



COVERSHEET

Minister	Hon Dr David Clark	Portfolio	Commerce and Consumer Affairs
Title of briefing	Water Services Economic Efficiency and Consumer Protection Bill – Approval for Introduction	Date to be published	8 December 2022

List of documents that have been proactively released

Date	Title	Author
October 2022	Water Services Economic Efficiency and Consumer Protection Bill – Approval for Introduction	Office of the Minister of Commerce and Consumer Affairs
20 October 2022	Water Services Economic Efficiency and Consumer Protection Bill – Approval for Introduction LEG-22-MIN-0172 Minute	Cabinet office

Information redacted

YES

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

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Cabinet Legislation Committee

Water Services Economic Efficiency and Consumer Protection Bill: Approval for Introduction

Proposal

- 1 I seek approval for the introduction of the Water Services Economic Efficiency and Consumer Protection Bill (the Bill) on 26 October 2022. I also seek agreement to refer the Bill to the Finance and Expenditure Committee for consideration, with the aim of the Bill being enacted by July 2023.
- 2 The Bill will establish an economic regulation and consumer protection regime for the reformed three waters services in New Zealand and establish the Commerce Commission as the regulator.
- 3 This Bill complements the Water Services Entities Amendment Bill that establishes the four new water services entities and provides them with the necessary legislative functions, responsibilities, and powers to be fully operational from their 'go live' date on 1 July 2024.

Policy

- 4 In July 2020, the Government launched the Three Waters Reform Programme to reform local government water services delivery arrangements, led by the Minister of Local Government, Hon Nanaia Mahuta.
- 5 The Three Waters Reform Programme has brought to light issues in the water services sector that are often associated with natural monopolies, where high capital costs and other barriers make competition economically impractical. These issues include poor service quality, under-investment in infrastructure assets, inefficient pricing practices, and a reduced capacity to deliver on community expectations.
- 6 The reformed sector will see the establishment of four new Water Services Entities (the entities) to provide the vast majority of New Zealanders with drinking water, wastewater, and stormwater services. While the entities will have the scale to improve some of the issues identified during the reform process, there is also a risk that, without sufficient independent scrutiny, they will act inefficiently and deliver poor outcomes.
- 7 To address these concerns, on 7 June 2022, Cabinet agreed to establish an economic regulation and consumer protection regime for three waters services in New Zealand, and for the Commerce Commission to be the regulator [CAB-22-MIN-0207 refers]. Cabinet agreed that:
 - 7.1 economic regulation be applied to all three water services of the

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- entities, allowing for a different approach to regulating entities, such as Entity A, and services, such as stormwater;
- 7.2 information disclosure regulation and quality-only regulation should apply in the first regulatory period and a presumption that information disclosure regulation and price-quality regulation will apply in the second regulatory period;
 - 7.3 there be some flexibility over the above implementation dates;
 - 7.4 the Commerce Commission be required to set and enforce minimum service level codes;
 - 7.5 a consumer dispute resolution scheme be established for the three waters sector, as well as other measures to strengthen the consumer voice;
 - 7.6 a position of a Water Commissioner, or similar, be established on the Commerce Commission board; and
 - 7.7 the economic regulation and consumer protection regime be funded via levies imposed on regulated suppliers.
- 8 Cabinet also agreed to new functions and powers for the Commerce Commission in relation to the entities' funding and pricing plans [CAB-22-MIN-0206 refers]. This included the ability to issue guidance or requirements on the implementation of pricing principles and amend entity's funding and pricing plans if required.
- 9 The proposals for economic regulation and consumer protection will be contained in a new Bill that will form part of a broader approach to reforming the three waters regulatory system. These broader reforms include the Water Services Entities Bill, currently before the Finance and Expenditure Committee, the establishment of the new drinking water regulator, Taumata Arowai, and the enactment of the Water Services Act 2021.

Overview of the Bill

Economic regulation

- 10 This Bill applies economic regulation to the drinking water, stormwater, and wastewater services of the entities. It provides that information disclosure regulation, quality regulation, and price-quality regulation can apply to the entities, but that at a minimum, information disclosure regulation will always apply. The Bill allows for these forms of regulation to be applied flexibly to allow for different approaches to regulating the entities and services. They will be underpinned by rules and processes known as input methodologies determined by the Commerce Commission.
- 11 The Bill will enable the Commerce Commission, as 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

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quality standards would be set via price-quality regulation and quality-only regulation.

- 12 The Bill also provides that individual, rather than generic, price-quality regulation can be applied to the entities. This will allow the economic regulator the flexibility to apply more tailored scrutiny to individual suppliers, if necessary, particularly regarding asset management and the prudence and efficiency of any major investments proposed by the supplier.
- 13 Consistent with Cabinet's decision, the Bill provides that quality regulation will also apply in the first regulatory period beginning on 1 July 2027 and contains a presumption that information disclosure regulation and price-quality regulation will apply from the second regulatory period beginning 1 July 2030. The Bill provides that the responsible Minister has the power to extend these implementation dates, or to fast-track price-quality regulation for Entity A.
- 14 To enable the Commerce Commission to both carry out significant preparatory work during the implementation period and engage with the water services sector to build its regulatory capability, I have decided that the Bill comes into effect the day after Royal Assent.

Consumer protection

- 15 The Bill puts in place consumer protections to help ensure the entities operate efficiently and are responsive to the needs of their customers. It provides that the Commerce Commission must determine a service quality code which sets out binding requirements on regulated entities.
- 16 While this will initially only apply to the entities, the Bill provides that the Commerce Commission can recommend to the Minister of Commerce and Consumer Affairs, after consulting with interested parties, that the consumer protection regime be extended to cover water services suppliers other than the entities or that certain suppliers or services be exempt from the regime.
- 17 The Bill also establishes an independent consumer dispute resolution scheme, to be appointed by the Minister of Commerce and Consumer Affairs. This will apply to the entities and drinking water suppliers, discussed further below.

Oversight on entity pricing and charging

- 18 The Bill enables the Commerce Commission to issue guidance, input methodologies and/or determinations to the entities on how to implement the legislative pricing principles set out in, and any pricing regulations made under, the Water Services Entities Act 2022. The Commission will also have powers to require the amendment of any funding and pricing plan or tariff list that is inconsistent with the pricing principles or regulations.

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Monitoring, Compliance and Enforcement

- 19 In exercising its powers under the Bill, the Commerce Commission will be able to use similar enforcement and functional powers that are set out in Part 4 of the Commerce Act 1986, including monitoring and investigation powers. This will ensure a common approach to carrying out the functions of the Commerce Commission across the legislation it regulates.
- 20 The Bill provides for a range of remedies and enforcement powers for breaches of regulatory obligations, including pecuniary penalties, enforceable undertakings, injunctions, damages, and compensation.
- 21 Additionally, the Bill empowers the Commerce Commission to carry out inquiries, reviews and studies (including international benchmarking) into any matter relating to the supply of water infrastructure services or the long-term benefit of consumers of water infrastructure services in New Zealand.

Te Tiriti o Waitangi and Te Mana o te Wai obligations

- 22 At a system level, effect is given to Te Tiriti and Te Mana o te Wai obligations 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.
- 23 The Bill complements these obligations. It provides that the Commerce Commission and the Minister of Commerce and Consumer Affairs must take into account the entities' Te Tiriti o Waitangi/Treaty of Waitangi, Te Mana o te Wai and Treaty settlement obligations when making recommendations, determinations or decisions.
- 24 Furthermore, it provides that the Commerce Commission must ensure it maintains systems and processes to ensure it has the capacity to perform its obligations in relation to Te Tiriti and Te Mana o te Wai.
- 25 Finally, the Bill provides for a Water Services Commissioner. The role is a recognition of the unique nature of the water services sector and the importance of Te Mana o te Wai. The Water Services Commissioner must have appropriate knowledge, skills, and experience for the role, including knowledge or experience in the water industry and in te ao Māori.

Additional policy decisions since June 2022 Cabinet decisions

- 26 In June 2022, Cabinet invited me to issue drafting instructions to the Parliamentary Counsel Office for the Bill and authorised me to make additional policy decisions and minor or technical changes, consistent with the general policy intent, regarding issues that arise in drafting [CAB-22-MIN-0207 refers]. Consistent with this authority, I decided to rename the Water Commissioner the Water Services Commissioner. This is because I considered that this name better reflects that the role carries responsibilities

across drinking water services, stormwater services, and wastewater services.

- 27 While I considered two different models in the design of the role, I decided that the Telecommunications Commissioner model under the Telecommunications Act 2001 would provide a single, accountable regulatory contact point that I was seeking.
- 28 Cabinet also delegated to the Minister of Local Government and me authority to make further decisions on the most appropriate structure of consumer dispute resolution schemes in the water services sector, with the objectives of:
- 28.1 ensuring that all drinking water consumers, and all consumers of wastewater and stormwater services provided by the entities have access to dispute resolution services;
 - 28.2 ensuring that Taumata Arowai obtains necessary and timely information on drinking water quality issues; and
 - 28.3 consumers having clarity regarding where to direct complaints.
- 29 The Minister of Local Government and I agreed to replace the complaints framework set out for drinking water suppliers in sections 38–40 of the Water Services Act 2021 with a single consumer dispute resolution scheme for all three water services in the Bill. The scheme will include the clear and comprehensive new framework that achieves the objectives outlined above.

Aspects of the Bill that may be contentious

- 30 Economic regulation under the Bill aims 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 and rating agencies.
- 31 Clause 12(d) of the purpose statement in the Bill refers to economic regulation limiting the ability of the entities to extract excessive profits. These words may surprise or concern some members of the public, as the entities are barred from paying dividends. However, I consider clause 12(d) is an important limb to retain because, even though the entities will not have an incentive to make excessive profits, they may act inefficiently in the absence of scrutiny by the economic regulator, or in the absence of appropriate revenue limits set under price-quality regulation.
- 32 Furthermore, the language in clause 12(d) mirrors the purpose statements contained in Part 6 of the Telecommunications Act 2001 (section 162) and Part 4 of the Commerce Act 1986 (section 52A). I consider that altering the

wording of the purpose statement risks reducing the ability of the economic regulator to draw on existing High Court precedent.¹ The approach to economic regulation in the Bill is applied in other regulated sectors and is well understood by capital markets, ratings agencies, and other interested stakeholders.

Impact analysis

- 33 The regulatory impact statement *Economic Regulation and Consumer Protection for Three Waters Services* was prepared and submitted at the time that Cabinet approval of the policy relating to the Bill was sought [CAB-22-SUB-0207 refers]. No change to this regulatory impact statement is required as a result of the subsequent additional policy decisions.

Compliance

- 34 The Bill complies with:
- 34.1 the principles of the Treaty of Waitangi;
 - 34.2 the rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - 34.3 the disclosure statement requirements (a disclosure statement has been prepared and is attached to this paper);
 - 34.4 the principles and guidelines set out in the Privacy Act 2020;
 - 34.5 relevant international standards and obligations; and
 - 34.6 the [Legislation Guidelines](#) (2018 edition) published by the Legislation Design and Advisory Committee.

Consultation

- 35 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 Ministry for the Environment, Ministry for Primary Industries, Ministry for Housing and Urban Development, Ministry of Health, Ministry of Justice, Land Information New Zealand, Ministry of Transport, Infrastructure Commission, and Office for Māori Crown Relations – Te Arawhiti. The Department of Prime Minister and Cabinet and Local Government New Zealand have been informed. The Legislation Design and Advisory Committee and the Treaty Provisions Oversight Group provided

¹ See, for example, [2013] NZHC 3289, where the High Court explained how the Commerce Commission's approach to economic regulation under Part 4 of the Commerce Act 1986 is to use a building-blocks model applied in a manner consistent with the principle of financial capital maintenance (FCM). The Court observed that FCM is a principle central to regulatory control of natural monopolies and noted that FCM is consistent with a regulated firm earning its cost of capital – i.e., making 'normal' but not 'excessive' profits, consistent with firms in workably competitive markets.

feedback on the policy proposals that informed the drafting of the Bill in April 2022.

- 36 The Bill's provisions were also consulted on publicly through the discussion paper *Economic Regulation and Consumer Protection for Three Waters Services in New Zealand* in October 2021. There were 53 submissions received from local councils, consumer groups, iwi/ Māori, the Commerce Commission and organisations representing the water industry. Submitters generally agreed with the proposals to introduce an economic regulation and consumer protection regime should the three water reforms go ahead.

Binding on the Crown

- 37 The Bill would bind the Crown.

Creating new agencies or amending law relating to existing agencies

- 38 The Bill does not create any new agencies. The Act will amend the law relating to existing agencies. The Ministry of Business, Innovation and Employment would administer the Act and the Commerce Commission would serve as the economic regulator and consumer regulator. The Act would provide extended powers and a sector-specific framework for the Commerce Commission to regulate the reformed water services sector.
- 39 The Act would not amend the existing coverage of the Ombudsmen Act 1975, the Official Information Act 1982, or the Local Government Official Information and Meetings Act 1987.

Allocation of decision-making powers

- 40 The Commerce Commission would be given certain decision-making powers (such as the power to issue determinations) consistent with its role as the regulator.
- 41 The Executive would be empowered to make regulations requiring the payment of levies to fund the ongoing costs of the economic regulation and consumer protection regime.
- 42 The courts would be able to make decisions about contraventions and pecuniary penalties, and other enforcement matters. Their powers under the Bill are based on existing powers under the Commerce Act 1986 and Telecommunications Act 2001.
- 43 The criteria relating to the qualifications and responsibilities of decision makers and the procedures that they follow have been applied.

Associated regulations

- 44 Regulations will be needed to bring the levies regime into effect. Those regulations will need to address the following substantive matters:

44.1 the class or classes of entities that are required to pay levies;

- 44.2 the amount of the levies, or the method of calculating or ascertaining the amount of levies; and
- 44.3 the payment and collection of levies.
- 45 Regulations will also have to comply with the matters set out in the Bill and be subject to a Costs Recovery Impact Assessment.
- 46 The Bill provides that regulations can be made under clause 106 to prescribe infringement offences.

Other instruments

- 47 The Bill provides that the Governor-General may, on the recommendation of the Minister, make an Order in Council designating additional water supply entities to be subject to the economic regulation and/or consumer protection provisions in the Bill. The designation approach allows the regulatory regime to be responsive to the needs of consumers by giving the responsible Minister the ability to ensure that a water services provider must comply with economic regulation requirements or minimum service standards.
- 48 At any time before 1 July 2026, the Bill allows the Governor-General, on the recommendation of the responsible Minister, to bring forward the date for price-quality regulation for Entity A.
- 49 At any time before 1 July 2027, the Bill allows the Governor-General, on the recommendation of the responsible Minister, to defer the implementation date of economic regulation by up to two years. This is because there is some uncertainty as to the maturity levels of different entities when economic regulation is due to be imposed on 1 July 2027.
- 50 The Bill also permits the Governor-General, on the recommendation of the Minister, to defer the date by which the Commerce Commission must determine an input methodology, a determination or the application dates for forms of economic regulation.

Definition of Minister/department

- 51 The Bill does not contain a definition of Minister, department, or chief executive of a department.

Commencement of legislation

- 52 This Act comes into force on the day after the date on which it receives the Royal assent. The consumer protection provisions come into force on 1 July 2024.

Parliamentary stages

- 53 I intend to introduce the Bill on 26 October 2022, and depending on the availability of House time, will move the first reading of the Bill on 10 November 2022. The Bill should be passed by 1 July 2023. The Bill has a

category 4 priority on the 2022 Legislation Programme (to be referred to a select committee in 2022), and I intend to seek a category 2 priority for the 2023 Legislation Programme (must be passed in the year).

54 I propose the Bill be referred to the Finance and Expenditure Committee
 Confidential advice to Government The Finance and Expenditure Committee is currently considering the Water Services Entities Bill and is expected to consider the related Bill, the Water Services Entities Amendment Bill.

Proactive Release

55 I intend to proactively release this paper within 30 business days, subject to possible redactions in line with the Official Information Act 1982.

Recommendations

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

- 1 note that the Water Services Economic Efficiency and Consumer Protection Bill Confidential advice to Government
- 2 note that the Water Services Economic Efficiency and Consumer Protection Bill provides for a regulatory regime to promote outcomes for consumers in water services markets consistent with those achieved in a competitive market, and to improve the quality of water services;
- 3 note that amendments have been made to the Water Services Economic Efficiency and Consumer Protection Bill since the June 2022 Cabinet decisions [CAB-22-MIN-0207 refers], and that the following changes have been made to the Bill to reflect additional policy decisions:
 - 3.1 establishing a single consumer dispute resolution scheme for all three waters in the Water Services Economic Efficiency and Consumer Protection Bill that replaces the complaints framework set out for drinking water suppliers in sections 38–40 of the Water Services Act 2021;
 - 3.2 providing that quality determinations by the Commerce Commission be subject to merits reviews by the High Court; and
 - 3.3 changing the name of the Water Commissioner to the Water Services Commissioner;
- 4 approve the Water Services Economic Efficiency and Consumer Protection Bill for introduction, subject to the final approval of the government caucus and sufficient support in the House of Representatives;
- 5 agree that the Water Services Economic Efficiency and Consumer Protection Bill be introduced on 26 October 2022; and

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6 agree that the Government propose that the Water Services Economic Efficiency and Consumer Protection Bill be:

6.1 referred to the Finance and Expenditure Committee for consideration,
Confidential advice to Government

6.2 enacted by July 2023.

Authorised for lodgement

Hon Dr David Clark
Minister of Commerce and Consumer Affairs

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