protection and dispute resolution should apply to any supplier (excluding self-supply).
4	Regulation of community and private schemes.	The focus of economic regulation should be on the four WSEs. See discussion in section 4.
5	Information disclosure regulation.	Support – see discussion above in section 8.
6	Water Services Entities & price-quality regulation in addition to information disclosure regulation.	See discussion above in section 8.
7	Individual price-quality regulation.	Yes – the entities are large, and each will be unique.
8 a & b	Gradual implementation, or transitional price-quality path?  Should a transitional price-quality path be developed and implemented by an independent economic regulator, or by Government and implemented through a Government Policy Statement?	Support gradual implementation. Further consideration required, see comments in section 12-14.
9	Applications for regulation.	See comments in section 4.
10	Purpose statements.	See comments in sections 6 and 10.
11	Specific economic regulation regime vs generic economic regulation.	Should be a new item of legislation and not the generic Part 4 or an addition to the Part 4 regime.

12	Length of the regulatory period.	See discussion in section 15 on planning cycles- don't prescribe a fixed length. Allow for a transition period, then a short first control period (2-3 years) then a range from 4-6 years. This will allow flexibility to adapt as WSEs stabilise and mature and will help setup a staggered reset workload.
13a	Developed and published input methodologies.	Yes - but need early engagement before these come into force.
13b	Minimising price shocks to consumers and suppliers.	Ensure the regulator has regard to price shock, and has tools to address them, is important – but an objective of 'minimising' is too crude.
13c	Efficiency challenge for each regulated supplier.	See comments in submission– need to balance efficiency challenge with increased investment required and achieving broader outcomes
14a	Policy objectives for the structure of three waters prices.	Government should not directly control pricing. Direction should be set through co-development of a GPS working with councils and Iwi.
14b	Responsibility for determining the structure of three waters prices.	See the discussion on pricing in section 14.
14c	Role of the economic regulator in regard to pricing structure.	See discussion in section 14 on pricing.
15	Merits appeals.	Providing for merits appeals make sense. The fear of litigation can stifle regulatory processes somewhat, and suppliers will always be reluctant to challenge their regulator, but on balance it's an important safeguard given the power that economic regulators wield.
16	Compliance and enforcement tools.	Tools proposed seemed reasonable. We note that table 4 in the MBIE discussion paper (page 47) was missing a row for pricing oversight.
17	Which organisation should be economic regulator?	As discussed above in section 9, we recommend that consideration is given to setting up a new regulator to cover economic and consumer protection regulation.
18, 19, 20	Levies.	Levies provide a good alignment of interests – the WSEs will have to pass levies through to their consumers. They won't want the levies too high as to add to pricing pressure, or too low as to cause the regulator to be under-resourced (and unable to make good decisions). Crown funding can be too fickle.  We would recommend the levy be calculated on the same basis as the Taumata Arowai levy.

<b>CONSUMER PROTECTION</b>		
21a	Are additional consumer protections warranted?	<p>Important to have sufficient consumer protection for the following reasons:</p> <ul style="list-style-type: none"> <li>• Water is essential for life managed by a monopoly industry with limited to no alternatives for consumers.</li> <li>• Water is a scarce resource, and it is costly to ensure quantity and quality – leading to a need for transparency.</li> <li>• Consumers have very high standards of performance and water quality.</li> </ul> <p>It is important to ensure there will be a meaningful process for handling consumer issues when service standards are not met.</p>
21b	Should regime contain a bespoke purpose statement?	<p>Purpose statement would be important to set the tone of the regime. The four elements outlined in the MBIE discussion paper at paragraph 166 are a start to the development of the purpose statement, but would benefit from the notion of fairness, and accountability being included.</p>
22	Minimum service level requirements via a mandated code.	As above – ensure adequate structures to set service levels.
23	Consumer protection regulator - empowered to issue guidance alongside a code?	As above – ensure adequate structures to set service levels.
24	Regulate water service quality in a single piece of economic regulation and consumer protection legislation?	<p>Needs to be transparent, fair and independent. Keep as simple and clear as possible. There are a large number of agencies with a say or interest in water and how it is delivered. The role of each needs to be clarified.</p> <p>See comments in section 1</p>
25	Variability of minimum service level requirements across different types of consumers.	Generally should be similar. Needs more definition of different types of consumers. Vulnerable consumers need a separate set of requirements, such as restricted service for difficulty with ability to pay.
26	Vulnerable consumers.	<p>Water is an essential commodity. Some consumers are ‘vulnerable’ because of their ability to pay, others are medically dependent on the supply of water.</p> <p>Minimum service level requirements, perhaps along the lines of the newly instituted Electricity Authority “Consumer Care Guidelines” should be considered.</p>

27	How Treaty of Waitangi principles should be factored into the design of consumer protection.	See comments made in section 7.  Coordinate with the work being done by the Māori Advisory Group, part of Taumata Arowai.
28	Should consumer protection regime should apply to all water suppliers?	For reasons set out in question 21 above. Apply to all water suppliers so consumers can have confidence in the industry and suppliers all operate on a level playing field.
29	Compliance and enforcement tools.	Make them clear and transparent, and identify which entity is responsible.
30	Which organisation should be the consumer protection regulator?	Refer section 9, we think a new regulator should be considered or changes to Commerce Commission to provide economic and consumer protection regulation. This will help ensure coherency between consumer protection measures and wider governance and control arrangements.
31	Should regulator be required to incentivise high-quality consumer engagement?	The providers in a 'mature' industry, should strive for high quality consumer engagement without regulator needing to provide incentives.
32	Expert advocacy body.	Beneficial to have a means for consumers to have representation on technical issues. However, is it already covered? Once there is a better understanding of the roles of the entities shown in Table 11, questions around the need for, and provision of, an expert advocacy body may become clear.
33	Should expert body be established via an extension to the scope of the Consumer Advisory Council's jurisdiction?	Note the CAC currently being established under the Electricity Price Review is not yet established or functioning and there is currently legislation in the Electricity Industry Amendment Bill includes the establishment of the Small Electricity Consumer Agency to protect the interests of domestic and small business consumers. It is too early to say if extending the jurisdiction of these bodies to the water sector would be appropriate.
34	Need for dedicated consumer disputes resolution scheme.	There is a need for a dedicated dispute resolution scheme. A well run, best practice scheme will provide confidence for consumers in dealing with providers, and access to justice through an independent, specialised scheme.
35	Should disputes be subject to a dispute resolution scheme? Any other kinds of issues that a consumer dispute resolution provider should be able to adjudicate on?	Subpart 4 of the Water Services Act 2021 deals with Consumer complaints and so any additional dispute resolution scheme should have clear jurisdiction, so consumers know which body is responsible. See comment in 36 below.

36	Should a mandatory statutory consumer disputes resolution scheme should be established for the water sector?	<p>A mandatory scheme is essential for consumer confidence in the industry and for a level playing field for suppliers.</p> <p>It is easiest for consumers to have a one-stop-shop for all complaints, rather than a variety of complaints covered by different dispute resolution processes, which may have overlapping issues. One independent, mandatory scheme protects the integrity of the decision maker, as suppliers cannot 'walk' if a decision does not go their way. To ensure the integrity of the scheme, provisions must include the ability for the Minister responsible to seek independent reviews of the performance of the scheme and the ability to withdraw approval of the scheme if it is not performing.</p>
37	Do you consider that a new mandatory statutory consumer disputes resolution scheme should be achieved via a new scheme or expanding the jurisdiction of an existing scheme or schemes?	<p>Utilities Disputes has an existing scheme and experience in dealing with water complaints. Any scheme should adhere to the six principles – accessibility, independence, fairness, accountability, efficiency, effectiveness from the Australian benchmarks for industry-based customer dispute resolution.</p>
38	Do you consider that the consumer disputes resolution schemes should apply to all water suppliers, water suppliers with 500 or more customers, or just Water Services Entities?	<p>It is important to require all water suppliers to join the mandatory scheme for dispute resolution to prevent forum shopping and to create a level playing field for all suppliers. Setting an arbitrary number of say 500 complicates resolution for consumers, eg, their supplier has 499 consumers and a month later has 501 consumers. However this needs to take into consideration that rural and community run schemes differ considerably in scale and operation. This issues should be given further consideration through the DIA Rural / Community water working group.</p>
39	Do you think the consumer dispute resolution scheme should incentivise water suppliers to resolve complaints directly with consumers?	<p>Suppliers should be required to first attempt to resolve complaints directly with the consumer. Complaints provide an opportunity for improving service. See AS/NZS 10002 – <i>Guidelines for Complaint Management in Organisations</i>, which sets out the standards for complaint handling and the Australian benchmarks also provide some guidance around the principles of dispute resolution which would be useful for organisations.</p> <p>If not resolved, then suppliers must tell consumers of their right to take the complaint to an independent dispute resolution scheme.</p>

40	Considerations for traditionally under-served or vulnerable communities?	Vulnerable communities, and those struggling with the ability to pay will need to be taken into account. Consider as part of the roles of the agencies in Table 11.
41	Should costs of consumer protection regime be funded via levies on regulated suppliers?	Levies should be paid by regulated suppliers as part of the cost of doing business. They also ensure ongoing recognition of the consumer protection regime.
42 & 43	Levy consultation and collection.	Refer to the answer above for questions 18, 19 and 20.
<b>Implementation and regulatory stewardship</b>		
44	Will regulatory charters and a council of water regulators arrangements provide effective system governance? Are there other initiatives or arrangements that you consider are required?	The objective should be clarity of roles and positive communication for all key players – regulator, Taumata Arowai and other regulatory bodies. See section 11.
45	Will regulatory charters and a council of water regulators arrangements will provide effective system governance?	Refer section 2. This needs to be considered as part of the system design of water reforms.
46	Do you consider it is useful and appropriate for the Government to be able to transmit its policies to the economic and consumer protection regulator(s) for them to have regard to?	Refer section 2. This needs to be considered as part of the system legislation and stewardship arrangements set by the Crown – this includes the Government Policy Statement for water services which should be co-developed between the Government, councils and Iwi / Māori. This is key to ensure a focus on longer term outcomes such as water quality, climate change, and support for housing
47	Should economic and consumer protection regulator be able to share information with other regulatory agencies?	Refer to Section 11