



COVERSHEET

Minister	Hon Andrew Bayly	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	New appropriation and proposed discussion document for levy recovery of the Commerce Commission costs for water services regulation	Date to be published	4 December 2024

List of documents that have been proactively released

Date	Title	Author
November 2024	New Appropriation and Proposed Discussion Document for Levy Recovery of the Commerce Commission Costs for Water Services Regulation	Office of the Minister for Commerce and Consumer Affairs
19 November 2024	New Appropriation and Proposed Discussion Document for Levy Recovery of the Commerce Commission Costs for Water Services Regulation EXP-24-MIN-0068 Minute	Cabinet Office
21 November 2024	Interim Stage 2 Cost Recovery Impact Statement – Commerce Commission Funding for Water Services Regulation	MBIE

Information redacted

YES / NO (please select)

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld for the reasons of commercial information and constitutional conventions.

[In Confidence]

Office of the Minister of Local Government
Office of the Minister of Commerce and Consumer Affairs

Cabinet Expenditure and Regulatory Review Committee

New appropriation and proposed discussion document for levy recovery of the Commerce Commission costs for water services regulation

Proposal

- 1 Under Local Water Done Well, the Government is establishing a new economic regulation regime for water services which will be implemented by the Commerce Commission (**the Commission**).
- 2 The Minister of Commerce and Consumer Affairs seeks funding for the Commission to carry out these new regulatory functions from 1 July 2025, which is proposed to be fiscally neutral to the Crown.
- 3 We are proposing to release a discussion document on 26 November 2024 that proposes a levy to fully recover the costs of the Commission's new functions as the economic regulator for water services.

Relation to government priorities

- 4 Local Water Done Well sets out a clear direction for financially sustainable water services, underpinned by a robust regulatory system. It puts an emphasis on meeting regulatory standards, and the transparent and sustainable performance of these services – but provides for local choice about the form of service delivery structures.
- 5 The current regulatory system has some gaps and weaknesses, which have contributed to decades of underinvestment in water infrastructure. Economic regulation implemented by the Commission will play a vital role in safeguarding the interests of consumers, and in providing incentives and regulatory oversight to improve levels of investment and performance.
- 6 The proposals in this paper will ensure there is a sustainable funding model for this regulatory regime, giving New Zealanders peace of mind that revenue collected by local government water services providers through rates or water charges is being spent on the level of water infrastructure needed.

Executive summary

- 7 The Commission needs to be resourced to carry out its new functions as the economic regulator under Local Water Done Well.

IN CONFIDENCE

- 8 The Minister of Commerce and Consumer Affairs is seeking funding for the Commission's regulatory functions under the enduring regime for regulation of water services, which commences following the enactment of the Local Government (Water Services) Bill (**the Bill**) in mid-2025.
- 9 We seek approval for a non-departmental appropriation of \$34.5 million over five years to fund the Commission. This will allow annual expenditure of \$6.5 million for core regulatory activities, which may be increased as additional regulation, such as price-quality regulation, is introduced. This appropriation is proposed to be fiscally neutral, with The Commission's costs fully recovered through a levy on regulated water services suppliers. This appropriation and the levy will be reviewed after two years.
- 10 We are seeking agreement to release a discussion document proposing to prescribe a levy under the Commerce Act 1986 to fully recover the costs of the Commission's new functions from 1 July 2025 onwards, excluding litigation and Crown Monitor costs for Watercare. We consider that this approach best promotes the principles of equity, efficiency (including simplicity), justifiability, and transparency.
- 11 We propose this consultation commences on 26 November 2024, to align with consultation that the Water Services Authority – Taumata Arowai (**the Authority**) will undertake on their levy under the Water Services Act 2021.
- 12 To provide more time to finalise the levy and draft regulations following consultation, we are seeking delegated authority to issue drafting instructions to Parliamentary Council Office for the two levies (one for the Commission and the other for the Authority). This will ensure that the levy regulations are in place mid 2025.
- 13 Following consultation, in 2025 we will report back to the Cabinet Legislation Committee with the outcome and recommendations, final levy design and quantum, and draft regulations.
- 14 We will also be seeking, where appropriate, to approve matters that may arise during the course of drafting and may be required to align with the decisions in this paper.
- 15 If Cabinet agrees, the next step is to release the discussion document for public consultation.

Background

The Commerce Commission will be the new economic regulator for water services

- 16 The Commission's role as economic regulator for water services will commence following the enactment of the Bill.
- 17 The Commission will have a range of tools under the Commerce Act 1986 to promote sufficient revenue recovery, and efficient investment and maintenance, so that water services meet regulatory requirements and are delivered at a quality that communities expect. These include:

IN CONFIDENCE

- 17.1 setting information disclosure requirements and preparing summary and analysis reports,
 - 17.2 setting maximum and minimum revenue thresholds,
 - 17.3 setting quality regulation,
 - 17.4 setting performance requirements,
 - 17.5 setting price-quality regulation,
 - 17.6 monitoring the regime, investigating and enforcing the requirements, including the financial ringfence; and
 - 17.7 if required, overseeing consumer protection measures.
- 18 The economic regulation regime will be risk-based and flexible, in line with regulated suppliers' different needs and situations. The Commission will be able to set individual requirements for certain suppliers, and common regulations where appropriate.
 - 19 While information disclosure will apply to all regulated suppliers for drinking water services and wastewater services, the regime will be flexible as the other regulatory tools may not be needed for all suppliers. There is also flexibility to bring stormwater into the economic regulation regime later, if necessary.
 - 20 The Commission is expected to develop the initial requirements for information disclosure by early 2026. Revenue thresholds could be set from early 2026. Quality standards, performance requirements, and price-quality regulation will not be applied until at least 2026.
 - 21 It is expected that the Bill will provide suitable transitional provisions to enable the water services economic regulation regime to be set up. This is expected to include the ability to treat consultation on this discussion document as sufficient for the purposes of meeting the requirement for the Minister of Commerce and Consumer Affairs to consult before recommending regulations be made setting levies on regulated water services suppliers under section 53ZE(4).

The Commerce Commission currently does not have funding for its new regulatory functions

- 22 Currently, the Commission has no funding for its upcoming role as the economic regulator for water services from 1 July 2025.
- 23 Budget 2024 only approved transitional funding for 2024/2025 of \$2.232 million, to allow the Commission to implement its foundational information disclosure role under the Local Government (Water Services Preliminary Arrangements) Act 2024 (**the Preliminary Arrangements Act**).
- 24 In June 2024, the Cabinet Economic Policy Committee noted the intention to recover as much of the Commission's costs as possible through levies on regulated water services suppliers [ECO-24-MIN-0107].

IN CONFIDENCE

- 25 In September 2024, the Minister of Local Government appointed the Commission as the Crown Monitor for the interim economic regulation of Watercare with immediate effect. Under the Preliminary Arrangements Act, the Crown will recover the costs of the Crown Monitor directly from Watercare Commercial Information. Note, this is separate from the \$6.5 million annual expenditure for core regulatory activities.
- 26 The discussion document we are proposing to release is attached to this Cabinet paper as **Appendix A**.

The proposed funding and levy model is consistent with how the Commerce Commission's costs are recovered from regulated suppliers under Part 4 of the Commerce Act 1986

- 27 Under Part 4 of the Commerce Act 1986, the Commission receives annual or multi-year non-departmental appropriations from the Crown which are fully recovered by levies on regulated entities under that Part.
- 28 Section 53ZE of the Commerce Act 1986 enables regulations to be made specifying the amount of levies, or method of calculating the amount of levies. Levies are set on the basis that costs of performing the Commission's functions, powers, and duties, and of collecting the levy money, should be recovered from regulated parties.
- 29 The Commerce (Levy on Suppliers of Regulated Goods and Services) Regulations 2009 (**the Regulations**) provide for a levy to recover the Commission's costs of regulation under Part 4 of the Commerce Act 1986. This requires regulated suppliers to pay to the Minister of Commerce and Consumer Affairs the levy determined in accordance with the Regulations. The Ministry of Business, Innovation and Employment (**MBIE**) administers the levy on behalf of the Minister of Commerce and Consumer Affairs. At year end, a wash up is conducted based on the Commission's actual costs, capped by the appropriation(s).
- 30 The Part 4 levy is used to recover the Commission's costs, rather than to directly fund the Commission.

Proposal for a levy to fully recover costs of the Commerce Commission's new functions as the economic regulator for water services

Additional funding from 1 July 2025

- 31 The Minister of Commerce and Consumer Affairs seeks agreement for funding for the Commission from 1 July 2025 onwards. This appropriation will cap the Commission's costs.
- 32 Given the uncertainty related to the new regime, we propose to cap the Commission's costs to \$6.5 million per year for core regulation, to be increased as additional regulation, such as price-quality regulation, is imposed. We seek approval for a non-departmental appropriation of \$34.5 million over the first five years. This appropriation will be reviewed after two years.

Proposed levy recovery of Commerce Commission costs

- 33 We are proposing to implement a levy to fully recover the costs of the Commission's new functions from 1 July 2025 onwards, excluding litigation and Crown Monitor costs for Watercare. The Crown Monitor's costs are directly recoverable from Watercare and are hypothecated for the Crown Monitor's functions.
- 34 This proposed levy model is used to recover the Commission's costs, not to directly fund the Commission, and is fiscally neutral for the Crown. The Commission would have incentives to operate efficiently and effectively within the appropriation over the appropriation period, and it returns any unspent funds to the Crown. The levy wash-up process ensures the regulated suppliers only pay the Commission's actual costs.
- 35 This proposed approach of 100 percent levy recovery is consistent with other regulated services under Part 4 of the Commerce Act 1986 (for example, electricity lines and gas pipeline services). It reflects the 'exacerbator pays' principle. These regulated suppliers drive the need for the Commission's functions and should bear the costs.
- 36 Any litigation would be funded through reprioritisation within the Commission's major litigation fund, which is a dedicated fund for litigation related to all the legislation that the Commission administers.

Levy directed to regulated suppliers

- 37 Section 53ZE of the Commerce Act 1986 requires suppliers, or prescribed classes of suppliers, of regulated goods or services to pay the responsible Minister a levy set in regulations made under that section.
- 38 The Bill is currently being drafted, however, it is proposed that a 'regulated supplier', in relation to water services, is a local government water service supplier that makes core decisions about water services, which include capital and operating expenditure and the level of charges or revenue recovery. This means there could be more than one regulated supplier within a geographic location if councils choose a split decision-making model.
- 39 In most cases, and in the first instance, we consider a third-party provider's compliance with regulatory requirements should be managed through the contract with the water services provider. To provide for this, the Bill does not automatically bring third-party providers into the economic regulation regime (unless they are responsible for the core decisions outlined above).
- 40 However, under the Bill, the Commission may recommend to the Minister of Commerce and Consumer Affairs that a third-party provider become a regulated supplier if it considers that it would better promote the purpose of Part 4 of the Commerce Act 1986.

How the levy will be calculated

- 41 Where practicable, we propose that the Commission's costs related to a particular regulatory tool should be recoverable from those regulated suppliers subject to that regulatory tool at that time.
- 42 We propose that the levy regulation should specify a method for calculating the levies and providing for different levies for classes of suppliers or services. This is to reflect the following range of cost categories:
 - 42.1 Core regulatory activities,
 - 42.2 Class of waters (considering that stormwater services can be regulated by designation),
 - 42.3 Consumer protection measures,
 - 42.4 Performance requirements regulation,
 - 42.5 Quality regulation, and
 - 42.6 Price-quality regulation.
- 43 Core regulatory activities include information disclosure regulation, including setting rules on core metrics such as asset valuation and cost allocation, performance monitoring and reporting and compliance investigations. The costs of other regulatory tools, including revenue thresholds, monitoring the financial ringfence and preparatory costs for additional regulation, are also included. We propose that these costs should be recoverable from all regulated suppliers up to a cap of \$6.5 million per annum subject to a review after two years.
- 44 We are proposing suppliers will be levied for drinking water and wastewater services. Stormwater services would be levied, if stormwater is brought into the economic regulation regime at a later date. Cabinet approval would be sought in order to bring stormwater services into the economic regulation regime.
- 45 The proposed approach in the discussion document is to allocate the costs of regulation in proportion to the normally residing population served by each regulated supplier, based on the latest census data. This ensures that suppliers serving larger populations contribute a correspondingly greater share of the costs, reflecting both the scale of service provided and the broader regulatory benefits to those communities. This is consistent with the proposed levy to fund the Authority.

IN CONFIDENCE

The levy should reflect the Chatham Islands and Watercare's specific circumstances

- 46 Watercare is currently subject to a bespoke interim economic regulation regime under the Preliminary Arrangements Act. The Commission has been appointed as the Crown Monitor and is responsible for monitoring Watercare's compliance with a charter that sets out minimum service quality standards and financial performance objectives. The charter is currently under development and is expected to come into effect mid 2025.
- 47 It is expected that Watercare will be subject to the economic regulation regime under the Bill once it passes. This means that Watercare, alongside all other regulated water services suppliers, would be subject to information disclosure and could be subject to other information requirement provisions under the Bill while the charter is in effect. This is to reflect the fact that the information requiring provisions under the Preliminary Arrangements Act are more limited and specifically related to the interim regime, but the Commission will need these tools under the Bill to set up its enduring function of regulating Watercare, and other regulated water services providers. The \$6.5 million annual expenditure for core regulatory activities does not include funding set aside for price-quality regulation of Watercare.
- 48 It is also expected that at the end of the charter period Constitutional conventions, Watercare will transition to a price-quality path under the Bill. The proposed levy has been designed so that the direct costs associated with this Watercare price-quality path are recovered directly from Watercare.
- 49 We consider that Chatham Islands Council should be excluded from the economic regulation regime. The Council provides drinking water and wastewater services to several hundred people. International evidence suggests that the benefits of regulating entities of this size are unlikely to outweigh the costs. With the Council also receiving most of its water services funding from central government, it is more appropriate for revenue sufficiency to be considered during the budget process. The designation regime will allow for the Council to become a regulated provider through an Order in Council process should circumstances change.
- 50 Consistent with the 'exacerbator pays' principle, we are proposing that Chatham Islands Council is excluded from the levy regime.

Review of levy after two years

- 51 We propose that the levy and appropriation are reviewed after two years in FY2027/2028 unless issues are identified earlier.

The Water Services Authority – Taumata Arowai levy

- 52 The Authority is a Crown entity responsible for the regulation of drinking water quality and oversight of the environmental performance of water services networks.
- 53 Cabinet has approved the release of a discussion document which proposes funding the Authority through a levy on territorial authorities or their council-controlled organisations that deliver water services [ECO-24-MIN-0222].

- 54 To reduce the burden on councils and have just one consultation period, the Authority has delayed consultation on their levy and will align this with the proposed consultation period for the levy proposing to recover the Commission's costs.
- 55 In addition, the proposed levy design to recover the Commission's costs, as far as practicable, aligns with the proposed levy for the Authority to minimise compliance costs to levy payers.

Cost-of-living implications

- 56 Under the proposed model, regulated water services suppliers will have flexibility to decide how best to recover the costs from consumers (e.g. targeted rates or water charges) and how to transparently record the costs (e.g. by including levy charge as an explicit line in rates bills). A Council Controlled Organisation that provides drinking water and wastewater services, for example, may choose to charge the households and businesses connected to its networks an equal amount. Ultimately, it is a cost that will be reflected in charges to consumer of water services.

Financial implications

- 57 As noted, funding provided by the Crown to the Commission for economic regulation under Part 4 of the Commerce Act 1986 is fully recovered through levies on regulated suppliers, except for major litigation. Accordingly, the preferred funding and associated levy proposals will have no impact on the Government's operating balance or debt.

Legislative implications

- 58 It is expected that the Bill will provide suitable transitional provisions to enable the water services economic regulation regime to be set up. This is expected to include the ability to treat consultation on this discussion document as sufficient for the purposes of meeting the requirement for the Minister of Commerce and Consumer Affairs to consult before recommending regulations be made setting levies on regulated water services suppliers under section 53ZE(4).

Impact analysis

Cost Recovery Impact Statement

- 59 An interim Cost Recovery Impact Statement (**CRIS**) has been completed and is attached in Appendix B. The final quality assurance rating has not yet been confirmed by the quality assurance panel; therefore, Cabinet's impact analysis requirements have not been met. As this is an interim CRIS to support consultation, updated analysis will be provided when final policy decisions are made.

Climate Implications of Policy Assessment

- 60 The Climate Implications of Policy Assessment (**CIPA**) team has been consulted and confirms that the CIPA requirements do not apply to this policy proposal, as the threshold for significance is not met.

Population Implications

- 61 The proposals in the discussion document do not have population implications. We expect the levy charges proposed in the discussion document will be distributed broadly and equitably across all ratepayers or consumers of water services.
- 62 The levy wash-up process is proposed to occur annually to ensure the regulated suppliers only pay the Commission's actual costs. This would enable any underspend, or additional spend, to be returned, or recovered from regulated suppliers.

Human Rights

- 63 The proposals in this paper have no human rights implications.

Use of external resources

- 64 External support was provided in relation to the development of this paper and the Cost Recovery Impact Statement associated with this paper.

Consultation

- 65 The following agencies were consulted on a draft of this paper: the Commission, the Authority, the Treasury, the Department of Internal Affairs, the Ministry of Housing and Urban Development and the New Zealand Infrastructure Commission.

Communications

- 66 If Cabinet agrees to the release of the discussion document associated with this paper, the MBIE will manage consultation on the discussion document, working with the Department of Internal Affairs and the Authority.

Proactive release

- 67 We propose to proactively release this Cabinet paper to support consultation on the discussion document. The Ministry of Business, Innovation and Employment will publish the Cabinet paper on its website.

Recommendations

We recommend that the Cabinet Expenditure and Regulatory Review Committee:

1. **note** that under Local Water Done Well the Government is establishing a new economic regulation regime which will be implemented by the Commerce Commission;
2. **note** that organisations subject to the economic regulation regime are local government water service suppliers that make core decisions about water services, which is likely to include capital and operating expenditure on the service and the level of charges or revenue recovery, excluding Chatham Islands Council unless designated;

IN CONFIDENCE

3. **note** that third-party providers that do not make core decisions about water services are not subject to the economic regulation regime, unless brought in later;
4. **agree** for the Minister of Commerce and Consumer Affairs to release a discussion document proposing a levy to recover the Commerce Commission's costs (at the same time as the Water Services Authority's discussion document) on 26 November 2024;
5. **authorise** the Minister for Commerce and Consumer Affairs to make minor amendments and refinements to the discussion document before it is released, including refinements to reflect final Cabinet approvals;
6. **note** that Cabinet has approved the release of the discussion document which proposes funding the Water Services Authority through a levy on territorial authorities or their council-controlled organisations that deliver water services [ECO-24-MIN-0222];
7. **note** that the proposed Commerce Commission levy is aligned with the Water Services Authority's levy, as far as practicable, to minimise compliance costs to levy payers;
8. **authorise**, following consideration of any feedback on both discussion documents, the Minister of Commerce and Consumer Affairs and Minister of Local Government to make decisions consistent with the policies set out in the respective papers seeking Cabinet approval to release the discussion documents, and to instruct Parliamentary Counsel Office to draft regulations prescribing the respective levies to recover the Commerce Commission's and the Water Services Authority's costs from 1 July 2025;
9. **authorise** the Minister of Local Government and the Minister of Commerce and Consumer Affairs to approve matters that may arise during the course of drafting and may be required to align with the decisions in this paper, for the respective levies;
10. **agree** for officials at the Ministry of Business, Innovation and Employment to review the Commerce Commission's levy and appropriation after it has been in effect for two years;

The Minister of Commerce and Consumer Affairs recommends that the Cabinet Expenditure and Regulatory Review Committee:

11. **note** that we propose the following forecast period and outyears levy funding for the new economic regulation of water services Part 4 of the Commerce Act:

IN CONFIDENCE

	2025/26 (\$m)	2026/27 (\$m)	2027/28 (\$m)	2028/29 (\$m)	2029/30 & outyears (\$m)	Total (\$m)
Core regulation of water services	6.500	6.500	6.500	6.500	6.500	32.500
Price-quality regulation (initially Watercare)	0	0	1.000	0.500	0.500	2.000
Other measures	0	0	0	0	0	0
Estimated cost (\$m)	6.500	6.500	7.500	7.000	7.000	34.500

12. **note** the discussion document to be released in recommendation 4 above proposes a levy for the following forecast period and outyears to fully recover the costs of Commerce Commission’s new function for economic regulation of water services:

	\$m – increase/(decrease)				
	2024/25	2025/26	2026/27	2027/28	2028/29 & outyears
Business, Science and Innovation Minister of Commerce and Consumer Affairs					
Non-Tax Revenue: Levy of Regulated Parties	-	6.500	6.500	7.500	7.000

13. **agree** to fund the economic regulation of water services under Part 4 of the Commerce Act 1986 in line with the forecasts as outlined recommendation 11;
14. **agree** to implement the economic regulation regime for water services by providing the Commerce Commission with funding to carry out this new regulatory function from 1 July 2025;
15. **agree** to establish a new Non-Departmental Output Expense “Regulation of Water Services” as an annual appropriation in Vote Business, Science and Innovation:

IN CONFIDENCE

Vote	Appropriation Minister	Appropriation Administrator	Title	Type	Scope
Business, Science, and Innovation	Minister of Commerce and Consumer Affairs	Ministry of Business, Innovation and Employment	Regulation of Water Services	Non-Departmental Output Expense	This appropriation is limited to the regulation of water services under Part 4 of the Commerce Act 1986 and any transitional regime.

16. **note** that an intention statement and performance measures for the new appropriation will be addressed in Budget 25 Estimates;
17. **approve** the following changes to further give effect to recommendations 13,14 and 15 above, fully offset by the changes described in recommendation 12 and so fiscally neutral with no impact on the operating balance or net core Crown debt:

	\$m – increase/(decrease)				
	2024/25	2025/26	2026/27	2027/28	2028/29 & Outyears
Vote Business, Science and Innovation Minister of Commerce and Consumer Affairs					
Non-Departmental Output Expense: Regulation of Water Services	-	6.500	6.500	7.500	7.000

18. **note** that the forecasts for core regulation of water services outlined in recommendation 11 cover information disclosure regulation of all regulated providers in the first five years (including Watercare), as well as revenue thresholds, monitoring financial ringfence and preparatory work for other regulatory tools, such as quality regulation, performance requirements or price quality regulation, as outlined in paragraph 43;
19. **agree** that the levy can on-charge costs up to \$6.5 million per year for 2025/26 and 2026/27 for the functions outlined in recommendation 18 at which point the levy will be reviewed;
20. **agree** that if it is determined that no increase is required following the review of the levy in 2026/27, the levy will continue to be capped at \$6.5 million for the functions outlined in recommendation 18 a further two years until 2028/29;

IN CONFIDENCE

21. **agree** that if the Commerce Commission moves to higher levels of regulation for providers other than Watercare within the 2025/26-2026/27 period, the cost for the additional regulation will be on-charged to the regulated provider(s) in question, and will not be included within the \$6.5 million limit for those financial years, subject to approval from the Minister of Finance, Minister of Local Government, and Minister of Commerce and Consumer Affairs.

Authorised for lodgement

Hon Simeon Brown

Minister of Local Government

Hon Andrew Bayly

Minister of Commerce and Consumer Affairs

Appendices

Appendix A – Discussion Document – Commerce Commission levy for the economic regulation of water services

Appendix B – Cost Recovery Impact Statement