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Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
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List of documents that have been proactively released		
Date	Title	Author
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7 June 2022	Economic Regulation and Consumer Protection in the Three Waters Sector CAB-22-MIN-0207 Minute	Cabinet office
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Information redacted

YES

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Some information has been withheld for the reason of Confidential advice to Government.

Office of the Minister of Commerce and Consumer Affairs

Cabinet Economic Development Committee

Economic Regulation and Consumer Protection in the Three Waters Sector

Proposal

- 1 I seek agreement to establish an economic regulation and consumer protection regime for three waters services in New Zealand. If agreed, these proposals will be included in a Water Regulation Bill, which has been given
Confidential advice to Government

Relation to government priorities

- 2 This Government is committed to significantly improving the safety, quality, resilience, accessibility, and performance of three waters services in a manner that is efficient and affordable for New Zealanders.
- 3 In April 2019, it was agreed that the Three Waters Reform is a government priority. The 2020 Labour Party Manifesto committed to reform New Zealand's drinking water and wastewater system, and upgrade water infrastructure.

Executive Summary

- 4 The Three Waters Reform has brought to light issues in the water sector that are often associated with natural monopolies, where high capital costs and other barriers make competition impractical. These issues include service quality, under-investment, inefficient pricing practices, and the capacity of the sector to deal with community expectations.
- 5 The reformed sector will see the establishment of four new Water Services Entities (**entities**) to provide the majority of New Zealanders with drinking water, wastewater, and stormwater services. While these entities will have the scale to address the issues identified during the reform process, there is also a risk that, without sufficient independent scrutiny, they will act inefficiently.
- 6 To address this risk, and to promote the long-term interests of consumers, I propose to establish an economic regulation and consumer protection regime. This regime would complement proposals made by the Minister of Local Government in the Cabinet paper *Pricing and Charging for Three Waters Services*, particularly those relating to mitigating price shocks.
- 7 In **Part A** of this paper, I propose to create a new economic regulation regime. Key recommendations are that:
 - 7.1 economic regulation be applied to all three water services of the entities, allowing for a different approach to regulating stormwater; and
 - 7.2 information disclosure and quality-only regulation apply in the first regulatory period and price-quality regulation in the second regulatory period, allowing for acceleration of this timeframe for certain entities.

- 8 To ensure that cultural and environmental considerations are reflected in the new regime, I also recommend that the economic regulator be required to take into account the entities' obligations in respect of Te Tiriti o Waitangi, Te Mana o te Wai, Treaty settlements, and climate change.
- 9 To further ensure that the entities act in the interests of consumers, in **Part B** of this paper I propose to put in place consumer protection mechanisms. Specifically, I recommend:
- 9.1 that the consumer protection regulator be required to set and enforce minimum service level codes; and
- 9.2 that a consumer disputes resolution scheme be established for the three waters sector and other measures to strengthen the consumer voice.
- 10 In **Part C** of this paper, I propose that the Commerce Commission be the agency responsible for implementing and enforcing this new regime, which could include establishing a role such as Water Commissioner. I propose to fund this regime via levies on regulated suppliers on behalf of consumers.

Background

- 11 In July 2020, the Government launched the Three Waters Reform Programme to reform local government water service delivery arrangements, led by the Minister of Local Government, Hon Nanaia Mahuta.
- 12 Independent reviews undertaken by international experts showed that the sector is currently inefficient (by comparison with international peers) and that there are credible prospects of significant efficiency gains. Realising these efficiency gains is one of the key drivers of the reforms, and will mean lower prices and improved services compared with what consumers would have experienced under the status quo.
- 13 On 14 June 2021, Cabinet made decisions on a comprehensive package of proposals to reform the three waters service delivery system [CAB-21-MIN-0226; CAB-21-MIN-0227; and CAB-21-MIN-0228 refer]. These proposals provided for the aggregation and transfer of water asset ownership of 67 local government suppliers into four new Water Services Entities (**entities**).
- 14 The Minister of Local Government sought approval to introduce the Water Services Entities Bill in May 2022. This Bill provides for the establishment of these new statutory entities, and for their ownership, governance, and accountability arrangements. The entities will be owned by councils on behalf of their communities, but will be prohibited from paying dividends to shareholders, so will operate as not-for-profit essential services providers.
- 15 Creating these new entities will improve the coordination of resources by considering New Zealand's infrastructure needs at a larger scale and moving the supply of three waters services to a more financially sustainable footing. This will help address the efficiency and capability challenges faced across the sector, and ensure all New Zealanders have equitable access to safe and affordable water services.

- 16 In December 2020, Cabinet agreed in principle that an economic regulation regime be applied to the reformed three waters sector, with information disclosure requirements at a minimum [CAB-20-MIN-0521.01 refers]. In June 2021, Cabinet also noted that that the full benefits of reform could not be achieved by scale alone, and the ability of the entities to realise efficiencies would depend on other factors, including the establishment of an economic regulation regime and mechanisms for protecting consumers.
- 17 In October 2021, Cabinet agreed to the release of the Ministry of Business, Innovation and Employment (**MBIE**) discussion paper '*Economic Regulation and Consumer Protection for Three Waters Services in New Zealand*' for consultation [CBC-21-MIN-0110 refers] (**the discussion paper**).
- 18 The proposals for economic regulation and consumer protection form part of the wider three waters reform (**the reform**), which includes the establishment of the new regulator, Taumata Arowai, and the enactment of the Water Services Act 2021. These focus on drinking water health and safety, as well as the environmental aspects of wastewater and stormwater services. The proposals in this paper seek to ensure that the economic and consumer protection regime complements existing accountability arrangements.

Part A: Economic regulation regime for the three waters sector

- 19 I consider economic regulation will be necessary to provide transparency and accountability in the reformed three waters sector since the entities will not face the usual equity market disciplines to operate efficiently. While economic regulators tend to rely on financial incentives to drive efficiency, the use of reputational incentives will be crucial to achieving efficiency gains in the water sector given the ownership structure of the new entities.
- 20 The Three Waters Reform programme has revealed a range of problems which are often associated with monopolies. This includes issues with:
- 20.1 low quality of service that does not reflect community expectation;
 - 20.2 long-term under-investment in infrastructure; and
 - 20.3 inefficient pricing practices that lack transparency.
- 21 A significant example of this was the Havelock North drinking water contamination incident, where one third of 15,000 residents were infected by campylobacteriosis, 45 were hospitalised, and three people died. While the new drinking water regulator, Taumata Arowai, will focus on ensuring incidents like this do not occur in future, economic regulation can complement Taumata Arowai's powers by ensuring the entities are responsive to consumer expectations and have robust asset management practices.
- 22 In terms of under-investment, evidence suggests that New Zealand's three waters infrastructure is old and increasingly prone to failure, with some estimates putting the national infrastructure deficit between \$120 billion and \$185 billion over the next 30 years. The scale of the new entities will make it easier for them to undertake this investment by accessing debt capital. I consider economic regulation will provide the oversight needed to ensure this

significant investment does not result in undue price shocks for consumers and will incentivise the entities to invest efficiently.

- 23 In relation to efficient and transparent pricing practices, economic regulation can give consumers confidence that the prices they are paying are justified, in that the regulator has scrutinised the prudence and efficiency of expenditure proposed by the entities. It also helps debt providers and rating agencies assess the scope of regulatory risk applying to regulated suppliers.
- 24 The Cabinet paper *Pricing and Charging for Three Waters Services (the pricing and charging paper)* presented by the Minister of Local Government sets out several proposals that will complement economic regulation, e.g. managing price shocks and controlling pricing practices.
- 25 Overall, submitters on the discussion paper agreed an economic regulation regime was needed to protect consumers from problems associated with monopoly suppliers. Several also submitted that the regime should reflect Te Tiriti o Waitangi and Te Mana o te Wai. As well as analysing submissions on the discussion paper and undertaking targeted stakeholder consultation, including with iwi/Māori groups, officials have engaged with international experts on economic regulation in developing the proposals below.
- 26 I am seeking agreement to proposals relating to the following key aspects for an economic regulation regime for the three waters sector:
- 26.1 purpose of the economic regulation regime;
 - 26.2 objectives relating to Te Tiriti o Waitangi and Te Mana o te Wai;
 - 26.3 climate change considerations;
 - 26.4 scope of economic regulation;
 - 26.5 form of economic regulation;
 - 26.6 implementation of economic regulation;
 - 26.7 flexibility in the economic regulation regime;
 - 26.8 compliance and enforcement tools; and
 - 26.9 legislative vehicle for the regime.

Purpose of the economic regulation regime

- 27 I propose that economic regulation should aim to promote the long-term benefit of consumers by promoting outcomes consistent with those produced in competitive markets. In existing economic regulation legislation in New Zealand, namely, Part 4 of the Commerce Act 1986 and Part 6 of the Telecommunications Act 2001, the purpose statements focus on outcomes relating to innovation, investment, efficiency, quality, prices, and profit. These purpose statements are well understood by industry and regulatory stakeholders in New Zealand, including capital markets.

- 28 Officials are working on how the regime could recognise the unique characteristics of the water sector, compared with other regulated sectors. For example, water is not a commodity in the usual sense as it is an essential service, and that the entities cannot pay dividends. I recommend that the Ministers of Local Government and Commerce and Consumer Affairs make final decisions on the purpose statement, based on the advice of officials.

Te Tiriti o Waitangi and Te Mana o te Wai obligations

- 29 In 2021, Cabinet agreed to a set of Māori-Crown relationship objectives to guide the consideration of issues relating to iwi/ Māori rights and interests, which were informed by engagement with iwi/ Māori and a consideration of the reform outcomes [CAB-21-MIN-0228 refers].
- 30 In accordance with these objectives, I have considered Te Tiriti o Waitangi and Te Mana o te Wai in the context of economic regulation and consumer protection for the three waters regime. Water is a taonga to Māori, and the Crown has a duty to protect iwi/ Māori rights and interests under Te Tiriti, and existing and subsequent Treaty settlements. A clear concern for iwi/ Māori is that proposals for the reformed three waters system need to uphold, align, and integrate with Te Tiriti and Te Mana o te Wai [CAB-21-MIN-0228 refers].
- 31 At a system level, effect is given to Te Tiriti and Te Mana o te Wai through various mechanisms, including the co-governance structure of the entities' regional representative groups, the internal competencies of the entities, Te Mana o te Wai statements, and the broader regulatory framework, which includes Taumata Arowai and regional councils. It is important that the obligations under the economic regulation regime complement those provided for elsewhere in the system and ensure regulatory coherence.
- 32 Consequently, I propose that decision makers (i.e. the economic regulator and the Minister of Commerce and Consumer Affairs) be required to take into account the entities' obligations in respect of Te Tiriti o Waitangi, Te Mana o te Wai, and Treaty settlements, as set out in legislation and Te Mana o te Wai statements, and other legislative instruments.¹
- 33 I believe this approach is preferable to a general operative clause requiring the economic regulator to have regard to the Te Tiriti and Te Mana o te Wai (without specifying what this means in practice), as the proposed approach strengthens consideration of Te Tiriti and Te Mana o te Wai across the system while still giving the economic regulator a clear obligation.
- 34 The aim is that decision makers would be required to take these obligations into account when making decisions about economic regulation, to ensure the entities' costs and processes are reflective of these obligations. For example, economic regulator could engage directly with mana whenua members of each of the entities' regional representative groups to make this assessment.

¹ The definition of "Treaty settlement obligations" would align with the definition set out in section 5 of the Water Services Entities Bill, namely "obligations under any of the following: (a) Treaty settlement Acts; (b) Treaty settlement deeds".

- 35 I further propose that the economic regulator be required to develop and maintain systems and processes to ensure it has the capability to uphold Te Tiriti o Waitangi, and to engage with and to understand perspectives of Māori.

Climate change considerations

- 36 Several submitters on the discussion paper highlighted the importance of ensuring assets are resilient to natural hazards and climate change, and recognising that climate change adaptations and mitigations may require additional investment. While this expenditure is likely to be in the best interests of consumers, I consider it important to have an explicit requirement to consider climate change obligations when assessing expenditure proposals. I therefore propose that the economic regulator be required to take into account the entities' obligations relating to climate change.

Scope of economic regulation

- 37 In determining the scope of economic regulation, it is necessary to consider:
- 37.1 which suppliers will be regulated (e.g. the entities, smaller suppliers);
 - 37.2 which services will be regulated (e.g. drinking water, wastewater, stormwater, other services).

I propose that the entities be subject to economic regulation in the first instance

- 38 The Government's reform to three waters service delivery arrangements will result in four new statutory entities providing services to approximately 4.3 million New Zealanders, or around 85 per cent of the population. The remaining 15 per cent of the population will continue to be served by small community, private schemes or self-suppliers, the majority of which serve fewer than 5,000 consumers.
- 39 No private or community drinking water schemes that serve more than 10,000 consumers would fall outside the coverage of the new entities. Experience overseas and in other industries in New Zealand suggests that it is unlikely to be economically viable to implement economic regulation for small entities, particularly entities that service fewer than 10,000 water consumers.
- 40 Therefore, I propose to apply economic regulation to the four new entities only. I do not propose to apply economic regulation to small suppliers as the benefits of doing so will not outweigh the compliance costs. However, I propose that the regulator be able to recommend the Minister extend the scope of economic regulation to include other suppliers if this becomes necessary. This would then be done via Order in Council.

I propose that all the three water services be subject to economic regulation

- 41 Analysis undertaken by the Department of Internal Affairs (**DIA**) shows that there is significant scope for efficiency gains across the entire water sector – see *Transforming the system for delivering three waters services* (2021). As such, my starting point is to recommend that all three waters be subject to

economic regulation. However, the task of regulating stormwater services is likely to be less straightforward than it is for drinking water and wastewater and may warrant a different regulatory approach, as discussed below.

- 42 While the scope of the entities' operations will largely be limited to providing three waters services, some of their activities may already be subject to competition (e.g. water system maintenance services). I consider any competitive activities should not be covered by economic regulation. However, if the level of competition in these markets diminishes, I propose that the regulator be able to advise the Minister of Commerce and Consumer Affairs as to whether they should be covered by the economic regulation regime.

Form of economic regulation

- 43 Implementing economic regulation for the three waters sector would involve applying the following forms of regulation:
- 43.1 information disclosure, which generally requires regulated suppliers to publicly disclose prescribed information about their performance to make them more accountable to stakeholders;
 - 43.2 price-quality regulation, which involves directly regulating suppliers' allowable revenue or prices and service quality to ensure consumers are receiving efficient services at appropriate prices and quality; and
 - 43.3 quality-only regulation, which involves the regulator setting network service quality standards without an accompanying revenue path.
- 44 These forms of regulation could be applied differently across regulatory periods and would be underpinned by rules and processes known as input methodologies. Input methodologies provide suppliers and consumers with certainty about how information disclosure and price-quality regulation will apply and can also provide valuable information to rating agencies. Paragraph 72 below sets out further details about the proposed regulatory periods.

I propose that information disclosure apply

- 45 There is currently a lack of robust information about the water sector, making it necessary for the entities to be subject to an information disclosure regime. This will promote transparency and accountability by providing interested parties with oversight of the entities' expenditure, demand forecasting, cost allocation, and the cost of debt. This will provide strong incentives to the managers of the entities to ensure they are operating efficiently.
- 46 I therefore propose that information disclosure should apply from the first regulatory period to regulated suppliers, including regular reporting on the relative performance of entities, with analysis and benchmarking of financial performance. This is consistent with Cabinet's in-principle decision that information disclosure apply to the reformed sector at a minimum [CAB-20-MIN-0521.01 refers]. This could initially be a basic form of information disclosure which is not underpinned by input methodologies, to help the

economic regulator understand the entities' costs and assets quickly.

- 47 Officials will also consider how to improve the sector's information base during the transition period, and ahead of economic regulation coming into force.

I propose that the regulator should be able to set performance requirements and quality standards

- 48 I propose that the legislation enable the economic regulator to set performance requirements that drive outcomes relating to the overall objectives of the regime, along with quality standards that focus on a narrower concept of network quality. This could include requirements relating to asset management and investment proposals. Performance requirements and quality standards would be set via price-quality and quality-only regulation.

I propose that the regime provide for individual price-quality regulation

- 49 Price-quality regulation (i.e. revenue limits) in New Zealand tends to employ:

49.1 individual price-quality regulation for sectors with a few large suppliers (e.g. electricity transmission, fixed-line telecommunications); or

49.2 lower-cost generic or 'default' price-quality regulation in sectors with a larger number of suppliers (e.g. electricity distribution).

- 50 I propose that the regime allow for individual price-quality regulation to be applied to the entities. This will allow the economic regulator to apply more tailored scrutiny to individual suppliers, particularly regarding asset management, and the prudence and efficiency of major investments.

- 51 It is important to note that price-quality regulation will involve the regulator setting allowable revenue, rather than regulating the specific prices charged to individual consumers. Under price-quality regulation, the entities will be able to choose the prices they charge within an overall revenue cap, whilst complying with the pricing principles and rules set out in legislation and applying the required input methodologies. Given the lack of profit motive, price-quality regulation will play a lesser role in the water sector but may add some additional benefit, above information disclosure regulation alone, for example, in driving efficiency gains.

I propose that input methodologies be included in the economic regulation regime

- 52 I propose the regulator be required to set input methodologies for the core aspects underpinning the forms of economic regulation set out above. These could be adapted from those set out under Part 4 of the Commerce Act 1986 and Part 6 of the Telecommunications Act 2001 and cover issues such as the cost of capital/debt, cost allocation, capital expenditure and asset valuation.

- 53 The determination process for input methodologies, as well as information disclosure, quality-only and price-quality regulation, would be similar to that required under Part 4 of the Commerce Act (subparts 2, 3, 4, and 6).

- 54 To encourage robust regulatory decision making, regulatory determinations are often subject to merits reviews. Appeal rights provide an avenue for natural justice for regulated suppliers or consumers. However, appeal rights can also create regulatory uncertainty, as well as costs and delays.
- 55 I propose that merits reviews of the regulator's input methodologies and price-quality regulation determinations should be available, since these will set regulatory controls that have significant impacts on specific suppliers. However, I do not consider merits reviews should be available for information disclosure or quality-only regulation determinations since these will not have significant impacts on individual suppliers.

I propose the regulator be able to set comparative efficiency benchmarks

- 56 I consider one of the key objectives of the new regime will be economic efficiency, given the significant role efficiency plays in the long-term welfare of consumers. Benchmarking of service quality and efficiency will also establish strong reputational effects. I propose that the regulator be able to set comparative efficiency benchmarks for suppliers in a way that ensures they remain financially viable. The early work with Watercare during the transition period will help to establish benchmarks that other entities could aim for.

I propose the economic regulation regime allow for a wash-up mechanism

- 57 In applying the initial price-quality path, there is a risk that the entities are exposed to demand forecasting risk (i.e. they set tariffs incorrectly or face unexpected demand changes). To address this, I propose that the economic regulator be able to apply a wash-up mechanism to address over- or under-recovery of revenue by entities during the previous period.

I propose the regulator be able to 'ring-fence' a portion of entities' allowable return

- 58 The regulator needs to be able to ensure the entities have the minimum required level of cash to finance their operations, and that they are not wasteful in spending this cash. I propose to give the regulator the ability to 'ring-fence' a portion of an entity's allowable return that would be held in reserve in case of any unexpected investment requirements.

The regulator be able to require pricing principles and rules be applied

- 59 The Minister of Local Government has proposed that legislation set pricing principles (e.g. that pricing must be simple, non-discriminatory, and cost-reflective) and pricing rules (e.g. regarding the use of block tariffs). The economic regulator would then have the power to direct entities to alter the Funding and Pricing Plan or tariff list if it thought these were inconsistent with these principles and rules – see the pricing and charging paper.

I propose the regulator be able to smooth revenue to mitigate average price shocks

- 60 The transition to the new regime could cause undesirable price shocks given the wide range of pricing approaches currently utilised. In the short term, the Government will have the power to limit the rate of residential price increases,

as set out in the pricing and charging paper. In the long term, I propose that, in setting price-quality regulation, the regulator be able to smooth maximum allowable revenue over multiple regulatory periods to minimise average price shocks to consumers and allow for financeability.

Implementation of economic regulation

61 I consider it necessary to provide certainty on the timeframes and on the form of regulation for the first regulatory period. I also consider it necessary to implement some form of quality regulation from the first regulatory period to ensure water services meet consumer demands and that entities are managing networks efficiently and delivering reliable services.

Length of regulatory periods

62 Economic regulation is typically applied in regulatory periods, which tend to be between three and six years in length. I propose that the first regulatory period be three years to allow price-quality regulation to come in as soon as possible. I further propose that the regulator be able to choose the length of subsequent regulatory periods, but that they be no longer than six years.

I propose the economic regulator work with industry in a pre-regulatory period

63 The economic regulator will need to undertake significant preparatory work before the first regulatory period commences. For example, it will need to undertake the resource-intensive task of developing input methodologies, and will also need to work with industry to build its capability in complying with economic regulation. Initially this would involve working with the National Transition Unit and local government stakeholders, and then working with the entities themselves after 1 July 2024.

I propose that quality-only regulation apply alongside information disclosure regulation in the first regulatory period

64 In addition to information disclosure regulation, I consider quality-only regulation to be appropriate for the first period because:

64.1 The lack of robust information in the water sector means that, during the establishment phase, entities will still be discovering their cost structures and the state of their assets. In the first regulatory period, it is unlikely the regulator will know enough about the entities' costs and assets to be able to mitigate inefficiencies via price-quality regulation.

64.2 Given this poor state of information, a revenue cap could cause unintended consequences. While it is important for the regulator to incentivise efficiency gains, this could impact the entities' ability to undertake the substantial upfront investment required or to otherwise obtain debt on appropriate terms if allowable revenues are set too low.

64.3 In the pricing and charging paper, the Minister of Local Government proposes to regulate the rate of price increases to mitigate the risk of price shocks as the entities are established. These proposals are likely

to be more effective at minimising price shocks than a revenue cap in the first few years of the reformed system.

I propose that price-quality regulation apply in the second regulatory period

- 65 I propose that legislation require the regulator to implement price-quality regulation for the second regulatory period unless the regulator recommends otherwise to the Minister of Commerce and Consumer Affairs, and the Minister accepts this recommendation. The Minister could then recommend an Order in Council be issued altering the form of regulation required by legislation in the second regulatory period.
- 66 This means that, while the default position would be the introduction of price-quality regulation in 2030 (i.e. seven years after enactment), this could be overruled by the Minister following the findings of a review undertaken by the economic regulator. This might occur if, for example, the regulator considers information is not sufficiently robust to support implementing price-quality regulation, or if it considers that the risks associated with price-quality regulation would outweigh any benefits.

Approach to regulating stormwater

- 67 As noted above, the approach to regulating stormwater may need to be different to the approach for drinking water and wastewater. This is because:
- 67.1 There are public good aspects of stormwater systems which make it difficult to identify and bill the end-users of these services.
- 67.2 As stormwater assets are often owned by other parties (e.g. Waka Kotahi) but will be maintained and operated by the entities, this could complicate economic regulation for stormwater. Councils will also continue to play a role in managing the stormwater system after the entities have been established.
- 67.3 Less is known about stormwater assets and network performance compared to drinking and wastewater assets.
- 68 For these reasons, I propose that stormwater services would only be subject to economic regulation to the extent that the entities are able to control these services. I also propose the legislation allows for flexibility by ensuring stormwater can be regulated separately to drinking water and wastewater, including a more tailored approach to phasing in economic regulation tools (e.g. stormwater to be subject to quality-only regulation in future even if drinking water and wastewater are subject to price-quality regulation).

Approach to regulating Entity A

- 69 Watercare, servicing the Auckland area, has relatively better-quality information about its regulatory asset base than other councils. While it has already achieved some of the advantage of scale, its performance is still below comparable international benchmarks. By virtue of its scale, structure and systems, it is better placed than other entities to make early gains.
- 70 Entity A, the entity that will serve Auckland and Northland, has the potential to set the benchmark by which performance (including quality and efficiency) for other entities will be measured. Establishing such benchmarks early could encourage other entities to also meet these benchmarks.
- 71 Working with Watercare/Auckland Council to improve the information base ahead of the introduction of statutory regulation will assist the new regulator to develop its regulatory approach, and train its staff, while also yielding earlier benefits for customers of Entity A. Confidential advice to Government

I propose the following timing of implementation for the first regulatory period

- 72 I propose that the economic regulation regime be implemented as follows:

Pre-regulatory period:

- 72.1 **Legislation enacted (mid-late 2023) until 1 July 2024:** the regulator works with the industry to build its capability in complying with economic regulation and with Watercare on a fast-tracked approach to implementing price-quality regulation for Entity A. Confidential advice to Government
- 72.2 **1 July 2024 until mid-2026:** the regulator develops input methodologies, as well as information disclosure requirements that do not require input methodologies (such as asset management plans). This more basic form of information disclosure would build on the information collected by Taumata Arowai.
- 72.3 **Mid-2026 until mid-2027:** the regulator develops remaining information disclosure requirements alongside quality-only regulation (quality standards and performance requirements).

First regulatory period

- 72.4 **Mid-2027 until mid-2030:** first regulatory period where full information disclosure and quality-only regulation apply.

Second regulatory period

- 72.5 **Mid-2030:** price-quality regulation implemented (unless the Minister of Commerce and Consumer Affairs accepts advice from the economic

regulator that it should not apply), including any necessary amendments to input methodologies.

- 73 I propose that the Minister of Commerce and Consumer Affairs be empowered to revise these implementation dates, after consulting with the economic regulator and following certain other requirements (e.g. see the requirements set out in section 9, Part 2 of Schedule 1AA of the Telecommunications Act 2001). For example, if the information disclosure regime allows the regulator to understand the entities' costs and assets faster than anticipated, the Minister could decide to require price-quality regulation be implemented earlier than 2030.
- 74 I also consider the regime should allow for different approaches in different regions, given the disparities between the approaches taken by different councils to managing their network assets.

I propose the regulator be able to conduct reviews and make recommendations

- 75 I consider the economic regulator should be able to conduct reviews and make recommendations to the Minister of Commerce and Consumer Affairs regarding a change in regulation, either on its own initiative, or after being directed to do so by the Minister. In addition, the regulator would need to consult with interested parties and have regard to the purpose of the regime before making a recommendation to the Minister.
- 76 I propose that the regulator be able to recommend certain services or entities be regulated, de-regulated or subject to a different form of regulation if certain criteria have been met, such as whether this would be in the best interests of water consumers. For example, as signalled above, the regulator would be able to conduct a review and make a recommendation to the Minister that:
- 76.1 a different form of regulation apply to certain services or entities; or
- 76.2 price-quality regulation should be implemented in the second regulatory period.

Compliance and enforcement tools

- 77 Having a range of compliance and enforcement tools will allow the economic regulator to tailor its enforcement responses according to the type of compliance issue.

I propose the economic regulator have a range of compliance and enforcement tools

- 78 I propose that the regulator have the following enforcement tools, adapted from the Commerce Act 1986 and Telecommunications Act 2001:
- 78.1 The ability to incentivise regulated entities to improve the quality of supply through use of rewards and penalties (e.g. section 53M of the Commerce Act). This would include the ability to use reputational incentives, such as schemes which rate or rank various aspects of performance.

- 78.2 That it be an offence to intentionally contravene certain regulatory requirements or fail to comply with an order (e.g. sections 86B and 87B of the Commerce Act).
- 78.3 The ability to accept enforceable undertakings (e.g. sections 74A-74C of the Commerce Act); issue infringement notices and warning letters.
- 78.4 The High Court may order any person who has contravened certain regulatory requirements (i.e. information disclosure, quality-only or price-quality regulatory requirements) to pay a pecuniary penalty, or for an order to comply with regulatory requirements (e.g. sections 86-86A of the Commerce Act). Penalties would not exceed \$500,000 for an individual, or \$5 million for a body corporate.
- 78.5 That the High Court may order a person to pay compensation in respect of a contravention of price-quality or quality-only regulation (e.g. section 87A of the Commerce Act); grant an injunction restraining an entity from providing services in contravention of price-quality or quality-only regulation (e.g. section 87C of the Commerce Act).
- 79 Given the entities will not face the usual profit-maximising incentives, the regulator will likely focus on using reputational incentives, rather than financial incentives such as penalties or fines, to drive compliance. Because the entities cannot pay dividends, there is also a risk that financial penalties are passed on to consumers in the form of higher prices, meaning enforcement activity could lead to perverse outcomes.
- 80 Educational and outreach activities can help mitigate compliance breaches by ensuring suppliers understand their obligations and consumers understand their rights. As such, I propose that the regulator be able to publish guidance information on its functions and powers under the new regime.

Monitoring powers of responsible agency

- 81 I propose the regulator have broad powers to monitor the three waters system to assess whether it is being operated efficiently and delivering good outcomes for consumers. This could include producing reports and requiring any water supplier to produce information. These powers would be based on the monitoring and investigation powers set out in sections 98, 98A, 98G, 99, 100 and 106, as well as in subpart 8 of Part 4, of the Commerce Act.

Legislative vehicle for the regime

- 82 It is important to assess whether separate legislation is needed, or whether the economic regulation and consumer protection regime could sit within an existing legislative vehicle, such as Part 4 of the Commerce Act 1986.

I propose to introduce sector-specific legislation for the new regime

- 83 I propose to enact new, sector-specific legislation for the economic regulation and consumer protection regime for three waters because:

- 83.1 of the unique characteristics of the entities compared with other monopoly businesses regulated under Part 4, particularly the fact that they will be publicly owned and unable to pay dividends;
- 83.2 of the unique characteristics of the three waters system, including the status of water as a fundamental human right, as well as considerations of the Te Tiriti o Waitangi and Te Mana o te Wai; and
- 83.3 given the Government's strong focus on efficiency and investment in the Three Waters Reform, a wider set of regulatory tools will be needed than what is available under Part 4 of the Commerce Act. For example, Part 4 prohibits comparative benchmarking, which I consider will be a useful tool for the three waters economic regulator in driving efficiency.

Part B: Consumer protection regime for the three waters sector

- 84 I propose the new regime include consumer protections over and above what is available in general consumer protection legislation. This will help ensure the entities are responsive to the needs of their customers, particularly given they will be monopoly businesses with a retail function. These consumer protection mechanisms will complement performance requirements set via economic regulation, as well as Taumata Arowai's powers.
- 85 Submitters on the discussion paper were supportive of additional consumer protections for the three waters sector, and submitted that the regime should aim to ensure high-quality services, effective redress, and transparency.
- 86 I seek agreement to proposals for the following key aspects of a consumer protection regime:
 - 86.1 purpose of the consumer protection regime;
 - 86.2 scope of the consumer protection regime;
 - 86.3 minimum service level code; and
 - 86.4 mechanisms for strengthening the consumer voice.

Purpose of the consumer protection regime

- 87 I propose that the purpose of the new consumer protection regime be to improve the quality of water services to reflect the demands of three waters consumers.²

Scope of the consumer protection regime

- 88 I propose that the consumer protection regime initially be applied only to the three waters services delivered by the entities. This is because this approach will promote regulatory coherence with the economic regulation regime, and because the costs of compliance for smaller suppliers are likely to outweigh

² The proposed regulation of service quality (focused on the entities' service delivery) is distinct from Taumata Arowai's regulation of the quality of drinking water itself.

the potential benefits for customers of those schemes.

- 89 As with economic regulation, I propose the consumer protection regulator be able to recommend to the Minister of Commerce and Consumer Affairs, after consulting with interested parties, that the consumer protection regime be extended to cover suppliers other than the entities. The regulator would also be able to recommend certain suppliers or services be exempt from the regime. The Minister could then recommend an Order in Council be issued in line with these recommendations.

Minimum service level code

- 90 I propose that legislation require the consumer protection regulator to set a minimum service level code setting out binding requirements on regulated entities. While, as with economic regulation, the contents of the code would be at the discretion of the regulator, it could include issues such as:

- 90.1 consumers' rights when they contact a water supplier with a complaint;
- 90.2 the level of communication with consumers on network outages, and the time taken to respond to outages and faults;
- 90.3 transparency of billing practices, including account queries;
- 90.4 redress where the quality of service does not meet appropriate standards, e.g. minimum flow or pressure rates;
- 90.5 conditions for the provision of water services to customers experiencing a form of hardship or other vulnerability, such as obligations of suppliers in dealing with non-payment; and
- 90.6 requirements for consulting and engaging with consumers and providing information about how to make or escalate a complaint.

I propose it be mandatory for entities to comply with the code

- 91 I propose that it be mandatory for the entities to comply with this code, but voluntary for other suppliers to sign up to. I also propose that, in setting these minimum service levels, the regulator be required to consider the interests of vulnerable consumers, and ensure they are flexible enough to accommodate a wide range of approaches to addressing consumer harm.

I propose a range of compliance and enforcement tools for code breaches

- 92 I propose that the consumer protection regulator have a range of compliance and enforcement tools at its disposal in relation to minimum service levels.
- 93 These tools could be adapted from remedies available under the Fair Trading Act 1986 and Telecommunications Act 2001, including:
- 93.1 the ability to undertake education initiatives and issue guidance, issue warning letters and infringement offences (e.g. sections 40B-40H of the

Fair Trading Act), and accept enforceable undertakings (e.g. sections 46A-46B of the Fair Trading Act);

93.2 the ability to use reputational incentives, such as schemes which rate or rank various aspects of performance; and

93.3 that the High Court be able to order pecuniary penalties and compensation, issue compliance orders and injunctions (e.g. sections 212-219 of the Telecommunications Act). Penalties would not exceed \$500,000 for an individual, or \$5 million for a body corporate.

94 As the entities will not face the same incentives as profit-maximising suppliers, the consumer protection regulator may choose not to seek financial penalties given the risk that these will be passed on to consumers.

Linkages with customer agreements

95 The Minister of Local Government is also proposing that entities be required to use customer agreements, with mandatory contents for the agreements set out in legislation. This may include the sorts of issues that would also be covered in a minimum service level code, such as issues with billing and non-payment, notification of outages or water restrictions.

96 The minimum service level code and customer agreements will complement each other in setting out certain requirements. As explained below, I propose that consumers be able to escalate complaints about breaches of customer agreements or minimum service levels to the disputes resolution provider.

Mechanisms for strengthening the consumer voice

97 Consumers often struggle to engage with the technical aspects of regulatory decision-making processes in the utilities sector. There is also an inherent power and resource imbalance between large monopolistic businesses and consumers. I propose to strengthen the consumer voice in the three waters system by enabling the regulator to require or incentivise the entities to undertake high-quality consumer engagement, including engagement with Iwi/Māori and vulnerable consumers.

98 I also propose to establish an expert body to advocate on behalf of consumers by engaging with regulators and the entities. I am proposing that this be done by extending the mandate of the Consumer Advocacy Council in the electricity sector by bringing in water sector experts.

Consumer disputes resolution

99 Dispute resolution schemes can provide consumers with a quick and cost-effective avenue for escalating complaints when they cannot resolve them directly with the supplier. Research commissioned by the Australia and New Zealand Energy and Water Ombudsman Network found that significant benefits accrue to consumers and suppliers in monopoly water markets when they can access independent dispute resolution services.

I propose to establish a consumer disputes resolution scheme

- 100 While a consumer complaints framework is already provided for under Taumata Arowai's legislation (sections 38-40 of the Water Services Act 2021), this focuses on drinking water suppliers, which leaves potential gaps in relation to consumer disputes about wastewater and stormwater services. However, I consider this complaints framework is important in that it gives:
- 100.1 customers of smaller suppliers (i.e. not the water services entities) an avenue to escalate complaints; and
 - 100.2 all consumers an avenue for raising serious concerns about water quality (e.g. if people are getting sick from their drinking water).
- 101 There are two broad options for managing any potential gaps, namely:
- 101.1 Create an additional consumer disputes resolution scheme for customers of water services entities to escalate complaints and disputes. The scheme would cover typical issues consumers experience with service providers, rather than public health issues that need to be dealt with quickly. For example, the scheme could deal with minimum service levels as set out in paragraph 90 above, access to water assets, actions of staff or contractors, and the provision of water services under customer contracts or legislation. Under this option, the proposed consumer dispute resolution scheme and Taumata Arowai's complaints framework would operate in parallel.
 - 101.2 Create a single consumer disputes resolution scheme that would cover all three waters services provided by water services entities. This would require some modifications to the Water Services Act. Under this option, the proposed consumer dispute resolution scheme would subsume Taumata Arowai's complaints framework.
- 102 I propose to work closely with the Minister of Local Government to make further decisions on the most appropriate structure of consumer dispute resolution schemes, with the following objectives:
- 102.1 ensuring that all drinking water consumers, and all consumers of wastewater and stormwater services provided by water services entities have access to appropriate dispute resolution services;
 - 102.2 ensuring that Taumata Arowai obtains necessary and timely information on drinking water quality issues; and
 - 102.3 consumers easily understand where to direct complaints.
- 103 Regardless of the option chosen, the Minister of Commerce and Consumer Affairs (or Taumata Arowai) will be able to appoint a provider who is able to deliver culturally responsive dispute resolution that is informed by te ao Māori and adopts tikanga-based processes. This is consistent with the findings of the Working Group on Representation, Governance and Accountability of New Water Services Entities. This could be operated by an existing

independent disputes resolution provider with experience in utilities-related disputes.

I propose it initially be mandatory for entities to belong to the scheme

- 104 I propose that membership to this disputes resolution scheme be mandatory for the entities at the commencement of the regime, with smaller suppliers having the option of voluntarily signing-up for the scheme. I also propose that the regulator be able, after consulting with interested parties, to recommend to the Minister that suppliers other than the entities be brought into the scheme.

I propose to establish the consumer dispute resolution framework in legislation

- 105 I propose that legislation set out the following framework, adapted from sections 38-40 of the Water Services Act, as well as Part 7 of the Telecommunications Act:
- 105.1 Members of the scheme must establish, maintain, and administer a consumer complaints process and provide information to consumers about how to escalate complaints.
 - 105.2 Consumers that are not satisfied with the outcome of a complaints process can refer the matter to the dispute resolution scheme.
 - 105.3 The disputes scheme can investigate a member's handling of a complaint and direct the member to take action to remedy the situation.
 - 105.4 The disputes resolution scheme can charge members of the scheme to investigate a consumer complaint.
 - 105.5 The dispute resolution scheme must, on request of the consumer protection regulator, provide information relevant to the administration of minimum service levels.
 - 105.6 The consumer protection regulator should periodically review the scheme to ensure it remains fit for purpose as well as make recommendations as to how it could be improved.

Part C: Regulatory responsibility for the new regime

- 106 I consider the agency responsible for economic regulation and consumer protection for three waters must meet all, or most, of the following criteria:
- 106.1 operate at arms-length from Government;
 - 106.2 have expertise and credibility implementing economic regulation and consumer protection regimes;
 - 106.3 have appropriate knowledge of the three waters sector;
 - 106.4 be able to deliver improvements to the regulatory system quickly; and

106.5 realise synergies from New Zealand's broader economic regulation and consumer protection system.

Options for agency responsible for the new regimes

107 I consider there are three possible options for who should be the economic regulator and consumer protection regulator, and that these options can be assessed against the above criteria in the following way:

107.1 *Expanding the remit of the Commerce Commission:* The Commerce Commission is experienced in implementing economic regulation in other utility sectors, as well as enforcing general consumer protection legislation. While the Commission does not currently have expertise in the water sector, it has a strong track record of implementing new economic regulation regimes, such as the fibre and fuel regimes.

107.2 *Establishing a new economic and consumer protection regulator for the water sector:* While this would allow a new entity to build specific expertise in the water sector, it would take some time to commence operation and involve significant cost. It would also likely see New Zealand's scarce economic regulation and consumer protection expertise spread across multiple agencies in a way that prevents synergies being realised, with impacts for other regulated sectors.

107.3 *Expanding the remit of Taumata Arowai:* While it is rapidly building its expertise in regulating aspects of the water sector, Taumata Arowai is a water quality regulator and a Crown agent and does not have economic regulation and consumer protection expertise, nor the degree of independence from Government to allow it to effectively implement these types of regulation. In other jurisdictions, the economic regulator tends to be separate from the water safety regulator.

I propose that the Commerce Commission be the responsible agency

108 I propose that the Commerce Commission be the agency responsible for implementing economic and consumer protection regulation for three waters.

I propose to establish a position of Water Commissioner

109 The discussion paper noted that there are options to provide a dedicated water sector focus within the overarching structure of the Commerce Commission. For example, a 'Water Commissioner' could be established within the overall governance structure in a similar way to the current Telecommunications Commissioner.

110 The proposed Water Commissioner would have a specific role in the Commerce Commission's governance structure. This would reflect the unique nature of the water sector, including the importance of Te Mana o te Wai. It could also provide industry with a figurehead to look to as it navigates this significant reform.

- 111 However, it would have the following disadvantages:
- 111.1 it could add unnecessary complexity to the Commerce Commission's governance structure, given water sector experts could be appointed to the board regardless; and
 - 111.2 it does not align with the Commerce Commission's role as a multi-sector regulator, whereby there is a Telecommunications Commissioner but no specific role on the board for other regulated industries (electricity, gas, airports, dairy, fuel).
- 112 On balance, I consider it desirable to establish a position of Water Commissioner, or similar position(s), within the Commerce Commission's board. Officials will undertake further analysis to determine how best to incorporate this in the Commission's governance structure.

Inter-agency collaboration

- 113 As mentioned above, there will be interdependencies between the regimes enforced by the economic and consumer protection regulator and other agencies overseeing the three waters system. Tools such as 'regulatory charters', memorandums of understanding and 'council of water regulators' would ensure effective stewardship of the system.
- 114 As noted in June 2021 [CAB-21-MIN-0226], DIA will lead and coordinate a cross-agency piece of work to identify and develop an appropriate approach to long-term stewardship arrangements and will provide advice to Three Waters Ministers by September 2024.

Information-sharing arrangements are already enabled

- 115 Information sharing between regulators will be important to enable overall regulatory coherence. The Commerce Amendment Act 2022 and Water Services Act 2021 already enable information sharing by both the Commerce Commission and Taumata Arowai. Therefore, no further changes are required to enable information sharing.

Financial Implications

- 116 Implementing the three waters services economic regulation and consumer protection regime comes with the following estimated costs:
- 116.1 developing the rules and processes underpinning the application of economic regulation is likely to cost around \$10 million over two years;
 - 116.2 costs of roughly \$5 million per year on average for information disclosure, \$3 million per year on average for price-quality regulation, and \$2 million on average for quality-only regulation; and
 - 116.3 costs of a minimum service code of around \$2 million in the first year and \$1.5 million per year in subsequent years.

- 117 The costs involved in developing and operating a consumer disputes resolution scheme would likely be met by the scheme's members. Comparable schemes in other sectors cost around \$2 to \$3 million annually.
- 118 The economic regulator will need to build the water sector's understanding of economic regulation during the 2022-2024 transition period. Cabinet agreed that this transition work will be funded via the *Transforming Three Waters Service Delivery for New Zealanders: Transition and Implementation* tagged contingency established as part of the Budget 2021 process, with \$4 million set aside across 2022/23 and 2023/24) [CAB-21-MIN-0419].
- 119 Officials are undertaking further analysis of what this transition work will involve and whether this tagged contingency amount is sufficient. For example, this amount may be insufficient if the regulator is required to expedite price-quality regulation for Entity A.

I propose that the new regime be majority funded via levies on regulated suppliers

- 120 Economic regulation and consumer protection will benefit the long-term interests of water consumers. While there are public benefits to having well-functioning three waters systems through use of economic regulation (especially for stormwater), most of the benefits are private ones.
- 121 As we can identify and cost-effectively charge the ultimate beneficiaries of the economic regulation and consumer protection regime, the costs referred to in paragraph 116 above should be covered by consumers. I propose the costs be recovered by levying regulated suppliers as a proxy for consumers, with the levies to be passed onto consumers through the entities' billing practises. This approach is typical of other economically regulated sectors as it ensures the consumers who use the regulated services pay for the regulatory work.

122

Confidential advice to Government

- 123 I propose that the legislation provide a levy-making power to the Minister of Commerce and Consumer Affairs, and that this be a Ministry-led process, in close consultation with the regulator (e.g. section 53ZE of the Commerce Act). This approach creates a degree of separation between the regulator and regulated suppliers in respect of the levy-charging process.

Legislative Implications

- 124 I propose that the policy outlined in this paper be given effect through the Water Regulation Bill (which has Confidential advice to Government). I also propose that this legislation commence in mid-2023 to allow the regulator to begin work ahead of the entities' 'go live' date of 1 July 2024.

- 125 While this could be a standalone Bill, I will also consider whether parts of the regime could be covered by the Water Services Entities Amendment Bill led by the Minister of Local Government, to ensure the regulatory system is cohesive. The Minister of Local Government and I will seek advice from officials and the Parliamentary Counsel Office on the appropriate location of issues in these two Bills.

Impact Analysis

Regulatory Impact Statement

- 126 The regulatory impact analysis requirements apply to the proposals in this paper. A regulatory impact statement has been prepared and is attached.
- 127 MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Impact Statement prepared by MBIE. The panel considers that the information and analysis summarised in the Impact Statement **meets** the criteria necessary for Ministers to make informed decisions on the proposals in this paper.

Climate Implications of Policy Assessment

- 128 The Climate Implications of Policy Assessment (**CIPA**) team has been consulted and confirms that the CIPA requirements do not apply to the proposals in this paper as there is no direct emissions impact. These proposals support the overall reform proposals which may have implications for emissions as wastewater emissions are likely to be better managed.

Population Implications

- 129 The proposals in this paper will not disproportionately impact population groups.

Human Rights

- 130 There are no human rights implications arising from the proposals in this paper. Consistency with the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993 will be discussed with the Ministry of Justice during the drafting process.

Consultation

- 131 MBIE released the discussion paper for public consultation in October 2021. It received 53 submissions, which have informed the proposals in this paper. Submissions came from stakeholders in the local government sector, water industry representatives, iwi/ Māori groups, membership associations, government agencies, and advocacy groups.
- 132 Throughout the policy process, officials have engaged with the Treasury, Taumata Arowai, Department of Internal Affairs and the Commerce Commission. Officials have also consulted with the Ministry for the Environment, Ministry for Primary Industries, Ministry for Housing and Urban

Development, Ministry of Health, Te Puni Kōkiri, Ministry of Transport, Infrastructure Commission, and the Office for Māori Crown Relations – Te Arawhiti. The Department of Prime Minister and Cabinet has been informed.

- 133 The Three Waters Steering Committee (comprising Local Government New Zealand, Taituarā and a range of territorial authority mayors and chief executives) has also been consulted. Officials have also undertaken targeted consultation iwi/ Māori groups, councils, and consultants.

Communications

- 134 I expect to work with the Minister of Local Government to make announcements about the economic regulation and consumer protection regime for three waters soon after Cabinet decisions are made.

Proactive Release

- 135 This paper will be published on MBIE's website within 30 working days once announcements have been made, subject to withholdings as appropriate under the Official Information Act 1982.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Cabinet Economic Development Committee:

Background

- 1 **note** that Cabinet previously made decisions on a comprehensive package of proposals to reform the three waters service delivery system, and noted that an economic regulation and consumer protection regime would help the four new Water Services entities (entities) realise efficiencies [CAB-21-MIN-0226; CAB-21-MIN-0227; and CAB-21-MIN-0228 refer];
- 2 **note** that the Minister of Local Government is leading the Three Waters Reform, but that economic regulation and consumer protection falls within the Commerce and Consumer Affairs portfolio;

Part A: Economic regulation regime

- 3 **agree** to create an economic regulation regime for three waters;

Purpose of economic regulation regime

- 4 **agree** that:
 - 4.1 the purpose of economic regulation will be based on the purpose statement set out in Part 4 of the Commerce Act 1986, i.e. promoting the long-term benefit of water consumers by promoting outcomes that are consistent with outcomes produced in competitive markets; but
 - 4.2 this purpose may need to be adapted to recognise the unique

characteristics of the water sector, including the fact that entities are prohibited from paying dividends;

Te Tiriti, Te Mana o te Wai obligations

- 5 **agree** that the economic regulator and the Minister of Commerce and Consumer Affairs be required to take into account the entities' obligations in respect of Te Tiriti, Te Mana o te Wai, and Treaty settlements, to ensure the relevant costs and processes are reflective of these obligations;
- 6 **agree** that the economic regulator be required to develop and maintain systems and processes to ensure it has the capability to uphold Te Tiriti o Waitangi, and to engage with and to understand perspectives of Māori;

Climate change considerations

- 7 **agree** that the economic regulator and the Minister of Commerce and Consumer Affairs be required to take into account the entities' obligations in relation to climate change;

Scope of economic regulation

- 8 **agree** that the legislation initially apply to all four entities, as specified by the legislation, but that the Minister of Commerce and Consumer Affairs have the power to exempt or designate certain suppliers via Order in Council on the recommendation of the regulator;
- 9 **agree** that the legislation apply to the drinking water, wastewater, and stormwater services of the entities;

Form of regulation

- 10 **agree** that information disclosure regulation should always apply to regulated suppliers;
- 11 **agree** that legislation set out that input methodologies and price-quality regulation determinations are subject to merits reviews by the High Court;
- 12 **agree** that legislation require the economic regulator to make price-quality and quality-only regulation determinations applying to the entities, and that these include quality standards and performance requirements;
- 13 **agree** that the economic regulator be able to make individual price-quality regulation determinations;
- 14 **agree** that the economic regulator be required to set input methodologies;
- 15 **agree** that the economic regulator be able to set comparative efficiency benchmarks in price-quality and quality-only regulation determinations;
- 16 **agree** that in making price-quality regulation determinations, the economic regulator be able to:

- 16.1 'ring-fence' a portion of entities' allowable return; in case of unexpected investment requirements;
 - 16.2 smooth maximum revenue over multiple periods to mitigate average price shocks; and
 - 16.3 allow for a wash-up mechanism for revenue over- or under-recovery;
- 17 **note** that the economic regulator will have responsibilities in relation to pricing principles and rules, as set out in the parallel paper on pricing and charging;

Implementation of economic regulation

- 18 **agree** that the economic regulator have the discretion to choose the length of regulatory periods beyond the first regulatory period, but that they be no longer than six years, and that the first regulatory period be three years;
- 19 **note** that there will be a pre-regulatory period (2023-2026) in which the economic regulator will work with the water sector to build its understanding of how to comply with economic regulation, before determining the rules required for the first regulatory period;
- 20 **agree** that quality-only regulation should apply alongside information disclosure regulation in the first regulatory period;
- 21 **agree** that the economic regulator develop input methodologies and basic information disclosure requirements between 2024 and 2026, develop full information disclosure regulation and quality-only regulation between 2026 and 2027, and that the first regulatory period run from 2027 to 2030;
- 22 **agree** that the Minister of Commerce and Consumer Affairs have the power to change these implementation dates;
- 23 **agree** that the legislation allow for different approaches to regulating different entities (e.g. Entity A) and services (e.g. stormwater);
- 24 **direct** MBIE and DIA officials to report back to the Ministers of Local Government and Commerce and Consumer Affairs by 31 August 2022 on options (particularly non-statutory options) for accelerating benefits to consumers from additional scrutiny of Watercare in the transition period, including on a fast-tracked approach to implementing price-quality regulation for Entity A and how much this would cost;
- 25 **agree** that on 1 July 2030 (i.e. seven years after enactment), the economic regulator be required to implement price-quality regulation, unless the Minister of Commerce and Consumer Affairs considers certain criteria have been met, including the best long-term interests of consumers, following a recommendation from the economic regulator, and recommends an Order in Council to change this requirement;

- 26 **agree** that the economic regulator be able to conduct reviews and make recommendations to the Minister of Commerce and Consumer Affairs regarding the scope or form of regulation;

Compliance and enforcement tools

- 27 **agree** that the economic regulator have a range of compliance and enforcement tools for breaches of regulatory requirements (as set out in determinations), adapted from the Commerce Act 1986 and Telecommunications Act 2001, including incentives, offences, enforceable undertakings, pecuniary penalties (maximum \$500,000 for an individual and \$5 million for a body corporate), compliance orders, compensation, injunctions, and educational activities;
- 28 **note** that the economic regulator may rely on reputational incentives, rather than financial incentives, in driving compliance;
- 29 **note** that the economic regulator will be able to issue guidance on its functions and powers under the new regime;
- 30 **agree** that the economic regulator have powers to monitor the wider three waters system in order to assess whether it is operating efficiently and delivering good outcomes for consumers, including investigative powers based on those set out in the Commerce Act 1986;

Legislative vehicle for the regime

- 31 **agree** to introduce a new, sector-specific economic and consumer protection legislative regime for three waters;

Part B: Consumer protection regime

- 32 **agree** to create a consumer protection regime for three waters;

Purpose of consumer protection regime

- 33 **agree** that the purpose of the new consumer protection regime be to improve service quality to reflect the demands of three waters consumers;

Scope of consumer protection

- 34 **agree** that the consumer protection regime initially apply to all four entities, as specified by the legislation, but that the Minister of Commerce and Consumer Affairs have the power to exempt or designate certain suppliers via Order in Council on the recommendation of the regulator;

Minimum service level codes

- 35 **agree** that the consumer protection regulator be required to set a minimum service level code via determination;
- 36 **agree** that in setting minimum service levels, the consumer protection regulator be required to consider the interests of vulnerable consumers;

- 37 **agree** that the consumer protection regulator have a range of compliance and enforcement tools at its disposal for breaches of minimum service levels code determinations, adapted from remedies available under the Fair Trading Act 1986 and Telecommunications Act 2001, including educational outreach activities, warning letters, infringement notices, enforceable undertakings, reputational incentives, pecuniary penalties (maximum \$500,000 for an individual and \$5 million for a body corporate), compensation, compliance orders and injunctions;
- 38 **note** that the minimum service level code will complement the customer agreement requirements proposed by the Minister of Local Government;

Strengthening the consumer voice

- 39 **agree** that the consumer protection regulator be required to incentivise entities to engage with consumers, including vulnerable consumers;
- 40 **agree** that an expert body should be established to advocate on behalf of three waters consumers on technical issues by extending the mandate of the Consumer Advocacy Council;

Consumer disputes resolution

- 41 **note** that sections 38-40 of the Water Services Act 2021 provide for all consumers to complain to Taumata Arowai about drinking water issues;
- 42 **agree** to establish a consumer disputes resolution framework for consumers of the services provided by the four waters services entities;
- 43 **delegate** to the Ministers of Local Government and Commerce and Consumer Affairs the authority to make further decisions on the most appropriate structure of consumer dispute resolution schemes in the water services sector, with the following objectives:
- 43.1 ensuring that all drinking water consumers, and all consumers of wastewater and stormwater services provided by the water services entities have access to appropriate dispute resolution services;
 - 43.2 ensuring that Taumata Arowai obtains necessary and timely information on drinking water quality issues; and
 - 43.3 consumers easily understand where to direct complaints;
- 44 **note** that the decisions in recommendation 42 may require amendment or repeal of sections 38-40 of the Water Services Act 2021;
- 45 **agree** that the Minister of Commerce and Consumer Affairs be able to appoint an existing independent disputes resolution provider to administer a consumer dispute resolution scheme;
- 46 **agree** that it be compulsory for the four new entities to belong to the consumer dispute resolution scheme, and voluntary for other suppliers;

- 47 **agree** that legislation set out the consumer disputes resolution framework, adapted from sections 38-40 of the Water Services Act 2021 and Part 7 of the Telecommunications Act 2001;

Part C: Agency responsibility for the new regime

- 48 **agree** that the Commerce Commission be the agency responsible for economic regulation and consumer protection in the three waters sector;
- 49 **agree** to create a position of Water Commissioner or similar on the Commerce Commission's board;
- 50 **note** that I have instructed officials to work with the Commerce Commission on how these governance arrangements could be designed, and will report back if necessary;
- 51 **note** that the Commerce Commission will be able to share information with Taumata Arowai, and vice versa;

Legislative implications

- 52 **note** these policy proposals will be given effect by the Water Regulation Bill, or by the Water Services Entities Amendment Bill,
- 53 **agree** that the legislation commence in mid-late 2023;
- 54 **authorise** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to the recommendations in this paper;
- 55 **authorise** the Minister of Commerce and Consumer Affairs to make minor or technical changes to the policy decisions in this paper, as well as additional policy decisions, consistent with the general policy intent, on issues that arise in drafting and passage through the House;

Financial implications

- 56 **note** that implementing economic regulation for three waters comes with the following estimated costs:
- 56.1 developing the rules and processes underpinning the application of economic regulation is likely to cost around \$10 million over two years;
- 56.2 costs of roughly \$5 million per year on average for information disclosure, \$3 million per year on average for price-quality regulation, and \$2 million on average for quality-only regulation; and
- 56.3 costs of a minimum service code of around \$2 million in the first year and \$1.5 million per year in subsequent years;

- 57 **note** that the costs involved in developing and operating a consumer disputes resolution scheme would likely be met by the scheme's members, and that comparable schemes in other sectors cost around \$2 to \$3 million annually;
- 58 **note** that Cabinet previously authorised the Minister of Local Government, the Minister of Finance and any other relevant appropriation Minister(s), to jointly draw down funding from the *Transforming Three Waters Service Delivery for New Zealanders: Transition and Implementation* tagged contingency up to a maximum of \$4 million to meet the costs associated with the work to support the transition to economic regulation, once they are satisfied that the relevant stage of the work programme has been sufficiently developed with detailed timeframes, milestones and costs [CAB-21-MIN-0419 refers];
- 59 **note** that I will work with officials to determine the appropriate funding arrangements for this work, including funding for:
- 59.1 preparatory work required during the pre-regulatory period, including engagement with Watercare; and
 - 59.2 the economic regulator's obligations relating to pricing and charging;
 - 59.3 a possible extension of the remit of the Consumer Advocacy Council;
- 60 **agree** that the Minister of Commerce and Consumer Affairs have the power to recommend levy regulations be made by Order in Council in order to levy regulated suppliers to fund the activities of the economic regulator and the consumer protection regulator, including input methodologies, information disclosure regulation, quality-only regulation, price-quality regulation and a minimum service level code, and that this be a Ministry-led levy process;

Additional matters

- 61 **note** that the Minister of Commerce and Consumer Affairs will work with the Minister of Local Government to make announcements about the economic regulation and consumer protection regime for three waters soon after Cabinet decisions are made;
- 62 **note** that this paper will be published on MBIE's website within 30 working days once announcements have been made, subject to withholdings as appropriate under the Official Information Act 1982.

Authorised for lodgement

Hon Dr David Clark

Minister of Commerce and Consumer Affairs