

WESTLAND
District Council | Te Kahui o Poutini



Submission to the Finance and Expenditure Select Committee on the Water Services Entities Bill

1. Introduction

Thank you for the opportunity to share our feedback on the Water Services Entity Bill 2022.

Westland District Council (WDC) is a statutory entity based on the West Coast of the South Island of New Zealand.

Our vision statement is: *We work with the people of Westland to grow and protect our communities, our economy and our unique natural environment.*

The Westland District is approximately 450 km in length and one of the most sparsely populated parts of New Zealand, with an area of 1,186,272 hectares and a population of 8,640 people (2018 Census, Stats NZ). Approximately 33% of the population (2,960) lives in Hokitika. The remaining 66% live in small villages and rural areas such as Ross, Franz Josef and Haast. The district has a focus on the outdoors and outdoor recreation (87% of the land area is DOC land), which is a tourism drawcard, alongside dairy farming, mining and other enterprises.

WDC is a plenary member of the Communities 4 Local Democracy - He hapori mō te Manapori (C4LD) coalition and we support their submission to the Select Committee. On behalf of the Westland Community, WDC owns \$117 million of three waters assets. These assets have been bought and paid for by these communities over many generations. The Westland community wishes to retain meaningful control and influence over the three waters assets. The Water Services Entities Bill (the Bill) before the Select Committee removes these rights.

Reform of the three waters sector is necessary and WDC is in support of this. WDC agrees with achieving appropriate health and environmental outcomes and ensuring that local iwi and hapū have appropriate input into investment decision-making at the local level. What WDC does not agree with is the proposed governance model and transfer of assets from the local community to a large entity with no real connection to the Westland District.

This submission contains the following recommendations:

1. That WDC opposes the Bill and recommends that it does not proceed any further in its current form and that there is a pause to consider a different approach built on the C4LD 10 point reform plan.

If the Select Committee does not prefer recommendation 1, then:

2. That the establishment date either be 1 July 2024, or be the earlier of either 1 July 2024 or a date set by Order in Council provided that such an Order in Council occurs after the date of the General Election following the 2020 General Election.
3. If the Bill does proceed, that the scope of the Bill be confined to drinking water and wastewater assets and that stormwater assets remain with territorial and unitary authorities.
4. If stormwater is to be included, then the Select Committee should amend the Bill to allow for the establishment of bespoke council-by-council pathways for this transfer, and include a clear definition of "stormwater services".

Westland District Council does not wish to appear before the Select Committee to speak to this submission.

2. Executive Summary

This submission from WDC outlines its support for the approach proposed in the C4LD submission. WDC believes that it is important for the assets to remain under the control of local government and the communities that have paid for the assets. Reform of the three waters system is necessary, however the reform model is based on modelling that is incompatible with the situation in New Zealand. Ensuring safe and clean water is important but WDC does not believe that the governance structure proposed in the Bill will achieve the outcomes the reform is aiming for.

This submission sits alongside the submission from C4LD in support of an alternative policy proposal that follows the Productivity Commission's recommendations in its Local Government Funding and Financing report.

WDC's submission covers the following topics:

- Giving our community a voice.
- Critique of the Government's case for change.
- Alternative Policy proposals
- Stormwater

3. Giving our community a voice

In September 2021 WDC undertook a public feedback exercise to gather information from the community to assist its feedback to the government on the proposed transition of the assets and governance function to the Water Service Entities.

The key concerns raised by the community were:

- The community wants three water services managed, built and operated locally, by people who understand the area.
- The community does not believe the reform will improve efficiencies.
- The community is concerned that they will not have a strong democratic say in how their three waters services are provided.
- The community is concerned their rates will fund upgrades in other areas.

WDC is concerned that the Government did not provide communities with a proper consultation process regarding the reforms and their effects before introducing the Bill to Parliament.

4. Critique of the Government's case for change

Castalia has provided a report to C4LD that sets out the analytical and policy failures of the Government review that underpins the reform model set out in the Bill. This is provided as an appendix to the C4LD submission.

The report identifies five key flaws in the Government's proposal, namely:

1. The Government claims that massive investment is needed in New Zealand water services. Case studies have illustrated that this analysis is flawed.
2. Under the current reform proposal, consumers risk paying high water charges. This is because the Government's claimed cost savings are implausible as they are based on incompatible comparative data.
3. Critically, the governance structure of the proposed water service entities will be disconnected from the unique issues of the communities of interest, which undermines their long-term sustainability.
4. The reforms also increase fiscal risk because the Crown is providing a fiscal backstop for the four water service entities who will become some of the largest corporates in New Zealand. Given the weak accountability framework, the risks are elevated and it is possible that the Crown takes a more direct governance interest in the entities over time, weakening local involvement; and
5. Finally, because of the Government's critical process flaws, available alternative reform options were not properly considered. Moreover, the evidence base the Government used was skewed towards a high-risk reform option.

5. Alternative policy proposals

Westland District Council supports appropriate reform of the Three Waters sector. Consequently, as a member of C4LD it was recognised from the outset that simply saying "no" was not enough and that there was an obligation to develop a set of alternative policy proposals that would advance a constructive reform agenda but in a manner that meaningfully respects community property rights and local voice.

C4LD engaged water regulatory infrastructure experts Castalia to provide that advice. This ultimately resulted in a set of material that was presented to the Minister and other political parties, and in substantive submissions on economic regulation in the Three Waters sector. Additionally, the Prime Minister and each Member of Parliament was sent a

letter outlining our approach. These can be found on the C4LD website here: <https://www.communities4localdemocracy.co.nz/ideas> and are attached as:

- a) Presentation to the Local Government Minister dated 4 April 2022 [**Appendix 1**];
- b) Letter to the Government dated 10 April 2022 [**Appendix 2**]
- c) Its submission to the Ministry of Business, Innovation and Enterprise on economic regulation dated 20 December 2021 [**Appendix 3**]; and
- d) Its letter to Members of Parliament dated 28 April 2022 [**Appendix 4**].

As this material illustrates, C4LD's alternative set of reform proposals are credible and supported by independent expert analysis.

The decision for the Select Committee is whether to support this reasonable alternative or to proceed with the Bill.

5.1 A better approach – C4LD's alternative reform proposals

On 12 December 2019 the Productivity Commission publicly issued its 30 November 2019 report on "Local Government Funding and Financing." Chapter 11 of that report dealt specifically with the Three Waters sector. The Productivity Commission made the following observations and recommendations:

1. The 3 Waters sector has substantial room for improved performance;
2. A key contributing factor to this state of affairs is a poor regulatory framework governing water quality (health and environmental);
3. The Government should encourage (but not direct) aggregation and improved governance over 3 Waters service delivery;
4. The performance of the three-waters sector would substantially improve by using an approach that:
 - i. rigorously enforces minimum performance standards; and
 - ii. is permissive about the way councils structure and operate their three-waters businesses;
5. The Government should consider also having backstop arrangements to deal with councils that fail to lift performance sufficiently to meet minimum health and environmental performance standards; and
6. Financial assistance to communities will likely be needed to assist deprived communities meet minimum health and environmental standards. The assistance needs to be designed to avoid rewarding past inaction and instead reward action for sustainably lifting the performance of water providers to these communities.

These recommendations followed approximately 18 months of analysis and evidence gathering (the inquiry commenced on 16 July 2018). WDC, along with our colleagues in C4LD fully supports the Productivity Commission's analysis and recommendations. In contrast, the Government's Bill almost completely departs from the Productivity Commission's recommendations.

C4LD has taken the Productivity Commission's approach and produced a 10-point Three Waters reform plan. C4LD's alternative Three Waters reform plan is centred around this 10-point plan. Its components are:

1. As a foundation principle, community property rights in Three Waters assets should be both respected and meaningful;
2. The Government should agree to amend its current reform process and allow time for the revised approach to be reflected in draft legislation;
3. With respect to investment decision-making, asset owners should actively seek to initiate authentic discussions with mana whenua at a local level that consider co-design and partnership arrangements that acknowledge and enable Te Tiriti based pathways at a local and regional level;
4. Asset owners agree to commit to meeting health and environmental standards, once known, within an appropriate time frame;
5. The regulatory framework should specify a "backstop" provision that identifies a set of circumstances which would justify future Crown intervention if an asset owner was not making acceptable progress towards meeting those regulatory requirements;
6. Progress should be reported on annually by asset owners and be benchmarked across the sector;
7. To further incentivise sector progress, a formal process might be established that requires an asset owner to prepare a plan that would map out the steps it proposes to take to meet the required standards in a financially viable and sustainable manner;

8. A process to finance and allocate funds to areas that will require financial assistance be designed that is national in application and independently administered accordingly to objective and transparent criteria;
9. This subsidy scheme will be designed to meet investment shortfalls until such time as sufficient progress has been made. At which point the scheme will cease and asset owners will finance matters on a business-as-usual approach; and
10. A sector-wide sector best-practice improvement process be created and membership made compulsory.

Each of these points is expanded on below.

5.1.1 Property rights and alternative asset configurations

Territorial and unitary authorities are body corporates with perpetual succession (s.12(1) LGA 2002). They have the full capacity to carry on or undertake any activity or business, do any act, or enter any transaction and have full rights, powers, and privileges (s.12(2) LGA 2002). In other words, they are legal persons capable of owning property and do so on behalf of their communities (s.12(4) LGA 2002). At present, territorial and unitary councils are the legal owners of their Three Waters assets. They have all the rights and obligations that go with ownership. Only Parliament has the power to remove these rights and obligations.

When this occurs, that act of property “taking” is known legally as expropriation. The usual obligation on the expropriating Government is to pay fair compensation to the previous owners of the expropriated property.

Under the Bill before the Select Committee, the assets of territorial and unitary authorities are to be compulsorily transferred to the four new water services entities. It is a compelled transfer not an agreed transfer. Further, the Bill allocates to these councils a ‘share’ proportionate to their population size, rather than being proportionate to the true value of the transferring assets, which entitles them to vote solely on a possible (but highly unlikely) privatisation proposal. **All other rights and obligations of the present owners of the Three Waters assets are extinguished.** This is most obviously seen in Clause 166 of the Bill which states as follows:

166 Financial independence

- (1) A territorial authority owner (in its capacity as a holder of shares in a water services entity, or any other capacity), a regional representative group, or a regional representative—
- (a) has no right, title, or interest (legal or equitable) in the assets, security, debts, or liabilities of a water services entity (and the constitution cannot confer any such right, title, or interest; and
 - (b) must not receive any equity return, directly or indirectly, from a water services entity; and
 - (c) must not give a water services entity any financial support or capital; and
 - (d) must not lend money or provide credit to a water services entity; and
 - (e) must not give any person any guarantee, indemnity, or security in relation to the performance of any obligation by a water services entity.

These are the common and usual rights and obligations associated with ownership. They will no longer exist.

There is no compensation clause contained within the Bill, instead the assets are expropriated without compensation from councils who hold the assets on behalf of their communities.

The Select Committee should enquire as to why this is occurring.

Having made those points, the question arises as to whether this intervention in property rights is necessary to achieve productive reform of the Three Waters sector? We do not agree that it is.

Set out in **Appendix 5**, is a powerpoint presentation from Castalia that identifies an alternative set of structural arrangements that would achieve the change that all agree is necessary, but which would crucially, respect community property rights.

The alternative reform models are summarised below.

1. Council owned plus regulation
 - Transition to locally appropriate and sized water services – backed by credible, enforced regulation and funding mechanisms.
 - Example enhancements: contestable water fund, water efficiency group.
 - Connected to iwi.
 - Include an economic regulator with responsibilities for monitoring and enforcement.
2. Council-owned enterprise
 - Regional enterprise co-owned by relevant councils in proportion to assets or number of connections.
 - No single council would control the entity.
 - Connection to iwi / hapū in the region.
 - Report to a water efficiency group, Taumata Arowai, Regional Councils and an economic regulator.

5.1.2 Reform timetable

Minor amendments to the Bill before the Select Committee cannot correct the issues already identified.

WDC supports a completely new approach built on the C4LD 10-point plan. It is acknowledged that this will take extra time, but the current position is a product of the flawed policy process that the Government has undertaken. While further delay is undesirable, it is preferable to ensure that the desired outcomes of the reform are achieved in a manner that is supported by the community and is fiscally responsible.

Recommendation

WDC's first recommendation is that the Bill does not proceed in its current form and that there is a pause to consider a different approach built on the C4LD 10 point plan.

“Establishment Date”

If the implementation of the Bill continues, WDC refers to the issue of the ‘establishment date; in Clause 1(1) of Schedule 1 to the Bill. Under the Bill the “establishment date” for the new water service entities is regarded as the earlier of 1 July 2024 or a date set by Order in Council.

WDC supports the C4LD view that the Government's proposal to strip communities of their property rights in Three Waters assets is proceeding without a clear electoral mandate. The Labour Party's 2020 Election Manifesto simply stated: “Labour will reform New Zealand's drinking water and wastewater system and upgrade water infrastructure to create jobs across the country.” This is a vague statement that in no way justifies the extensive nature of the reform set out in the Bill.

WDC supports reform to improve Three Waters but not in the manner set out in the Bill.

It is worth reflecting on the fact that both the National Party and ACT have publicly committed to repeal this Bill (if passed) should they be successful at the next General Election. Given the long-term regulatory and investment uncertainty this position gives rise to, WDC makes the following recommendation.

Recommendation

WDC recommends that, if the Bill proceeds, the “establishment date” either be simply 1 July 2024 or be the earlier of either 1 July 2024 or a date set by Order in Council provided that such an Order in Council occurs no earlier than the date of the General Election that follows the 2020 General Election.

5.1.3 Mana Whenua

WDC supports the involvement of mana whenua in investment making decisions about three waters.

Under C4LD's approach, the Three Waters assets would remain under community ownership. As part of the regulatory framework, Three Waters asset owners would be required to engage with mana whenua on what role in investment decision-making best suits mana whenua. This approach allows a spectrum of possible outcomes from co-governance through to simple consultation and involvement between asset owners and mana whenua on investment decisions. That is the essence of local voice and of the rights associated with owning property. It is a position that allows for the

local arrangements between councils and mana whenua to be co-designed locally so that they are more direct and meaningful

To be very clear on this point, C4LD has released a position statement on Iwi/Māori partnership in the context of Three Waters reform. This is attached in **Appendix 6**.

5.1.4 Improved regulation

A key part of the C4LD 10-point plan is an improved regulatory framework. WDC congratulates the Government on the creation of Taumata Arowai and fully supports that body provided it remains independent and able to make evidence-based decisions and rules.

An effective regulatory regime through Taumata Arowai provides a strong incentive on asset owners to ensure that investment is made in a timely manner to avoid breaching the minimum regulatory standards (health and environmental).

Failure to meet the required standards is now likely to result in vigorous enforcement. This will provide a powerful incentive on asset owners to keep investment up to date.

In the environmental space, there is likely more work to be done to ensure that the regulatory regime sends appropriate and timely signals to asset owners to invest appropriately.

WDC through C4LD supports the Productivity Commission's recommendation for a backstop regulatory intervention if asset owners do not move with appropriate speed to address investment concerns. Such an approach would provide a further incentive on asset owners to reform governance and operational models in the sure knowledge that if they did not, the Crown would have the ability to intervene and force outcomes to occur.

5.1.5 Sector collaboration, benchmarking and financial assistance

The Productivity Commission recommended there was a need for financial assistance to some communities to meet future water standards. WDC supports this recommendation and C4LD's approach as described below.

To achieve sector collaboration, benchmarking and financial assistance as outlined in C4LD's 10 point plan, there is a need for an organisation which can lead the asset owners' response and implementation. This organisation also needs to be responsible for identifying those communities that will need support to reach the regulatory standards in a timely fashion. There is also a need for an allocation mechanism (criteria) and a source of funding.

Experience in the transport and other sectors has also shown that benchmarking is a critical tool to lift performance as the information disclosure provides an incentive to improve. There are a number of mandatory reporting rules (standards) already approved by the Secretary of the Department of Internal Affairs (s 26(1)(b) of the Local Government Act 2002) which could be built on as they include safety, maintenance, customers (e.g. faults, response times, satisfaction), regulatory compliance, demand management, system adequacy (Stormwater). Some of these measures could be used by an economic regulator should this be necessary after a review of the new systems performance. It is critical any measurement has a strong focus on an Iwi/Maori, customer, health, environmental, economic benchmark approach to levels of service and performance. They also need to drive the effective and efficient delivery of the three waters services.

A National competency based Board, could be appointed by the relevant ministers and local government on behalf of the asset owners to identify communities which need financial support to meet water areas of investment, Financial Assistant Rates and overview benchmark performance in the sector. This would include bringing together data from Taumata Arowai, the economic regulator, regional councils and the economic regulator should this be established in the future. This could be funded by a per connection charge for users possibly matched with Crown investment, direct Crown investment or a combination of approaches.

5.1.6 Implementation process for the C4LD model

WDC supports the implementation process for the C4LD model outlined below.

C4LD refers to the precedent set by the Energy Companies Act 1992. A possible framework might look as follows:

1. Not later than an appointed, but, reasonable, date each territorial and unitary authority must prepare and submit to the Minister, for the Minister's approval, an establishment plan relating to the creation and/or operation of a Three Waters asset owning entity in respect of the assets that territorial or unitary authority owns;
2. The Establishment Plan might be required, inter alia, to:
 - i. Identify with reasonable precision the Three Waters assets to be vested in the relevant Three Waters entity;
 - ii. Value a Three Waters entity on an appropriate basis;
 - iii. Contain a share allocation plan to the local authority owner or owners;
 - iv. Indicate whether or not any debt securities should be issued by the relevant Three Waters entity to any person on the vesting in the Three Waters entity of the relevant Three waters assets;
 - v. Contain, in draft form, the governing documents in respect of the Three Waters entity;
 - vi. Indicate the time within which the relevant Three Waters assets should be vested in the relevant Three Waters entity;
 - vii. Identify a fair and equitable system for the transfer of appropriate employees from a local authority to the Three Waters entity; and
 - viii. Contain such other details as either the Minister or territorial or unitary authority considers appropriate.
3. The framework should allow an establishment plan to be prepared and submitted jointly by two or more local authorities;
4. The framework should allow for an existing corporate entity to be used if that is appropriate in the circumstances;
5. There should be public consultation by local authorities on the proposed establishment plan;
6. The future financial stability of the Three Waters entity should be a criterion for the Minister to consider;
7. The Minister should have the ability to require a proposed establishment plan to be revised if the Minister is not satisfied with part of the original establishment plan; and
8. There should be enforcement consequences for failing to submit an establishment plan to the Minister by the set deadline.

6. Stormwater

Three Waters assets are composed of three asset classes: drinking water; wastewater; and stormwater. Drinking water and wastewater assets are (for the most part) readily identifiable and it is these asset classes on which the bulk of policy work has focused. Stormwater assets are less readily identifiable.

Broadly speaking, the concerns are:

- The net benefits of the case for transferring stormwater infrastructure to the proposed new water entities has not been made with sufficient robustness, nor have the implications of doing so been fully understood. Consequently, the proposals for stormwater are under-developed and the scope and impacts are uncertain;
- Stormwater facilities are key parts of a city and districts greenspace and provide significant co-benefits through recreational, ecological and cultural services. Considerable drainage infrastructure is in the road corridor – kerbs and channels and some blue-green infrastructure such as tree pits, rain gardens and swales. This also means that some of the key expertise in relation to stormwater management sits within a council's parks/planning and transport teams;
- Often a stormwater system is a fully integrated system which includes public and private land, roads and waterways, meaning that ownership and management of the stormwater system is complex and fragmented – key owners include council, transport authorities and private property owners. This all makes it very difficult to identify "users" in the same way as other services, and to determine who would drive priorities for flood management under the proposed new structure; and
- Stormwater is intrinsically linked to placemaking and closely connects with a number of other council roles, functions, and services. Many of these involve material overlaps: they serve different functions at different times which may it difficult to immediately transfer.

If stormwater is to be included in the new regime, WDC supports LGNZ's proposal to undertake a staged transition of stormwater, or to have a "joint arrangement" (between entities and council/s) to establish a unique transition

pathway. It is important that there is a negotiated approach to the transition, which takes into account the individual circumstances of each Council's stormwater assets and service delivery.

WDC supports Christchurch City Council's recommendations to the Select Committee, that:

- a) The transfer of stormwater to the four new water service entities should be deferred until full assurance of the feasibility of including stormwater in this model can be provided; or
- b) If stormwater is to be included, then:
 - establish bespoke council by council pathways for this transfer; and
 - include a clear definition of "stormwater services".

7. Conclusion

WDC does not support the Water Entities Bill in its current form because:

- a) It expropriates, without compensation, community assets contrary to all principles of law;
- b) It is widely opposed by communities across New Zealand because it removes local voice in favour of a centralised approach contrary to all principles of localism;
- c) It is based on data and analysis that is incorrect or, at best, seriously flawed;
- d) In an asset class that requires regulatory certainty to achieve investment certainty, it has failed to achieve bipartisan support across political parties meaning it will not deliver a durable and sustainable basis for reform; and
- e) Alternative approaches to reform could achieve a more durable outcome to the long-term benefit of the country.

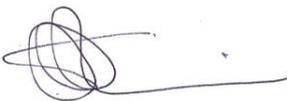
Accordingly, WDC strongly opposes the Water Services Entities Bill and its primary recommendation to the Select Committee is that the Water Services Entity Bill not proceed further in its current form and that there is a pause to consider a different approach built on the C4LD 10 point plan.

If the Bill does proceed, for the reasons described above WDC's secondary recommendations are:

- i. That the "establishment date" defined in the Bill either be simply 1 July 2024 or be the earlier of either 1 July 2024 or a date set by Order in Council provided that such an Order in Council occurs after the date of the General Election following the 2020 General Election.
- ii. That the scope of the Bill be confined to drinking water and wastewater assets and that stormwater assets remain with territorial and unitary authorities;
- iii. If stormwater is to be included within the scope of the Bill, then the Select Committee should amend the Bill to allow for the establishment of bespoke council by council pathways for this transfer, and include a clear definition of "stormwater services."

WDC does not wish to appear before the Select Committee to speak to its submission.

Ngā mihi nui,



Simon Bastion, Chief Executive



David Carruthers, Westland District Acting Mayor



Scott Baxendale, Group Manager: District Assets

Appendices

1. **Presentation to the Local Government Minister dated 4 April 2022**
2. **Letter to the Government dated 10 April 2022**
3. **Submission on Economic Regulation dated 20 December 2021**
4. **Letter to Members of Parliament dated 28 April 2022**
5. **Castalia – Better Water Reform Options**
6. **Position statement on Iwi / Maori partnership**

Communities **4** Local Democracy
He hāpori mō te Manapori

**Fresh ideas.
Better water.**

3 WATERS REFORM: AN ALTERNATE APPROACH THAT EVERYONE CAN SUPPORT

Presentation to Hon. Nanaia Mahuta,
Minister of Local Government
4 April 2022

INTRODUCTION

- Thank you for the opportunity to meet with you.
- The 31 Partner Councils of Communities 4 Local Democracy representing 1.4 million people, came together to work collectively to find a better way to achieve the health and environmental outcomes that we all desire.
- It is our view that the Government should be specifying the required health and environmental policy outcomes but it should not be micro-designing how to achieve those outcomes.
- The obligation should be on council asset owners, working, partnering, and co-designing with mana whenua, to structure and operate their assets to achieve those outcomes, with clearly understood consequences if they do not.
- This approach would better support local voice and protect community property rights.
- The current set of proposals do not achieve that goal. Opposition parties have publicly committed to repeal them if they become Government. Public polling continues to show widespread dissatisfaction with the proposed set of reforms.
- However, if the Government were open to our alternative approach, Communities 4 Local Democracy would champion that approach standing alongside the Government.
- It is a way to achieve a durable and bipartisan regulatory framework.
- It is not too late to find a middle ground.

PART A ALTERNATIVE MODELS: KEY ASPECTS



WE SUPPORT THE RECOMMENDATIONS OF THE PRODUCTIVITY COMMISSION

1. The 3 Waters sector has substantial room for improved performance
2. A key contributing factor to this state of affairs is a poor regulatory framework governing water quality (health and environmental)
3. The Government should encourage (but not direct) aggregation and improved governance over 3 Waters service delivery
4. The performance of the three-waters sector would substantially improve by using an approach that:
 - i. rigorously enforces minimum performance standards
 - ii. is permissive about the way councils structure and operate their three-waters businesses
5. The Government should consider also having backstop arrangements to deal with councils that fail to lift performance sufficiently to meet minimum health and environmental performance standards
6. Financial assistance to communities will likely be needed to assist deprived communities meet minimum health and environmental standards. The assistance needs to be designed to avoid rewarding past inaction and instead reward action for sustainably lifting the performance of water providers to these communities

ORGANISATIONAL DESIGN

Jointly Owned Council Enterprise

- Protects community property rights and community voice
- IFRS 10 achieves balance sheet separation if no one council holds more than 50% (deals substantially with the Government's desire for balance sheet separation)
- Allows for co-design with mana whenua
- Establishment process potentially subject to ministerial oversight (e.g. through Energy Companies Act 1992 type process to provide comfort to Government)

Single Council Owned Enterprise

- Protects community property rights and community voice
- Would require commitment to a credible financing plan to ensure needed investments proceed
- Allows for co-design with mana whenua
- Establishment process potentially subject to ministerial oversight (e.g. through Energy Companies Act 1992 type process to provide comfort to Government)

Both options were independently reviewed and assessed by Castalia as workable approaches that can address the core policy issues

WORKING WITH MANA WHENUA

- All our members value the importance of developing strong and meaningful partnerships with Iwi Māori for the future of 3 Waters

BUT

- The Government's 'one size fits all' model does not reflect local realities and communities of interest and, importantly, iwi and hapū rohe and areas of interest.
- We believe any arrangements will be more effective if they reflect common local interests, decision-making and build on existing relationships.
- We actively seek to initiate authentic discussions with mana whenua at a local level that consider co-design and partnership arrangements that acknowledge and enable Te Tiriti based pathways at a local and regional level.
- We seek a pause so we can have more time to work on a way forward that works for everyone.

REGULATORY BACKSTOP

- To assist with creating a strong incentive on asset owners to improve outcomes, Communities 4 Local Democracy agree with the Productivity Commission's recommendation to include in the legislative framework a “regulatory backstop” provision
- A regulatory backstop provision requires careful design to take account of consenting and construction timeframes BUT it would require certain outcomes to be achieved by a fixed point in the future
- Failure to achieve the required outcomes would justify further Crown intervention (see for example: former subpart 3 of Part 4A of Gas Act 1992)

BALANCE SHEET SEPARATION

- Where financing requirements necessitate this, then NZ International Financial Reporting Standard 10 delivers the required outcome provided no one council in a regional grouping holds more than 50% of the shareholding in a combined entity
- An Auckland specific regime would require design as IFRS 10 would not work for Auckland
- Where a single council owned model applies, council would have to show a credible financing strategy and if not, would need to move to join a larger collective

FINANCIAL ASSISTANCE TO COMMUNITIES

- Two key aspects:
 - Allocation mechanism
 - Funding source
- Allocation mechanism could be built on principles used to allocate financial assistance (FAR) in transport (not suggesting that this involves Waka Kotahi in any funding allocation role)
- Allocation decisions should support best practice in service delivery
- Allocation regime should be supported by a Road Efficiency Group/One Network Framework type regime for 3 Waters
- Funding could be built on a per connection charge across the country (C4LD has had limited time to design more options but consider this an appropriate model with precedent in other regimes)
- This is a form of cross-subsidisation but it is transparent to consumers and the funding pool is spread nationally rather than regionally

WATER EFFICIENCY GROUP

An owners organisation with a competency based board, funded by a levy on three water connections responsible for:

1. Identifying and approving investment criteria and distribution of funding to three water delivery agencies (identified by the criteria) as having challenges to meet regulatory standards in a suitable timeframe or other reasons. Criteria could include:
 - A high level of deprivation
 - A static or declining population / commercial base which impacts on their ability to pay
 - Condition of the network the timeframe needed to bring it up to a regulatory standards
 - Support for tourism destinations with peak day pressures and a small number of water connections.
 - Would potentially breach borrowing debt limits (LGFA or self improved)
2. Investing in programmes continuous improvement in governance/ management and sector performance these would include activity asset management standards, meta data, procurement, training and development, benchmarking

PART B

ASSESSMENT OF WORKING GROUP RECOMMENDATIONS



ASSESSMENT (1)

Shareholding model:

- Does not address the core legislative taking of property rights – “With ownership comes rights, responsibilities and obligations” – Mayor Goff

Accountability to communities and customers:

- Remains weak (despite new sub-committees idea)
- Complex governance arrangement - diagrams in the paper oversimplify what is a messy accountability framework. This will weaken the incentives on management to meet the objectives (safe, resilient, environmentally sound water services at least cost)
- Retains the flawed uniform pricing and cross-subsidy at the level of the whole Water Services Entity

Management and operational performance:

- Likely to be weakened as even more complex oversight

ASSESSMENT (2)

Access to financing:

- Any improvements in access to financing will require **explicit** Crown support.
- Undermines the financing concerns that drives the case for the mega-entity approach
- **Increases** the likelihood of Crown intervention in future since fiscal risk would be directly and explicitly linked to the Crown. England and Wales from 1972-1989 had exactly this issue: Whitehall took over financing and investment decisions to manage Crown fiscal risk, and ultimately privatised the Regional Water Boards into 10 private companies

Diseconomies of scale or loss of economies of scope:

- Fails to address the valid critique that significant economies of scale not available
- Fails to address the loss of coordination and scope benefits from planning, transport and water services being aligned (Mayor Goff picks up those points)

Inflexible to change and new information due to sprawling and complex nature

Working group does not explain how the large Water Services Entity model improves affordability

PART C
**PARAMETERS OF A POSSIBLE
REVISED REFORM PROPOSAL**

A 10 Point Plan

COMPROMISE PROPOSAL: 10 POINT PLAN

1. Foundation principle - community property rights in Three Waters assets are to be both respected and meaningful
2. The Government agree to pause its reform process to allow time for the revised approach to be refined
3. With respect to investment decision-making, asset owners should actively seek to initiate authentic discussions with mana whenua at a local level that consider co-design and partnership arrangements that acknowledge and enable Te Tiriti based pathways at a local and regional level.
4. Asset owners agree to commit to meeting health and environmental standards, once known, within an appropriate time frame
5. The regulatory framework should specify a “backstop” provision that identifies a set of circumstances which would justify future Crown intervention if an asset owner was not making acceptable progress towards meeting those regulatory requirements
6. Progress should be reported on annually by asset owners and be benchmarked across the sector
7. To further incentivise sector progress, a formal process might be established that requires an asset owner to prepare a plan that would map out the steps it proposes to take to meet the required standards in a financially viable and sustainable manner
8. A process to finance and allocate funds to areas that will require financial assistance be designed that is national in application and independently administered accordingly to objective and transparent criteria
9. This subsidy scheme will be designed to meet investment shortfalls until such time as sufficient progress has been made. At which point the scheme will cease and asset owners will finance matters on a business-as-usual approach
10. A sector-wide sector best-practice improvement process be created and membership made compulsory

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Better water.**

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Appendix 2

C4LD Letter to Government April 2022

10 April 2022

Hon. Nanaia Mahuta
Minister of Local Government
Parliament Buildings
WELLINGTON

By email: n.mahuta@ministers.govt.nz
Copy to: Rt. Hon. Jacinda Ardern, Prime Minister
Hon. Grant Robertson, Minister of Infrastructure

Tēnā koe e te Rangatira,

ALTERNATIVE PROPOSAL TO ADVANCE THREE WATERS

Thank you for your letter dated 8 April 2022 and for meeting with the representatives of Communities 4 Local Democracy - He hapori mō te Manapori ("C4LD") on 4 April 2022.

We received your 8 April letter just prior to the dispatch of our own letter to you setting out in summary form C4LD's proposals and, in particular, our offer to partner and champion a revised set of policy proposals that are more likely to achieve multi-party support in Parliament. Multi-party support would deliver a set of reforms that would be more durable and provide better outcomes for our country.

We have accordingly taken the time to consider the points in your letter and to reflect to you our immediate perspective on them, as well as making the points we originally intended to convey to you on Friday. This has necessitated responding in the weekend as we are anticipating early Cabinet consideration of your proposals, perhaps as soon as Monday.

As we mentioned at our meeting with you, C4LD is comprised presently of Partner Councils, representing 1.4 million people. We came together to work collectively to find a better way to achieve the health and environmental outcomes that we all desire. However, the Government should clearly understand that, quite apart from the Partner Councils of C4LD, there are many other councils that do not support the mandated four entity model. Most notably Auckland Council representing 1.7 million people. And there are many others.

In this letter we record the parameters formally of an alternative set of reform proposals which would achieve the health and environmental policy outcomes that most parties agree are desirable. More importantly, and as signalled above, it is our view that the set of proposals outlined in this letter are likely to achieve multi-party support in Parliament; indeed, this is an outcome we are prepared to champion with all Members of Parliament.

Without multi-party support the Government's reforms will not be durable. Without regulatory certainty there cannot be investment certainty. Without investment certainty there will not be investment. Such an outcome accordingly fails the chief measure of success for any set of infrastructure policy reform. The result is that needed improvements to health and environmental settings will once again be delayed.

As we outlined in our meeting with you (the presentation is appended in **Attachment 1**), our alternative proposal has 10 high-level components. They are:

1. Foundation principle - community property rights in Three Waters assets are to be both respected and meaningful;
2. The Government should agree to amend its current reform process and allow time for the revised approach to be reflected in draft legislation;
3. With respect to investment decision-making, asset owners should be required to actively seek to initiate authentic discussions with mana whenua at a local level that consider co-design and partnership arrangements that acknowledge and enable Te Tiriti based pathways at a local and regional level;
4. In return, asset owners agree to commit to meeting health and environmental standards, once known, within an appropriate time frame;
5. The regulatory framework should specify a "backstop" provision that identifies a set of circumstances which would justify future Crown intervention if an asset owner was not making acceptable progress towards meeting those regulatory requirements;
6. Progress should be reported on annually by asset owners and be benchmarked across the sector;
7. To further incentivise sector progress, a formal process might be established that requires an asset owner to prepare a plan for ministerial approval that would map out the steps it proposes to take to meet the required standards in a financially viable and sustainable manner (a similar process that respected property rights was used in the Energy Companies Act 1992);
8. A process to finance and allocate funds to areas that will require financial assistance, be designed that is national in application and independently administered accordingly to objective and transparent criteria (this is consistent with the recommendation of the Productivity Commission in November 2019);
9. This subsidy scheme will be designed to meet investment shortfalls until such time as sufficient progress has been made. At which point the scheme will cease and asset owners will finance matters on a business-as-usual approach; and
10. A sector-wide sector best-practice improvement process be created and membership made compulsory (in similar manner used to implement successfully the One Network Road Classification Framework and now One Network Framework in the road infrastructure area; and governed by Waka Kotahi (NZTA) and the Local Government Sector).

Our analysis (**Attachment 2**) prepared by our independent consultants, Castalia, show that alternative structural arrangements to that proposed by the Government are perfectly capable, and in most cases, more capable, of achieving the desired policy outcomes. Importantly, these alternative structural arrangements protect local voice, respect community property rights, and

just as importantly, are a far more effective protection against privatisation than any legislation which could be easily unwound by a future Parliament. As we all know, a current Parliament cannot bind a future Parliament.

We proposed to you two broad approaches:

1. A regional multiply-owned council water enterprise. Such an approach achieves your goal of balance sheet separation provided no one council owns more than 50% of that enterprise. This is specifically provided for in International Financial Reporting Standard 10. The proposed Hawkes Bay regional model is a good example of the type of enterprise that could be established and which would have local community support; and
2. A single council owned water enterprise. We accept that this option would not achieve balance sheet separation. Accordingly, we think proponents of this approach would have to satisfy you that it would be backed by a financially viable investment plan (using the proposed process noted above). But in principle, if a single-council owned entity is viable and could achieve the health and environmental outcomes required, then the Government ought to be agnostic about organisational design, particularly for assets it neither owns nor is proposing to purchase.

Mana whenua involvement in investment decision-making (as opposed to regulatory decision-making) is a key aspect of the reforms for your Government. The Partner Councils of C4LD support that objective consistent with the protection of both local voice and community property rights. Indeed in our view, the Government's proposal will not reflect local realities and communities of interest and, importantly, iwi and hapū rohe and areas of interest, in most parts of the country. We consider that a more local approach gives better representation to mana whenua, particularly in the North Island where there are very many iwi and hapū.

We are conscious that there is significant and mischievous comment currently circulating about C4LD's approach to mana whenua involvement in investment decision-making. We reject categorically such comment. To clarify matters, Partner Councils have prepared the attached statement (**Attachment 3**) which clearly sets out our position.

Turning now to some of the points raised in your letter of 8 April.

Your summary of the points of agreement between C4LD and the Government is generally correct. However there is one significant point of clarification required.

C4LD believes that 3 Waters assets should continue to be owned by councils either directly or through real shareholding arrangements that confer the usual rights and obligations that go with equity ownership. The Government's approach does not do that. Further it is our view that the Government's approach amounts to the expropriation of council assets without true value compensation. We note that this matter is at issue in the litigation being pursued by some councils at present.

We note your comments that regulatory levers alone are unlikely strongly to incentivise improvements. Clearly we disagree on this point. But again we emphasise that our view is also the view of the Productivity Commission. It is a conventional viewpoint and one that protects community property rights. This is why the Government's approach ultimately will not be durable.

Page 4
10 April 2022
Hon. Nanaia Mahuta - Alternative Proposal to Advance Three Water Reform

Communities **4** Local Democracy
He hapori mō te Manapori

On our proposal for a FAR type approach to assisting deprived areas, you have misunderstood our suggestion. This approach would not require additional taxes. It would require additional revenue, but this could be sourced, for example, contractually through connection charges which would reduce over time. Connection charges are very common in utility markets.

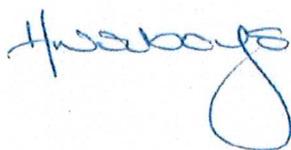
All Partner Councils are budgeting significant expenditure on 3 Waters in their Long Term Plans (which we understand to be many billions of dollars). We are confident that with the regulatory backstop, the direct charge for services that the Council entities would be putting in place, and the sector wide best practise improvement process – that your concerns that future Councils will not vote appropriate budget for the investment required would not be an issue.

In terms of the Working Group, we must, we think, agree to disagree. We do not think that the Working Group has developed proposals that address our fundamental concerns. The fact that one member (Hon Phil Goff Mayor of Auckland representing 1.7 million people) wrote a minority report and another has dissociated himself from the Working Group indicates that the Working Group's approach is not the breakthrough it has been presented as being. We will be developing further our critique of the Working Group in due course depending on the degree of take-up by the Government of the Working Group's recommendations.

Minister, at this point in time, the Government's proposals are widely opposed across the country and as others have noted, the Government simply has failed to bring the people with it on this initiative. Whilst presently, you have the Parliamentary majority to achieve your preferred position, this does not mean that the position is durable. It is not. The Opposition Parties have already publicly committed to repeal any such legislation. Our preference, and we think the country's preference is to achieve a multi-party and durable approach. In our view our proposal can achieve that with the Government's support. We commend it to you.

As we discussed it is not too late to rectify matters. We are not that far apart in our objectives. Indeed, what we are offering in our 10 point plan is an approach that we believe would achieve broad support. We ask that you take the time to allow for a revised approach to be refined. We are prepared to partner and work with you and the Government to turn this around and find a lasting solution that we can all support.

Nāku noa, nā



Mayor Helen Worboys
Manawatu District Council
Chair
helen.worboys@mdc.govt.nz



Mayor Dan Gordon
Waimakariri District Council
Deputy Chair
dan.gordon@wmk.govt.nz

Att 1: Presentation to Minister of Local Government 4 April 2022

Att 2: Castalia Report - Improved Options for Three Waters reform January 2022

Att 3: Communities 4 Local Democracy He hapori mō te Manapori (C4LD) Position on Iwi Māori Partnership



20 December 2021

Competition and Consumer Policy
Building, Resources and Markets
Ministry of Business, Innovation & Employment\PO Box 1473
WELLINGTON 6140

Re: Submission on Economic Regulation and Consumer Protection for Three Waters

On behalf of the Partner Councils of **Communities 4 Local Democracy - He hāpori mō te Manapori**, we provide, as an attachment to this letter, a submission on the above matter prepared for Partner Councils by Castalia.

Communities 4 Local Democracy - He hāpori mō te Manapori is a newly formed group of 24 councils (as at 20 December 2021) from around the country. The group was created in response to serious concerns about the nature of aspects of the Government's Three Waters reforms. Information about our group may be found at:
<https://www.communities4localdemocracy.co.nz>.

If you would like to discuss points arising from this submission, please contact in the first instance, Andreas Heuser at: andreas.heuser@castalia-advisors.com.

Yours faithfully

A handwritten signature in blue ink, appearing to read "Helen Worboys", with a large loop at the end.

Mayor Helen Worboys

Chair

Communities 4 Local Democracy

A handwritten signature in black ink, appearing to read "Dan Gordon", with a large loop at the end.

Mayor Dan Gordon

Deputy Chair

Communities 4 Local Democracy



Improving Three Waters Regulatory Regime

Submission on behalf of the Partner Councils of

Communities **4** Local Democracy
He hapori mō te Manapori

DECEMBER 2021

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Definitions

WSE	Water Service Entity
CCO	Council Controlled Organisation
EDB	Electricity distribution businesses
ISP	Independent Selection Panel
LGFA	Local Government Funding Agency
LGNZ	Local Government New Zealand
MBIE	Ministry of Business, Innovation and Employment
NPS	National Policy Statement
RRG	Regional Representative Group
WSE	Water Service Entity

Executive summary

The government is reforming the drinking, waste and stormwater (Three Waters) sector. It intends to create four new large water service entities (WSEs) that will hold all Three Waters assets and provide the Three Waters services currently provided directly by local authorities or, in some cases, by council-controlled organisations. The WSE proposal will create four new statutory entities, and amalgamate the water services of 67 local authorities into them.

The Three Waters sector has had poor water quality regulation and enforcement, some local authorities have under-charged for services, and some have under-invested in assets and renewals. A new water quality regulatory regime is being established under Taumata Arowai. The government also intends to improve environmental outcomes by improving the regulatory regime.

An economic regulation regime is now proposed to complement these structural reforms. Policy makers expect that economic regulation will lift performance of water service providers and ensure that the customers of monopoly utilities receive services of a satisfactory quality for a reasonable price.

Communities 4 Local Democracy - He hapori mō te Manapori is making a constructive contribution to improve water sector outcomes for all affected communities

Communities 4 Local Democracy - He hapori mō te Manapori is group of councils (together referred to in this submission as “Partner Councils”) that includes local authorities of large cities, provincial and rural communities from across New Zealand. The Partner Councils have appointed Castalia to prepare an in-principle submission on the core design features of the economic regulation regime proposed in the Ministry of Business, Innovation and Employment’s (MBIE’s) Discussion Paper: Economic Regulation and Consumer Protection for Three Waters Services in New Zealand (the Discussion Paper). Castalia has also been appointed to advise Partner Councils whether the proposed regime will achieve the objectives sought.

Partner Councils want to make a constructive contribution to designing a modern, effective, and cost-efficient economic regulatory system for the Three Waters sector. Partner Councils support the provision of safe and environmentally sound, resilient, reliable, and customer responsive water services, at least cost. They recognise that economic regulation can play a key role in ensuring that the quality of service is optimal and tariff levels are reasonable so that consumers’ interests are served.

Local authorities like the Partner Councils are the best representatives of the interests of current and future water consumers, ratepayers and affected communities in this reform process. No other organisations represents the voice of the consumer in this important, but technical, reform process. Mayors and councillors have been elected by their communities to oversee the water services of the respective local authorities, and represent their interests in national reform processes such as this.

In light of this proposed major change to the way water services are delivered, it is critical that the proposed regulatory regime is tested to ensure it will deliver satisfactory quality services and reasonable prices for New Zealanders, as well as achieving the other outcomes sought from reform. This submission highlights some of the risks, and shows how changes to ownership and governance of water services, and changes to the economic regulation regime can improve outcomes for all affected communities.

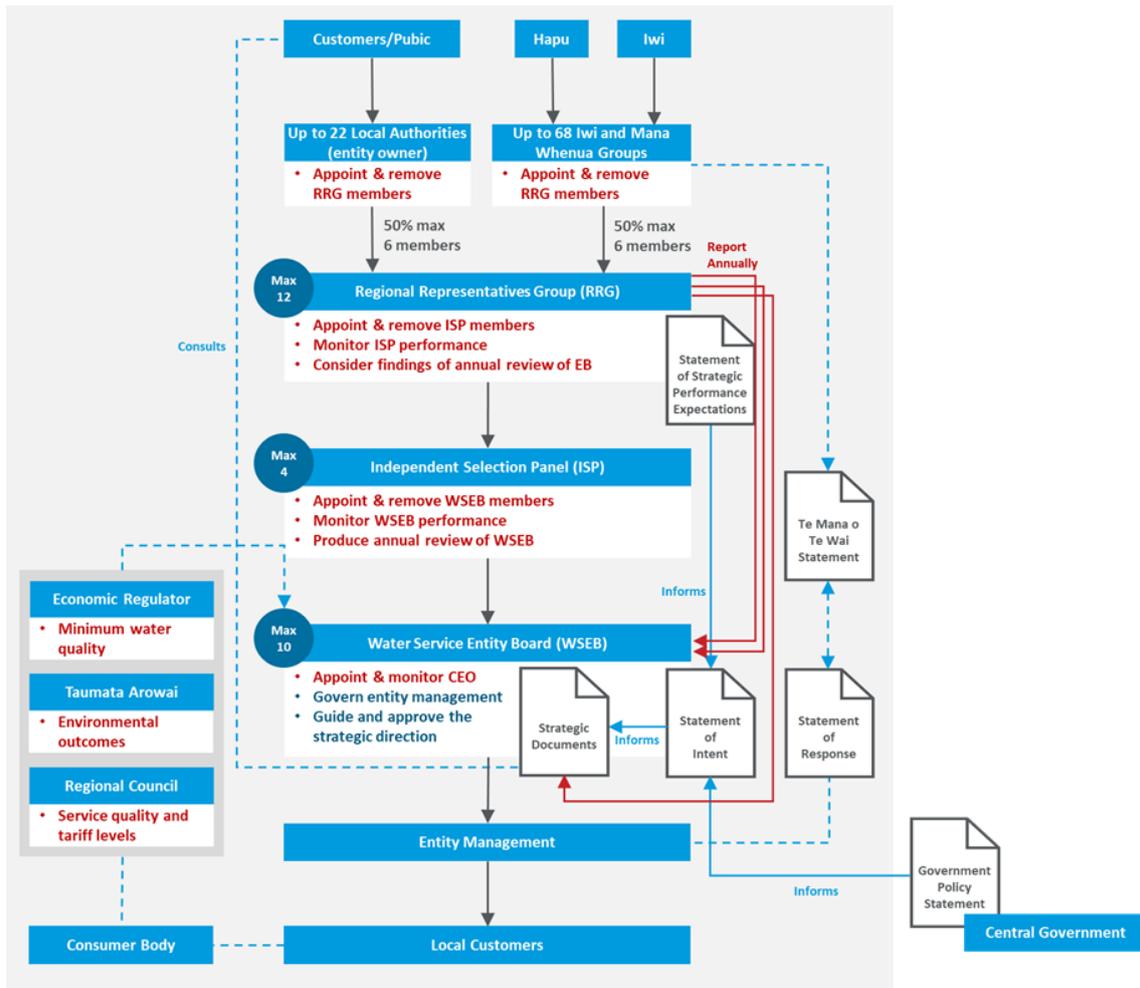
Economic regulation needs to be in balance with public ownership and governance

Economic regulation and public ownership are both used to overcome the problem of monopoly provision in the water sector. Economic regulation uses an independent party to monitor whether the cost of service is optimal for the price-quality combination consumers want, and that prices are reasonable. This outcome can also be achieved by the public owning the water utility and holding those overseeing it to account. Complex economic regulation is often unnecessary because public accountability through effective governance can ensure that acceptable services and reasonable prices are provided.

However, the chosen WSE model is highly complex, multi-layered and with competing accountability mechanisms

However, the public accountability mechanism under the proposed WSE design is highly complex. The WSEs have unusual governance, accountability, and incentive structures. The WSE management will be four steps removed from those who have direct accountability to the consumers served. Several accountability documents and statements then overlay this arrangement. Figure 0.1 shows the complexity and disconnect between customers, communities, mana whenua and the WSE management (which is tasked with improving the service).

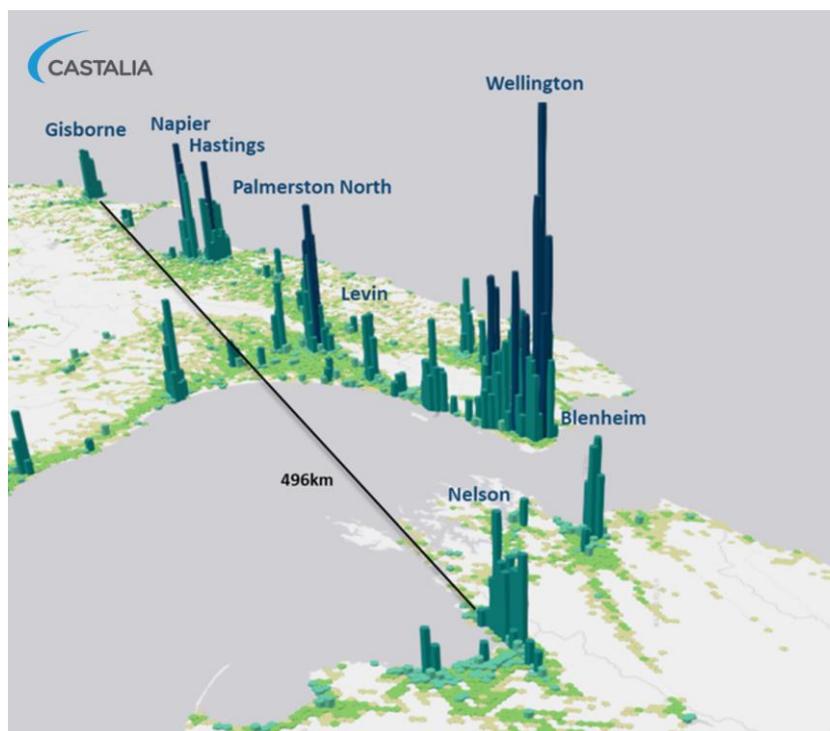
Figure 0.1: Proposed WSE entity governance and accountability structure



WSEs will have to serve a mix of diverse interests across dozens of idiosyncratic networks—all with a harmonised single water price

In addition, the WSEs will serve highly diverse populations ranging from large cities to rural settlements. The spatial distances are significant. Management is intended to be centralised into four locations. While administration will be merged, no meaningful physical joining of water networks will occur (as Figure 0.2 illustrates for Entity C). Dozens of discrete networks will have to be managed, each with highly idiosyncratic physical, engineering, topographical, environmental and climatic conditions. The government has also required that WSEs must charge uniform, harmonised tariffs.

Figure 0.2: Cities and towns in Entity C with population densities



Castalia adapting Statistics New Zealand visualisation

Economic regulation as designed will not achieve the water sector outcomes all parties seek

The net result of the regulatory regime proposed in the Discussion Paper will be a system that is unlikely to be net-benefit justified. Customers will receive fewer benefits for more costs compared to if the ownership and governance structure was better balanced with regulation.

Designing an effective economic regulation regime for the WSEs—as currently structured—will be an immensely difficult task. The regulatory regime will be globally unique. By overlaying the proposed regulatory framework over the complex WSE structure, New Zealand risks introducing a regulatory structure that will not overcome the underlying policy problems.

Conventional regulation works by channelling private, profit-seeking incentives towards publicly beneficial ends. However, the WSEs for New Zealand will be not-for-profit and will have a range of socio-cultural objectives to meet that cannot be measured easily with typical financial and economic toolkits used by regulators. All of New Zealand's usual comparator

countries use economic regulation where water utilities have a profit motive, with a single exception. In New Zealand, our fully community-owned electricity distribution businesses (EDBs) are not subjected to price-quality regulation. This is because governance arrangements are considered adequate.

Fit-for-purpose regulation is more likely to succeed if changes to governance and the reform model are made

The Partner Councils have proposed reform options that will achieve the balance of public ownership and fit-for-purpose regulation. The two Partner Councils Options are:

- **Council-owned plus regulation:** Amending the current local authority-owned and operated model with targeted interventions to address financing, funding constraints and credible enforcement mechanisms from water quality, environmental and economic regulators
- **Council-owned organisation:** Local authorities would own shares in a regional organisation. The local authorities would remain democratically accountable to voters (and water customers), and would exercise appointment rights over the organisation board. The organisation would own and manage the three waters service for the area.

Adopting these reform models will deliver on the objectives sought, and also allow a well-designed regulatory framework to work effectively. Relevant global experience with water and energy networks, and with New Zealand EDBs, highlights that balancing public ownership and governance arrangements with regulation leads to good outcomes for consumers. Adopting the Partner Councils Options will focus regulation on information disclosure, benchmarking and incentive-based oversight, at lower cost than the complex and ineffectual regulatory system that will result if the government's flawed mega-WSE model is pursued.

1 Introduction

This submission is made on behalf of 24 local authorities (as of 20 December 2021) that represent diverse communities in Aotearoa/New Zealand called Communities 4 Local Democracy - He hapori mō te Manapori (the Partner Councils). Partner Councils reflect the full spectrum of New Zealand's local authorities, and the group includes large cities, provincial centres, and predominantly rural communities.

This submission is intended to assist policy-makers and MBIE with the difficult task of designing an appropriate regulatory regime. The complex governance and ownership model of the WSEs creates globally unique challenges for economic regulation. In this submission, Partner Councils provide constructive suggestions that will avoid the risks of this regime failing.

This paper makes the following points:

- The objective for reform should be water services that are safe and environmentally sound, resilient, reliable, and customer responsive, at least cost (section 2)
- However, the government intends to reform the water sector into the four WSEs with complex governance and accountability arrangements (section 3)
- Economic regulation and public ownership in water services need to be in balance to achieve the objectives (section 4)
- The proposed regulatory regime—as designed for the WSEs—will not achieve the objectives (section 5)
- Therefore, the public ownership structure and governance regime must be improved to enable a fit-for-purpose regulation to work (section 6).

2 Overall objectives of water reform and need for change

The ultimate objective for New Zealand’s water services reform should be to achieve safe and environmentally sound, resilient, reliable, and customer responsive water services, at least cost. Partner Councils agree that there are deficiencies, and that regulation needs to be improved. Central and local government mostly agree about the root causes for the need for change, and that better water services should be achieved.

Safe water provision through ensuring minimum quality standards are met

Central and local government both agree that drinking water quality levels should meet minimum standards so that everyone in New Zealand has access to safe drinking water.¹ The Government has already undertaken significant steps to overhaul the Ministry of Health’s failures in regulating water quality and has created Taumata Arowai via legislation in 2020.² Partner Councils support it becoming a responsive and proactive water quality regulator of the 67 local authorities, water CCOs and any future water service providers.

Improve environmental outcomes associated with Three Waters services

Central and local government representatives agree that the regulatory reform should also improve the environmental performance of water service delivery.³ However, this has received less attention, and the improvement of environmental outcomes related to wastewater treatment and discharge/disposal still requires policy attention.

Resilient and reliable services

Government and local authorities agree that the reform should improve the resilience of the Three Waters sector to both short-term and long-term shocks. This includes climate change and changes in population.^{4 5}

Customer responsive

Local government wants the reformed water service entities to be governed by community preferences.⁶ Central government, in contrast, has not made this a priority.

¹ LGNZ Three Waters 101: Available online at: <https://www.lgnz.co.nz/assets/Three-Waters-101-Infographic.pdf>; DIA report, page 2. Available online at: [https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/\\$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf)

² Taumata Arowai—the Water Services Regulator Act 2020

³ DIA report, page 2. Available online at: [https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/\\$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf); LGNZ Three Waters 101: Available online at: <https://www.lgnz.co.nz/assets/Three-Waters-101-Infographic.pdf>

⁴ DIA report, page 2. Available online at: [https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/\\$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf)

⁵ LGNZ Three Waters 101: Available online at: <https://www.lgnz.co.nz/assets/Three-Waters-101-Infographic.pdf>

⁶ LGNZ Three Waters 101: Available online at: <https://www.lgnz.co.nz/assets/Three-Waters-101-Infographic.pdf>

Least-cost services

Central government has stated that the reform should drive productive efficiency.⁷ However, this is subject to a functional economic regulation regime. All parties agree that cost-effective water services are desirable. All parties agree that the financial sustainability of water service providers should improve. This includes both access to financing and ensuring funding sources are adequate.^{8 9}

3 New Zealand's proposed WSE model is complex

In response to problems with the water sector, the government has proposed a reform model. The model deserves analysis in this paper because it is important to lay out how the designers of the model expect it to work to deliver on the policy objectives.

The government's proposal for reform into four mega water service entities (WSEs) is highly complex, novel and untested. The governance model also requires balancing various socio-cultural objectives.

3.1 Governance of the WSEs is highly complex, novel and untested

The proposed WSE will have unique and complex governance mechanisms. Those charged with governance of the WSEs will have diverse interests to serve. The management of the entity is four steps removed from local voters and Iwi members. There are also a variety of accountability documents issued by various parties. In addition, three regulators (water quality, environmental and economic regulators) will have to monitor compliance with their standards and rulings and attempt to enforce breaches.

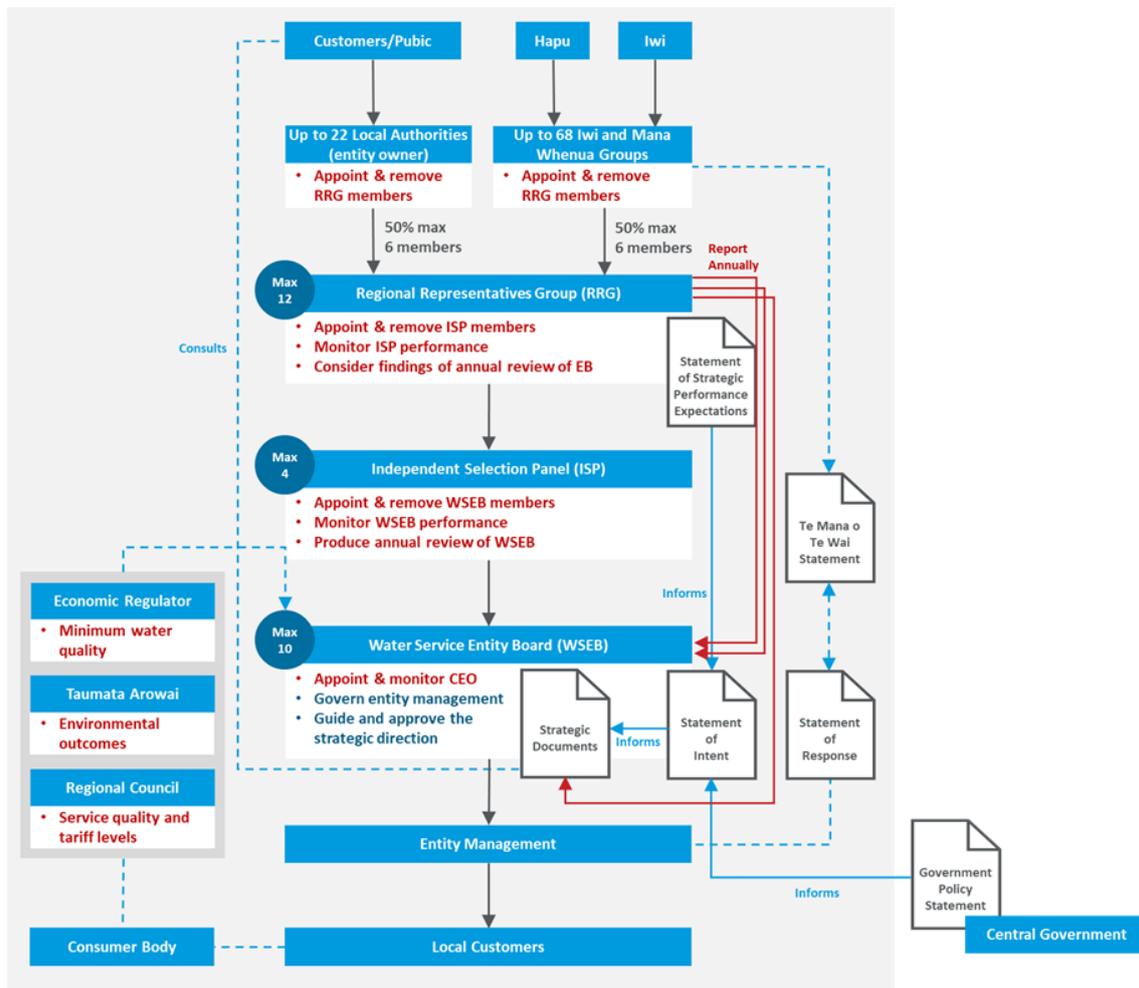
⁷ DIA Regulatory Impact Assessment Decision on the reform of three waters service delivery arrangements. Page 115

⁸ DIA report, page 2. Available online at: [https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/\\$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf](https://www.dia.govt.nz/diawebsite.nsf/Files/three-waters-reform-programme-2021/$file/transforming-the-system-for-delivering-three-waters-services-the-case-for-change-and-summary-of-proposals-30-june-2021.pdf)

⁹ LGNZ Three Waters 101: Available online at: <https://www.lgnz.co.nz/assets/Three-Waters-101-Infographic.pdf>

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Figure 3.1: Proposed WSE governance and accountability model



WSE will be unique entities under New Zealand law with no shareholders, and will not disburse surpluses to any owners

The WSEs will be creatures of statute and unique in New Zealand law and government practice.¹⁰ There will be no shareholders. The statute will deem that the local authorities within the WSE area will “own” the entity on behalf of their communities.¹¹ However, local authorities will not have typical rights of ownership such as rights of use, to gain a return, to dispose, control it or control its use. Surplus earnings must be retained by the WSE and can be reinvested in delivery of water services. That is, the WSEs will be not-for-profit.

WSEs will have independent balance sheets. Each WSE will own all three waters assets and associated debt.¹² This will increase the level of borrowing in the sector as it will remove water service providers from the financial restraints of debt limits imposed by LGFA and council

¹⁰ 14 June 2021, Cabinet Paper: Designing the New Water Service Delivery Entities: Paper Two, Office of the Minister Local Government, p. 7

¹¹ We are advised that this definition of “ownership” is subject to ongoing legal proceedings as the claimants do not consider that it complies with the common law definition.

¹² LGNZ website: Three Waters, available online at : <https://www.lgnz.co.nz/reforms/three-waters/#ownership>

balance sheets. WSEs will be able to independently raise finance from a variety of sources, including, but not limited to local and international retail and wholesale capital markets or the LGFA.¹³

This will, however, also transfer the risk of poor investment choices and costs not being recovered to the WSEs customers.

WSE governance regime is complex, novel and untested

The governance regime is detailed and has multiple people holding different roles.¹⁴ The WSE board will be made up of no more than 10 members, and the chair will hold a casting vote. The board appointment process requires multiple steps.

The requirements of the Companies Act 1993, including fiduciary duties and associated penalties, will not apply. It is unclear if the statute creating the WSEs will impose similar duties as typical Companies Act duties.

Appointments to the WSE board will be made by an Independent Selection Panel (ISP) made up of four members who are independent and appropriately qualified.¹⁵ ISP members are in turn appointed by the Regional Representative Group (RRG). The RRG will be required to conduct performance reviews of the ISP every three years. RRG members are appointed by local authorities and mana whenua in the WSE area via a complex nomination and voting process. Member local authorities and mana whenua must collectively vote at a meeting for the relevant entity for RRG appointees.¹⁶ The RRG will be made up of no more than 12 members, of which 50 percent are represented by local authority representatives and 50 percent by mana whenua representatives.

The RRG is then responsible for appointing a four-member ISP. The ISP appoints the board of the WSE. It is intended that the WSE Board will comprise professional directors. The ISP is supposed to conduct a performance review of the WSE board annually.

WSE accountability framework is also multi-faceted and complex

The government has proposed additional measures to try and hold the WSE board and RRG accountable to certain additional requirements. These requirements are imposed by central government as command and control mechanisms in which certain requirements are set out which the WSE board and RRG must report on. The net result is that WSEs are more accountable to central government, than the local authorities that are deemed to be “owners” in the proposed legislation.

The government may define certain outcomes it seeks in a National Policy Statement (NPS). WSEs may retain operational autonomy in how they will give effect to the NPS.¹⁷ The NPS is

¹³ 14 June 2021, Cabinet Paper: Designing the New Water Service Delivery Entities: Paper Two, Office of the Minister Local Government, p. 5

¹⁴ 14 June 2021, Cabinet Paper: Designing the New Water Service Delivery Entities: Paper Two, Office of the Minister Local Government. p. 15

¹⁵ 14 June 2021, Cabinet Paper: Designing the New Water Service Delivery Entities: Paper Two, Office of the Minister Local Government

¹⁶ 14 June 2021, Cabinet Paper: Designing the New Water Service Delivery Entities: Paper Two, Office of the Minister Local Government

¹⁷ DIA Three Waters Regulatory Impact Assessment – Strategic RIA – May 2021

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intended to provide strategic direction to WSEs at a high level and communicate government expectations for WSEs to address inequalities and deliver in relation to Māori interests.

The RRG must prepare a Statement of Strategic Performance Expectations at least once every three years which is used to monitor the performance of the WSE against the Statement of Intent.

In response to the NPS and Statement of Strategic Performance Expectation, the WSE board will have to produce a Statement of Intent. WSEs must then report against the Statement of Strategic and Performance Expectations annually.

Each WSE will also produce an investment prioritisation methodology. This does not require approval by the RRG, although it could be influenced by the Strategic and Performance Expectations. In addition, the ISP will conduct an annual performance review of WSE boards.

The government has acknowledged that the command and control accountability mechanisms it has designed are not capable of completing the governance arrangements. Cabinet stated: “the level of independent governance proposed requires the addition of appropriate consumer protection and accountability mechanisms.”¹⁸

3.2 WSEs will have various socio-cultural objectives

Socio-cultural objectives in the delivery of utility services are common. Governments often have policy objectives that are realised through the provision of essential infrastructure services like drinking water, wastewater, electricity distribution and so on. This is often why governments choose to own essential infrastructure service providers.

However, it is unusual for water utilities to provide a range of potentially competing socio-cultural objectives, and for the entity to be subjected to price-quality economic regulation (that is, regulation aiming to broadly improve consumer welfare and service efficiency). The WSEs will be tasked with achieving a range of socio-cultural objectives from the outset. These include Iwi-Māori objectives and equity, affordability objectives and any others that the government may specify in a National Policy Statement.

Iwi-Māori objectives will be prioritised

The governance framework will promote Iwi-Māori influence on the WSEs’ objectives. First, since Iwi-Māori will have one half of the appointment rights to the RRG, it is expected that those appointees will represent the priorities and objectives of Iwi-Māori. The Government’s WSE design is intended to ensure that WSEs “engage meaningfully with iwi/Māori to inform understanding of Treaty rights and interests”.¹⁹ The WSEs will also be required to adhere to operating principles that relate to “partnering and engaging early and meaningfully with

¹⁸ 14 June 2021, Cabinet Paper: Designing the New Water Service Delivery Entities: Paper Two, Office of the Minister Local Government. Page 5

¹⁹ DIA (2021), Transforming the system for delivering three waters services: The case for change and summary of proposals report, p. 21.

Māori, local government and communities”²⁰ and “supporting and enabling matauranga Māori and tikanga Māori and kaitiakitanga to be exercised.”²¹

The WSEs will attempt to give effect to Te Mana o te Wai.²² The government intends to achieve this through ensuring that the WSE boards have relevant competencies and through reflecting “Te Mana o te Wai Statements” prepared by mana whenua. The WSE will be required to prepare and publish a formal reasonable response to such statements with a prescribed timeframe.²³

The WSEs do not earn any profit (and “owners” do not receive dividends). Therefore, the WSE board and its appointing entities (RRP, ISP, local authorities and mana whenua) will have to measure performance in terms of the delivery of the outcomes for Iwi-Māori set out in these accountability documents.

Improved services in areas where affordability challenges exist

The government also intends that the new WSEs will ensure “affordable” services in areas where affordability is a challenge. It has said that the reform should address affordability challenges that currently exist in the sector and ensure all New Zealanders have access to affordable three waters services.²⁴ This includes ensuring an acceptable level of service can be delivered affordably in smaller, rural communities²⁵. The government recognises this will require cross-subsidisation—metropolitan areas where the average cost of service is typically lower will effectively support an improvement in water service delivery in more rural areas.²⁶ However, many provincial centres, smaller cities and more rural communities have well-functioning water services and may end up effectively cross-subsidising some metropolitan areas too.

Further socio-cultural aims are to address inequality and support housing and urban development.

3.3 WSE management will be centralised and operations will remain dispersed

The introduction of a new regulatory system in New Zealand will coincide with large-scale administrative mergers. The proposed WSEs will oversee geographically dispersed areas, from

²⁰ DIA (2021), Transforming the system for delivering three waters services: The case for change and summary of proposals report, p. 24.

²¹ DIA (2021), Transforming the system for delivering three waters services: The case for change and summary of proposals report, p. 24.

²² Te Mana o te Wai is defined by Taumata Arowai as follows: a universal concept for all Aotearoa New Zealanders. It refers to the fundamental importance of water and recognises that protecting the health of freshwater protects the health and wellbeing of the wider environment. It protects the mauri of the wai. Te Mana o te Wai is about restoring and preserving the balance between the wai, the wider environment and the community

²³ Cabinet Paper “Protecting and Promoting Iwi/Māori Rights and Interests in the New Three Waters Service Delivery Model: Paper Three, CAB-21-MIN-0228

²⁴ DIA (2021), Transforming the system for delivering three waters services: The case for change and summary of proposals report, p. 2.

²⁵ DIA (2021), Transforming the system for delivering three waters services: The case for change and summary of proposals report, p. 15.

²⁶ DIA (2021), Departmental Regulatory Impact Assessment, Decision on the reform of three waters service delivery arrangements, p. 106

a centralised head office. Management and administration will be centralised to four main centres in each WSE area. The head offices are expected to be Auckland (Entity A), Hamilton (Entity B), Wellington (Entity C) and Christchurch (Entity D). It is expected that key management staff will be co-located.

This means that sophisticated management and reporting mechanisms will be needed to ensure that the multiple discrete networks report cost and quality information back to head office.

Policy-makers should understand the differences between water and other infrastructure: Unlike the national electricity networks, water networks are highly localised. The environmental conditions are very different between networks. For example, some regions draw drinking water from multiple bores from a large aquifer (like Christchurch), whereas other regions take surface water from purpose built dams (like Auckland) or from rivers. The drinking water reticulation network and waste water networks are highly localised because water has a low value to weight ratio. This is unlike electricity where the network covers the whole country.

Appendix B contains 3D maps of New Zealand communities and the population densities in each. The maps show the physical distances between towns and illustrate the challenge of managing dozens of physically separate drinking water, wastewater and stormwater networks and production facilities.

3.4 Claimed cost efficiencies from administrative merger

The reform, and the regulatory design, are premised on an assumption that cost efficiencies will emerge from an administrative merger, and that those cost efficiencies are only available at a particular size (800,000 connections is cited). Department of Internal Affairs and its consultants claim that 50 percent capex and up to 60 percent opex efficiencies will be achieved following the reform. That is, the government's advisors claim that the WSEs will pay half as much for capex as smaller entities might pay, for the same outcome and that operating costs will fall by over half (in spite of assurances that no jobs will be lost). MBIE has cited these claimed scale benefits uncritically.²⁷

There is, in fact, a body of academic literature and previous Castalia analysis²⁸ that shows that production cost savings are not available from administrative mergers of discrete networks. Therefore, the premise of mergers being required for cost savings should not be accepted as a necessary condition of the regulatory design.

²⁷ For example, at paras 4, 5, 7-9, 35, 55 of the Discussion Paper

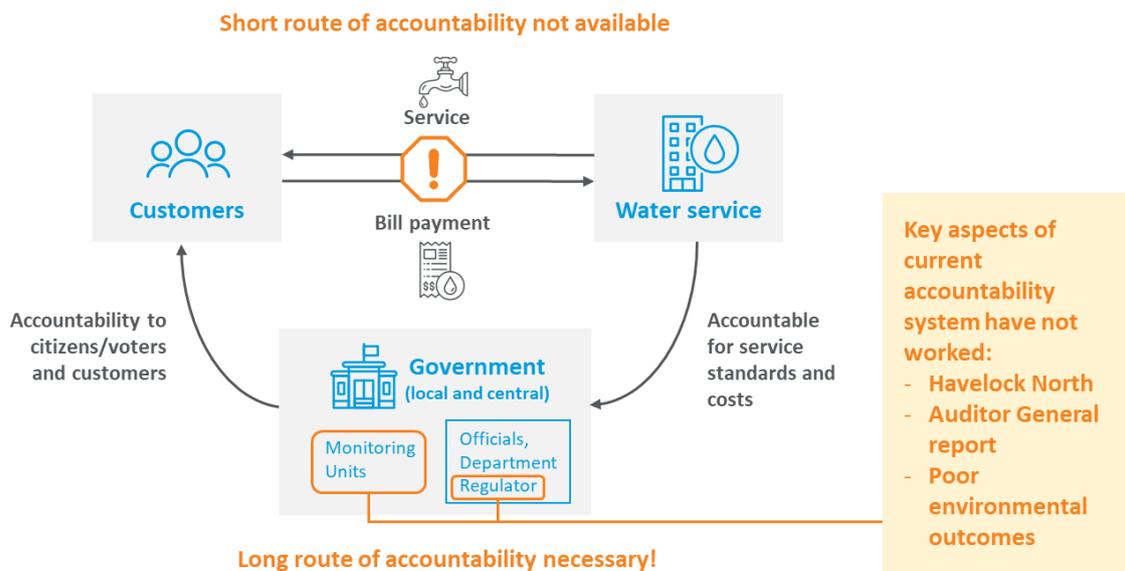
²⁸ Castalia's reports for Local Government New Zealand and the Joint Steering Committee, available at: <https://www.lgnz.co.nz/assets/LGNZ-release-of-Castalia-reports-context-and-response-v2.pdf>; Castalia's analysis for various local authorities, for example: <https://www.wdc.govt.nz/Whats-new/News-and-notice/Faulty-Assumptions-Three-Waters-20210903>

4 Role of regulation and public ownership in water services

It is useful to outline the role of regulation, and the role of public ownership in water services. Governments are involved in water services because drinking, waste and stormwater networks are natural monopolies and essential for community wellbeing. High fixed costs mean that it is more efficient for one service provider to take up the whole market.²⁹ So consumers cannot choose between competing suppliers. Water is also valuable to consumers and the costs of alternatives are often very high. Therefore consumers are willing to pay much above the cost of delivery for water services. This is a classic market failure. It means that the typical way that customers hold a service provider accountable (by choosing an alternative, reducing consumption or demanding better service) are not available.

As a consequence, governments own water services, regulate them, or both. In any case, a long route of accountability to customers is needed. Government (local and/or central) needs to play a role. Figure 4.1 illustrates the short and long routes to accountability.

Figure 4.1: Accountability for water services and issues in New Zealand

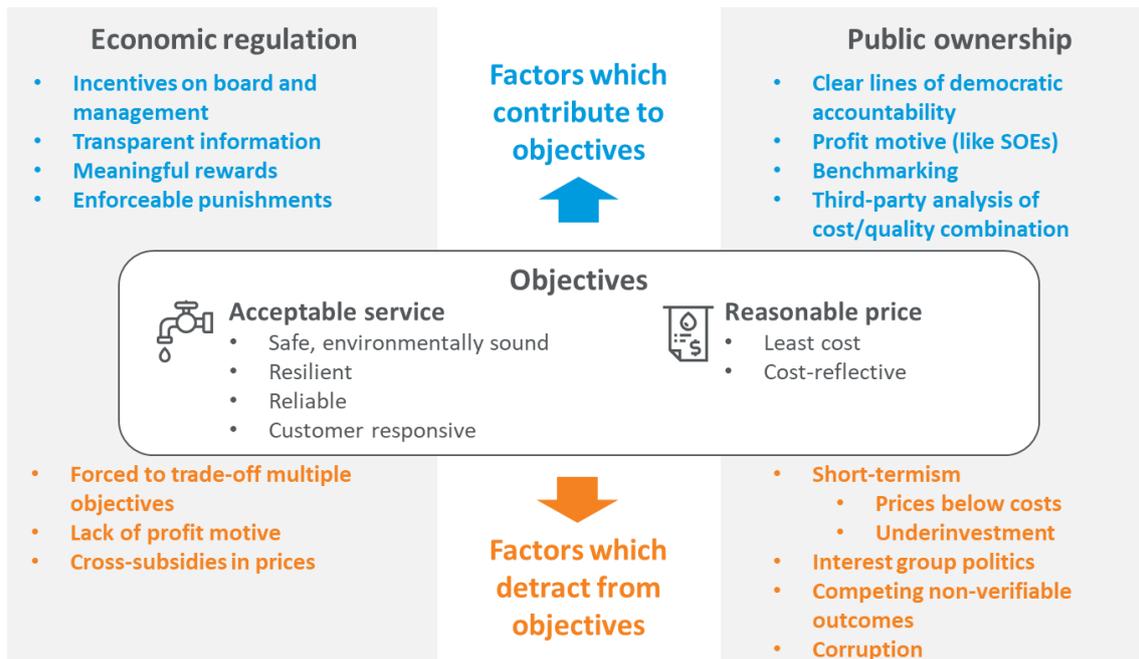


Castalia, adapted from Water Sector Board, *Improving Governance and Fighting Corruption in the Water Supply and Sanitation Sector*

The role of regulation and public ownership in providing accountability to customers for water services must be balanced. There are factors that can positively impact economic regulation, and factors that detract from it. Public ownership also has factors that positively contribute to objectives, or detract from achieving those objectives. Figure 4.2 illustrates these factors.

²⁹ Discussion Paper, para 17

Figure 4.2: Factors in economic regulation and public ownership that determine reaching objectives



In the following, we discuss how economic regulation of water services can improve water services. We then discuss how government ownership can improve water services.

4.1 Economic regulation can improve water services under certain conditions

Economic regulation of water services has been proposed to support the reform objectives. As the Discussion Paper notes, well-designed economic regulation should have the primary objective of promoting the interests of consumers. A secondary objective is economic efficiency.

It is important for policy-makers to understand the core function of economic regulation, and how using price-quality regulation for not-for-profit, government-owned water utilities is rare. Evidence suggests that the performance of economic regulation for public-owned water utilities is poor, with few exceptions. Therefore, when considering how to use economic regulation for publicly-owned water utilities, MBIE, and other government policy-makers should take care.

Regulation can protect consumers from lower quality and higher-priced services due to monopolistic behaviour arising from market power

Economic regulation aims to protect consumers from the exercise of monopoly power by a utility. We agree with MBIE's core definition of the reason for regulating water utilities.³⁰

³⁰ Discussion Paper, pp. 14 and 15

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The voices of consumers and communities should be incorporated throughout the design of the three waters regulatory system, to ensure it is responsive and accountable. For example, consumers should be able to expect a certain level of service when they contact a water supplier with a query or complaint. Consumers should also expect clear communication about planned or unplanned network outages, and transparency from their supplier about how water services are billed.³¹

Regulation exists to achieve consumer welfare outcomes in the water sector that exist regardless of country. There are also New Zealand-specific outcomes that regulation can support.

The monopoly problem in water services is much more obvious when a water utility is a profit-seeking private firm. The firm can overcharge and/or deliver poorer quality service at the expense of consumers unless there is regulatory intervention. Economic regulation can be an effective tool to address this problem. MBIE is correct to note:³²

Overseas experience regulating water services, as well as domestic experience regulating other utilities, suggest that price-quality regulation is a highly effective tool in attaining the sorts of outcomes the Three Waters Reform aims to achieve, i.e. incentivising suppliers to provide affordable, high-quality water services. In particular, price-quality regulation often plays a crucial role in driving economic efficiency within regulated suppliers to ensure that water services are as affordable as possible for consumers.

Price-quality economic regulation for not-for-profit, government-owned utilities is rare

While MBIE is correct to note that price-quality regulation is generally effective, it is almost exclusively successful where the regulated water utilities have:

- Profit motive
- Clarity of purpose focussed on price and quality of service.

We reviewed the regulatory regimes in many jurisdictions that have been examined by New Zealand policy-makers in the reform process. In Tasmania, New South Wales, Victoria, England and Wales, Florida, large publicly-owned water companies have a profit motive that supports achieving the desired regulatory outcomes. Price-quality regulation is only applied to not-for-profit utilities in a minority of cases. The analysis is contained in Appendix A.

Research into the question of how economic price-quality regulation works for publicly-owned, not-for-profit water utilities is rare. This is because there are few examples. However, a 2010 study examining five countries, found that price-quality regulation has done little to boost the performance of government-owned utilities, and those systems typically fail.³³

³¹ MBIE (2021), Economic regulation and consumer protection for three waters services in New Zealand, Summary Document

³² Discussion Paper, para 72.

³³ Ehrhardt, D, Janson, N (2010), Can Regulation Improve the Performance of Government-Controlled Water Utilities, Water Policy 12 Supplement 1 (2010) 23–40

4.2 Public ownership and sound governance of natural monopoly utilities can also improve consumer welfare

Public ownership is the obvious alternative to overcoming the monopoly problem in water services. Newbery (1999) points out that regulation and public ownership are alternative (not complementary) approaches:

*The conventional analysis of network industries starts from...market failure, which justifies regulation **or public ownership** to restrain prices...*³⁴

The success of the public ownership model in meeting the public interest (and achieving the commonly accepted objectives we outline above) depends on how the entity is governed, and the incentives inherent in the governance design. Success requires that the management is accountable to the body charged with governance, and therefore that management has suitable incentives to perform well. In New Zealand, elected councillors currently hold the council CEO and senior management to account for water services.

Success of the public ownership model also requires that the body charged with governance is also appropriately incentivised to meet the objectives. This should occur via elections, where elected members respond to the interests of voters (customers) and implement their wishes.

However, the accountability mechanism of public ownership often does not work adequately. There are four systematic conceptual reasons for this:

- Selective representation of customer needs: governments may represent the interests of some constituencies more than others. Poor or marginalised communities that do not have electoral representation can be overlooked
- Short-term political aims: Higher water tariffs are usually politically unpopular in the short-term, while longer-term deterioration in service quality due to longer-term decline in viability of the water provider is less noticeable. Short-term political motives can drive government owners to hold water tariffs below cost
- Capture of the utility for personal ends: The governance and management can inflate their own salaries or transfer resources to personal or party-political ends. Staff can engage in corrupt practices for personal enrichment
- Provider capture: The entity is co-opted to serve the commercial, ideological, or political interests of a particular constituency. This can include the service providers to utilities, or a particular profession.

Therefore, when designing the governance and regulatory framework for publicly-owned water utilities, it is important that the regime addresses these issues. In the remainder of this submission, we outline how the regulatory model cannot achieve the agreed objectives, given the chosen ownership and governance structure, and then how better options would enable a fit-for-purpose regulatory regime to work.

³⁴ Newbery, D. M., "Privatization, Restructuring, and Regulation of Network Industries". Cambridge, MA: MIT Press, 1999. p.2.

5 Regulatory model will not achieve objectives

The regulatory model anticipated in the Discussion Paper is incapable of achieving the outcomes sought for water services. Furthermore, it cannot be adapted due to the fundamental problems with the design and accountability framework of WSEs. The regime is unlikely to improve consumer welfare or lift economic efficiency. We explain why in the following.

5.1 Regulator will face challenges improving availability of relevant information

Information is required for a regulator to determine the efficient costs of the WSE. The information asymmetry between managers of monopoly utilities is compounded by idiosyncratic water sector regulation issues, and a current lack of accurate information in New Zealand.

The New Zealand regulator will have to gather information from highly complex WSEs, that themselves will attempt to hold and record information about a vast array of networks and local conditions. This will be a challenge for the proposed economic regulator.

Information asymmetry in water services

The typical economic regulation challenge is the information asymmetry between managers of the utility and the regulator. The managers have the best information about the utility, and know its costs and factors that influence prices. This challenge would apply to the WSEs here in New Zealand.

Idiosyncratic challenges in water sector

Water services are highly idiosyncratic. Regulating water services is a different challenge from the experience that New Zealand policy-makers are familiar with in electricity, gas and telecommunications. Water networks are designed around natural features—access to water sources for drinking water, and access to suitable locations to treat wastewater and dispose of it. This is why networks are local, and do not extend over long distances, unless serving a contiguous urban area.

Exposing information for regulatory purposes from water service providers, therefore, has unique challenges. The regulator will need to independently judge whether the WSEs costs are fairly attributable to the different topographies, geographies, water sources and so on that will apply differently in across its jurisdiction. This is different to other utility regulation, like electricity, which has fewer idiosyncrasies.

New Zealand-specific challenges compound challenges to obtain information

However, there are additional challenges in New Zealand. There is a lack of relevant and accurate information on the current value and state of water assets and networks. There is also limited information on the volumes of water consumed (or lost as non-revenue water). A large number of water networks in New Zealand remain unmetered.

The management of proposed WSEs will have very poor information for the first few years of the regulatory regime. Managers will struggle as they have to integrate information from multiple legacy local authority water services.

New Zealand water services have also not accurately calculated the cost of service. In some cases, the financing related to water assets is not clearly linked. Local authorities have raised finance for general purposes. Opex can be shared across different local government functions. Given the existing information, there is less scope for a regulator to drive efficiencies than in, for example, the electricity sector.

5.2 Regulator will have issues incentivising management and governance to optimise costs and quality of service

Regulation should mimic the pressures that competition provides in other markets. Regulation should make providers offer services that customers want at reasonable prices. Reasonable prices are prices that cover the reasonable cost of service, including a reasonable return on capital used, but no more. To get a corporation (even a publicly owned one) to behave as if it were in a competitive market requires incentives on the people working in the organisation—principally, management.

5.2.1 Price-quality regulatory model will not incentivise management to be efficient

Typically, price-quality regulation incentivises management to improve efficiency by setting the prices that water utilities can charge at a level that reflects reasonable costs. Under the discussed price-quality model, the regulator would set a price or revenue cap at the level of the water utility's expected reasonable costs, based on the cost of capital, plus depreciation and operating expenses, and allow the utility to retain any outperformance against the allowances. Therefore, in profit-seeking entities, the management has an incentive to reduce costs because cost savings translate into higher profits.

However, the WSEs do not have a profit motive. There will be no commercial incentive to reduce costs (or increase revenues). Managers will receive no rewards for innovating, finding ways to save resources, or the myriad of other efficiencies that profit-maximising managers might identify. In fact, managers might even be incentivised to increase some costs, which we discuss below.

5.2.2 Regulatory model could risk tariffs remaining too low

In profit-maximising water utilities, the dominant incentive is to increase tariffs to increase profits. Without a profit motive for WSEs, there is no basic incentive to increase tariffs. This is a problem for the proposed New Zealand WSEs because, in some cases, local authorities failed to charge tariffs that cover the cost of service. This is one of the government's justifications for sector reform.

Therefore, the regulator will need to actively monitor tariff-setting to ensure that tariffs are set at a level that covers cost. This is an unusual position for a New Zealand regulator, yet it is not acknowledged in the Discussion Paper as a possible outcome, nor are any options discussed for addressing this issue. We are happy to discuss international examples of this problem with MBIE to ensure policymakers are receiving the full range of global evidence.

Those tasked with governance of the WSEs, at any level of the four layers between voters and WSE management, could have incentives to keep tariffs low. This is a particular risk given the significant cross-subsidies that will exist. Voters in metropolitan areas that experience tariff rises due to the need to cross-subsidise costlier rural water services may put pressure on elected MPs or Ministers (who can influence the National Policy Statement content), or on local councillors for lower tariffs. Unless the regulator itself initiates tariff increases, even in the absence of WSE's proposing such increases, typical price or revenue cap regulation may prove ineffective.

5.2.3 Regulator can inadequately monitor over-spending or corruption

The WSEs will control substantial resources, and will access significant new capital for the claimed new investment (up to \$180 billion over 30 years is claimed). The not-for-profit WSEs have no in-built incentive to focus management attention on lowering costs and identifying innovative processes. Without such a profit-motive, and because the WSEs will be large with myriad reporting mechanisms and accountabilities, the incentive and opportunity will arise for individuals to overspend or even engage in corrupt practices. While rare, blatant corruption can occur in New Zealand.³⁵ Much larger budgets and more complex accountability mechanisms is likely to increase opportunities for corrupt practices.

New Zealand's economic regulators are unaccustomed to monitoring such conduct.

5.2.4 Uniform tariffs can hide inefficiencies

The government promotes tariff harmonisation as a feature of the proposed WSEs. It claims it is desirable that tariffs will be the same between low cost and high cost of service areas. This makes the task of effective economic regulation difficult for a regulator.

The regulator will be required to understand the differences between idiosyncratic networks to be able to judge whether costs are justified. However, the regulator will be unable to analyse price differences between localised networks because tariff harmonisation is a feature of the WSEs. The large-scale tariff harmonisation of the sort proposed will create opportunities for inefficiencies and improper conduct to be concealed because both the governance bodies and regulator will be unable to monitor it.

There are significant differences in the cost of service between different local authorities. The highly idiosyncratic nature of water networks means costs can vary greatly between different parts of New Zealand. There are different costs associated with the features of natural water sources. For example, Christchurch has 150 water bores around the city that feed the network whereas Auckland takes water from two large dams and the Waikato river. Topography influences costs as pumping requires a lot of energy—hillier areas have higher energy costs. Typically, more rural areas have a higher average cost of service due to dispersion of population.

In infrastructure regulation, zonal pricing recognises that the location of consumers, particularly relative to production facilities, can affect the cost of service. Zonal pricing can

³⁵ For example, the Murray Noone and Stephen Borlase case where a local authority manager colluded with a supplier on roading contracts and received undisclosed payments and gratuities. See: [https://www.rnz.co.nz/news/national/325076/pair-jailed-over-\\$1m-bribery-case](https://www.rnz.co.nz/news/national/325076/pair-jailed-over-$1m-bribery-case)

enhance the efficiency of the utility. However, the government has specifically ruled out WSEs being able to charge zonal prices.

Typically, a regulator can add value by monitoring that zonal prices reflect costs, and that different parts of the utility are not cross-subsidising others. Since the regulator cannot perform this function, it makes little sense to pay the regulatory costs.

5.2.5 Regulator has no viable way to enforce breaches

As the Discussion Paper notes, “[e]ffective compliance and enforcement is essential for any regulatory regime to achieve its purpose and objectives.”³⁶ Effective regulation requires the ability to reward good performance and punish poor performance. The purpose of the warnings, reprimands, injunctions, orders, financial penalties and criminal penalties listed in paras 136-139 of the Discussion Paper is to incentivise management and governance to provide the services at least cost for a fair price.

As the Discussion Paper notes, conventional civil penalties are likely to be ineffective in addressing WSE misconduct due to a lack of profit motive. Indeed, the costs of any sanctions will ultimately be borne by customers. If the regulator punishes a WSE for inefficient performance by refusing a tariff increase, the WSE will have to cover the deficit through retained funds, or cut back on service. In either case, the consumer suffers. While, in theory, this might result in the WSE board changing management, or the RRG influencing the ISP which may then replace board members, in reality it is likely that repeated breaches would be needed to prompt any action.

5.3 Regulator cannot adequately address socio-cultural outcomes

The economic regulator will be required to monitor the socio-cultural outcomes sought from these reforms. It is an inevitable consequence that the regulator will have to judge the trade-offs between different values. An economic regulator is ill-suited to the role of determining whether investments and tariffs are appropriate in light of socio-cultural objectives.

In MBIE’s view, it “*is an open question as to whether the economic regulator should have regard to a broader range of objectives, including things such as Te Mana o te Wai (the vital importance of water) and climate change.*” However, in economic theory, and in practical reality, the economic regulator will be unable to escape having to evaluate the WSEs’ choices between different socio-cultural objectives.

Improving the performance of water utilities is generally cost-benefit justified, but not Pareto efficient. In other words, there are winners as well as losers. The regulator is tasked with defining the level of productive efficiency—best service for least cost. The regulator therefore has to understand how to value the socio-cultural matters that will be traded off.

The WSE will have to evaluate its investment decisions *ex-ante* (before investing). This will involve weighing up complex socio-cultural matters against customers’ diverse demands and interests (and groups of customers). For example, a wastewater treatment scheme discharge may require design features to realise Te Mana o te Wai outcomes. There will inevitably be

³⁶ Discussion Paper, para 136.

choices about different designs to address the problem, with different costs and different benefits. Each WSE will have to carry out an ex-ante evaluation and justify its decisions to the regulator.

This will be complex. The WSEs will be required to make investment decisions that reflect the different needs of over 60 Iwi (for Entity B), and many more hapu groups. As the Government itself acknowledges, to realise the objective of improved kaikiakitanga, the WSE will have to connect governance with delivery on the ground at a hapū/whānau level.³⁷

There are risks the regime reflects interest group politics

We have established that regulators will face challenges determining whether the WSE's decisions are cost-benefit justified. This, in turn, gives rise to risks that political incentives may emerge for the WSE's management to suggest investments for board approval that serve particular interest groups.

For example, the WSEs are required to prioritise investment in rural communities. This creates an incentive to expand or upgrade networks in some places, whether or not that is justified on a cost-benefit basis or under the direction received under the accountability mechanisms. This can be at the expense of other investments that meet objectives for lower cost. Incentives to secure political support will follow.

5.4 Costs of regulation likely to materially exceed benefits

New Zealand regulatory law and practice requires that regulation is only imposed where the benefits of regulation materially exceed the costs.³⁸ The highly complex, unworkable, nature of the proposed WSE governance structure and how it interacts with the economic regulator will impose additional costs than would be necessary if a different governance regime were chosen. The regime also materially reduces the scope for creating benefits through regulation.

The net result of the regulatory regime proposed in the Discussion Paper will be a system that is unlikely to be net-benefit justified. Customers will receive fewer benefits for more costs compared to if the ownership and governance structure was better balanced with regulation. The deficiencies will require extensive adjustments and additional investment in the economic regulatory regime. However, the regime cannot be improved to adequately regulate the sector. If it proceeds, future attempted changes will become necessary, which impose additional costs.

³⁷ DIA (2021), Departmental Regulatory Impact Assessment, Decision on the reform of three waters service delivery arrangements, p. 296

³⁸ For example, Section 52G Commerce Act 1986

6 Public ownership and governance model must be improved to enable effective economic regulation

The proposed ownership and governance of the WSEs will prevent economic regulation from being effective. Instead, the governance structure needs to be improved to a more direct relationship between customers, voters and those tasked with governance and management of the WSEs.

We outline how Castalia is working with Partner Councils on developing options that provide a better governance regime. This will then enable fit-for-purpose regulation to work.

6.1 Other public ownership and governance options deliver direct accountability

In parallel to this submission, Castalia has prepared an analysis of options to structure the New Zealand water reforms. In that analysis, improved public ownership and governance models are identified that provide more direct accountability between consumers. The Castalia analysis highlights how two options can address local and central government's shared objectives for safe, environmentally sound, resilient, customer-responsive water services at least cost. The detailed analysis will be available shortly.

In summary, two options would provide customer accountability, and drive appropriate incentives of governance and management. These are the "Partner Council Options":

- **Council-owned plus regulation:** Amending the current local authority-owned and operated model with targeted interventions to address financing, funding constraints and credible enforcement mechanisms from water quality, environmental and economic regulators
- **Council-owned organisation:** Local authorities would own shares in a regional organisation. The local authorities would remain democratically accountable to voters (and water customers), and would exercise appointment rights over the organisation board. The organisation would own and manage the three waters service for the area.

In both Partner Council Options, the improved models remove the multi-layered governance and appointment systems, as well as the competing priorities in performance accountability instruments. This is all replaced with simple democratic accountability of elected councillors. This would be supported by the regulatory regime which sets and enforces minimum quality standards, environmental outcomes, and economic performance benchmarks.

In the remainder of this section, we explain how an improved economic regulation regime would work with the Partner Council Options.

6.2 Information disclosure and benchmarking would support public ownership model

If one of the proposed Partner Council Options is pursued, then an information disclosure regulatory regime would be appropriate. It would already be a significant improvement on the status quo.

Information disclosure should include relevant, timely and understandable cost, revenue and quality metrics which is standard between water entities

This would require water service providers (whether local government or regional corporation-owned) to disclose the costs of service, revenues, and other performance metrics. Such information would provide all levels of management, governance and the ultimate owners (the public) with information about how the utility is performing:

- Utility management can assess performance of different functions within the organisation
- Those tasked with governance (councillors or the board) would have information to understand how the utility and its management is performing
- Ultimate owners and customers (the public) would be able to evaluate the performance of their elected representatives.

However, it is important that the information disclosed is relevant, timely and understandable. Therefore, imposing regulatory standards for the information to be disclosed is important. Standardised disclosures of asset values, investment plans, financing and other opex provides basic information about costs. Water quality monitoring results, environmental performance, customer complaint records, outages and similar information provides basic information about service quality.

Benchmarking is a critical tool to lifting performance

Benchmarking involves the economic regulator publishing the information gathered and presenting it in a way that enables comparison between utilities. Benchmarking should enable voters, customers and elected officials to understand the performance of utilities, and also insights into what is possible in the way of service and efficiency. OFWAT benchmarks the water and sewage companies and water-only companies in England and Wales, enabling comparison. As MBIE notes, the New Zealand Commerce Commission benchmarks EDBs in terms of quality of service and costs.³⁹

Information disclosure has performed very well in New Zealand for customer-owned EDBs

Information disclosure already performs very well in New Zealand. An empirical analysis published in the globally respected *Energy Economics* journal in 2020 found:⁴⁰

[E]mpirical analysis of New Zealand EDBs suggests customer ownership is associated with lower prices, and also with higher quality, efficiency and welfare. These empirical findings are comparable with those of Kwoka (2005a), who found public ownership – rather than

³⁹ Figure 4 in the Discussion Paper shows that the 12 EDBs subject to information disclosure-only regulation have a similar performance to those also regulated for price and quality.

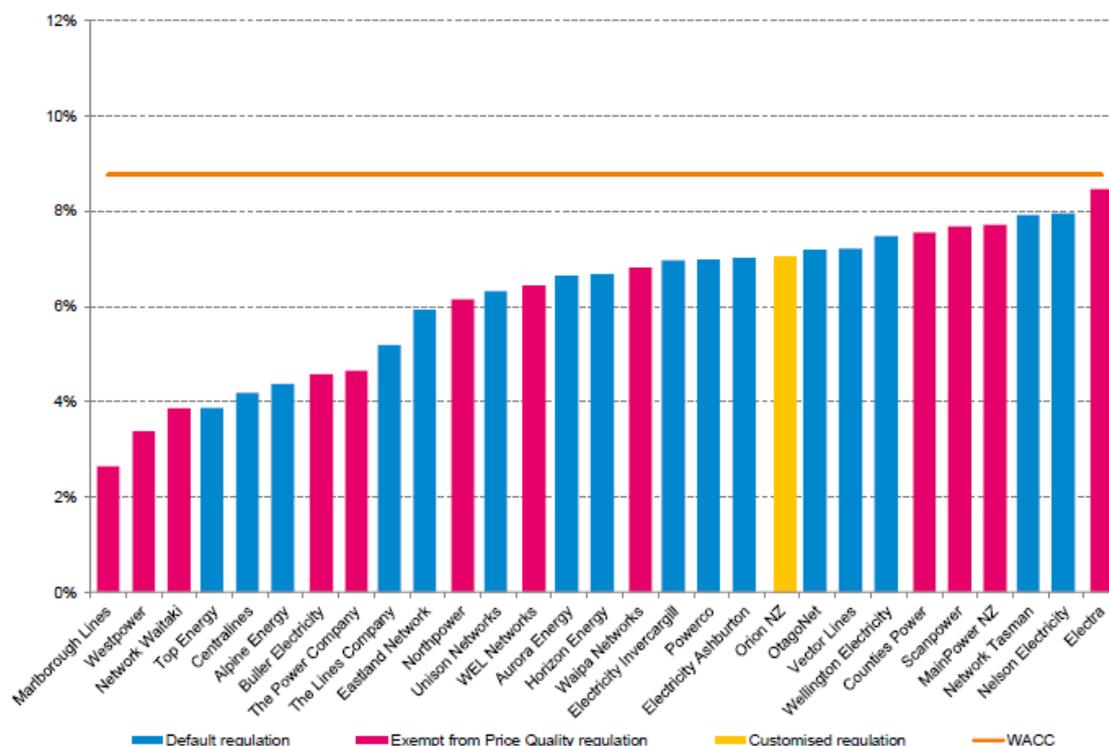
⁴⁰ Meade, R, Söderberg, M, (2020), Is welfare higher when utilities are owned by customers instead of investors? Evidence from electricity distribution in New Zealand, *Energy Economics*

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customer ownership per se – of US electric utilities to be associated with lower costs and higher quality relative to investor ownership.

Analysis in the government’s Electricity Review (overseen by MBIE) at Figure 6.1 also shows that the profits of the 12 EDBs subject only to information disclosure were not structurally dissimilar from the EDBs subject to information disclosure and price-quality regulation.

Figure 6.1: EDBs’ profits compared with 8.77 percent WACC (2013–15)



Electricity Price Review, First Report for Discussion (2018)

This evidence is consistent with the economic theory and the policy rationale that justifies for the regulatory regime for customer-owned EDBs. Where customers have direct accountability is that because of customer ownership, a reduced regulatory burden is sufficient.

6.3 Better governance can enable incentive-based regulation

Improving the ownership structure and governance of water service entities can improve the incentives on governance and management. The best outcomes from government economic oversight and regulation occurs when regulatory interventions work hand-in-hand with the underlying incentives of the owners of the regulated firms.

If an appropriate governance model is confirmed—in line with Castalia’s analysis for Partner Councils—the regulatory model will be able to work better. This is because the incentives of

governance and management of future water entities will be better aligned with the interests of customers.

The key desirable incentives that improve outcomes are:

- Incentives to charge reasonable tariffs
- Incentives to improve efficiency and provide a service that reflects consumer demands
- Incentives to share benefits of any efficiency savings with customers
- Incentives to innovate and invest in replacement, upgraded and new assets.

6.3.1 Better governance and targeted regulation will align incentives with reasonable tariffs

There are limited incentives on publicly-owned water utilities to impose high and extractive prices on customers (who are also voters). The regulatory system, therefore, needs to provide the conditions for prices that recover the cost of service, for the services at the quality and the cost that citizens want (subject to meeting safety standards).

The regulator can assist by identifying the optimal trade-off between cost and quality. It can use the business plans disclosed to it under information disclosure to ensure that services are provided at a quality and cost that citizens want, and to optimize the trade-off between cost and quality. The real value of such an exercise for publicly-owned entities would be in helping customers (voters) and elected decision-makers understand what is reasonably possible. The regulator could publicise the consequences of failing to set adequate tariffs in the form of deteriorating assets and service.

6.3.2 Better governance can ensure incentives to improve efficiency and provide a service at a quality that reflects consumer demands

In principle, firms in natural monopoly industries have a strong incentive to minimise costs and ensure productive efficiency, because their owners wish to maximise surplus available to them. Hence, even in the absence of competitive pressures, owners have no incentive to permit waste. This is true of both investor-owned and consumer-owned firms: investors wish to earn the greatest profits, while consumers wish to take advantage of the lowest possible prices. Modern economic literature, however, highlights the fact that managers and workers do not share the owners' objectives.⁴¹ Managers may prefer an easy life, or may have other objectives, which would tend to raise costs and reduce productive efficiency. In competitive industries, managers face both direct supervision from business owners and pressure from competitors. Investor-owned utilities also face take-over threat, which in principle puts management at risk of being replaced. This combination serves to align their behaviour with the interests of owners.

⁴¹ Jensen, M. and Meckling, W. "Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure", 1976. *Journal of Financial Economics* 3. pages 305-60; Buchanan, J. M., & Tullock, G. (1965). *The calculus of consent: Logical foundations of constitutional democracy* (Vol. 100). University of Michigan press, Von Mises, L., & Morris, R. (1944). *Bureaucracy* (p. 47). New Haven: Yale University Press; Niskanen, W. A. (2017). *Bureaucracy & representative government*. Routledge; Dunleavy, P. (2014). *Democracy, bureaucracy and public choice: Economic approaches in political science*. Routledge. We note that MBIE confirmed by e-mail to Castalia that it cited this literature for its para 19 of the Discussion Paper.

In natural monopoly industries, the absence of competitive pressures may give managers more leeway, allowing them to be less efficient. For this reason, regulators often believe that their interventions can contribute to productive efficiency of regulated firms, over and above the pressure from the owners.

However, this is not always true for consumer-owned or public firms. It is difficult for regulators to construct the cost models which are supposed to reflect efficient costs of an efficient firm.⁴² By setting prices with reference to those efficient costs, regulators force managers and owners of regulated firms to recognise gaps in performance—a regulated firm which is not able to earn reasonable returns at regulated prices would, by definition, be less efficient than the benchmark used by the regulators. Hence, this gap would provide owners with the information needed to demand improved performance from managers.

A consumer-owned or publicly-owned water entity will have as much incentive as the regulator to set prices which maximise consumer surplus. This would improve allocative efficiency.

Finally, if the governance and ownership structure delivers the closer alignment of customers, owners, governance and management, it can be a good mechanism for ensuring that the price-quality trade-offs selected by the distributor reflect those desired by its consumers.

6.3.3 Ensure benefits of efficiency gains shared with consumers, including through lower prices

Publicly-owned or consumer-owned water entities, with the governance changes Partner Councils seek, can ensure that benefits from efficiency gains are passed on to customers, rather than dispersed among management (through inefficiencies or inflated salaries) or particular sub-sets of customers. Even if earnings are not distributed as dividends, retained earnings benefit consumers through enhanced services, or reduced future borrowing.

There are a number of ways to align incentives to ensure efficiency gains are shared with consumers. The Castalia advice on Partner Council Options is the first step in identifying the appropriate model for the sector. Thereafter, the economic regulation mechanisms that align the incentives for efficiency gains with the optimal ownership and governance model should be explored.

6.4 Better governance can reduce costs of regulation

By aligning the incentives of public ownership and accountability to the public through governance mechanisms, the costs of regulation can be reduced. Under the government's proposed WSE model, the regulator would have to assess each WSE's business plans and costs against efficiency benchmarks. The regulator also has to overcome the information gaps it has in understanding the highly complex networks and competing socio-cultural and efficiency objectives of each WSE.

New Zealand regulators have experience regulating almost 30 EDBs, and using cost-effective tools to do so where governance is accountable to customers. There is every reason to expect

⁴² Or by using benchmarking, which is supposed to reflect efficient prices.

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that a regime that balances ownership and governance with regulatory tools can achieve a similar cost-effective outcome in water services.

Appendix A: Analysis of economic regulation in selected jurisdictions

Table A.1: Analysis of economic regulation in selected jurisdictions

Jurisdictions (Entity name)	Economic regulator	Total entities	Number of customers (range)	Profit motive	Tariff setting	Monitor and enforce tariffs	Monitor and enforce service standards	Water quality, Environmental protection
Tasmania (TasWater)	Office of the Tasmanian economic regulator	1	522,000	Yes	Sets tariffs	Yes	Yes	Public Health Services, Environmental Management and Pollution Control Act
New South Wales	IPART	5	600,000 – 5,000,00	Yes	Sets tariffs	Yes	Yes	WaterNSW, NSW Department of Planning, Industry and Environment
Victoria	Essential Services Commission (ESC)	15	17,265 – 839,516	Yes	Sets price caps	Yes	Yes	Environmental Protection Authority, Department of Environment, Land, Water, and Planning, Department of health and human services (drinking water quality standards)
Scotland (Scottish water)	WICS	1	5,000,000	No	Sets price caps	Yes	No	Drinking water quality regulator (DWQ), Scottish Environment Protection Agency (SEPA)

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England and Wales	OFWAT	32	Over 50 million	Yes	Sets price caps	Yes	No	Drinking water inspectorate, Environment Agency
Ireland (Irish water)	The commission for regulation of Utilities (CRU)	1	1,800,000	No	Reviews and approves tariffs	Yes	Yes	Environmental protection agency (EPA)
Florida	Florida Public Service Commission	147	Up to 2,000,000 customers	Yes (for Investor-Owned Utilities)	Sets tariffs	Yes	Yes	US Environmental protection agency (EPA), Florida Department of Environmental protection (FDEP)
Jamaica (National water commission Jamaica)	Office of utilities regulation (OUR)	National water commission, other water and sewerage providers, and national irrigation commission	2,000,000	No	Sets tariffs	Yes	Yes	None
Columbia	'CRA' and 'Basic sanitation regulatory commission'	Numerous entities (High degree of fragmentation)	Wide range	Yes (for private/public stock corporations)	Sets tariffs	No ⁴³	No	Vice Ministry of water and sanitation defines sector standards. Multiple regulators (CEA, SSPD, Basic sanitation regulatory commission)

Sources: *TasWater, ESC, IPART, OFWAT, WICS, OUR, CRU, Scottish Water, Irish Water and Castalia research*

⁴³ Enforced by Superintendencia de servicios Publicos Domiciliarios (SSPD).

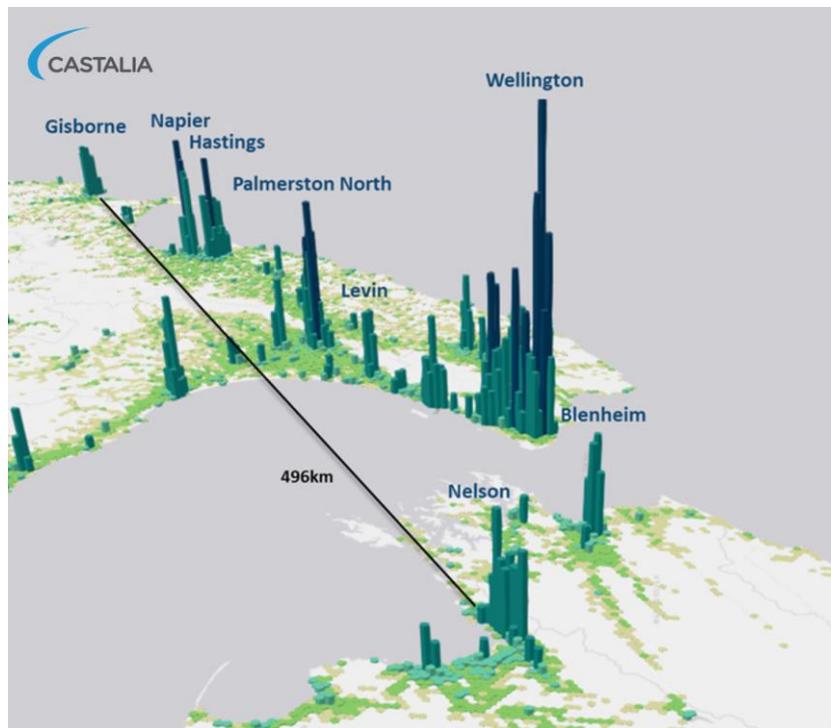
Appendix B: Maps of Water Service Entities and population centres

Figure B.1: Cities and towns in Entity A with population densities



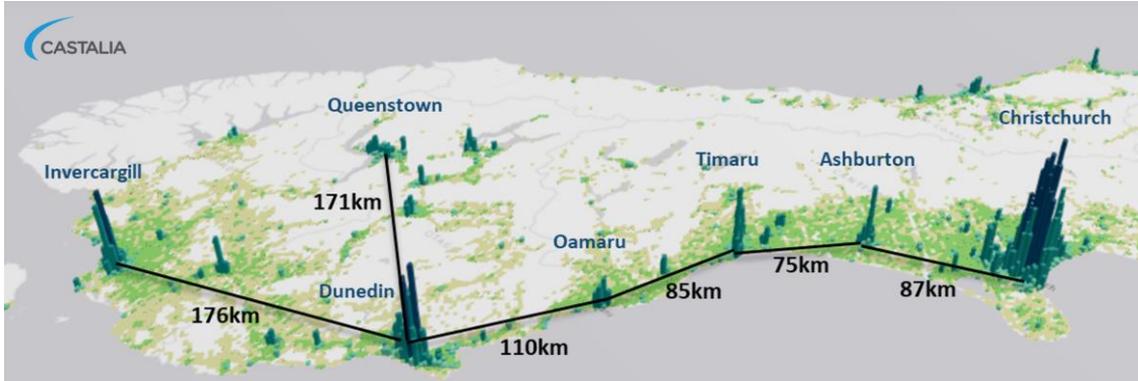
Castalia adapting Statistics New Zealand visualisation

Figure B.2: Cities and towns in Entity C with population densities



Castalia adapting Statistics New Zealand visualisation

Figure B.3: Cities and towns in Entity D with population densities



Castalia adapting Statistics New Zealand visualisation



Castalia is a global strategic advisory firm. We design innovative solutions to the world's most complex infrastructure, resource, and policy problems. We are experts in the finance, economics, and policy of infrastructure, natural resources, and social service provision.

We apply our economic, financial, and regulatory expertise to the energy, water, transportation, telecommunications, natural resources, and social services sectors. We help governments and companies to transform sectors and enterprises, design markets and regulation, set utility tariffs and service standards, and appraise and finance projects. We deliver concrete measurable results applying our thinking to make a better world.

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Communities **4** Local Democracy
He hapori mō te Manapori

**Fresh ideas.
Better water.**

Appendix 4

C4LD Letter to Members of Parliament

26 April 2022

Member of Parliament
Parliament Buildings
WELLINGTON

By email

Dear

ALTERNATIVE PROPOSAL TO ADVANCE THREE WATERS REFORM

The Government intends to soon introduce into Parliament a Bill that will reorganise extensively the Three Waters sector (drinking water, wastewater, and stormwater) in New Zealand.

The purpose of this letter is to outline to you as a Parliamentarian who soon may be considering that Bill, the views of the member Councils of Communities 4 Local Democracy - He hapori mō te Manapori ("C4LD") on the Government's proposals.

C4LD is comprised presently of 32 Partner Councils, representing approximately 1.4 million people. We came together to work collectively to find a better way to achieve the health and environmental outcomes that most people desire. However, quite apart from the Partner Councils of C4LD, there are many other councils that do not support the Government's mandated four entity model. Most notably Auckland Council, representing another 1.7 million people.

In this letter we set out the broad parameters of an alternative set of reform proposals which would achieve the health and environmental policy outcomes that most parties agree are desirable. It is our view that the set of proposals outlined in this letter are likely to achieve multi-party support in Parliament; indeed, this is an outcome we are prepared to champion with all Members of Parliament.

Without multi-party support the Government's proposed reforms will not be durable. Without regulatory certainty there cannot be investment certainty. Without investment certainty there will not be investment. Such an outcome accordingly fails the chief measure of success for any set of infrastructure policy reform. The result is that needed improvements to health and environmental settings will once again be delayed.

We presented our alternative proposal to the Minister of Local Government Hon Nanaia Mahuta and her officials when we met at Parliament on the 4th of April and followed this up with a letter.

Our alternative proposal has 10 high-level components. They are:

1. Foundation principle - community property rights in Three Waters assets are to be both respected and meaningful;
2. The Government should agree to amend its current reform process and allow time for the revised approach to be reflected in draft legislation;
3. With respect to investment decision-making, asset owners should be required to actively seek to initiate authentic discussions with mana whenua at a local level that consider co-

design and partnership arrangements that acknowledge and enable Te Tiriti based pathways at a local and regional level;

4. In return, asset owners agree to commit to meeting health and environmental standards, once known, within an appropriate timeframe (for this reason we fully support the drinking water regulator Taumata Arowai);
5. The regulatory framework should specify a “backstop” provision that identifies a set of circumstances which would justify future Crown intervention if an asset owner was not making acceptable progress towards meeting those regulatory requirements;
6. Progress should be reported on annually by asset owners and be benchmarked across the sector;
7. To further incentivise sector progress, a formal process might be established that requires an asset owner to prepare a plan for ministerial approval that would map out the steps it proposes to take to meet the required standards in a financially viable and sustainable manner (a similar process that respected property rights was used in the Energy Companies Act 1992);
8. A process to finance and allocate funds to areas that will require financial assistance, be designed that is national in application and independently administered accordingly to objective and transparent criteria (this is consistent with the recommendation of the Productivity Commission in November 2019);
9. This subsidy scheme will be designed to meet investment shortfalls until such time as sufficient progress has been made. At which point the scheme will cease and asset owners will finance matters on a business-as-usual approach; and
10. A sector-wide sector best-practice improvement process be created and membership made compulsory (in similar manner used to implement successfully the One Network Road Classification Framework and now One Network Framework in the road infrastructure area; and governed by Waka Kotahi (NZTA) and the Local Government Sector).

Our analysis ([Attachment 1](#)) prepared by our independent consultants, Castalia, shows that alternative structural arrangements to that proposed by the Government are perfectly capable, and in most cases, more capable, of achieving the desired policy outcomes. Importantly, these alternative structural arrangements protect local voice, respect community property rights, and just as importantly, are a far more effective protection against privatisation than any legislation which could be easily unwound by a future Parliament. As we all know, a current Parliament cannot bind a future Parliament.

We propose two broad approaches:

1. A regional multiply-owned council water enterprise. Such an approach would achieve the Government’s goal of balance sheet separation provided no one council owns more than 50% of that enterprise. This is specifically provided for in International Financial Reporting Standard 10. The proposed Hawkes Bay regional model is a good example of the type of enterprise that could be established and which would have local community support; and
2. A single council owned water enterprise. We accept that this option would not achieve balance sheet separation. Accordingly, we think proponents of this approach would have to satisfy the Government of the day that it would be backed by a financially viable investment plan (using the proposed process noted above). But in principle, if a single-council owned entity is viable and could achieve the health and environmental outcomes required, then a Government ought to be agnostic about organisational design, particularly for assets it neither owns nor is proposing to purchase.

Mana whenua involvement in investment decision-making (as opposed to regulatory decision-making) is a key aspect of the reforms for the Government. The Partner Councils of C4LD support that objective consistent with the protection of both local voice and community property rights. However, in our view, the Government's proposal will not reflect local realities and communities of interest and, importantly, iwi and hapū rohe and areas of interest, in most parts of the country. We consider that a more local approach gives better representation to mana whenua, particularly in the North Island where there are very many iwi and hapū.

We are conscious that there is significant and mischievous comment currently circulating about C4LD's approach to mana whenua involvement in investment decision-making. We reject categorically such comment. To clarify matters, Partner Councils have prepared the attached statement ([Attachment 2](#)) which clearly sets out our position.

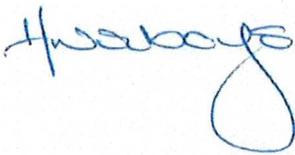
C4LD believes that Three Waters assets should continue to be owned by communities through their councils either directly or through real shareholding arrangements that confer the usual rights and obligations that go with equity ownership. The Government's approach does not do that. Further it is our view that the Government's approach amounts to the expropriation of council assets without true value compensation. We note that this matter is at issue in the litigation being pursued by some councils at present.

The Government's proposals are widely opposed across the country. Whilst presently, the Government has the Parliamentary majority to achieve its preferred position, this does not mean that the position is durable. It is not. Opposition Parties have already publicly committed to repeal any such legislation. Our preference, and we think the country's preference is to achieve a multi-party and durable approach. In our view our proposal can achieve that with your support. We commend it to you.

It is not too late to rectify matters. We are not that far apart in our objectives. Indeed, what we are offering in our 10 point plan is an approach that we believe would achieve broad support. We are prepared to partner and work with the Government and all political parties to turn this around and find a lasting solution that we can all support.

We would be happy to meet with you to further explain the detail of our alternative approach to Three Waters reform if you would find that helpful.

Yours sincerely



Mayor Helen Worboys
Manawatu District Council
Chair
helen.worboys@mdc.govt.nz



Mayor Dan Gordon
Waimakariri District Council
Deputy Chair
dan.gordon@wmk.govt.nz

Att 1: *Castalia Improved Options for Three Waters reform January 2022*

Att 2: *Communities 4 Local Democracy - He hapori mō te Manapori (C4LD) Position on Iwi Māori Partnership*



Improved options for Three Waters reform

Report to Communities for Local
Democracy

JANUARY 2022



Contents

Executive summary

Shared objectives for Three Waters reform

Policy process for Three Waters reform has been flawed

Criteria to evaluate options

Three options for Three Waters:

- **Council-owned plus regulation and financing changes**
- **Council-owned enterprise**
- **Government's mega-entity proposal**

Results of evaluation

Appendix A: DIA's objections to alternative models are misguided

Appendix B: Evaluation criteria in detail

Executive summary—part 1

There is a case for change—very clear problems in some localities with three waters regulation, investment and delivery

Critical wellbeing issue—local and central government, mana whenua and communities share the same objectives

Reform process has been flawed—premature selection of “mega model” without properly considering available evidence and alternatives

Credible alternative models deserve analysis—local authorities are now providing this constructive assistance

Executive summary—part 2

Castalia’s assesses alternative models against neutral criteria—
already accepted by Joint Steering Committee

Castalia reviewed three models across a spectrum—all assume:

- Robust regulatory framework, with “backstop”
- Raised water quality, environmental and financial performance standards
- Good faith, facilitative role of central government



Executive summary—Evaluation results

	Council-owned plus regulation	Council-owned enterprise	Mega-entity proposal
 Accountability to customers			
 Iwi-Māori partnership			
 Management and operational performance	 → 		
 Incentives of management and governance			
 Access to financing	 → 		
 Scale and scope efficiencies	 → 		
 Flexibility for the future			
	Improvements achieved with targeted regulation design	Fit-for-purpose regulation will support outcomes	Regulation cannot solve the fundamental flaws

Key:  = Change from targeted design improvement

Shared objectives for Three Waters reform

Local government's objectives are consistent with the government's:



Provide safe water services



Iwi/Māori outcomes improved



Lift resilience and reliability



Ensure water service provision and tariffs are fair



Improve customer responsiveness



Services at least cost



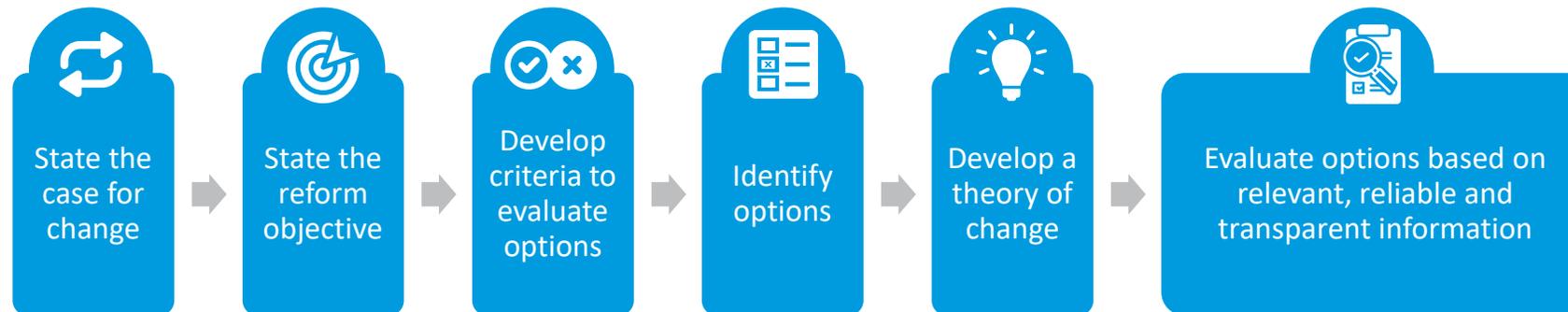
Improve environmental outcomes

Major policy change deserves proper process

Water services are critical to wellbeing

It is important to carry out a proper policy process with agreed objectives which **fairly** assesses available options using relevant, reliable and transparent information

Standard policy process:



Unfortunately, standard policy process has **not been followed**. A preferred entity design was chosen before options properly identified and evaluated.

Evaluation criteria for water reform options

Local government provided neutral evaluation criteria that Joint Steering Committee had no objections to (expanded in Appendix B):



Is the water delivery service **accountable to customers**?



Will the reform option **improve iwi-Māori partnership**



Does the option **improve competence of management and operations**?



Are the **incentives of management and governance aligned** with objectives?



Are providers able to **reliably raise the finance** needed for investment?



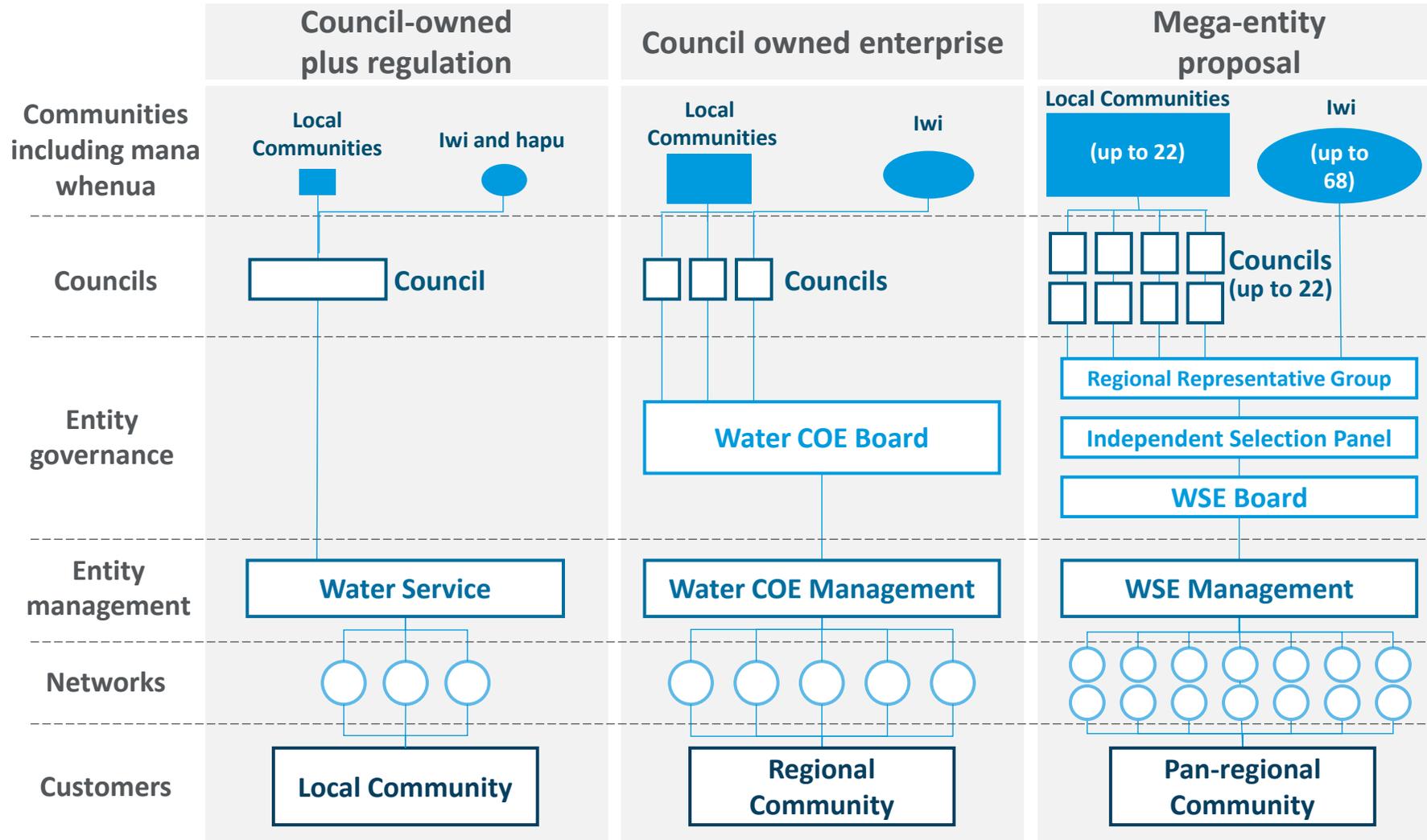
Does the option achieve **economies of scale and scope**?



Will the option be **flexible and adapt to change and new information**?

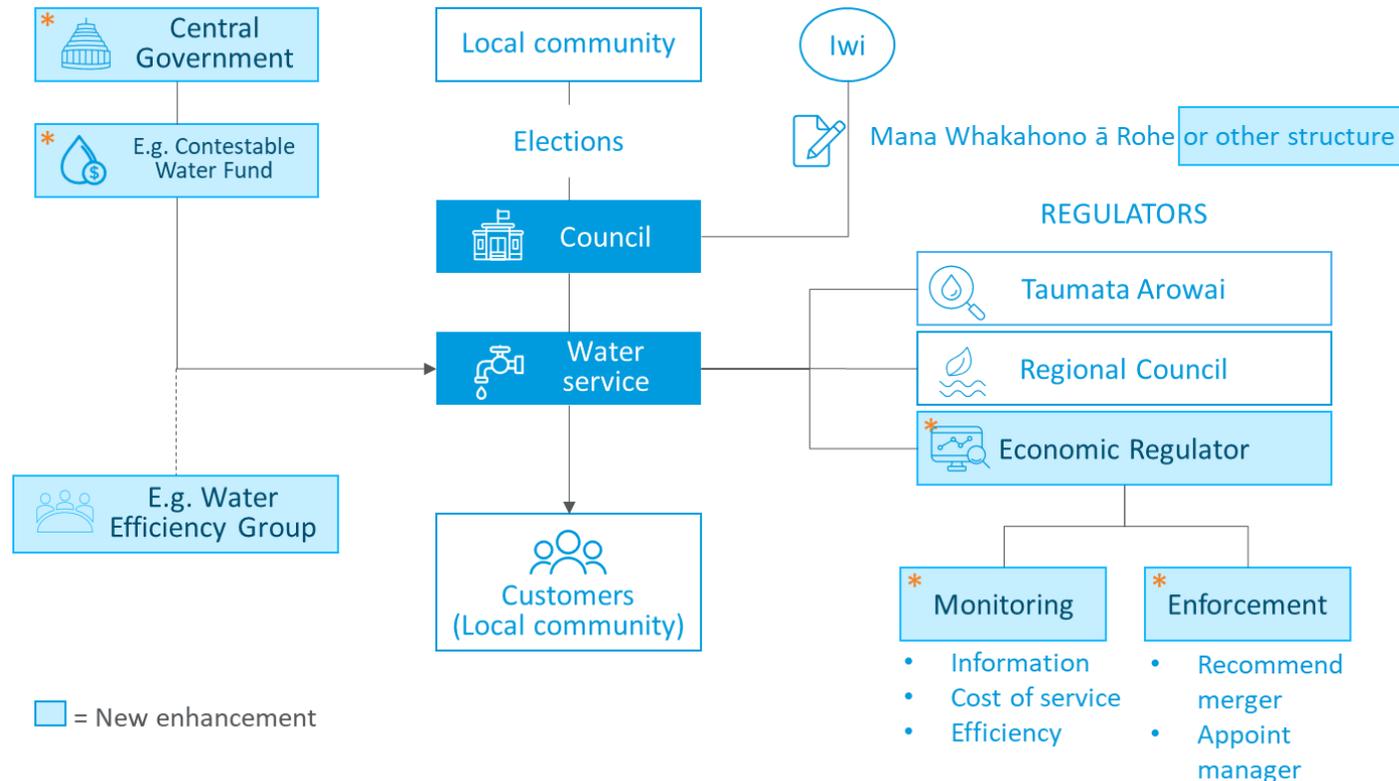
- See: Castalia (2020), Parameters for Parameters for Evaluating Aggregated Water Service Delivery Models, released by LGNZ

Castalia evaluated three models across a spectrum



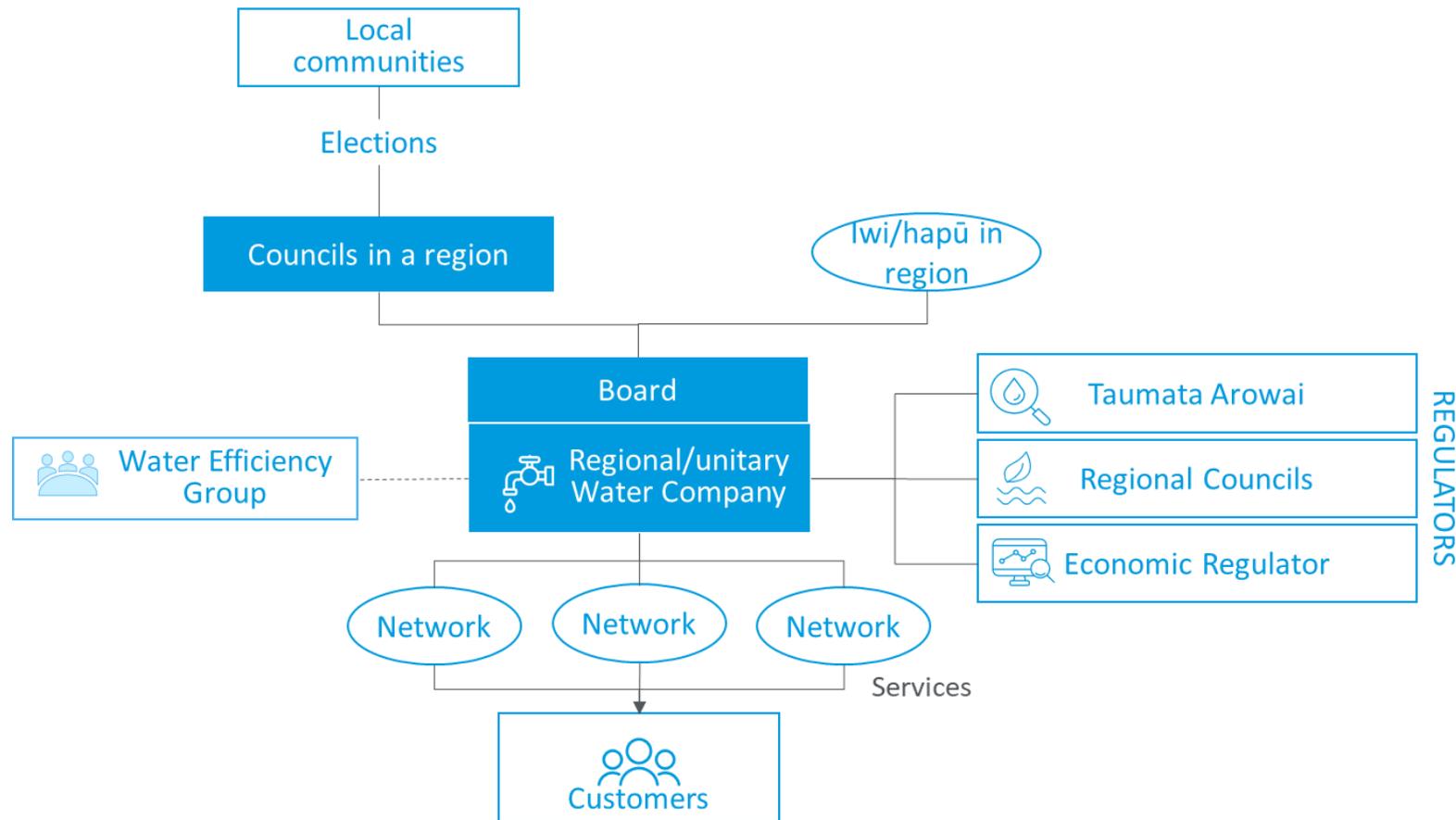
Model 1: Council-owned plus regulation

- Transition to locally appropriate and sized water services—backed by credible, enforced regulation and funding mechanisms
- Horses for courses: stand-alone, regional cooperation, regional merger—menu of options. Credible regulation incentivises adoption of appropriate model

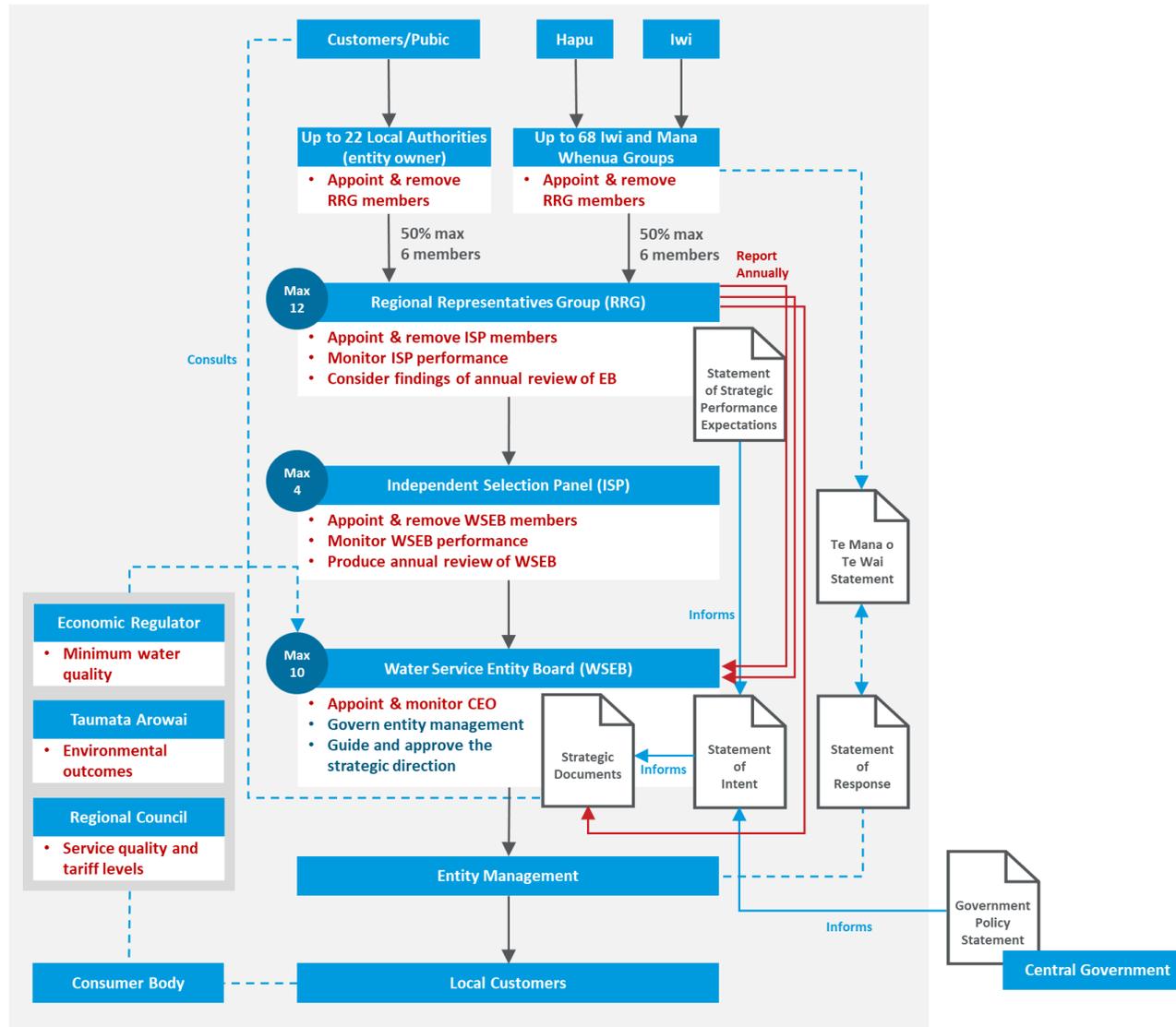


Model 2: Council-owned enterprise

- Regional enterprise co-owned by relevant councils in proportion to assets or number of connections.
- No single council would control the entity (ie, must have <50% shares)



Model 3: Government's proposed mega-entity model

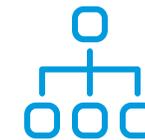


Evaluation results

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	Council-owned plus regulation	Council-owned enterprise	Mega-entity proposal
 Accountability to customers			
 Iwi-Māori partnership			
 Management and operational performance	 → 		
 Incentives of management and governance			
 Access to financing	 → 		
 Scale and scope efficiencies	 → 		
 Flexibility for the future			
	Improvements achieved with targeted regulation design	Fit-for-purpose regulation will support outcomes	Regulation cannot solve the fundamental flaws

Key:  = Change from targeted design improvement



Accountability to customers

Model	Council-owned plus regulation	Council owned enterprise	Mega-entity proposal
Score			
Evaluation	<ul style="list-style-type: none"> Moderate to good outcomes likely Elected councillors are responsible for the water service, and therefore can be held to account for poor performance Some deficiencies due to information asymmetry problem which causes: <ul style="list-style-type: none"> Short-termism on tariffs and investment levels Interest group politics 	<ul style="list-style-type: none"> Moderate to good outcomes likely Elected councillors appoint COE board. Councillors accountable to public Multiple entities means regulators can more effectively benchmark Separate COE has “customer service” ethos 	<ul style="list-style-type: none"> Very poor outcomes likely Complex governance means low Accountability (four layers of governance) Would require national-level political scandal to hold performance of WSE and regulator accountable if these fail
Improvements	<ul style="list-style-type: none"> Fit for purpose regulation can improve outcomes 	<ul style="list-style-type: none"> Fit for purpose regulation can improve outcomes 	<ul style="list-style-type: none"> Regulatory framework and Accountability mechanisms (SOI and NPS) will not address fundamental problems

Iwi-Māori partnership

Model	Council-owned plus regulation	Council owned enterprise	Mega-entity proposal
Score			
Evaluation	<ul style="list-style-type: none"> Moderate to good outcomes likely on average Local electoral law changed in 2021 29 councils will have Māori wards in 2022 local elections Mana Whakahono ā Rohe an option which could be expanded—currently in place with several councils Councils (as smaller unit of Government) can engage with hāpu and Iwi over specific issues, communities and water bodies Locally appropriate solutions, aligned with rohe and takiwa more likely 	<ul style="list-style-type: none"> Moderate to good outcomes likely on average Māori ward councillors will be involved in COE board appointment Mana Whakahono ā Rohe an option which could be expanded—currently in place with several councils COEs as a mid-sized, regional administrative unit can engage with hāpu and Iwi over specific issues, communities and water bodies, aligned with rohe and takiwa Regionally appropriate solutions more likely 	<ul style="list-style-type: none"> Moderate outcomes likely on average Governance model unlikely to reflect diverse Iwi and hapu needs across wide geographic and culturally diverse area Most Iwi have low RRG representation Entity A: 27 Iwi (5.4 Iwi per seat) Entity B: 68 Iwi (13.4 Iwi per seat) Entity C: 35 Iwi (7 Iwi per seat) Entity D: 1 Iwi (0.2 Iwi per seat)
Improvements	<ul style="list-style-type: none"> Effective partnership with Māori over Te Tiriti rights and interests (MRI) may require additional policy change (for example, recognition of property rights in water resources) 	<ul style="list-style-type: none"> Effective partnership with Māori over Te Tiriti rights and interests may require additional policy change (for example, recognition of property rights in water resources) 	<ul style="list-style-type: none"> Unlikely to change as a result of additional policy

Management and operational performance



Model	Council-owned plus regulation	Council owned enterprise	Mega-entity proposal
Score			
Evaluation	<ul style="list-style-type: none"> Moderate outcomes likely (but poor in some areas) Many councils struggle to recruit and retain staff Some councils cannot justify hiring for some expertise Castalia analysis and Auditor General report confirm issues 	<ul style="list-style-type: none"> Good outcomes likely Larger size eases recruitment and retention of staff Castalia analysis confirms size correlates with better asset management 	<ul style="list-style-type: none"> Moderate to good outcomes likely Larger size eases recruitment and retention of staff Castalia analysis size confirms correlates with better asset management Large organisations can become inefficient and bureaucratic Difficult to manage staff over vast distances (100s of KMs) Cannot enforce breaches effectively
Improvements	<ul style="list-style-type: none"> Enforce quality, environmental and financial standards Outsourcing can lift capability Give regulator tools to drive change 	<ul style="list-style-type: none"> Enforce breaches of water quality, environmental and financial performance standards 	<ul style="list-style-type: none"> Change regulation to increase incentives on better managerial performance

Incentives of management and governance



Model	Council-owned plus regulation	Council owned enterprise	Mega-entity proposal
Score			
Evaluation	<ul style="list-style-type: none"> • Moderate to good outcomes likely • Councillors have incentive to reflect local community priorities • Requires competent and experienced individuals in governance roles • Will be limited by effectiveness of regulatory regime 	<ul style="list-style-type: none"> • Moderate to good outcomes likely • Governance has incentives to implement local community interests • Corporatised entity would have competent and experienced individuals in governance roles • Competitive dynamic between COEs would encourage improvement of managerial talent • Will be limited by effectiveness of regulatory regime 	<ul style="list-style-type: none"> • Poor outcomes likely • Few incentives to reduce costs • Cross-subsidies can hide inefficiencies • Governance may have incentives to keep tariffs too low • NZ regulators unaccustomed to assess spending across multiple socio-cultural and economic objectives • Regulator has no viable way to enforce breaches
Improvements	<ul style="list-style-type: none"> • Effective regulation (at least information disclosure) would enable governance to monitor performance and hold management accountable 	<ul style="list-style-type: none"> • Effective regulation (at least information disclosure) would enable governance to monitor performance and hold management accountable 	<ul style="list-style-type: none"> • Requires significant overhaul of proposed regulatory system—still likely to fail • Price-quality regulation works better with profit motive

Access to financing



Model	Council-owned plus regulation	Council owned enterprise	Mega-entity proposal
Score			
Evaluation	<ul style="list-style-type: none"> Moderate to poor outcomes likely Some councils are constrained in raising financing Household bills higher than necessary due to inability to access additional debt finance for investment Some councillors can be averse to debt due to short-term political pressures 	<ul style="list-style-type: none"> Good outcomes likely Increased borrowing capacity Provided no council owns or controls 50%, no balance sheet consolidation Financed as independent company If supported by robust information disclosure regulation, likely attractive to lenders 	<ul style="list-style-type: none"> Good outcomes likely Standard & Poor's advice confirms WSEs will be able to independently finance (up to 500% debt-to-revenue)
Improvements	<ul style="list-style-type: none"> Effective regulation and , benchmarking improves incentives on councillors to raise finance Explore alternative financing structures (revenue bonds) 	<ul style="list-style-type: none"> Will not work for Auckland/Watercare Explore alternative models: <ul style="list-style-type: none"> Owned by consumers or trust NZ Super/ACC own 51% 	<ul style="list-style-type: none"> Relies on effective economic regulation so that WSEs make investments that can recover costs in long-run

Scale and scope efficiencies

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Model	Council-owned plus regulation	Council owned enterprise	Mega-entity proposal
Score			
Evaluation	<ul style="list-style-type: none"> Moderate outcomes likely Stand-alone councils cannot generate any additional efficiencies from scale Scope efficiencies between urban planning and transport remain 	<ul style="list-style-type: none"> Good outcomes likely Relatively minor scale efficiencies available in procurement and operating functions Scope efficiencies possible from integrating regional urban and transport planning 	<ul style="list-style-type: none"> Moderate outcomes likely No strong evidence of mergers causing significant capex cost savings from economies of scale Due to complex interactions between volumes, connections, number of networks and transport Relatively minor savings in procurement Scope efficiencies from aligning urban planning, land transport and water services reduced
Improvements	<ul style="list-style-type: none"> Effective regulation and monitoring would incentive regional cooperation and/or coordinated procurement 	<ul style="list-style-type: none"> Unlikely to change as a result of additional policy Scope efficiencies will align with planned RMA reforms 	<ul style="list-style-type: none"> Unlikely to change as a result of additional policy



Flexibility for the future

Model	Council-owned plus regulation	Council owned enterprise	Mega-entity proposal
Score			
Evaluation	<ul style="list-style-type: none"> • Councils have range of options to respond to change: merger, shared services, outsourcing • Better understanding of local conditions to adapt • Does not require multi-regional consensus to make decisions 	<ul style="list-style-type: none"> • Moderate to good outcomes likely • Good understanding of local conditions to adapt • Effectiveness reduced somewhat by need to reach regional consensus 	<ul style="list-style-type: none"> • Large entity has less understanding of multiple jurisdictions and networks • Can be difficult to keep different interest groups happy • Historically, regional public companies triggered further consolidation and in some cases eventually privatization (England and Wales 1989, Scotland 2002, and Tasmania 2013) • Tends towards excess bureaucracy
Improvements	<ul style="list-style-type: none"> • Unlikely to change as a result of additional policy 	<ul style="list-style-type: none"> • Unlikely to change as a result of additional policy 	<ul style="list-style-type: none"> • Unlikely to change as a result of additional policy

Appendix A:

Answers to anticipated feedback



Answers to anticipated feedback

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1	Economies of scale are needed— minimum 800,000 connections	Government misreads evidence: Limited scale benefits from administrative merger
2	COEs cannot raise finance independently	DIA did not ask question: accounting rules say yes
3	Solutions do not work for Watercare and Auckland Council	Design a solution for Auckland—Welsh, customer trust-owned, or KiwiBank model or Crown fiscal backstop
4	Some communities still face affordability challenges	Waka Kotahi-style targeted central government funding
5	Regional models have been proposed and shown not to work	Untrue – have not been examined properly

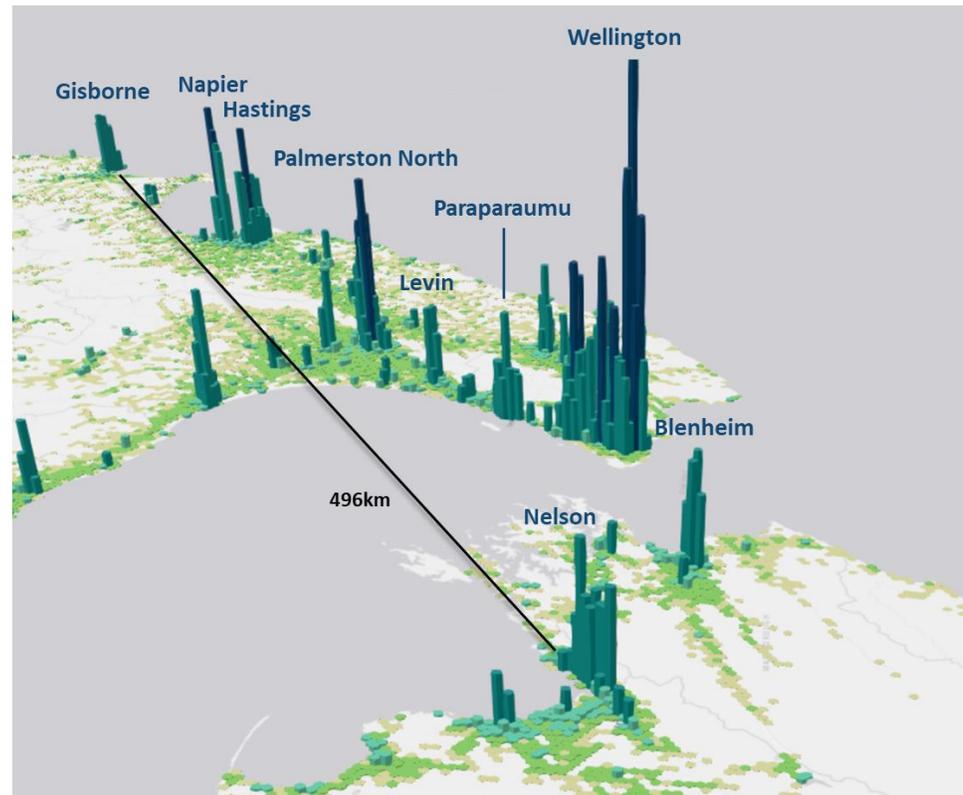
Objection 1: Economies of scale

Claim: Economies of scale are necessary at a minimum of 800,000 connections

- WICS modelling is crude, and based on “observations of UK experience” to justify 50 percent cost savings
- Government has confused the evidence of efficiencies from privatisation and regulatory reform (which we agree drives efficiencies) with evidence of reductions in costs from amalgamations
- WICS itself acknowledges that WICS’ claimed 50 percent capex cost saving is “a function of **several factors**: economy of scale, clarity of policy priority, robust water quality and environmental regulation, economic regulation and excellence in management.” **Translation:** WICS says it is not just about scale
- 800,000 connections in a continuous network usually means lower average costs than, say, 100,000 connections **but** merging eight towns with 100,000 each into a single company will not necessarily result in same lower average cost
- Castalia carried out analysis of available economies of scale for LGNZ in 2020. It found there are only limited opportunities for cost savings from administrative mergers. Report available at: <https://www.lgnz.co.nz/assets/LGNZ-release-of-Castalia-reports-context-and-response-v2.pdf>
- Review of Castalia economies of scale work by FarrierSwier was misdirected. Castalia agrees that regulatory reform (like in Victoria, England and Wales) can improve efficiency. However, cost savings from administrative amalgamations **alone** will not drive cost savings
- Academic consensus (including those cited by WICS and DIA) confirm that you cannot avoid spatially driven cost differences. WICS has not attempted to model the aggregation of different **networks** to determine efficiency frontier

Objection 1: Economies of scale

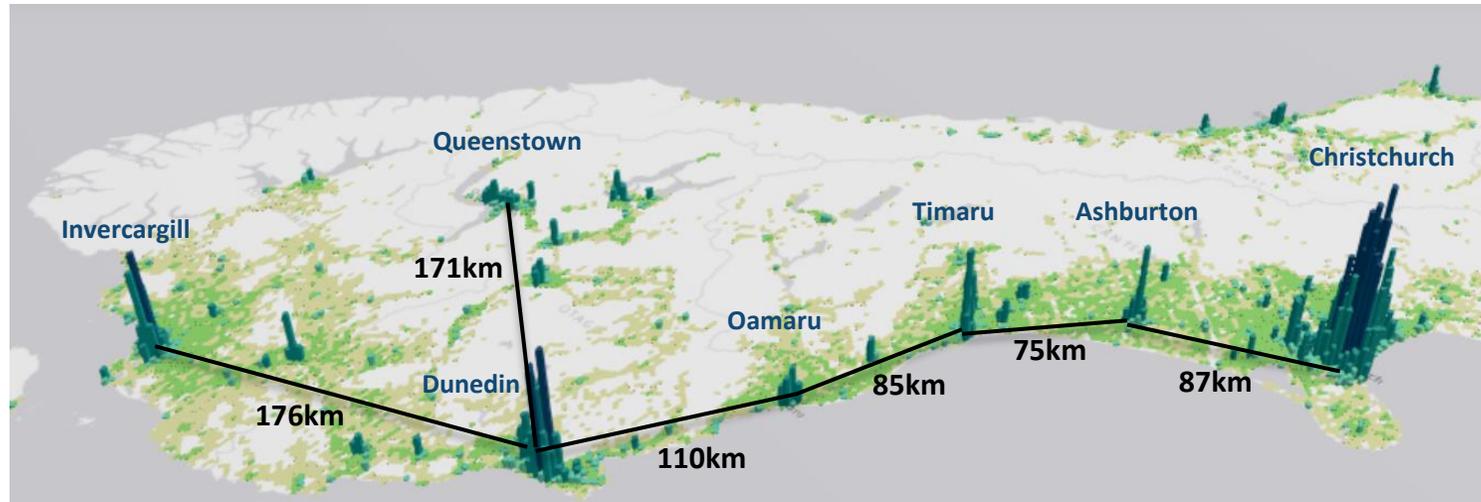
- Spatially-driven cost drivers:



None of these water networks will be merged (Wellington-Hutt water network has been merged since early 1900s)

Objection 1: Economies of scale

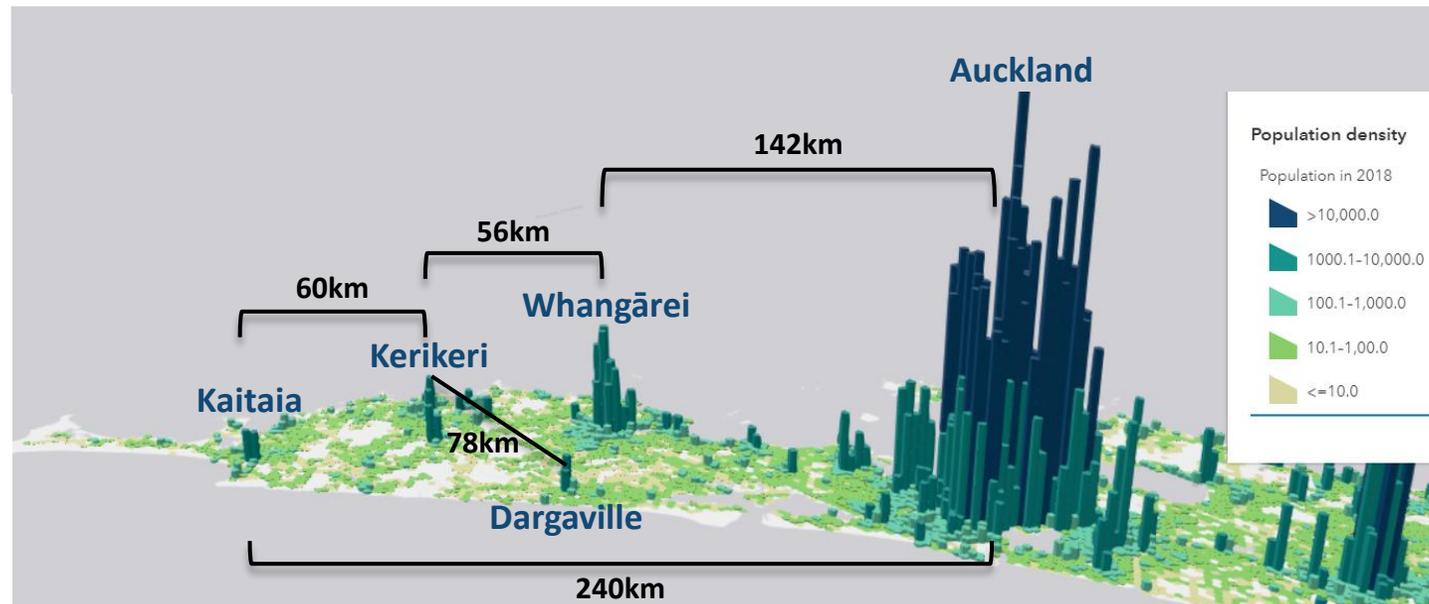
- Spatially-driven cost drivers:



None of these water networks will be merged

Objection 1: Economies of scale

- Spatially-driven cost drivers:



- Majority of these water networks will not be merged. Mangawhai (pop. 1,000 and under Watercare’s jurisdiction) may connect to Whangarei network

Objection 2: Raising finance independently

Claim: A council owned enterprise cannot raise the finance needed for future investment

- DIA did not ask Standard & Poors the obvious question: would a company with council shareholders, where no single council controls 50 percent impact the credit rating of those councils? See: NZ Herald <https://www.nzherald.co.nz/nz/politics/three-waters-reforms-doubt-over-claims-watercare-model-properly-investigated/I6GPEWLGESZTKRV6L6YB7CMIWY/>
- Plain reading of accounting rules (NZ IFRS 10) says that the regional council owned enterprise would not consolidate
- If still an issue, there are other options to achieve balance sheet separation:
 - Public good company owns water entity (Welsh model)
 - Co-operative ownership—one share per household/business connection (Fonterra?)
 - Trust ownership (like many NZ electricity lines companies)
 - Co-ownership with publicly-owned but commercial entity (NZ Super and/or ACC, like KiwiBank model)

Objection 3: Solutions do not work for Auckland

Claim: Only a fully independent model will work for Auckland and Watercare—this rules out the council owned enterprise model

- Watercare’s major issue is a **financing constraint**: needs to finance massive investment, but cannot exceed Council’s debt cap. Under status quo, customers will pay higher bills over next 10 years as current revenues used to pay for long-lived infrastructure. Castalia analysed this for Watercare in 2021 and agrees this is inefficient
- Alternative ownership models could separate Watercare from Auckland Council:
 - Public good company owns water entity (Welsh model)
 - Co-operative ownership—one share per household/business connection (Fonterra)
 - Trust ownership (like many NZ electricity lines companies)
 - Co-ownership with publicly-owned but commercial entity (NZ Super and/or ACC, KiwiBank model)
- Government credit backstop for Watercare: enable it to increase borrowing
- Should the “tail wag the dog”? Why does an Auckland problem drive solutions for rest of New Zealand?

Objection 4: Some communities still face affordability challenges

Claim: Some communities will never afford the needed investment, so amalgamation is necessary

- Many well-established policy mechanisms for addressing equity concerns exist —For example, Waka Kotahi/NZTA Land Transport Fund Funding Assistance Rates (NLTF FTAs)
- Improve funding mechanisms. Globally common models were not considered:
 - Use bond lenders’ criteria to guide funding assistance decisions
 - Use local revenue mechanisms to recover costs of transient/tourist population
 - Allow councils to share in GST
 - National water fund and levy.
- Make subsidies transparent—not efficient to “smear” cross subsidies across vast geographic area
- Should the “tail wag the dog”? Why does this discrete issue for certain communities drive solutions for rest of New Zealand?

Objection 5: Regional models have been considered

Claim: Regional models have been proposed and will not work

- Some regions have considered an alternative model:
 - Hawkes Bay, Northland, Southland, Canterbury, Waikato, Bay of Plenty
- Many are positive about regional reform
- Others had only just began investigation and were not given the opportunity to progress work
- DIA's interpretation of Otago/Southland's work (cited in the DIA RIS) only concludes mega-entity reform would be better because rest of South Island could subsidise Otago/Southland. This is not a relevant assessment approach
- Wellington Water model is not proposed:
 - That model is shared management only—no investment decision-making, only advice
 - Has had same deficient central government regulatory regime

Appendix B: Explanation of criteria



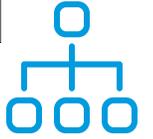
Evaluation criteria—explanation and more information

The following seven slides provide more detail on the seven evaluation criteria.

More information, and a fulsome description of six of the seven criteria is contained in work Castalia carried out for the Joint Steering Committee in 2020 on behalf of Local Government New Zealand:

- Castalia (2020) Parameters for Evaluating Aggregated Water Service Delivery Models
- Castalia (2020) Comparative Analysis of Institutional Forms in Water Services for Proposed New Zealand Reforms

Both reports are available to the public here: <https://www.lgnz.co.nz/assets/LGNZ-release-of-Castalia-reports-context-and-response-v2.pdf>



Accountability to customers

- Ensures customers act on concerns and receive the level of service they demand for a fair price
- Subject to minimum standards, water service providers can deliver services of a range of different quality levels—minimum to high-quality:
 - Water services range from basic to high-end (not like electricity, “on” or “off”). Water service provider should meet customers’ demands
 - Differences in how some hāpu and iwi want cultural values reflected in service delivery. Water service entity needs to be accountable to those people
- Cost quality trade-offs generally should be made in a way that is accountable to customers
- Typically, this occurs via governance, regulation, contract with customers

This criterion assesses the extent to which the institutional design is likely to improve iwi/Māori partnership on rights and interests through the governance, management and operation of the water service entity

- Iwi-Māori rights and interests, and outcomes are important
- We can apply standard techniques of governance and management theory to determine whether iwi-Māori outcomes will be met under the model as those outcomes have been articulated by the government (which reflects iwi-Māori consultation as set out in Cabinet Paper Three). Castalia is not claiming any specialist expertise on this topic
- The Minister noted from engagement and feedback that iwi-Māori experience of water service delivery, and rights and interests in water resources is likely to be at the whanau/hapū level, as well as iwi level (Cabinet Paper three, paras 82.2, 92, 108)
- The criterion should assess the extent to which the institutional structure increases the likelihood that the water services entity has the ability to connect governance with delivery on the ground at a hapū/whānau level (Cabinet Paper three, page 26).
- Rohe and takiwa boundaries are relevant to how iwi-Māori rights and interests in freshwater, receiving environment for wastewater and stormwater management are respected by the institutions of government (local and central) and water service entities. The choice of boundaries for a water service entity therefore impact on promoting iwi-Māori rights and interest
- Protection of existing arrangements should transfer to any new entity

Management and operational performance



- Essential to safe and efficient water services
- Can be achieved by scale, competition, regulation and outsourcing
- Scale: Castalia analysis of New Zealand water asset management competence confirms it is correlated with scale
- Competition: Multiple providers competing to attract skilled staff increases competence
- Regulatory enforcement: Enhances competition if fines or public reprimand incentivises behavioural change
- Outsourcing: Contracting for expertise is a common model to lift competence locally and globally



Incentives of management and governance

- Institutional setting that incentivizes those charged with governance and management to make decisions that achieve the overarching objective
- Short- and long-term incentives should be aligned with objectives
- Short term incentives generally ensured by profit motive
- Long term incentives can also be aligned but requires more care
- Short time horizon of council decision making contrasts the long life of water infrastructure assets

Access to financing



- Essential to meeting investment needs
- How well can water service providers access finance that reflects the riskiness and revenues of the water business and its projects alone
- Water services involve high fixed cost assets with long lives and lumpy investments—financing can improve intergenerational equity and efficiency
- Financing barriers prevent efficient investment, including for future growth
- Many councils are constrained by overall indebtedness of councils consolidated balance sheet and caps imposed



Scale and scope efficiencies

- Scale and scope efficiencies exist where average costs fall as scale or scope increases
- Scale economies are **independent** of other factors that coincide with greater scale but are also possible without scale
- Economies of scale in water services need to be carefully examined
- Proper empirical evidence required to measure extent of scale efficiencies. Distinction required between contiguous or separate networks
- Economies of scope can exist at both small and large scales
- Amalgamation risks increasing costs as scope economies are reduced



Flexibility for the future

- Technology, customer preferences, and society's expectation can change over time
- Climate change will require greater flexibility
- Water services must adapt to changes in housing development and urbanisation
- Providers closer to customers can generally adapt more easily due to better local knowledge and understanding
- Institutional settings can also ensure dynamism and responsiveness to customer demands over time
- It may be desirable to preserve the option for water services to change size and form over time



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Thinking for a better world.

Position on Iwi Māori Partnership

Key Points

- The Government's 'one size fits all' model does not reflect local realities and communities of interest and, importantly, iwi and hapū rohe and areas of interest.
- We believe any arrangements will be more effective if they reflect common local interests, decision-making and build on existing relationships.
- We actively seek to initiate authentic discussions with mana whenua at a local level that consider co-design and partnership arrangements that acknowledge and enable Te Tiriti based pathways at a local and regional level.
- We seek a pause so we can have more time to work on a way forward that works for everyone.

Detail

The Government's decision to mandate the Three Waters Reform was disappointing to most Councils in Aotearoa New Zealand. Ninety percent of Councils submitted their opposition to the Government's four entity model.

The Government did not respond to this opposition, nor the significant negative public reaction, and continued with their plans to mandate the implementation of this model.

In response, some concerned Councils got together and developed a Memorandum of Understanding in order to better work together on an alternative way to effect change.

We formed Communities 4 Local Democracy He hapori mō te Manapori (C4LD) which now has 31 partner Councils representing over 1.4 million New Zealanders and is growing.

We are providing a constructive voice for the majority of Aotearoa New Zealand with real concerns about this reform and the rush with which it is being imposed on our communities.

There are 10 specific things we agree on and that we stand for, three of which are:

- Better drinking water and environmental outcomes are essential
- Proper and effective regulation and an independent regulator
- Partnering with mana whenua and co-designing a governance framework locally and regionally

Overall, we stand for fresh ideas for better water for everyone.

All our members value the importance of developing strong and meaningful partnerships with Iwi Māori for the future of 3 Waters.

We do not, nor believe we should, have a fixed view on how we would best achieve this.

We do know that a 'one size fits all' solution simply will not work for anyone.

The Government's proposal will not reflect local realities and communities of interest and, importantly, iwi and hapū rohe and areas of interest.

Any arrangements will be more effective if they reflect common local interests, decision-making and build on existing relationships.

We actively seek to initiate authentic discussions with mana whenua at a local level that consider co-design and partnership arrangements that acknowledge and enable Te Tiriti based pathways at a local and regional level.

The concept of Te Mana o te Wai reflects the paramount importance of the wai. In particular it is about restoring and preserving the balance between te wai, te taiao, and nga tāngata.

The guidance provided by Te Mana o te Wai delivered with local knowledge will help us better respond to current challenges and realise future opportunities to achieve objectives that are shared by all communities.

Together as a community we can tackle the pressing issues of water quality, water security, sustainable economic growth and development, resilience and climate change mitigation and/or adaptation, and to do this in a way that also respects shared values.

Our primary undertaking, therefore, must be to care for water.

The next step is to consider how we make decisions in partnership, in the best interests of our water in a holistic sense. Seeing Three Waters Reform through this lens is an attractive kaupapa.

It is unfortunate that the Government and Department of Internal Affairs did not consider and discuss the proposed Three Waters Reform on this basis.

This is complex work, and our members have continually underlined the importance of Government providing sufficient time to work through this. It is worth noting that in most cases, partner Councils already had workstreams under way that were leading us in the direction of change.

We have an opportunity to turn this around.

To do this we are seeking a pause so we can have more time to work on a way forward that works for everyone. A vital part of this is developing a true partnership with mana whenua with hui and kōrero about how we best achieve this.

Rushed and forced reform is in no-one's interest. For such significant reform it is imperative that this is done in partnership and with the consent of both the sector and Iwi Māori.

We support a bipartisan political approach so that changes brought about by these reforms endure. There is a commitment from all partner Councils to achieve this. Without bipartisan support there is a high risk that the changes proposed by the Government will not survive future changes of government.

We have particularly focused our attention on two models which we believe will achieve a more durable approach, and also ensure greater involvement for mana whenua than is presently being offered by the Government - essentially a panel that appoints the board, and a guiding document "Mana Whakahono ā Rohe". We acknowledge the working group has recommended some changes but in our view those recommendations fall short of what is required to achieve broad support.

We would value the opportunity to discuss this further with mana whenua and seek to create opportunities to do so. We all are also supportive of a greater involvement for mana whenua with the new Water Regulator, Taumata Arowai.

We are aware there are those who would benefit by discrediting our group or by misrepresenting our values and aims.

Our group are committed to genuine partnership with mana whenua and a reform proposal that is durable, widely-supported and fit for purpose.

We represent a significant percentage of the local government sector and over 1.4m people.

We are genuine in our desire to work in partnership with Iwi Māori and would welcome discussion on these matters and opportunities for clarification.

We want to make it clear:

- Iwi partnership and relationships are critical and important to us, and any suggestion otherwise is simply not correct
- All partner Councils have relationships with their mana whenua at a local level and these are highly valued
- We strongly support giving effect to Te Mana o te Wai

C4LD formed just 12 weeks ago, and we accept there is a lot more work for us to do, including furthering authentic conversations and discussions with mana whenua. While there have been attempts to do this, we are very clear that more work is needed – work that we are committed to doing.

We believe a less rushed process would have allowed the creation of an appropriate governance in a co-design process with mana whenua. This outcome can still be achieved.

We want to know what success looks like for mana whenua and how we can work collectively, collaboratively and in partnership to achieve better outcomes for all our communities.

Ngā mihi



Mayor Helen Worboys
Chair



Mayor Dan Gordon
Deputy Chair



Mayor Lyn Riesterer
Co-chair
Iwi Māori Working Group