

Water Services Economic Efficiency and Consumer Protection Bill

Submission to the Finance and Expenditure Committee

February 2023



What is Taituarā?

Taituarā — Local Government Professionals Aotearoa (Taituarā) thanks the Finance and Expenditure Select Committee (the Committee) for the opportunity to submit on the Water Services Economic Efficiency and Consumer Protection Bill (the Bill).

Taituarā is an incorporated society of approximately 1,000 members drawn from local government Chief Executives, senior managers, and council staff with significant policy or operational responsibilities. We are an apolitical organisation. Our contribution lies in our wealth of knowledge of the local government sector and of the technical, practical, and managerial implications of legislation.

Our vision is:

Professional local government management, leading staff and enabling communities to shape their future.

Our role is to help local authorities perform their roles and responsibilities effectively and efficiently. We have an interest in all aspects of the management of local authorities from the provision of advice to elected members, to service planning and delivery, to supporting activities such as elections and the collection of rates.

We offer the perspectives of a critical adviser.

Taituarā is a managerial organisation as opposed to a political one. Our role therefore is to advise on consequence, and to assist policymakers to design a policy that can be implemented effectively. We participated (and continue to participate) in the reform process to provide these perspectives. As with our work in this area, our submission takes the perspective of a 'critical adviser' in the reform process – supportive of the need for affordable, sustainable three waters services, while keen to ensure the reforms work effectively.

Economic regulation is fundamental to the success of three waters reform.

This is the third Bill implementing the Government's policy decisions to reform the delivery of so-called 'three water' services.

Reforms are likely to founder if there is any suggestion that water users are being 'overcharged' for this service, or that the funds raised are not being spent 'appropriately'. Overseas jurisdictions rely on a framework of economic regulation to exercise some control over price, quality, and investment. Typically, this regulation is based on requirements to disclose key information about charges, costs, and investments (a good example are the disclosure regulations that apply to various parts of the energy sector in this country).

Economic regulation will play an important role in securing overall consumer confidence in any change proposals.

The headline policy intent and design of this Bill is therefore quite sound. The remainder of this submission therefore makes recommendations that are intended to support the Bill in order to better achieve the stated objectives.

It is also appropriate that the regime for economic regulation of three waters services is purpose built. Although three waters infrastructure has similar attributes to telecommunications and energy networks, there are some important differences. Three waters infrastructure is subject to a regime designed to promote a set of public health outcomes (administered by Taumata Arowai) and a mix of nationally set and regionally-set environmental standards. And unlike these other services, three waters services are necessary to sustain life.

Additionally, some features in the design of the water services entities (WSEs) should influence the degree of regulation. While the model of public ownership is somewhat unconventional, there are significant restrictions on the ability to take the WSEs outside of this ownership model. The Water Services Entities Act 2022 expressly prohibits the WSEs from distributing any surplus to their owners (and one of the unconventional aspects of the ownership model is that it does not entitle the owners to any of the revenues or surplus).

This points to a regime that is 'lighter-handed' and more about supporting the accountability of the WSEs to the public for their planning and financial management (thus avoiding price shocks or at least minimising them). Information disclosure regimes and the associated 'benchmarking' are a commonly-used tool to introduce some degree of competitive tension into monopoly services.

The purpose of the regulatory regime could be better defined.

We note that the purpose of the regulations (as per clause 3 and 12) has been modelled on the Telecommunications Act 2001. Taituarā considers that this could be further improved.

We are concerned that the above purpose clause does not specifically recognise the need for long-term sustainability of services. This is critical to counteracting the understandable, but undesirable, tendency to short-termism, and is critical to promoting long-term management of the assets. Arguably, sustainability of service might be captured by the phrase 'long-term benefit of consumers'. This intent should be clearer.

The purpose statement refers to service quality that reflects consumer demands. In many services that is appropriate. However, three waters services are subject to a higher level of regulation of quality standards than consumers might set in a free market, especially safety and environmental standards. The purpose statement should be expanded to include regulatory requirements.

WSEs cannot distribute profits to their owners. That being the case, there is little incentive for the water services entities to price in a manner that would generate excess profits. We are not convinced that there is any need for 12(d).

Recommendation

- 1. That the Select Committee amend clause 12 to clarify the purpose for regulation by**
 - a. adding references to the long-term sustainability of service**
 - b. adding references to consistency with regulatory standards**
 - c. deleting subclause 12(d) as it is unnecessary given the design features of water services entities.**

The regime's prescriptiveness may inadvertently work against some of the reform objectives.

Our submission on what is now the Water Services Entities Act expressed a concern that the wide range of regulatory and policy instruments that bind WSEs could limit their governance role, and give rise to some difficulty recruiting skilled directors. If this occurs then one of the Government's 'four bottom lines' for the reforms, good governance, would be placed at risk.

While we support economic regulation in principle, we the Commerce Commission has wide powers and a very wide scope as to the matters that it can regulate. In particular we look at the range of matters where the Commerce Commission may introduce an input methodology, and the range of matters subject to section 15 determinations. We refer the Select Committee to clauses 27 and 34, and 39 (more on that shortly).

Legislation that is over-prescriptive also works against two of the principles under which the WSEs are expected to operate. Specifically, the more prescriptive the legislation, the less empowered WSEs are to "(be) *innovative in the design and delivery of water services and water services infrastructure*" or to apply "water-sensitive design"

methods. Often the generation of efficiency gains arises out of an innovation – the Select Committee should be wary of being overly prescriptive.

One of the checks on regulatory agencies is a requirement that they undertake an analysis of the costs and benefits of their regulatory proposals. We refer the Select Committee to examples such as the analyses that the Ministry for the Environment prepares in regards to the introduction or amendment of National Policy Statements and National Environmental Standards, as a model.

Such a requirement should apply to the issuing of any clause 15 determinations required under clauses 27, 34, and 39. There should be some tolerance built in to allow the Commissioner to avoid producing a regulatory analysis or to tailor such an analysis for amendments that are minor or technical.

Recommendations

- 2. That the Select Committee include an explicit requirement on the Commerce Commission to consult Taumata Arowai when developing input methodologies and quality standards.**
- 3. That the Select Committee insert requirements on the Commerce Commission to undertake a regulatory analysis of any proposals made under clauses 27, 34 or 39.**

Clause 39 stands out as particularly intrusive.

Clause 39(3)(b)(ii) empowers the Commerce Commission to direct certain types of investment. Clause 39(3)(b)(ix) specifies a particular type of project evaluation methodology – cost/benefit analysis.¹ And clause 39(3)(b)(xi) appears to give the Commerce Commission powers to dictate consultation and engagement provisions over and above those that Parliament set in the Water Services Entities Act.

Clause 39(3)(b)(i) provides the Commerce Commission with the power to regulate a particular approach (emphasis supplied) to risk management – we do not disagree that the WSEs should be managing risks in accordance with commercial and best practice.² But this clause goes further and empowers the Commerce Commission to

¹ There are many different forms of project evaluation methodologies – for example, the Better Business Case model, multi-criterion analysis, return on investment or net present value and so on. The Commerce Commission should not specify particular procedures, rather it should require only that a methodology is applied.

² See section xx of the Water Services Entities Act 2022.

regulate a particular approach to risk management. We submit that this effectively inserts the Commerce Commission into what is an operational matter, and in so doing it also puts the Commerce Commission (and Government) in the firing line should there be a fault in any regulated approach.

Recommendation

- 4. That the Select Committee agrees to:**
- a. delete the words “a particular approach” from 39(3)(b)(i)**
 - b. delete clause 39(3)(b)(ii) thus limiting the Commerce Commission’s powers to direct investment by the water services entities**
 - c. delete clause 39(3)(b)(ix) thus removing the Commerce Commission’s powers to direct a particular method or methods of investment evaluation**
 - d. delete clause 39(3)(b)(xi) thus removing the Commerce Commission’s powers to dictate engagement over and above the provisions of the Water Services Entities Act.**

Commerce Commission directions to amend funding and pricing plans should come with greater mandatory disclosure on the Commerce Commission’s part.

Clauses 51 to 53 are other examples of the broad nature of the powers afforded to the Commerce Commission. The Commerce Commission has the power to review funding and pricing plans and to issue what is effectively a direction to amend the plan.

The Bill appears to contemplate that the Commerce Commission’s review would come after a final plan has been adopted and made publicly available. We say this because there is no reference to any consultation or engagement process, nor is there any qualifier such as the word ‘draft’ in the reference to the funding and pricing plan in clause 51.

That cannot be what was intended – that a WSE would develop and engage on a plan and then adopt it, only to have the Commerce Commission tell them to reconsider an aspect or aspects of the plan (in effect that the WSE has ‘got it wrong’). The Commerce Commission should be weighing in during the drafting of the plan in the first instance, with a further final check before the plan is made publicly available. That process may necessitate amendments to the Water Services Entities Act 2022 to require WSEs to send drafts and proposed final funding and pricing plans to the Commerce Commission.

As the legislation currently stands, the Commerce Commission needs only to provide a WSE with a direction to reconsider the WSE's plan. It appears this direction need not even be in writing. Given the Commerce Commission's power overrides a policy decision made by the WSE Board and its community, there should be a greater onus on the Commerce Commission to document its reasons and provide some suggestion as to how the WSE might amend the plan to give effect to the principles.

Recommendations

- 5. That the Select Committee agree to amend clause 51 to require the Commerce Commission to review drafts of funding and pricing plans during the engagement on these documents and before the final plans are adopted by the WSE.**
- 6. That the Select Committee agree to amend clause 52 to require that any direction from the Commerce Commission (i) be in writing and (ii) sets out the nature of the inconsistency between the charging principles and the funding and pricing plan as well as the Commerce Commission's reasons for reaching this conclusion, and (iii) what actions or actions the water services entity might take to resolve the inconsistency.**



Professional excellence in local government

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